Is This Stock the Next Berkshire Hathaway?

Description

In the 440px-Buffett_&_Obama Image not found or type unknown back of every investor's mind is the stock that got away and became a huge success.

Take **Berkshire Hathaway** (NYSE: BRK-A)(NYSE: BRK-B) for example. Over the past 50 years, Warren Buffett grew the company from a small textile manufacturer into a massive business conglomerate. If you had purchased a single share of stock back in 1964 for $11.50, your total investment would be worth $190,500 today.

Unfortunately, this performance can't continue. If Berkshire were to somehow maintain this growth rate over the next 25 years, the company would be worth more than $17 trillion by 2039. That's larger than the entire U.S. economy today.

Clearly, the company is unlikely to accomplish this feat. So savvy investors must start looking for the *next* Berkshire Hathaway. One company just might have what it takes.

Could this company be the next Berkshire Hathaway?

At first glance, **Fairfax Financial Holdings** (TSX: FFH) looks just like another boring Canadian financial company. To *really* understand the magic that's taking place at this Toronto-based company, you have to take a crash course in the insurance business.

This may come as a shock to many, but insurance is one of the best businesses in the world. That's because people pay premiums upfront, yet this money doesn't get paid out until a later date when an accident or natural disaster occurs.

For example, when someone pays for car insurance, these payments are made despite the fact that he or she has not yet been in an accident. All of this money sits in a pool, called a "float", until an accident — which might never even happen.

It's a license to borrow money for free. The brilliant part is that smart managers can generate exceptional returns on these floats by simply buying stocks and bonds to earn higher returns.

This is exactly how Berkshire Hathaway and Fairfax Financial have been set up.

Fairfax's Chief Executive Prem Watsa has an incredible investment track record. Indeed, he sold equities ahead of the crash in 1987 and foresaw the collapse of Japan's stock market in 1990. He predicted the mortgage crisis of 2008, and when no one wanted to touch stocks with a 20-foot pole in the fall of 2009, Watsa began buying equities then too.

Like Buffett, Watsa's investment philosophy is based on common sense: Focus on wonderful businesses, buy them below their intrinsic value, and hold on for the long haul.

It's no wonder he has earned the nickname as "The Warren Buffett of Canada". Over the past decade, Fairfax has delivered an 8.9% compounded annual return for investors. This figure doesn't even include the billions of dollars paid out to shareholders as dividends.

Here's the best part about this story, though: Fairfax still a relatively small company.

As Buffett himself admits, "It's a huge structural advantage not to have a lot of money." The problem is that once a company is worth hundreds of billions, directing its investment portfolio becomes a bit like steering a tanker ship. It's difficult to stay nimble and respond to the best opportunities.

With a market capitalization of only $10 billion, Fairfax is less than 10% the size of Berkshire. At this size, managing a portfolio is more akin to driving a speedboat. Fairfax can maintain a higher growth rate for decades to come before running into the law of large numbers.

Fairfax Financial Holdings looks remarkably similar to Berkshire Hathaway 40 years ago. The stock's long-term performance speaks for itself. For fans of common sense value investing, this stock would make an excellent addition to any portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BRK.B (Berkshire Hathaway Inc.)
2. NYSE:BRKA (Berkshire Hathaway Inc.)
3. TSX:FFH (Fairfax Financial Holdings Limited)

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