



Missive

MAY 10, 2022

Buffett's Buying Oil Stocks

Dear fellow investors,

"I can't think of anything more useful than oil!"
—Charlie Munger

After listening to the Berkshire Hathaway Annual Meeting on April 30, 2022, we thought it would be appropriate to frame the aggressive buying of Occidental Petroleum (OXY) and Chevron (CVX) in the first quarter of this year. Buffett and Munger bought around \$27 billion of shares in these two companies at around \$52 per share on Occidental and around \$160 per share on Chevron.

We would argue that Buffett and Munger, who know more about clean energy from owning the largest energy utility in the U.S., see an incredible margin of safety on these two stocks. Buffett says that he read the transcript of OXY's Q4 earnings report/call and realized what a gusher OXY was becoming. He already owned CVX and sensed that the share prices of these two oil powerhouses were severely lagging behind the profitability and free cash flow the higher oil prices will cause.

Here are a few facts which might be helpful to understanding Buffett and Munger's thinking:

1. California gets nearly 50% of its electricity from natural gas, which is found in the process of drilling for oil.
2. Russia has crippled its ability to serve customers.
3. Middle Eastern oil producers are seeing terrorist attacks on their oil production and are unlikely to make up for any shortfalls elsewhere in the world.
4. Buffett says, "Those who think we will transition away from fossil fuels quickly and those who think we will never transition are crazy!"

5. Munger said, "I can't think of more impressive people than the petroleum engineers and geologists that create new oil supplies."
6. Buffett and Munger consider oil to be a national security priority.

Buffett and Munger must know that oil will be extremely useful for much longer than the investment markets expect. Producing new sources of oil should occur in the powerhouse companies like the two he bought. And that might not come close to stopping oil prices from rising toward \$150 to \$200 a barrel. If you think we are kidding, consider we are at \$104 per barrel with the largest population country (China) in the world locked down because of COVID-19. Chevron and OXY own the land, the leases and have the talented people Munger was praising.

Why did he spend so much more on Chevron than he put into OXY? Chevron is a massive capitalization company (around \$315 billion) and the only way Buffett could spend \$20 billion on OXY would be to take it private. He doesn't do hostile deals and what he would be willing to pay is below what we think the company could be worth in the open market in five years.

Buffett is looking at the free cash flow and returns on equity going forward and pouring money into these companies. In an exceedingly difficult stock market environment, these oil stocks might be an excellent way for Berkshire and Smead to avoid "stock market failure."

Warm regards,

Bill Smead
Chief Investment Officer

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