



# Missive

JULY 6, 2022

## Love is in the Air

Dear fellow investors,

*Love is in the air, everywhere I look around  
Love is in the air, every sight and every sound  
And I don't know if I'm being foolish  
Don't know if I'm being wise  
But it's something that I must believe in  
And it's there when I look in your eyes*

Chairman and largest shareholder, Harold Hamm, is trying to own our shares of Continental Resources (CLR US) at a price of \$70. We've seen it trade above there in the open market in the last month. How strange? Warren Buffett is bidding on a regular basis to buy shares of Occidental Petroleum (OXY) from other existing shareholders. The stock isn't sprinting higher on this news. How strange? These are historically control investors who don't mind playing for keeps.

Public markets need to recognize that, "Love is in the air, everywhere I look around." People in the oil and gas business are petrified of the environment that we are in because they had to live through the miserable 2010s and stared into the abyss of negative oil prices in the spring of 2020. This has caused the industry to look at mid-cycle pricing of \$50-\$70 per barrel in making their capital allocations and forecasts. We don't agree with this, "And I don't know if I'm being foolish." These companies are cheap and exploding with cash. No new supply is in sight. We see \$85 per share, "And it's there when I look in your eyes!"

*Love is in the air, in the whisper of the tree  
Love is in the air, in the thunder of the sea  
And I don't know if I'm just dreaming  
Don't know if I feel safe  
But it's something that I must believe in  
And it's there when you call out my name*

Investor unwillingness to own oil and gas investments comes down to a few simple things. First, they have been taught that volatility is a bad thing. In fact, the investment business might have a special place in hell ready for the promoters of these insane doctrines. You wouldn't know who Sir John Templeton and Warren Buffett are if they hadn't been willing to trade volatility for investment success. The unwillingness to provide capital in lieu of focusing on volatility is near-sighted. We believe that low volatility is a crowded investment space.

We are thankful for these teachings because it is keeping volatile commodity markets far away from the capital allocations of individual and institutional investors. This is making owning oil and gas very profitable per dollar of market cap or book value, but leaves these stocks open to "the whisper of the tree" and, in the Hamm and Buffett sense, "in the thunder of the sea."

We see this all over in the oil and gas markets. Our ownership in MEG Energy (MEG CN) has large deferred-tax assets (DTAs) from large losses in prior years. This multi-billion-dollar asset could be consumed by a large company like our other holding, Cenovus (CVE CN). Cenovus could more quickly recognize these assets via their tax-paying income streams. In effect, an acquirer could use the DTAs to fund the premium to purchase MEG, thus getting the income-producing assets for no premium. If these markets are too bearish, the long-lived Alberta tar sands assets have higher break-even costs. These could possibly be the biggest winners from oil supply dwindling and the market being scared of their own shadow!

*Love is in the air  
Love is in the air  
Oh, oh, oh, oh*

This John Paul Young song is a perfect theme for the consolidation of the oil industry. We'd make one tweak to the words to make it very clear to the investors of Smead Capital Management. "Love is in the air. Love is in the air." Oil, oil, oil, oil... We don't "know if I'm just dreaming. Don't know if I feel safe. But it's something that I [we] must believe in." Our investors could be ready to make great money "when you call out my name."

## Love is in the Air

These periods when *Love is in the Air* in the energy space usually cause more deal activity. To quote Sam Zell in his book, *Am I Being Too Subtle?*, “If you do deals for a living, you know the energy that a big one generates. It’s intoxicating; the air crackles with energy of anticipation. You are bouncing on your toes all day, every day. It is, quite simply, really fun.” In summary, we will flirt with the same love note idea that Sam Zell sent to Steve Schwarzman that got their Equity Office Properties deal going in 2007:

*Dear Warren or Rick:*

*Roses are Red*

*Violets are Blue*

*Looking for an all-stock offer*

*Will it be you?*

*Love and kisses*

*—Smead*

Fear stock market failure,



**Cole Smead, CFA**  
President & Portfolio Manager

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