## Buffett's Adventures In Oil

Warren Buffett tells the story of an old oil prospector who passed away and moved on to the great hereafter. Unfortunately, St. Peter had some bad news for him:

> "You're qualified for residence," said St. Peter, "but, as you can see, the compound reserved for oil men is packed. There's no way to squeeze you in." After thinking a moment, the prospector asked if he might say just four words to the present occupants. That seemed harmless to St. Peter, so the prospector cupped his hands and yelled, "Oil discovered in hell." Immediately the gate to the compound opened and all of the oil men marched out to head for the nether regions. Impressed, St. Peter invited the prospector to move in and make himself comfortable. The prospector paused. "No," he said, "I think I'll go along with the rest of the boys. There might be some truth to that rumor after all."

We were reminded of this tale late last year when it was disclosed that Mr. Buffett, through his company Berkshire Hathaway (BRK.A), took a $3.4 billion stake in ExxonMobil (XOM).

You may have seen something about that investment in the news, but did you know that this is not the first time Berkshire has owned Exxon? That may come as a bit of a surprise, because many market watchers tend to equate the name Warren Buffett with the investment strategy known as "buy and hold."

That is, once you decide to buy a stock, you hang on to it for many years, and perhaps indefinitely. Since many of Buffett's biggest holdings have been in his portfolio for long stretches, in some cases decades, there is some truth to that general idea. However, Mr. Buffett sometimes moves in and out of stocks much more quickly, and this recent purchase of Exxon is a good reminder of a historical example of just such an instance.

### Back to the Future

In the last quarter of 1984, Berkshire Hathaway purchased 3.9 million shares of Exxon Corporation (XON, at the time) for an average price of about $44.50 each. That was an outlay of $173 million, which would be a paltry sum in Berkshire's portfolio today. But in 1984, it represented a full 14% of the $1.3-billion investment portfolio pie. Can you imagine doing something similar in your own portfolio? Finding a stock you like so well that, when you buy it, you immediately make it a 14% position? Mr. Buffett has never been accused of not having the courage of his convictions.

Just for the sake of comparison, the most recently available annual report from Berkshire lists $88 billion worth of stocks held by the company. The largest position, Wells Fargo (WFC), accounts for 18% of the portfolio, but Berkshire is sitting on a 43% gain with that one.

Anyway, back to Exxon. How long would you guess he held on to those 3.9 million shares? Exxon in 1984 was the largest company in the Fortune 500, its profits were rivaled by nearly no one, and it had been spewing out gushers of cash dividends to its shareholders for decades. Sounds kind of like the ExxonMobil (XOM) of today, doesn't it?

Before we answer our question, though, let's look at the larger holdings in Mr. Buffett's current portfolio and see how long he's held some of those shares:

| Company | % of Portfolio | Years Held |
|---|---|---|
| Wells Fargo (WFC) | 18% | 23 |
| Coca-Cola (KO) | 17% | 25 |
| IBM | 15% | 2 |
| American Express (AXP) | 10% | 20 |
| Wal-Mart (WMT) | 4% | 8 |
| Procter & Gamble (PG) | 4% | 22 |

That's an average of 17 years for six of Berkshire's largest stock holdings. So you may be as surprised as we were to learn that Mr. Buffett dumped the XON shares, which he purchased in 1984, the very next year. That's right. As of December 31, 1985, Exxon was not listed as a stock held by the company.

## Quick Flip

What happened? Well, Exxon's stock was up about 20% in 1985, so Berkshire earned probably a little less than that, depending on which prices Berkshire sold at. Twenty percent is hardly ever a bad return; however, when you consider that the market overall, as measured by the S&P 500 index, was up 32% that year, you have to wonder what Mr. Buffett was thinking when he sold his XON position so quickly.

Another question you may be asking is whether Berkshire would have been better off simply holding on to the shares. Let's think about that together to see what sort of return would have been earned on that investment.

First of all, if Berkshire had held onto its original investment in XON, it would no longer hold 3.9 million shares of XON. With three two-for-one stock splits along the way, and one mega-merger with Mobil Oil, those original 3.9 million shares of Exxon Corporation would now be 31.2 million shares of ExxonMobil.

At the time of Berkshire's recent purchase of XOM, it bought 40.1 million shares for an estimated average price of just above $86. Those 31.2 million shares, which were originally bought for $173 million, would at that time be worth $2.7 billion. Not a bad return, eh?

But that's not all. There are $673 million worth of dividends that would have been collected along the way, too, for a total value received of $3.4 billion. (This figure, coincidentally, is only about 3% lower than the estimated value of Berkshire's 2013 purchase of Exxon stock.) Our Excel spreadsheet tells us that equates to an average annual return of 12.1%. Not too shabby. Also, though Buffett's actual Exxon bet lost out to the S&P 500 over its brief holding period, that 12.1% annual return is better than the S&P 500 index did over that same 29-year period, which was 10.9%. So, at first glance, it seems like perhaps he would have been better off holding on to the stock.

**When Beating the Market is Not Good Enough**

However, the true test of whether Mr. Buffett was right to sell is not determined by whether he would have beaten the market if he had held on. The true test is determined by answering the question, "By selling XON in 1985 and redeploying the proceeds into other vehicles, how much money did Berkshire end up with in 2013? Was that figure more or less than the $3.4 billion it would have received by buying and holding Exxon?"

Of course, hypothetical questions like that are nearly impossible to answer. But we can look to two measures that might put our response at least in the right ball park.

First, we can look at how Berkshire's per-share net worth has grown from 1985 to 2013. Second, we can look at how Berkshire's stock has performed over that same time period.

As for the net worth question, Berkshire's net worth per share around the time of the most recent ExxonMobil purchase was $129 thousand. As of the end of 1985, we estimate it was about $2 thousand, which represents an average annual gain of between 17% and 18%.

As for the stock price question, Berkshire's share price at the time of the recent XOM purchase was about $170,000. At the end of 1985, a share of Berkshire was selling for around $2,500, which would have yielded an average annual return of 16.5%.

Either way you slice it, we're talking about giving up a 12.1% return in exchange for a 16.5% return or a 17-18% return. Over the course of one year, that may not amount to much. But remember that we're talking about a 29-year period here. The difference between a 12.1% return and a 16.5% return over 29 years, on an original investment of $173 million, is $9.7 billion:

| Value of $173 million investment over 29 years at annualized returns of: | | |
|---|---|---|
| 12.1% | 16.5% | Difference |
| $4.7B | $14.4B | $9.7B |

That $9.7B difference is worth about $6,000 for each share of Berkshire today. So while we may not understand what Mr. Buffett was thinking when he did a quick flip of Exxon stock 29 years ago, it turns out that selling it and utilizing that money elsewhere within the Berkshire empire was a sound economic decision. Who needs "buy and hold," anyway?

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