Black Gold – Animal Spirits or Common Sense?

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I read the book 'Killers of the Flower Moon' 3 years ago. It tells the true story of the Osage American Indian band finding oil on their unceded territory, and of them becoming some of the wealthiest people in the world. It all ended very badly as greed resulted in a spate of serial murders of the Osage people in the 1920's. Eventually this led to the establishment of the FBI. Fascinating. I look forward to seeing the Scorsese movie about it that has just been released.

Since 1859, when former train conductor Edwin Drake's experimental drill [*image below*] first brought it to the surface, oil has been called 'Black Gold'. As it is with discoveries of innovative technologies, it brought fortune, fame, and longevity to a few, but it also brought bankruptcy, infamy, and premature death to many others. Ironically, Edwin Drake remained dirt poor, while John D. Rockefeller became the world's richest person. Go figure.

The global oil and downstream oil products markets are notorious for their tendency to boom and bust in a cyclical manner. Despite this cyclicality, there are a few businesses in this industry that stand out above the average and consistently produce excess returns over the full business cycle. Two of the largest and most well-known ones are Exxon Mobil and Chevron, both listed in the USA.

In the past weeks each of these businesses announced their largest ever acquisitions – Exxon Mobil is buying Pioneer Natural Resources for US$60bn, while Chevron is buying Hess for US$53bn. In both cases there is no cash involved - they are paying by issuing more of their own shares and will continue doing share buybacks and paying dividends.

Both Pioneer and Hess are US listed businesses, with publicly available records that go back decades. This is great, because in comparison to private market transactions we have access to comprehensively detailed information about them. The data shows clearly that Exxon Mobil is paying a fair valuation multiple for Pioneer, while Chevron is paying a high valuation multiple for Hess. This is interesting because Exxon Mobil's CEO Darren Woods and Chevron's CEO Mike Wirth are both considered particularly astute global executives, and you can be sure they have no shortage of top global deal advisors at their sides. Even by modern-day money standards, deal values of US$50bn or more is in the major league.

However, it is not so much in their differences but their similarities that these two transactions are so notable. Two industry leading US businesses strategically chose to acquire two large US based businesses. This might be a sign of America becoming more inward-focused. Another interpretation is that, given current global geopolitical uncertainties, primary energy security is becoming increasingly important to the US. Exxon Mobil officially stated "*Strengthens US economy and energy security*" as part of their deal rationale.

Time will tell if this was indeed examples of animal spirits or common sense. Based on what we saw here, we are leaning toward the latter.

Our work continues…

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