



## Why is Warren Buffet Buying This Stock?

### Description

When Warren Buffett buys a stock, he emphasizes this factor above all others.

You won't find it in the financial statements. It's value cannot be calculated.

Yet for Buffett, this single variable is the most important characteristic when evaluating a business.

So what is this element? What is the most important factor for long term investment success?

It's integrity.

When evaluating a company, it's critical to determine whether management is running the business in the best interest of shareholders. And no where is that more apparent than Buffett's investment in **Suncor** (TSX: SU, NYSE: SU).

### The Warren Buffett guide to investing

Why is Warren Buffett one of greatest investors in history?

He's an exception capital allocator. Buffett is excellent at identifying cheap sources of capital and redeploying that into better opportunities. It's no surprise, therefore, that this is what he looks for in a manager.

The question Buffett is asking when he is evaluating a business is whether this company can generate a high return on investment. And if not, does the management team have the discipline to return excess capital to shareholders.

Capital allocation was a major consideration behind his decision to invest in **IBM** ([NYSE: IBM](#)). In his 2011 letter to shareholders, Buffett praises CEOs Lou Gerstner and Sam Palmisano for their ability to transform IBM from a decaying company into a global IT player. But he then goes on to discuss the importance of capital allocation.

*"I can think of no major company that has had better financial management, a skill that has materially increased the gains enjoyed by IBM."*

For IBM it's not about size but about generating value for shareholders. And this is clearly evident in where IBM allocating its capital. Since 1995, the company has reduced its share count by almost 50%. A much better investment than low-return expansion projects.

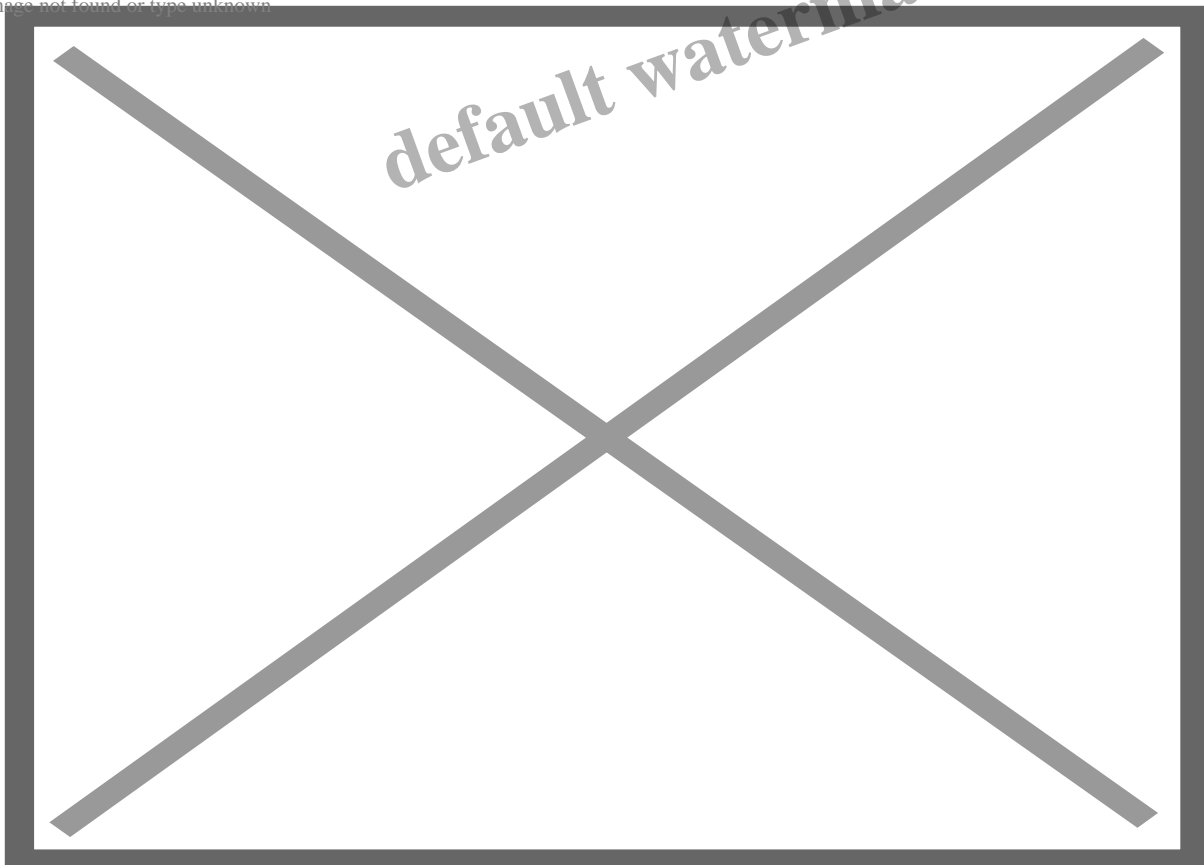
The same is true with Buffett's investment in **ExxonMobil** ([NYSE: XOM](#)). Under Chief Executive Rex Tillerson and former boss Lee Raymond, Exxon has repurchased nearly half of its outstanding shares over the past 15 years. Good oil men are actually more proud of the deals they didn't do.

While this might sound like common sense, most executives are all too eager to reinvest shareholder capital into marginal ventures. That's because overseeing a larger business empire is both ego boosting and personally lucrative.

### **Invest like Buffett; How to find wonderful management teams**

So if Buffett only invests alongside the best capital allocators in the business, why did he buy Suncor? His investment thesis could probably be best summarized by this graphic.

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*Source: Suncor Investor Presentation*

Suncor is under new management.

Since taking over in 2011, Chief Executive Steve Williams has abandoned his predecessor's growth targets, scrapped unprofitable projects, and introduced a 15% return hurdle rate on new investments. During his short tenure, Williams has also repurchased \$3.2 billion in outstanding shares and almost doubled the company's dividend.

And this is a good policy for an investor's perspective. The oil sands, really Suncor's core business, are a marginal asset. High costs and low bitumen prices limit profitability.

Why plough more capital into these low return ventures? It's a far better proposition for shareholders to get a fat dividend cheque and reinvest that capital elsewhere.

Williams isn't a empire builder. He's a capital allocator. A philosophy likely adopted during his time at ExxonMobil. Is it any surprise, therefore, that Buffett chose Suncor over other oil sand players?

### **Foolish bottom line**

The most important factor Buffett considers when evaluating a business are the people actually running the operation. Dividend hikes and share buybacks are an easy way to determine if a company is being managed in the interests of shareholders. And this is definitely the case at Suncor today.

### **CATEGORY**

1. Investing

### **TICKERS GLOBAL**

1. NYSE:IBM (International Business Machines Corporation)
2. NYSE:SU (Suncor Energy Inc.)
3. NYSE:XOM (Exxon Mobil Corporation)
4. TSX:SU (Suncor Energy Inc.)

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### **Date**

2025/09/11

### **Date Created**

2013/12/09

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