Warren Buffett Is Betting Big on This Canadian Oil Stock

Description

Warren Buffett isn't the biggest fan of Canadian stocks. Over the decades, he's only invested in a handful of Canadian companies.

In 2019, however, he made a big bet on a local energy company. This isn't the first time he's invested either. Years ago, he also put hundreds of millions of dollars into this stock.

If you want to bet on oil next year and prefer to follow one of the greatest investors of all time, this is the stock for you.

What Buffett likes

Suncor Energy Inc. (TSX:SU)(NYSE:SU) is Buffett's pick. This shouldn't be surprising.

In late 2018, the Canadian energy sector experienced extreme turmoil. Surging supply overloaded pipelines, causing transportation bottlenecks that threatened nearly every producer. With no alternatives, oil companies bid to the death to secure pipeline capacity, forcing local selling prices below US$15 per barrel. Meanwhile, U.S. prices remained above US$50 per barrel.

The collapse pushed a dozen operators to the edge of bankruptcy. The Alberta government instituted mandatory production cuts in a rare emergency move. The industry still hasn't recovered. Well, some companies have. Companies like Suncor.

In mid-2017, Suncor shares traded for $37 apiece. Today, they're above $40. Compare that to less-advantaged competitors that have seen their share prices trend dangerously close to $0.

What exactly is Suncor's advantage? It's what Buffett seems to like most: its integrated strategy.

Stick with integrateds

What is an integrated oil company? It's a business that is, well, integrated. You've likely heard of vertical integration, where a company owns every step of the supply chain. An integrated oil company follows the same logic.

For example, an oil driller often needs to pay a pipeline company in order to sell the output to a refinery. The refinery may pay another pipeline to ship the production to market. Finally, a petrol station purchases the final product and sells it to the consumer.

At each step of the way, middlemen take a cut. If you owned every step, however, you don't have to cut anyone else in. That's what an integrated oil company does.

As an integrated company, Suncor drills for oil, transports it using its own pipelines, refines the output with its own refineries, and takes the end-product to market. This boost profits, but more importantly, reduces volatility.

During the 2018 oil rout, dozens of companies were shut out from pipeline capacity. They needed to take steep losses to avoid catastrophe. Not Suncor. Because it has its own pipeline network, the company completely side-stepped the crisis.

Additionally, its refining margins helped offset falling oil prices. When energy prices fall, refining margins often rise. This allows Suncor to mitigate volatility through every part of the cycle.

It's clear that Buffett isn't betting on any one segment of Canada's oil sector. Instead, he's taking a diversified approach, opting for mitigated risk over huge upside potential.

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