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Berkshire's Slick Deal for Lubrizol

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Buffett bags a nice prize at a good price with his "elephant gun."

Berkshire Hathaway appears to have gotten a good deal with its purchase of Lubrizol, paying a reasonable 12 times estimated 2011 profits for the maker of engine additives and industrial lubricants.

Berkshire (ticker: BRKb) announced Monday morning it will buy **Lubrizol** (LZ) for $9 billion in cash, plus about $700 million in assumed net debt. Berkshire is paying $135 a share, a 28% premium to Lubrizol's closing price of $105.44 on Friday.

Lubrizol shares are up $28.41 at $133.85 this morning, trading slightly below the takeover price as arbitragers figure there won't be a topping bid. Assuming the deal closes in the summer, arbs stand to earn a return of 3% or less, which is low relative to other announced takeover situations. That reflects the confidence that any deal involving a handshake from Berkshire Chief Executive Warren Buffett has a very high likelihood of closing.

Berkshire's **class A shares** (BRKa) are down $1,600, at $125,400, this morning and the B shares are down $1.05, at $84.25, as the overall stock market continues to trade lower. Barron's has been bullish on Berkshire, arguing it could approach its record high of $149,000 this year, boosted by growing profits ("**Do Berkshire's Best Days Lie Ahead?**," Feb. 28.) Berkshire may earn $12 billion this year.

Buffett wrote in his annual shareholder letter that he had an "elephant gun" ready and was primed to do a major acquisition. This is his first big deal since the $34 billion purchase of Burlington Northern announced in November 2009.

The Lubrizol deal should boost Berkshire's profits because the company's $35 billion in cash (at its insurance units) has been earning virtually nothing with short-term interest rates near zero. Berkshire likely will be getting almost $9 billion in investments paid off this year when **Goldman Sachs Group** (GS) and **General Electric** (GE) redeemed preferred stock that Berkshire bought in 2008.

Interestingly, Lubrizol's projected annual income for 2011 of $750 million is about equal to the dividend income that Berkshire will lose when the GE and Goldman preferreds are redeemed.

Lubrizol is expected to earn about $11.25 a share this year, up from just under $10 in 2010. At a per-share price of $135, Berkshire is paying about 12 times estimated 2011 profits for the company, a discount to other specialty chemical makers such as **Valspar** (VAL) and **Cytec Industries**, which each command about 17 times and 15 times, respectively, estimated 2011 profits.

Lubrizol has traded at a discount to peers despite its strong market position in a range of chemicals, including polymers and resins, because Wall Street has worried about the company's ability to pass through price increases on raw materials, notably base oil, a petroleum input.

Leave it to Buffett to find a strong, well-managed company trading for less than the current market multiple and reach a deal to buy it without triggering an auction. While it's always possible there could be a topping bid for Lubrizol, the markets now are putting relatively low odds on that. Looks like Warren bagged a nice prize with his elephant gun.

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