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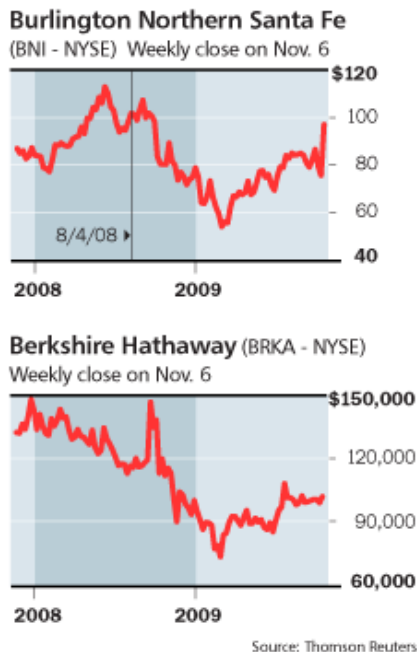
# Riding the Rails With Buffett

*A return to topics discussed in earlier issues.*

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**YOU HAVE TO LOOK PRETTY FAR** down the tracks to see what Warren Buffett sees.

His recent \$34 billion deal for **Burlington Northern Santa Fe** (ticker: BNI) is a bet that America's aging rail industry will eventually enjoy a renaissance as high fuel costs hurt trucking. But that may take a few years, not a few months, to truly get underway. "He is willing to take the long view, to look past some immediate problems to the promising, more distant future," says another railroad fan on Wall Street.



*Barron's*, too, is bullish on the long-term prospects for a rail -- a case we first laid out in a cover story last year ("**All Aboard!**," Aug. 4, 2008). That piece, which took note of Buffett's then-18% stake in Burlington Northern, argued that both freight and passenger trains would gain in popularity as consumers get fed up with gas prices and companies look for more efficient ways to move goods.

First, the industry has to overcome some big obstacles: capacity problems on key sections of track, the high costs of track expansion, and regulators' opposition to further price increases. That's to say nothing of what promises to be a long, slow economic recovery.

In other words, all the investors who piled into rail stocks last week after Buffett's move may have a relatively long wait for the gravy train. The stocks of **CSX** (CSX), **Union Pacific** (UNP) and **Norfolk Southern** (NSC) each rose about 13% on the week. Burlington was up nearly 30% for the week, to about \$97.

Buffett's **Berkshire Hathaway** (BRK-A) agreed last Tuesday to buy the portion of Burlington it doesn't already own for \$100 share. Was that a good deal for Buffett? As colleague Andrew Bary wrote for *Barrons.com* last week, it's good but not great. Berkshire is swapping a

combination of low-yielding cash and undervalued stock in a deal that values Burlington at more than 20 times estimated '09 profit. But, instead of just receiving dividends on a minority stake, Berkshire will get to consolidate Burlington's expected \$1.7 billion of 2009 earnings.

Before the offer, Burlington, whose tracks crisscross the Western states, was trading for around 15 times forecast profit, in line with valuations of rivals.

While the real payoff should come as the economy strengthens, at least one benefit may arrive quickly for Berkshire: inclusion in the Standard & Poor's 500. Burlington is a component of the index, and acquiring companies are often added to the index.

Right now, Berkshire's stock is way too expensive for the index. But the company has proposed a 50-for-1 split of its Class B shares, now around \$3,380. That could pave the way for index inclusion -- and thus heavy buying by index-tracking funds. Investment-bank Jefferies & Co. estimates such buyers would snap up 60 million shares, or 38 days' worth of normal trading volume.

Listen closely and you can hear the whistle a-blowin'.

-- *Jay Palmer*

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