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Berkshire Buys Burlington in Buffett's Biggest Deal (Update4)

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By Andrew Frye and Hugh Son



Nov. 3 (Bloomberg) -- **Warren Buffett's Berkshire Hathaway Inc.** agreed to buy railroad Burlington Northern Santa Fe Corp. in what he described as an "all-in wager on the economic future of the United States."

The purchase, the largest ever for Berkshire, will cost the company \$26 billion, or \$100 a share in cash and stock, for the 77.4 percent of the railroad it doesn't already own. Including his previous investment and debt assumption, the deal is valued at \$44 billion, Omaha, Nebraska-based Berkshire said today in a statement. The railroad's stock closed yesterday at \$76.07.

Berkshire has been building a **stake** in the Fort Worth, Texas-based railroad since 2006 as Buffett looked for what he called an "elephant"-sized acquisition allowing him to deploy his company's cash hoard, which was more than \$24 billion at the end of June. Trains stand to become more competitive against trucks with fuel prices high, he has said.

"It is Warren being Warren, taking advantage of a market that is soft at a time when the possibility for competitive bids is relatively low," said **Tom Russo**, a partner at Gardner Russo & Gardner, which holds Berkshire shares. "He looks at this as a business that has advantages against other forms of transportation."

At \$100 a share, Buffett is paying 18.2 times Burlington Northern's estimated 2010 earnings of \$5.51, according to the average analyst projection in a **Bloomberg survey**. That compares with the 13.4 multiple for the **Standard & Poor's 500 Index** as of yesterday's close. Shares of Burlington Northern, the largest U.S. railroad, dropped 13 percent in the 12 months through yesterday.

Union Pacific, CSX

Competing railroad **Union Pacific Corp.**'s ratio was 13, while Jacksonville, Florida-based CSX Corp.'s was 13.1, Bloomberg data show.

Union Pacific rose \$3.74, or 6.8 percent, to \$58.80 at 1:14 p.m. in New York Stock Exchange composite trading. CSX climbed 6.6 percent. Burlington Northern surged to \$97.58. Berkshire Class A shares rose \$1,569, or 1.6 percent, to \$100,319.

The deal culminates a search by Buffett, 79, that sent him to Europe looking for possible acquisitions and lamenting in letters to shareholders that he and Vice Chairman **Charles Munger** couldn't find companies they considered large enough to meaningfully add to annual **earnings**.

Buffett needs "elephants in order for us to use Berkshire's flood of **incoming cash**," he said in his annual letter to shareholders in 2007. "Charlie and I must therefore ignore the pursuit of mice and focus our acquisition efforts on much bigger game."

Trains, Trucks

Burlington Northern, with pretax income of \$3.37 billion on revenue of \$18 billion last year, would be Berkshire's second-largest operating unit by sales. The McLane unit, which delivers food to grocery stores and restaurants by truck, earned \$276 million on revenue of \$29.9 billion in 2008.

Berkshire's largest business is insurance, with units including auto specialist Geico Corp. Buffett, who is the company's chairman and chief executive officer, has said he likes insurance because he gets to invest the premiums paid by customers until the cash is needed to pay claims. The insurance businesses last year collectively earned \$7.51 billion on revenue of \$30.3 billion.

Buffett will use \$16 billion in cash for the deal, half of which is being borrowed from banks and will be paid back in three annual installments, he told the CNBC. Berkshire will have more than \$20 billion in consolidated cash after the purchase, he said.

Cash Hoard

"It doesn't mean we're out of business, but it does mean that we won't be making any huge deals for a while," Buffett told the network today. He said earlier this year the company needs at least \$10 billion in cash to be ready for unforeseen events such as catastrophe claims at its insurance units.

Buffett built Berkshire into a \$150 billion company buying firms that he deems to have durable competitive advantages. His largest purchases include the 1998 deal for General Reinsurance Corp. for more than \$17 billion. Buffett expanded into power production with the purchase of **MidAmerican Energy Holdings Co.**, and last year bought Marmon Holdings Inc., the collection of more than 100 businesses, from the Pritzker family. Marmon's **Union Tank Car** unit manufactures and leases railroad cars.

He expects the economy to recover, he said in an interview in September with his company's Business Wire unit.

"We are still tossing out 14 trillion worth of product a year," he said. "It will return. It's already returned with most people in most ways, but it's not back 100 percent. It'll get there."

'Simple Bet'

The U.S. economy returned to growth in the third quarter after a yearlong contraction as government incentives spurred consumers to spend more on homes and cars. The world's largest economy expanded at a 3.5 percent pace from July through September, Commerce Department figures showed last week.

"It's a pretty simple bet," said **Mario Gabelli**, CEO of Gamco Investors Inc., which has holdings in Berkshire and Burlington Northern. "Warren knows the assets. He's been involved in basic businesses like this for years."

Buffett is increasing his stake in an industry that doesn't have any competitors for certain types of freight. Federal law requires some chemicals to be moved only by rail.

Railroads burn less diesel fuel than trucks for each ton of cargo carried, giving companies such as Burlington Northern and Omaha-based Union Pacific a grip on bulk commodities such as coal. That fuel-efficiency advantage also gives railroads a share of the profits from moving goods such as Asian imports of cars and other consumer goods sent to U.S. West Coast ports.

From ships, containers are loaded onto railcars to be hauled to so-called intermodal terminals, where they're transferred to trucks for the final leg of their journey.

Fuel Prices

Buffett said in 2007 that railroads may prosper at the expense of trucks. "As oil prices go up, higher diesel fuel raises costs for rails, but it raises costs for its competitors, truckers, roughly by a factor of four," Buffett told shareholders in 2007 at his company's annual meeting. "There could be a lot more business there than there was in the past."

Berkshire's board approved a 50-to-1 split of its Class B shares as part of the acquisition plan, the company said in a second statement. Berkshire will schedule a shareholder meeting to vote on an amendment to the company's certificate of incorporation that's needed to split the stock. B share typically trade for about a thirtieth of the price of A shares.

Most of the shares exchanged for Burlington Northern stock will be Class A shares, Berkshire said. Splitting the B shares is designed to accommodate the smallest holders who elect for a tax-free swap of the railroad's stock, it said.

'Fired Up'

Goldman Sachs Group Inc., Evercore Partners Inc., and Cravath Swaine & Moore LLP are advising Burlington. Berkshire didn't disclose a financial adviser and said Munger Tolles & Olson LLP furnished legal advice.

Matthew Rose, the chief executive officer of Burlington Northern, said he struck the deal with Buffett after the two met in Texas. Buffett, named by Forbes as the second-richest American, was visiting because he has other business interests in the state, Rose said.

"We spent a couple hours talking about the economy and the business," Rose told Bloomberg Television. "The next day I got a call. He asked me to meet on a Friday night down in downtown Fort Worth. It was a relatively short conversation; he told me what he wanted to do. The next day we fired up the process."

Burlington Northern operates 32,000 miles of track, with 6,700 locomotives, according to its [Web site](#). Most of the carrier's network is west of the Mississippi, where it competes with Union Pacific.

Antitrust Review

The U.S. Department of Justice will conduct an antitrust review, which Burlington expects to be completed by the first quarter of next year, the company said today in a conference call with analysts and investors.

Burlington Northern said two-thirds of the shares that aren't held by Berkshire must vote in favor of the transaction for it to proceed under Delaware law. The railroad said it anticipates a shareholder meeting in the first quarter of 2010 and the completion of the transaction "very shortly thereafter."

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