

Six lessons to learn from Warren Buffett's latest deal

By Tom Stevenson, 4 November 2009

The Sage of Omaha's acquisition of a US railway operator is a classic Berkshire Hathaway deal.

This week's acquisition by Warren Buffett of the Burlington Northern Sante Fe railway is a classic investment by the so-called Sage of Omaha. Reportedly negotiated in just 15 minutes, the deal shows the decisiveness of the world's most successful investor and the desire of every chief executive in America for the ultimate seal of approval – an offer from Berkshire Hathaway.

Mr Buffett has been looking for an "elephant" of a deal for some time. Valuing the railway at \$44bn, this purchase is certainly that; it is the biggest ever acquisition by the former textiles company that, since 1965, has become a by-word for investment success.



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As ever, investors can learn a great deal from Mr Buffett. Here are six lessons to take away from the deal:

For the last time this year – I promise! - here are the key arguments for not letting inertia get the better of you this weekend.

- If you believe that an investment makes sense you should back your conviction with enough of your portfolio to make a difference. For most investors, it is not necessary to make a multi-billion dollar purchase to make a noticeable contribution to their performance. But the principle remains the same. If you have gone to the trouble of investigating an investment theme, and then sought out a stock or fund with which to play that idea, it makes no sense to apply too small a proportion of your available investment firepower to it (albeit any portfolio should remain sufficiently diversified). If you are hesitating about backing the idea, perhaps deep down you don't really believe in it.
- Favour investments in defensible businesses – companies surrounded by what Mr Buffett calls a "deep moat". Berkshire Hathaway has specialised in this kind of investment over the years, companies like Gillette, Wrigley, Coca Cola and the Washington Post newspaper which have unique brands that any competitor will struggle to emulate. No-one else is likely to build a

railway network to rival BNSF's in the western states of America so it can focus its attention on running its business as efficiently and profitably as possible without looking nervously over its shoulder at its rivals.

- Investors are always tempted by the "new", but the "tried and tested" often make better investments. This is because novelty and blue-sky promise come at a price. What everyone is familiar with (and may have written off as yesterday's story) can often be undervalued by the market. The railways are a classic example of this, with even Mr Buffett's generous premium price equating to just nine times BNSF's forecast earnings before interest, tax, depreciation and amortisation.
- Mr Buffett was able to pick up BNSF at this kind of valuation because the consensus is that railways are a capital-intensive relic from the pre-Interstate era. As ever, he has taken a contrarian view – that railways are actually the surface transportation of the future. With the oil price threatening to rise ever higher and increased regulation to fight the threat of global warming, that could be an extremely astute call. Sometimes the right answer is just too obvious for most people to see.
- Another contrarian aspect of this deal is its implicit backing of the US economy over the more obvious (and so crowded) view that the future lies in the emerging world. The popular trade is always the most expensive one and the best bargains in investment are found by looking where no-one else is. "I basically believe that this country will prosper and you'll have more people moving more goods 10 and 20 and 30 years from now and the rails should benefit" Mr Buffett said after the deal was announced.
- Finally, understand that investment is about taking manageable risks. Stack the odds in your favour, as Mr Buffett has by making such a big purchase in the wake of a severe bear market. If the long-term vision is wrong, or takes longer to pay off than expected, BNSF's strong cash flows and its undemanding price tag will provide a very comforting margin of safety.

With Warren Buffett approaching his 80th birthday, the acquisition of Burlington Northern Santa Fe could well prove to be the Sage of Omaha's last really significant deal. It has all the hallmarks of being one of his best.

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