

Stock Data		Exchange: NYSE
Company	Burlington Northern Santa Fe Corp.	
Ticker	BNI	
Recommendation	BUY	
Date	4/25/2009	
Current Price (4/24/09) \$67.14		
Target Price (12/31/09) \$80.12		
52-Week Range \$50.86 - \$114.58		
Shares Outstanding (Million) 341.90		
Market Cap (Million) \$22,955.17		
Total Enterprise Value (Million) \$31,761.17		
Ratios	Comp Avg.	BNI
P/E (ttm)	10.16	11.04
Forward P/E (1 Yr.)	11.08	11.28
EV/EBITDA (ttm)	6.47	6.55
ROA (ttm)	6.02%	6.99%
ROE (ttm)	14.42%	18.99%
Comparables:		
Union Pacific Corporation, CSX Corporation, Norfolk Southern Corporation, Kansas City Southern, Canadian National Railway Company and Canadian Pacific.		

We recommend a **BUY** on Burlington Northern Santa Fe Corp. for the following reasons:

Investment Thesis

- Strong free cash flow. We predict this to exceed \$2 billion in 2011.
- Solid annual dividend of \$1.44 in 2008. We expect this to increase to \$1.84 in 2011.
- ROA and ROE exceed competitors'.
- Low credit risk with only 14% of total debt due in the next 3 years.
- Burlington Northern effectively manages operating costs. In the first quarter of 2009 the company has seen a decline in operating ratio (computed as operating expenses over revenue) of 1% despite declining revenue of 24%. We expect this trend to continue and increase profitability in the future.

Company Overview

Burlington Northern Santa Fe Corporation is a holding company that was incorporated in Delaware in 1994. The company, through its wholly owned subsidiary is primarily involved in the freight rail transportation business. This business involves the movement of

numerous consumer products, coal and various agricultural products.

The company operates a rail network that is approximately 32,000 miles long with 6,700 locomotives. This rail network passes through 28 states and 2 Canadian provinces (see appendix for a copy of the rail map). The company employs over 40,000 people and is headquartered in Fort Worth, Texas.¹²

Industry Overview

The railroad industry, like most other industries is currently experiencing significant declines in its business. The declines in freight loads is due to lack of consumption by businesses and consumers. Carloads in the 1st and 2nd quarters were down 16% and 22%, respectively. However, investors do not seem to be following this trend as overall investment in the industry has increased 40% since March lows.³ We believe this to be a reaction to the cyclical nature of the industry as investment in railroads tends to be weak at the beginning of the year. We also believe the positive reaction from the market is due to the presumptive eventual recovery of the economy.

Management Overview

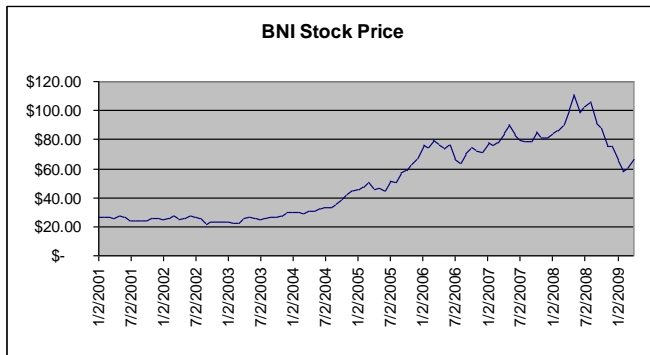
Matthew K. Rose has served as the Chief Executive Officer of Burlington Northern Santa Fe Corporation since January of 2001. He joined the company in 1993 and had served the company as Chief Operating Officer since 1999. Prior to his employment with the company he was employed by Norfolk Southern's Vice-President of Transportation.⁴ Mr. Rose is 49 years of age and we do not believe he will vacate his position with the company in the next few years. As seen in following chart, his tenure as CEO has seen the stock price of the company grow substantially, notwithstanding the recent decline due to our current economic environment.

¹ Company 10-K, Filed 2/13/09, Accessed 4/25/09

² <http://finance.yahoo.com/q/pr?s=BNI>, Accessed 4/25/09

³ Credit Suisse, Keeping Score; Weekly Railroad Update, 5/01/09, Accessed 5/01/09.

⁴ http://findarticles.com/p/articles/mi_m1215/is_1_202/ai_70034740/, Accessed 4/25/09



It is also important to note that the Chief Operating Officer and Chief Financial Officer are long time company employees. They have also served in their respective positions since 2001.

Locomotive Overview

As stated previously, the company operates 6,700 locomotives. Per the last 10-K filing, the average useful life of these locomotives is 15 years. The company increased the number of locomotives it operates by 110 in the previous year. It plans to acquire an additional 350 locomotives in 2009. The company plans to acquire a total of 1,245 new locomotives by 2013. The acquisition of these new more fuel efficient locomotives will help the company to reduce its fuel expense going forward.

Economic Overview

We believe that the current economic crisis will last through the middle of 2010 with a small recovery seen starting in the 1st Quarter of 2010. We believe that prior to this recovery, consumer and corporate spending will deteriorate further. However, we believe the company serves as an economic indicator and will be one of the first corporations to see an increase in sales as the economy recovers. During this recovery we expect Burlington Northern's pricing power to increase due to rising commodity prices, such as coal. We also expect the company to keep volumes relatively stable during this rough economic patch and, through the effective management of operating costs, will not adversely affect earnings in the near future.

Risks

The company operates in an industry with numerous risk factors. The primary risks the company faces include: competition, economic downturns, losses related to transportation of hazardous materials, changes in government regulation and union collective bargaining agreements.⁵

We are of the opinion that currently the most significant of these risk factors is a prolonged economic downturn.

Competition

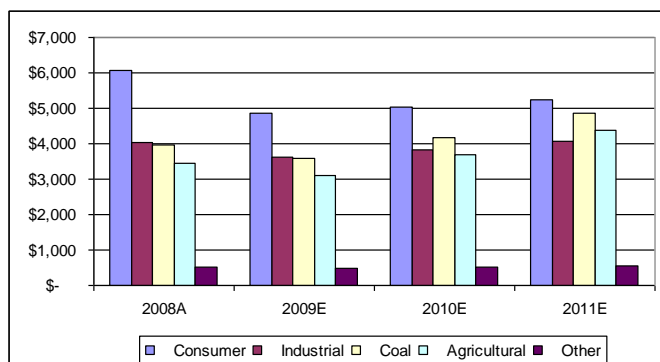
The company operates in a highly competitive industry. Depending on the location the company faces competition from other rail carriers in addition to truck carriers, ships and pipelines. We believe going forward that the competition from truck carriers will be reduced as the Obama administration pushes the country to become more energy efficient.

The rail carrier competition in the U.S. is somewhat limited with only seven major carriers currently operating in the United States. These companies are Burlington Northern Santa Fe Corporation, Union Pacific Corporation, CSX Corporation, Norfolk Southern Corporation, Kansas City Southern, Canadian National Railway Company and Canadian Pacific.⁶ However, Norfolk Southern and CSX operate rail lines primarily located on the east coast that do not significantly overlap with Burlington Northern's rail lines.

⁵ Company 10-K, Filed 2/13/09, Accessed 4/25/09

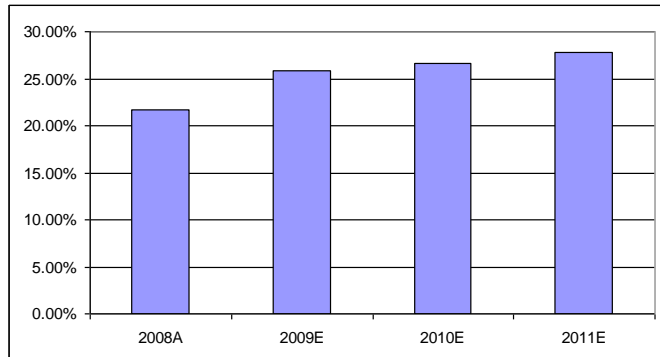
⁶ http://www.nationalatlas.gov/articles/transportation/a_freightrr.html#one, accessed 4/25/09

Revenue Projection



We project that in 2009 total revenue will fall by 13% with consumer shipments falling at the greatest percentage. We believe this is due to a lack of corporate and consumer spending. In 2010 we project revenues will begin increasing again as the economy begins to recover.

Operating Margin



We project that the company will increase its operating margin over the next three years. Burlington Northern Santa Fe recently reported a 24% drop in first quarter operating revenue, yet the operating ratio (computed as operating expenses over total revenue) decreased from 80% to 79%.⁷ We believe this shows management's ability to effectively manage operating costs and will eventually increase operating margin to about 28% in 2011.

Dividend Information

	2008A	2009E	2010E	2011E
Dividend Per Share	\$ 1.44	\$ 1.36	\$ 1.57	\$ 1.86
Dividend Yield	1.90%	2.12%	1.77%	1.63%
Dividend Payout Ratio	23.68%	21.22%	21.22%	21.22%

We forecast that Burlington Northern Santa Fe will increase the dividend per share over the next three years. Over the last three years the company has averaged a dividend payout ratio of 21.22% and we forecast that the company will target a payout ratio near this figure because of its strong free cash flow and a strong commitment to investors. Since we expect an increasing net income, this will increase the amount of the dividend to \$1.86 in 2011.

Capital Expenditures

In our discounted cash flow model we assumed a 10% growth each year in capital expenditures. This estimate is based on the number of locomotives the company plans to purchase in the next few years, in addition to the number of rail miles it plans to lay during the same time period.

Long-Term Debt

Long-Term Debt						
	2009	2010	2011	2012	2013	2014 & After
Amount due	\$254	\$345	\$631	\$451	\$393	\$6,458
% of Total	3%	4%	7%	5%	5%	76%

As seen in the chart above only a small piece of the company's debt is due in the near future. We believe this is a positive for the company as they will not need to refinance debt at unfavorable rates due to the current economic crisis.

Valuation

To determine our target price, we used multiple valuation techniques including a relative valuation, discounted cash flow and dividend discount model. We believe that the most appropriate method to value the

⁷ Wall Street Strategies, Initial Reaction to Earnings Report BNI, 4/24/09, 5/01/09

stock price of Burlington Northern Santa Fe is by using the discounted cash flow technique due to the large amount of free cash flow we have projected. Based on our estimates we have calculated a target price of \$80.12 for 12/31/2009. We therefore believe that the stock is currently undervalued by 19.3%.

DCF Key Assumptions			
2009 Revenue Growth	-13.29%	Growth Perpetuity Rate	2.00%
2009 Operating Margin	25.89%	WACC	7.37%
2009 Profitability Margin	14.03%	Market Return	10.00%

According to our forward looking estimates of the company's revenue and margins, we believe the company will have a declining free cash flow in 2009 due mainly to decreasing revenues. We project that free cash flow will then increase through 2011:

Free Cash Flows (millions)				
	2008A	2009E	2010E	2011E
EBITDA	\$ 5,309	\$ 5,284	\$ 5,950	\$ 6,829
- Cash Taxes	\$ 1,253	\$ 1,352	\$ 1,538	\$ 1,794
- Capex	\$ 2,175	\$ 2,393	\$ 2,632	\$ 2,895
- Δ NWC	\$ (220)	\$ (65)	\$ 78	\$ 82
= Cash Flow	\$ 2,101	\$ 1,604	\$ 1,702	\$ 2,058

Sensitivity Analysis

To test how our assumptions of 2009 Revenue Growth and Growth Perpetuity Rate affected the target price of Burlington Northern Santa Fe we performed a sensitivity analysis.

Δ Revenue Growth	Growth Perpetuity Rate		
	0.0%	1.0%	2.0%
-25.0%	\$ 52.31	\$ 63.42	\$ 78.68
-13.29%	\$ 53.76	\$ 64.87	\$ 80.12
0.0%	\$ 55.40	\$ 66.51	\$ 81.76

From this analysis, we conclude that the stock is fairly valued with a growth perpetuity rate of 1.0% regardless of the revenue growth faced in 2009. With a growth perpetuity rate of 2.0% or higher the stock price for Burlington Northern Santa Fe is significantly undervalued.

Relative Valuation

Relative Valuation		
	Intrinsic Price	% Undervalued
EV/EBITDA (2009)	\$ 74.78	11.40%
Forward P/E (2009)	\$ 71.48	6.50%

The comparables we used in our relative valuation were the other six major railroads currently operating in North America. Burlington Northern Santa Fe outperformed the comparable average on Return on Assets and Return on Equity indicating that the company manages the use of its assets efficiently while producing quality returns to shareholders.

We expect the company to have a down 2009. However, 2009 EV/EBITDA and 2009 P/E multiples find that the company is currently undervalued by 11.40% and 6.5%, respectively. Once the company starts to increase their revenues in 2010 and 2011 the stock would be even more undervalued.

We ultimately chose to use our target price from our discounted cash flow because of the company's large free cash flow which we believe is more predictive of the intrinsic price than the relative valuation.

APM Portfolio

The KU APM Portfolio currently holds 1,600 shares of Kansas City Southern stock which is a direct competitor with Burlington Northern Santa Fe.⁸ We believe it would be best if the APM Portfolio sold its position in Kansas City Southern and replaced it with Burlington Northern Santa Fe.

The first reason we recommend such a move is based on the dividends paid by each company. In contrast to Burlington Northern Santa Fe who pays a dividend which we project will increase over the next few years, Kansas City Southern pays no dividend at this time. By investing our funds with Burlington Northern Santa Fe the KU APM portfolio can see an immediate return through the dividend payment.

⁸ http://www.business.ku.edu/headers/apmheader_portfoliotable.asp
(accessed 4/26/09)

The second reason we believe Burlington Northern Santa Fe should replace Kansas City Southern is the original investment thesis for Kansas City Southern. The KU APM investment is based on the potential in the Port of Lazaro Cardena providing dramatic growth to the company.⁹ We believe that based on the current economic crisis and the current instability in Mexico that this is unlikely in the near future.

The APM portfolio currently has exposure to Burlington Northern Santa Fe as Berkshire Hathaway Inc. currently owns over 20% of the company.¹⁰ However, we believe it would be best to directly invest in Burlington Northern Santa Fe as potential gains received through Berkshire Hathaway Inc. could be diluted through losses in other investments.

Recommendation

Based on the above analysis, we recommend a **BUY** on Burlington Northern Santa Fe Corp.

Appendix: Rail Network Map



Source: Company 10-K, Filed 2/13/09, Accessed 4/25/09

⁹ http://www.business.ku.edu/FileLibrary/PageFile/991/KSUcase_Group1.pdf (accessed 4/26/09)

¹⁰ <http://finance.yahoo.com/g/mh?s=BNI> (accessed 4/26/09)