

GraefCrystal.com

The Crystal Report on Executive Compensation



Burlington Northern: Warren Buffett's New Toy

by Graef Crystal

November 23, 2009

Warren Buffett's shareholders ought to be thrilled he never got a toy train when he was a boy.

Berkshire Hathaway is buying Burlington Northern Santa Fe (Ticker Symbol: BNI). And of all the assets Mr. Buffett is acquiring, perhaps the most important one is BNI's 50-year old CEO, Matthew Rose.

He is that rare combination of an outstanding performer and a decent buy.

Tremendous Performance

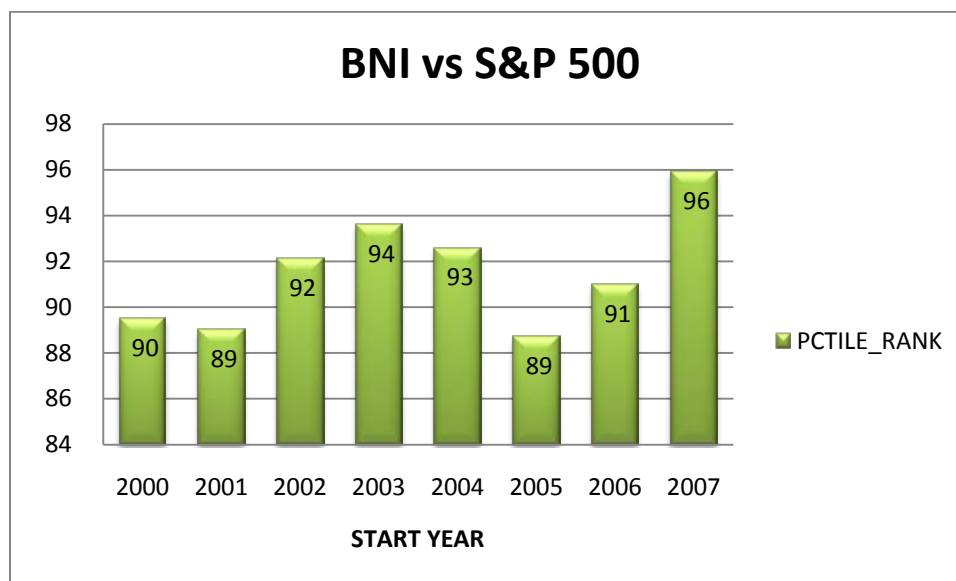
Let's review BNI's performance first.

Mr. Rose became CEO in early Dec. 2000.

I measured his performance in eight different time windows. The first began on Nov. 30, 2000, just before he became CEO. Thereafter, each succeeding time window started one year later, i.e., Nov. 30, 2001, Nov. 30, 2002, etc. The narrowest time window began Nov. 30, 2007. All eight time windows ended Nov. 10, 2009, when I completed the analysis for this article. (I could have added a time window that began Nov. 30, 2008 and ended Nov. 10, 2009, but I am hesitant to measure performance in a period of less than a year.)

In each case, I compared BNI's total return to each of the current members of the Standard & Poor's 500 Index that had a continuous stock price history for the entire time window.

Then I calculated BNI's percentile rank, which is shown in the following chart:



The median percentile rank for the eight time windows was 92, meaning that BNI outperformed all but eight percent of the S&P 500 companies.

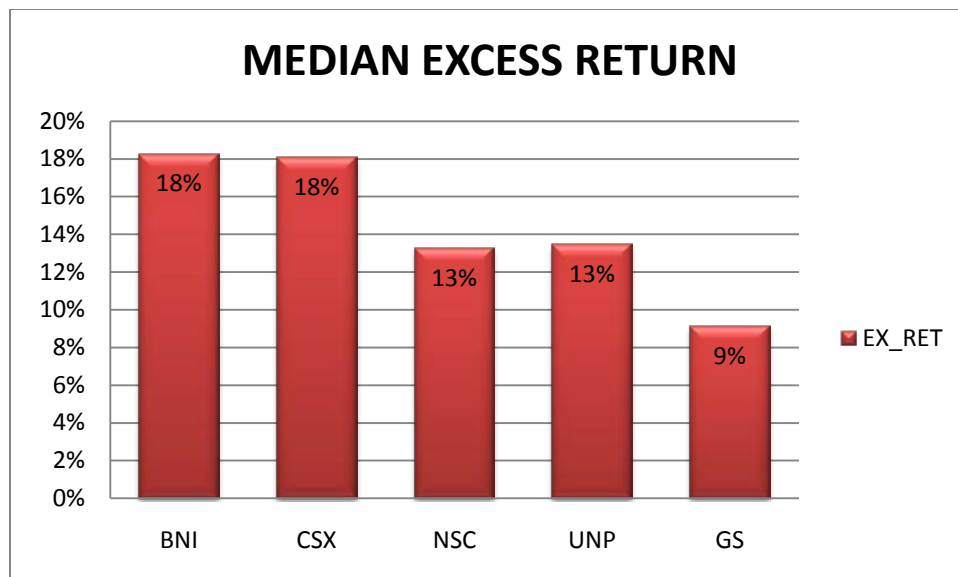
Note also the consistency of percentile rankings from time window to time window. It doesn't seem to matter when you bought the stock; you came out just fine.

Although BNI has a terrific performance record, it turns out that all the other three major railroads do as well.

I looked here at not only BNI but also CSX (Ticker Symbol: CSX), Norfolk Southern (NSC) and Union Pacific (UNP). In each case, I calculated the company's total return in the eight time windows mentioned above. Then I deducted the comparable returns on the S&P 500 to produce so-called "excess returns".

Below is a chart showing the median excess return (for all eight time windows) for the four major railroads. And just to be perverse, I included a fifth bar showing the comparable figure for Goldman Sachs (GS).

Why Goldman Sachs? They're not a railroad. No, they're not. But they pay the moon to their senior executives, and you'd think for all the money those folks get, they would have produced at least the same level of total return as a prosaic railroad. Not so, as it turns out.



Utterly Reasonable Pay

Turning to Mr. Rose's total compensation, I found the following:

- For 2005, \$8.7 million.
- For 2006, \$13.4 million.
- For 2007, \$13.6 million.
- For 2008, \$17.7 million.

(Total compensation includes: base salary; annual bonus; my estimate of the grant date fair value of stock options and free shares granted during the year; the target value of contingent long-term performance grants; deferred compensation, pension accrual and miscellaneous compensation.)

These dollar figures may be compared to those paid by hundreds of other major companies in each year. In each case, a multiple regression analysis was run, showing that two significant factors influenced pay: company size, as measured by net sales; and pay risk (as measured by the ratio of option present value to total pay, options being generally considered the most risky part of a pay package).

Taking these factors into account:

- For 2005, Mr. Rose's pay was 35 percent below the market.
- For 2006, it was 3 percent above the market.
- For 2007, it was 6 percent below the market.
- And for 2008, it was 18 percent above the market.

For all practical purposes, therefore, Mr. Rose was neither underpaid nor overpaid during the years 2005 through 2008. Yet he was a tremendous performer.

Unlike Warren Buffett, I did have a toy train set when I was a child. But the love of trains never left me. When I lived in downtown San Diego, I used to walk many days to where huge BNSF freight trains were assembled. Then like a little kid, I waved to the engineer as he rode by.

//////

The compensation data used in this article were obtained from Equilar Inc., a leading provider of executive compensation information. Please click here to go to Equilar:

<http://www.equilar.com>

Graef Crystal's is now in his 51st year in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. (He still contributes occasional columns to Bloomberg News.) He has written six books and more than 1,600 articles on executive pay.