THE RAILROAD WEEK IN REVIEW

March 14, 2014

"More than half of BNSF freight revenues are covered by contractual agreements of varying durations." - BNSF 10-K for 2013

BNSF total 2014 freight sales plus "other revenues" came to $21.6 billion, up five percent, on 10.1 million revenue units, up five percent. Operating expense grew half as much as revenue, 2.5 percent, leveraging a 12 percent operating income gain. The annual OR shed 182 basis points to a commendable 69.1 percent of total revenue. Net income was $4.3 billion, up 15 percent; net margin was 19.8 percent, also an industry-leading number. Free cash flow after capex was $2.3 billion.

The railroad breaks its freight business onto four broad categories. Of most interest to short lines are the Ag and Industrial Products groups. Agricultural products is all the STCC 01s plus STCC 20 grain mill products from corn oil and corn syrup to specialty grains like malt and milo; ethanol and STCC 28 ferts are also in the ag group. For the year, vols drifted south thanks in part to the drought and global competition.

The Industrial Products group is about 27 percent of revenues and includes all building and construction materials (wood, metal, clay, etc.); petroleum products from asphalt to LPG to crude oil; all STCC 28 chemicals excluding ethanol and ferts; and STCC 20 packaged food and beverages. The group's 2013 revenue-unit gains were largely a function of crude-oil.

Auto and intermodal containers, both domestic and international, are in the Consumer Products group. Here, domestic boxes were up as more truckers switched from road to rail; international grew on higher export demand. Coal turned the corner to positive on higher nat-gas prices plus reduced utility stockpiles; vols weren't quite what they could have been except for severe weather issues impacting service levels. Note BNSF puts coke in the IP group, unlike the eastern roads. RPU was up three percent in ag and IP, flat in coal and consumer.

Fuel surcharges of $2.9 billion are included in freight revenues and represented for 2013 some 67 percent of total fuel expense. The amount collected is a function of how much fuel prices exceed a certain threshold. BNSF uses three ways to calculate fuel surcharges, depending on commodity: mileage-based, a percentage of revenue per move, and, in some cases, using a fuel-price basis from as much as 60 days prior to the move. Spreads between fuel expense and fuel surcharge will vary according to business mix and price volatility.

As to where BNSF fits in Berkshire family, Warren Buffett writes in his 2013 Annual Letter:

> BNSF is one of our "Powerhouse Five" – a collection of large non-insurance businesses that, in aggregate, had a record $10.8 billion of pre-tax earnings in 2013, up $758 million from 2012. The other companies in this sainted group are MidAmerican, Iscar, Lubrizol and Marmon… The $10.4 billion gain in annual earnings delivered Berkshire by the five companies over the past nine years has been accompanied by only minor dilution. That satisfies our goal of not simply growing, but rather increasing per-share results. If the U.S. economy continues to improve in 2014, we can expect earnings of our Powerhouse Five to improve also – perhaps by $1 billion or so pre-tax.

BNSF delivered half that $billion earnings-gain target all by itself in 2013. Moreover, BNSF reported $5.9 billion of earnings before taxes, nearly 30 percent of the $20 billion the operating businesses - insurance, Marmon (UTLX lives here), MidAmerican and others - generated for the full year 2013.

Meanwhile, outside the annual report, BNSF announced this week a congestion-relief project to double-track the ex-Great Northern main between Minot, N.D., and Glasgow, Mont., at a cost of $162 million. Another $26 million is going into North Dakota run-around tracks on the Hillsboro Sub between Fargo and Grand Forks. Montana's Dickenson Sub will get $14 million in new run-arounds between Bismarck and Glendive.

North Dakota's Devils Lake Sub will get $13 million for side-tracks between Minot and Grand Forks. Another $13 million is to add needed capacity on the Noyes Sub that extends into Canada through the Port of Pembina, $11 million will buy CTC on the Jamestown Sub between Bismarck and Fargo, and the KO Sub will get $8 million for sidings and signal work. Add it all up and you have nearly $250 million in capex. And they don't have to answer to Wall Street for any of it.

GWR Feb carloads for North America increased two percent over Feb, 2013, negatively affected by severe winter weather at most North American regions. Coal is still king at 21 percent of NA commodities; carloads increased by 12 percent, thanks mainly to increased steam coal shipments in the Midwest and Ohio Valley Regions, partially offset by decreased shipments in the Mountain West Region.

Of the other five commodities comprising 80 percent of NA carloads, STCC 28 chems, both forest products STCCs, and metals were off slightly. Year-to-date revenue units are up oh-point-seven percent and Feb loads came down ten percent sequentially from Jan.

Total shortline revenue units year-to-date are off 2.4 percent based on 427 roads reporting to RMI's RailConnect Index. The best year-over-year growth is in ores, up nine percent, and aggregates, up seven percent. Coal came down three percent, lumber two percent and paper one percent. Grain, 11 percent of vols, was off a point.

The common thread between GWR and RMI is that volumes of stuff moving in boxcars - forest products, processed foods, metal products - do not inspire a great degree of confidence. This squares with what we heard at the recent *Railroad Equipment Finance* conference and with the March 7 AAR *Rail Time Indicators*: Feb 2012-Feb 2014 lumber and plywood are up 6.6 percent, pulp and paper down 1.9 percent, food products down 3.7 percent. Primary metals products are down 13.8 percent.

Excluding intermodal boxes, the AAR says the US Class Is handled 1.1 million units in Feb. The four commodity groups above amounted to 103,007 loads, 9 percent of the AAR total carloads. Worse, the average boxcar moves empty 6.2 miles for every 10 loaded miles, adding to GTMs but not RTMs. Is it any wonder the boxcar gets no respect?

Shortline pioneer and long-time Pinsly Railroad leader Maggie Silver passed away March 9. She was 88. Retiring from an active role at Pinsly in 1997, Maggie wrote *finis* on a career with the firm father Samuel Pinsly created in 1938. When he died in 1967, she succeeded him as president. In 2000, Silver became chairman of Pinsly's board, and her son, John Levine, became president.

Silver joined the ASLRA board in 1978, long before the Association added “Regional Railroads” to its name, becoming the ASLRRA. Always maintaining a leadership position, Maggie had served on ASLRRA's Eastern Region Board since 1979, including five years as the region's vice president. Silver became director emeritus of ASLRRA at the end of her term in 1994, and remained active in association and board activities after her 2007 retirement. She also was a past president of the New England Railroad Club and held a leadership role at the Massachusetts Railroad Association.

She was one of the first short line presidents to understand and embrace change brought on by the Staggers Act of 1980, which fundamentally changed the rail industry. Silver also served as a mentor for hundreds of women beginning their rail industry careers. Judy Petry, an ASLRRA board member and good friend of Silver's, considers her the leading lady of the railroad industry and “my mentor.” Says Kathy Cassidy, ASLRRA’s VP for Meetings and Member Services, “Maggie was one of the most thoughtful, forward-thinking individuals that I have ever known,”

Silver is survived by her husband, Robert, three sons, a daughter, two step daughters and eight grandchildren. She will be remembered fondly by all of us, especially by those of us who counted her as a friend for more than 20 years.