THE RAILROAD WEEK IN REVIEW

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"We expect that BNSF revenues and earnings over the remainder of 2014 will exceed 2013." — Berkshire Hathaway 10-Q

BNSF reports $5.5 billion in freight revenues, up three percent, on 2.5 million revenue units, up one percent, for the first quarter. I'm using the Week 13 carloads from the the Investors page on their website as a proxy for the quarter's revenue units and the Q's broad-brush revenue:

> In the first quarter of 2014, revenues from industrial products increased 5 percent to $1.4 billion reflecting a 1 percent increase in volume primarily due to petroleum products, while revenues from agricultural products increased 7 percent to approximately $1.0 billion. These increases were attributable to increased rates and product mix. Coal revenues during the first quarter of 2014 increased 1 percent to $1.2 billion, reflecting a 4 percent increase in volume, partially offset by lower rates. Revenues from consumer products during the first quarter of 2014 were $1.7 billion, and were relatively unchanged from 2013.

From this you have to back into the 2013 numbers, dividing the 2014 number given by one plus the percentage change over 2013. The website carload commodity breakout is quite detailed, so you have to know what goes into the industrial products, agriculture, coal and consumer buckets used in the Q. Most of it's intuitive; however, there are tweaks. Coal and coke are separate so I put coal in coal and coke in industrial. "Food" is STCC 20 processed food in boxcars, so that's industrial, not ag. Auto and intermodal are combined into "consumer." I put the difference between the sum of the commodity group revenues given and the reported revenue in "other."

Within the industrial products group, petroleum products was the only double-digit gainer, up 12 percent to 134,000 units. BNSF doesn't break out crude oil from the STCC 29 petroleum products, but the STB does in its QCS files. The 2012 and 2013 fourth quarter numbers suggest BNSF runs a consistent 57,000 STCC 29 carloads a quarter, so the deltas must be in crude oil. I make it first quarter crude oil up 22 percent to 77,000 carloads. And since the entire BNSF revenue unit delta was only 25,000 units, you can see how the losses elsewhere — grain, chems/ferts, non-met mins, e.g. — are masked.

Operating expense jumped seven percent, more than twice the revenue gain, pushing ops income down seven percent to $1.4 billion, and the OR up nearly three points to 74.9. Net income shrank nine percent to $724 million. Now, to get closer to peer comps, I needed some eps numbers. I start with BNSF and UP share counts at the end of 2008: BNSF 387 million; UP 515 million.

Over the next five years, UP reduced its share count 11.5 percent. I did the same with BNSF since they already had a buy-back program in place 2007-2008, arriving at a pro forma year-end

2013 share count of 343 million. That gives us pro forma first quarter per-share earnings of $2.11, in the ball park with the $2.38 UP reported. To get at a share price, you need a full-year 2014 earnings estimate. UP's is $10.91, 4.6 times the first quarter eps.

Do the same with BNSF and get $9.67 a share. Rails are trading right at 16 times 2014 earnings, giving us a $155 year-end price target for BNSF by itself. With Berkshire trading in the $120s today, it seems to me you can get BNSF at a fair price and the rest of Berkshire for free. Buffett himself always talks about value investing — getting good companies at half of what they're worth. What about paying up for one tenth of the firm's sales and getting the rest for free?

And speaking of Buffett, the WSJ blog on the audience Q&A during last week's Berkshire Annual Meeting tells us us of an exchange between Buffett and analyst Jonathan Brandt. The question had to do with BNSF's challenging winter and whether UP is doing better. Buffett acknowledges the service hiccups, particularly in the north. He adds that BNSF is spending more money than UP (2014 capex estimates $5 billion for BNSF, $4 billion for UP) to address capacity, noting that the ex-GN "has got a lot of trains that weren't running five years ago."

Another questioner asked how the oil sands and the Keystone pipeline will affect Berkshire businesses. Buffett replied Marmon's Union Tank Car will benefit, as will "a newly acquired unit that helps move oil through pipelines will do more business." But the big winner regardless of Keystone is BNSF with its 700,000 car-a -year crude oil run rate and its "greater flexibility for choosing a destination for oil." He sees oil sands as an "an important asset for mankind over the centuries to come, but I don't think it'll dramatically change anything at Berkshire."

Naturally, the question of tank-train derailments came up. Buffett thinks each of the four [sic] major rails has the financial capacity to handle a "huge reward," but it's "not a question that keeps me awake nights." However, he correctly notes that "BNSF isn't getting paid enough" for hauling hazmats from ammonia ferts to chlorine for drinking water to ethanol and crude oil.

Elsewhere, the current "Friday Freight" letter from Wolfe Research addresses service trends as perceived by a big grain shipper. The contact says everybody is recovering from the winter slow-down, that UP is doing best, the eastern rails are on the mend, while BNSF has yet to turn the corner. The shipper says unit train cycle times are down 20 percent so he's moving 20 percent fewer trains. If there is any upside, it could be in the rate department. The rails are acknowledging the loss of value added and are looking at two percent increases in 2014 vs. double that in years past.

Last week's thread on my rail ops panel st NEARS has brought some thoughtful replies. A long-time reader and good friend who's worked both the Class I and shortline sides in senior positions takes exception to my "sounds easy enough" comment re collaboration between carriers. Says he,

I'd offer some caution. This has been a vexing problem for well over a century. The very production process involving multiple trains and multiple yards introduces uncertainty into transit times. While railroads have been able to raise reliability in specific lanes by concentrating attention and resources, they've never solved the problem on an overall basis.

There are times when overall reliability is better and times when it's worse, generally reflecting the degree of capacity utilization. There is an inherent tension between maximizing service reliability (measured by, say, maximum 48-hr percentage, i.e. compactness of the distribution, not by percent making schedule which is generally meaningless) and maximizing utilization of crews, locos, etc. We can see this illustrated by the drop in service levels since the depths of the recession.

Trip plans are of questionable value, particularly in times of unreliable service. ShipXpress, one of the companies offering tracking/tracing software and services to rail customers, actually provides a projected ETA based on historical performance, which they find to be more accurate than the trip plan. Class I trip plans for merchandise cars frequently come undone at the end of the trip, the move to the serving yard and then the customer. This is, of course, the very worst time from a customer standpoint, as there's the least time to react. Fortunately, short lines do much better in providing on time deliveries over the "last mile."

Of course, if you're the customer, not knowing if a car with a seven day trip plan will actually take six days or eleven, takes most of the utility out of the trip plan anyway. There's not much point in planning if there's nothing to plan on and that's the way it's been most of this year, at least. Incidentally, short lines have lost a lot of loads, especially in the first quarter, due to the Class I meltdown (excepting UP and KCS). Disruptions have continued into the second quarter, although things are improving.

It appears I was was unclear in my original comments. What I meant to say is it sounds easy enough to get everybody talking on the same page. What I heard in Providence is they are not. If a shipper does't know the scheduled trip times, he ought to ask. The Class I customer service rep ought to be able to tell the shipper which release days offer the best travel times in the specific lane. And shippers need to keep rail reps up to date on upcoming moves and volume changes. The common thread seems to be data exchange. Each side must tell the other what it wants to do and then do it, managing the exceptions ahead of time.

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