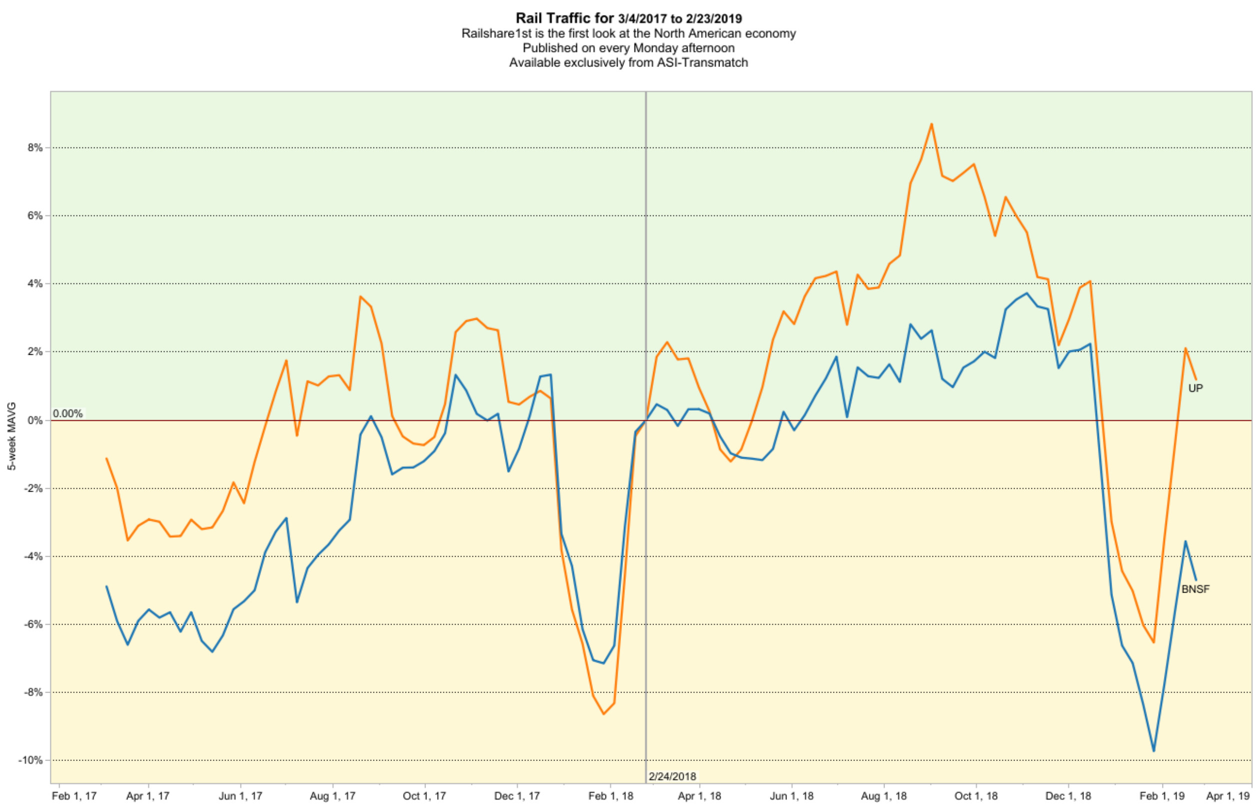
RAILROAD WEEK IN REVIEW

March 1, 2019

"Despite our recent additions to marketable equities, the most valuable grove in Berkshire's forest remains the many dozens of non-insurance businesses that Berkshire controls…Berkshire's runner-up grove by value is its collection of equities… Our two towering redwoods in this grove are BNSF and Berkshire Hathaway Energy… In the years ahead, we hope to move much of our excess liquidity into businesses that Berkshire will permanently own." — Warren Buffett, Chairman's Letter, 2/23/2019

"BNSF reported solid revenue growth of 10 percent y/y in 4Q, but its operating income increased just 3 percent y/y which was worst among the rails in 4Q. The OR deteriorated 225bp y/y to 66.8 percent, second worst among the rails as headcount increased materially. BNSF's OR was 520bp worse than the 61.6 percent OR reported by UNP, and this is the largest OR spread between BNSF and UNP in over 4 years." — Scott Group, Wolfe Research

As noted above, Scott Group writes BNSF total revenue was up 10 percent y/y in 4Q, but its operating income increased just 3 percent y/y which was worst among the rails in 4Q. Neighborly comps are instructive, so I've included a Transmatch chart showing BNSF vs UNP revenue units for two years. Says Scott, "BNSF's OR was 520bp worse than the 61.6 percent OR reported by UNP, and this is the largest OR spread between BNSF and UNP in over 4 years."



Based on these results, one might say that in 2018 BNSF put revenue growth ahead of margin. Total full year sales hit $23.9 billion, up 12 percent, more than any other Big Six Class I but CP and it was a tie there (BNSF doesn't report quarterly results which may in itself not be such a bad thing). Revenue units hit 10.7 million loads, up 4.1 percent, second only to NS and CN with 4.2 percent revenue growth at both. RPUs increased 6.3 percent, second only to CP at 7.9 percent. Fuel surcharge collections surged 65 percent to $1.4 million; pure freight revs now $22.4 billion.

Operating Expense jumped 14 percent to $16.1 billion; operating income gained only seven percent to $7.8 billion, so the OR gained 140 basis points to 67.3, highest among all Class Is including KCS. I say rev growth came ahead of margin because ops expense was up four percentage points more than revenue, thanks in part to double-digit gains in Purchased Services, MS&O, and fuel. (BNSF doesn't give us any ton-mile data, so no GTMs, RTMs or fuel-related comp.)

Since BNSF's commodity breaks are so broad (Industrial, Agriculture, Coal, Consumer), it's useful to use the Week 52 carload report to the AAR for greater detail on the 17 carload commodity groups ex-coal. Alone among Class Is, BNSF had year-over-year gains in each:

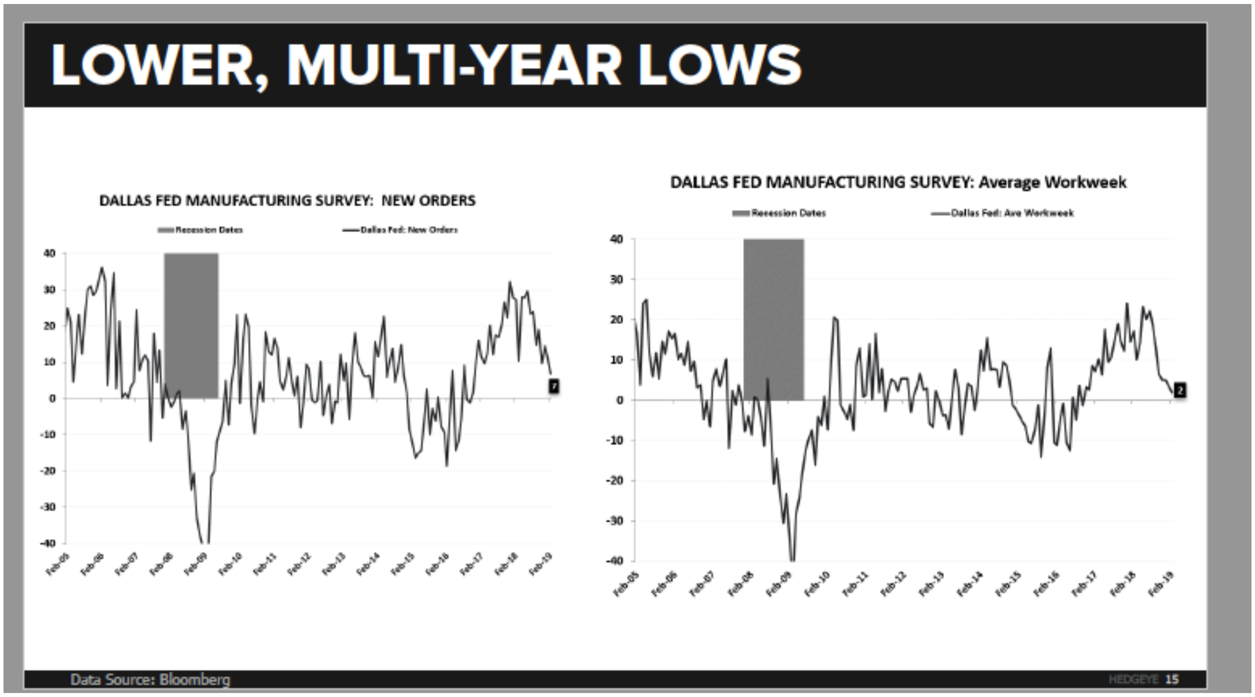
* Grain up 10.3 percent. Grain mill (oils, sweeteners) up10.3 percent;
* Auto up 1.9 percent (5 percent of the reported "consumer products" number; IM the rest;
* Within Industrial, Petroleum Products was the big gainer on crude oil, up 23.7 percent. Metals up 14.1 percent, Aggregates including frac sand up 11.7 percent, Pulp/paper up 10.2 percent. Steel scrap up 21.2 percent (supports gain in metals), other Waste up 11.4 percent.

System RPU was up six percent on increases everywhere but Ag abetted by higher fuel prices, and business mix changes. Consumer Products volumes increased on higher domestic intermodal volumes due to economic growth and tight truck capacity, road-rail conversions, and ag exports in containers. Industrial Products volumes increased on petroleum products, building products, construction products, and plastics.

Agricultural Products volumes gained on corn, beans, ferts, partially offset by a reduction in soybean and wheat exports. Coal volumes decreased due mainly to plant retirements combined with competition from natural gas and renewables, mostly offset by market share gains and improved export volumes.

All in, I'd say it was a respectable year, and the solid carload gains across every commodity group bodes particularly well for BNSF short lines.

Continuing the theme of a slowing economy, I keep seeing charts that confirm the thread. From hedgeye.com comes this eye-opener:



The New Orders trend shows how history repeats. Back in Feb 2006, the Dallas Fed New Order Index rose 30 percent to the upside. Two years later, the Index had lost all its gains and the 2008 recession began. As new orders fell, so did the length of the average work week. Here again, as the Index turned negative, recession ensued. Both indictors are flashing red right now.

Hedgeye's not alone. Liz Ann Sonders at Charles Schwab tweets, "The consensus real GDP estimate for 1Q19 as per @Bloomberg has moved down sharply over past few months" and shows a drop to 1.9 from 2.4 percent last September. Raoul Pal at realvision.com tweets, "January and Feb credit card data have fallen off a cliff" as consumers cut back.

The S&P 500 Index may have regained most of its December losses, yet it seems stuck just above the 200-day average. It hasn't been able to break above the 2810 resistance hit three times Oct-Dec before the final plunge to 2468 Dec 27. As Raoul Pal says repeatedly, you can't say *when* things will get really ugly, but the rate of change in charts says it will be sooner rather than later.

Short lines really need to pay attention because their fortunes are closely linked to the number of carloads they see. Present vols may work today, but tomorrow??