RAILROAD WEEK IN REVIEW

March 4, 2022

"Your railroad had record earnings of $6 billion in 2021. Here, it should be noted, we are talking about the old-fashioned sort of earnings that we favor: a figure calculated after interest, taxes, depreciation, amortization and all forms of compensation. (Our definition suggests a warning: Deceptive "adjustments" to earnings – to use a polite description – have become both more frequent and more fanciful as stocks have risen.)" — Warren Buffett Annual Letter, February 26, 2022

"The rail car surpluses will continue to shrink, but at a slower pace than in 2021. Retirements will remain well above the long-term replacement trend. New car orders will be healthy-to-strong, with the backlog rising some — deliveries should mostly offset the order rate. Finally, and at least what the lessors have been waiting for… higher lease rates." — Richard Kloster, Commtrex

"The North American railroads have very minimal direct exposure to volumes to/from Russia and Ukraine. However, there are some indirect impacts from the conflict that could be positive for the rails… Russia and Ukraine account for almost 30 percent of global wheat exports. Wheat prices have spiked top their highest level since 2008." — Scott Group, Wolfe Research

BNSF 2021 net income increased 16 percent year-over-year to $5.99 billion on operating income of $8.8 billion. Freight revenue was up 11 percent to $10.6 billion on 10.1 million revenue units, up 6.9 percent. Each of the commodity groups — industrial, agriculture, coal, and consumer (intermodal and auto) — posted full-year increases. Operating expense was held to a ten percent increase, in spite of the fuel bill going up by half again what it was in 2020.

I was pleased to see RPU gain was up a mere three percent, even with volume increases in each commodity group. I follow the weekly AAR carload data and use the Week 52 report as a proxy for the full year. I think the 52-week AAR numbers and the BNSF full year numbers are close enough — 10.112 million units for 52 weeks vs.10.135 reported — to fit.

The Consumer Products Group (intermodal and auto) accounts for some 56 percent of total revenue units. This highly successful unit is run by Group VP Tom Williams. His approach is simply to meet customer requirements:

> Our customers have unique supply chains that require multiple segments and handoff points. In order to efficiently and reliably meet our customers' expectations, we offer our customers a suite of Application Programming Interfaces (API) that make it even easier to communicate real-time shipment data. Our APIs allow customers to track their freight from origin to destination,

view transcit schedules to know when to plan their shipments and get up-to-date information from our intermodal facilities about storage location and truck driver pick-up and delivery directions.

Of the 18 commodity groups in the above-mentioned AAR report, BNSF was down in only two —farm products ex-grain and petroleum products, most of which is crude oil. Both are tiny percents of total units. The bigger picture is BNSF isn't goosing revenue — and lowering the OR — by raising rates where volumes are declining. I remember BNSF President Katie Farmer saying early that on she wanted to get a YES when asking a customer for an order. That's the way to run a business and clearly it's working for her.

Wheat prices have shot up markedly on the Ukraine situation, as Scott Group notes above. On Wednesday, May futures closed above the $10/bushel mark for the first time since March, 2008. Just to put things in context, it appears that Russia is the largest exporter of wheat (the U.S. is second) and Ukraine is number six among global wheat exporters.

Among North American railroads, BNSF is the leader in the AAR grain category, which includes beans, corn and wheat. The STB waybill sample Quarterly Commodity Statistics shows BNSF carrying as much wheat as the other Class Is combined over the past three years. In 3Q2021 it was nearly 60,000 carloads.

Potash is another commodity coming out of that part of the world in significant volumes. Group writes that Russia and Belarus are the 2nd and 3rd largest potash producers in the world (Canada is in first position). Prices were already at a 13-year high before the invasion so "sanctions and disruptions will likely lead to increased demand for Canadian potash." CP will benefit from its Canpotex franchise — six percent of total revenue units. This customer is the world's largest exporter of potash and is reported to have already inked 2022 sales contracts with both China and India.

And, speaking of CP, recall they do a lot of business with Teck, the coal miner. One of their specialties is coking coal, and its price is off the charts. Doomberg said just last week there was an Australian contract at $430 a ton against a production cost of $60. If this is so, then Teck is going to be printing money — as long as CP can rail the product to Kamloops and thence over CN to the docks in Vancouver.

The former Northern Illinois & Western short line has morphed into a full-fledged locomotive leasing company, NIWX corporation. Founded in 1999 by Ellen and John Howell, over the years the couple operated short lines in several states (and became fast friends, I might add).

Their loco leasing program is unique. It offers only four-cycle GE and Caterpillar-powered four-axle power. The reason is that NIWX has found that four-cycle diesel engines such as GE's 7FDL and Caterpillar's 3500 series engines "are more fuel-efficient and consume very little, if any, engine oil, offering customers significant periodic maintenance cost savings while simultaneously reducing the environmental footprint."

NIWX has determined that companies that traditionally had leased or owned their locomotives began hiring service providers who offered "contract" switching services yet using the customers' locomotives, operators, and mechanics. However, says NIWX, "contract switching has turned into a highly competitive market with locomotive quality, reliability, and safety being deferred due to the razor-thin 'profit' margin."

That's something else that makes NIWX unique: providing a few locomotive types best suited to short lines and contract switching — easy to maintain using a small inventory of repair parts. To this NIWX adds a network of seasoned maintenance personnel to support customer operations. Their new website, NIWX.com, is up and running and you can get acquainted right away on Twitter — @NIWXCorp.