RAILROAD WEEK IN REVIEW

August 12, 2022

"BNSF operating revenues increased 15 percent in the second quarter of 2022 compared to 2021 primarily due to a 22 percent increase in average revenue per car/unit resulting from higher fuel surcharge revenue driven by higher fuel prices, along with increased rates per car/unit. Railroad operating revenues reflected lower volumes of six percent in the second quarter compared to 2021." — Berkshire Hathaway 10-Q

"Recent circumstances have shown that coal still plays an important part in worldwide energy, enticing coal producers to try and beef up production. But experts say the U.S. coal industry cut capacity during the COVID-19 pandemic, and that capacity isn't likely to come back." — Trains News Wire, August 9

"Scheduled railroading is transforming CSX into a more efficient and reliable railroad. Based on five guiding principles — safety, service, cost control, asset utilization and people — scheduled railroading is both an operating model and a shared commitment to excellence." — CSX home page, www.csx.com

BNSF reported second quarter 2022 revenue of $6.5 billion, up 15 percent, on 2.5 million revenue units, down six percent. RPU gained 22 percent, with all commodity groups taking double-digit hikes. Operating income was $2.4 billion, gaining just seven percent since ops expense jumped 20 percent; the OR was 63.2, up 2.7 points. Interestingly, even though The Street scolds BNSF for a higher OR than rival UP, BNSF's operating income delta bested that of UP by six percentage points.

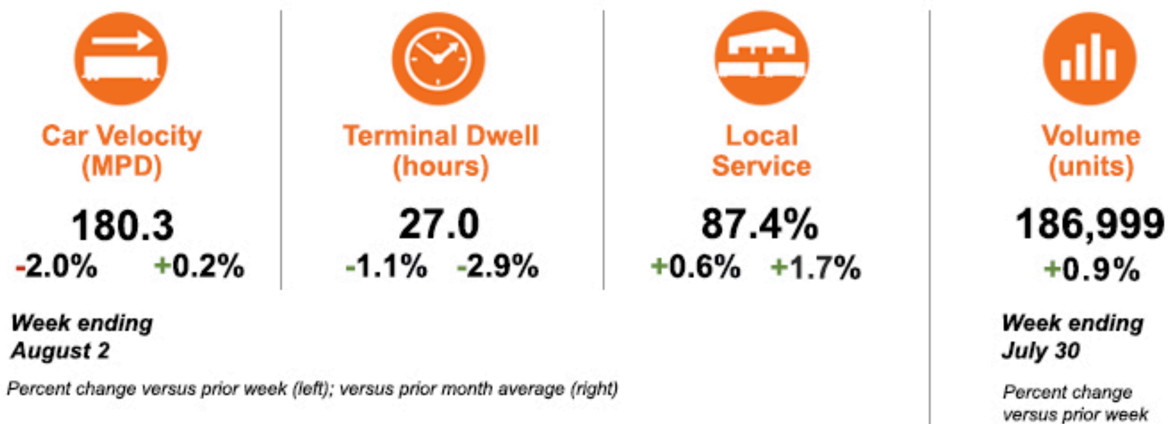
Operating revenue from consumer products (auto and intermodal) was $2.5 billion in the second quarter, up 18 percent on higher RPU, partially offset by a seven percent cut in revenue units due mainly to fewer international boxes. Modest gains in auto and domestic intermodal helped ease that hit.

Industrial products revenue was up eight percent to $1.5 billion. Carloads were off four percent, posting significant declines in metallic ores and petroleum — mainly crude oil; aggregates, including frac sand, gained nine percent. Ag revenue was up nine percent on a three percent cut in carloads. The volume decreases were primarily due to lower grain exports, partially offset by higher volumes of renewable diesel and oil feedstocks. The AAR scores these as STCC 29 chemicals, up five percent including the STCC 28s.

Then there's coal. Revenue surged 30 percent even though carloads slipped three percent — credit RPU up 34 percent! For the six months, however, volumes were up five percent due to increased electricity generation, higher natural gas prices and improved export demand. All-in, not a bad quarter. Net income was up 12 percent to $2 billion and free cash flow was $3 billion, up five percent.

BNSF is unique among Class I railroads in that it provides weekly "Customer Notifications" by commodity group — intermodal, industrial products, ag products, coal and automotive. Customers can subscribe through the Customer Portal on bnsf.com. Here are excerpts from the August 5 Industrial Products page:

Under *Operational Performance* we get updates on the Southern Transcon derailment in Illinois, gradual relaxation of the temporary permit embargo in California, and "how this temporary reduction of railcars on the network is generating the additional capacity needed to improve fluidity and service consistency."



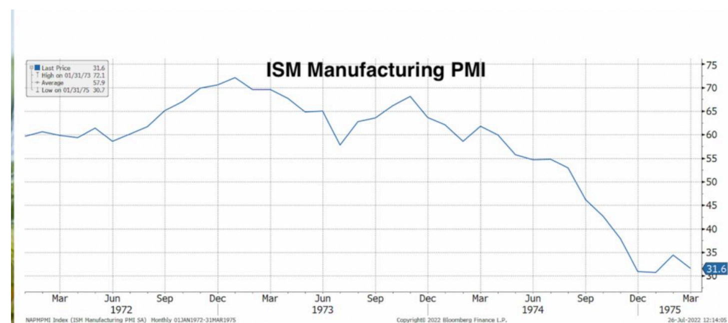
Under *Service Expectations for the Week Ahead*, BNSF advises, "Much of the Plains and upper Midwest will experience excessive heat through the weekend, with temperatures exceeding 100 degrees in many locations. Heavy rains and flood watches are in place in parts of the Southwest. More seasonable conditions are expected across much of the

network later in the week, with no significant service interruptions due to weather anticipated at this time."

I think this kind of customer advocacy is essential when selling a service that is designed to protect customers' supply chains. It was painfully clear during the April service adequacy hearings at the STB that customers were seeing service disruptions but hadn't a clue as to why or how to deal. This BNSF Customer Notifications service sure helps.

There's a lot of talk of recession out there and one of the charts that ought to raise many red flags is the ISM Manufacturing PMI, where a reading below 50 signals a significant pullback in manufacturing activity. Where are we now? The curve edged lower to 52.8 in July of 2022 from 53.0 in June, albeit beating market forecasts of 52.0. The reading pointed to the weakest rate since June of 2020, as new order rates continue to contract although supplier deliveries improved and prices softened to levels not seen in two years.

History repeats. This chart is from the 1970s, where the ISM went from 56 to 30 in four months. Don't forget that the 1970s — like now — was a time of high inflation, and the way for the Fed to stem that tide was to raise interests rates.



And so it was the Fed in the 70s was raising interest rates. There's 100 percent track record suggesting higher interest push down the ISM. Look at 2001 and 2008, where expectations of inflation did as much damage as inflation itself.

When the ISM falls, people stop making stuff, so there are fewer finished goods for sale. There's also a huge reduction in the demand for raw materials to make that stuff. And that's where the railroads come in. They are at their best in bulk and with less bulk they don't do so well. That's why I'm looking askance at all the rosy earnings projections we're getting from the carriers and the street. It's hunker down time, and mandating two in the cab makes it that much more expensive to run trains. Hunker down indeed.

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