RAILROAD WEEK IN REVIEW

May 5, 2023

"To be successful, we know that we must always stay focused on growth. One thing truly consistent about BNSF is our focus on growth. We need a bias for growth to be successful in growing with our customers. We really have to be nimble and agile enough to reinvest in our business and have capacity so we can say 'yes' to new business opportunities." — Katie Farmer, BNSF President & CEO, Railroader of the Year, Railway Age, January, 2023

"BNSF, our third Giant, continues to be the number one artery of American commerce, which makes it an indispensable asset for America as well as for Berkshire. If the many essential products BNSF carries were instead hauled by truck, America's carbon emissions would soar. 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."— Warren Buffett, 2021 Chairman's Letter, page 6

"Outside of green energy, some infrastructure spending, cyber, aerospace/defense, digital advertising, and cloud computing, I don't see much vitality in this economy at all, sad to say. And the political backdrop here and globally is not what I would call confidence-inspiring (which leaves me ongoingly bullish on gold as the natural hedge against elevated levels of geopolitical uncertainty)." — Breakfast with Dave (Rosenberg), May 2

BNSF reports Saturday along with parent Berkshire Hathaway. When BNSF reported Week 13 commodity volumes to the AAR on April 1, they showed total YTD revenue units down 11 percent, with intermodal the biggest drag, down 18 percent. Merch carloads ex-auto, 31 percent of total units, slipped only four percent. A third of the merch commodity groups showed gains, with ag products in the lead by several points.

Among the Big Six North American Class I railroads, BNSF was down the most in revenue units as a percent of total — 11 percent — but had company in the double-digit decline category, with CSX and CN off more than ten percent. In grain, BNSF and UP were both off by a tenth or so; total merch carloads were soft everywhere.

It stands to reason BNSF numbers are skewed the most by swings in intermodal box counts — intermodal revenue is 36 percent of BNSF total 2022 revenue; second place is CN with 30 percent of 2022 revenue coming from intermodal. On the other hand, BNSF derives only 44 percent of revenue from merch carloads — mainly ag and industrial — against 55 percent for arch competitor Union Pacific.

In comparing quarterly results one must also consider the cultural difference between BNSF and its US peers — the role of PSR and the operating ratio. BNSF doesn't use PSR per se — Buffett said as much to a question asked at an annual meeting a couple of years ago. Katie Farmer sums up the BNSF focus in a few words: getting to yes with the customer. Moreover, the seeds of PSR were planted at BN when HunterHarrison worked there in the early 1980s. His focus was on service, asset utilization, cost control and safety as a means to get operations under control. —sound familiar?

Author Howard Green writes in his Harrison biography, *Unfiltered Genius*, "Harrison was determined to grab back share with a better product that included precise schedules and better pricing, underpinned by a more efficient operation. Satisfied customers could then lower their inventories and get rid of excess boxcars, saving costs."[1]

Eventually BN bought the Santa Fe and we got BNSF. The operating rigors Hunter brought on were carried forward and are alive and well today. So when Katie Farmer says she wants to say yes to customers, it means that BNSF has figured out what it will cost to provide the requested service and what a reasonable rate will be. And that's the essence of running a precision railroad. BNSF just hasn't seen fit to hang the PSR label on itself. Getting to yes is what counts.

The STB has extended the EP 770 temporary reporting period for all Class I carriers to December 31, 2023 and modified reporting requirements for CSX. In the May 1 Decision the Board writes, "Data from recent weeks show that NSR currently is not meeting its one-year targets for service improvement, BNSF and UP are currently meeting some of their one-year targets, and CSXT currently is meeting nearly all its one-year targets."

CSX won the reprieve because "With few exceptions, CSXT has exceeded its velocity, terminal dwell, TPC, and FMLM targets in recent months. With respect to TPC in the four most recent weeks, CSXT has fluctuated above and below its targets for some unit train traffic (ethanol and grain), but CSXT has exceeded its TPC targets for other types of traffic. CSXT's recent data shows that its performance generally has improved."

Investors too appreciate this signal accomplishment. Share prices have been marching steadily north for a week. Kudos to all.

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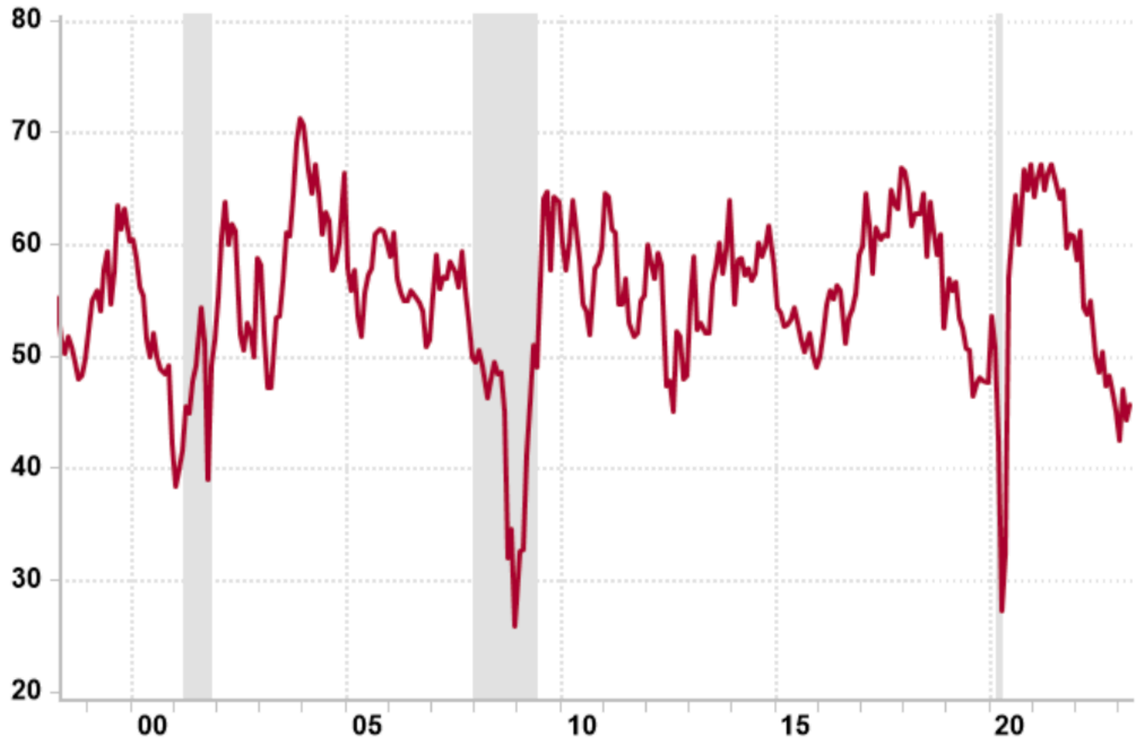
[1] It has to be working, The BNSF April 21 EP770 report to the STB shows 90% of industry pull/place happens according to plan.

I continue to see less than robust forward economic indicators. This from Dave Rosenberg: "For the first time in nearly seven years, we have a situation where businesses see more clients having too much rather than not enough inventory on hand. All we see is commodity prices and freight rates under downward pressure. Not good for coming production schedules at all. "

CHART 4: New Orders Index

United States: *ISM Manufacturing PMI*
(index; >50 denotes expansion)



Shading indicates recession
Source: Haver Analytics, Rosenberg Research

Gonna make it tough if you're in the business of moving raw materials and finished goods.