# THE RAILROAD WEEK IN REVIEW

## August 10, 2012

*"Overall, the increases in revenues in 2012 reflected higher average revenues per revenue unit as well as increases in revenue units handled." -- Berkshire Hathaway 10-Q, 2Q2012*

**Burlington Northern Santa Fe** may not be reporting quarterly results to Wall Street, but that's no excuse for not getting the story from their SEC reports and website entries. The 10-Q puts Q2 total railroad revenue at $5.1 billion, up 5.7 percent over last year's $4.8 billion. Ops expense was held to a 1.3 percent gain for an 18.8 percent gain in ops income to $1.4 billion from last year's $1.2 billion. The operating ratio came down three points to a respectable 71.7 for the quarter. Below the line, BNSF net income to Berkshire Hathaway was $802 million, up 16.2 percent from last year's $690 million.

BNSF moved 2.4 million revenue units (from the Weekly Carloads page in the Finance section of bnsf.com) of which 0.7 million units were in the industrial, ag and auto groups, up 6.1 percent year-over-year. Coal, 0.5 million units, was off 9.2 percent from last year. And intermodal, 1.2 million containers and trailers, was up 4.2 percent year-over-year. What's most telling about this is that merchandise was up two points more than intermodal and within the merch sector (ex-auto) aggregates, petroleum (think Bakken crude, up 74.7 percent), waste products and STCC 24 wood products all increased by double-digits. On the other hand, grain was down 13.6 percent.

Putting BNSF in perspective with the other seven North American Class Is for the quarter, BNSF in percentage change terms ranked fourth in revenue increase, third in revenue-unit increase, second (to UP) in merchandise carload increase, third in ops income gain, and third in operating ratio improvement.

**Ethanol, evidently, has not won** the hearts and minds of the general populace, according to Thursday's *Pittsburgh Tribune*. The paper reminds us that the feds in 2012 require ethanol producers to sell 13.2 billion gallons of the stuff, chiefly to gasoline-makers, and that works out to 10 percent ethanol in every gallon of auto fuel sold at the pump. Worse, the feds want the producers to sell 15.0 billion gallons starting in 2015 and into 2015. And with ethanol burning up two out of every five bushels of corn coming out of the fields, the food chain suffers. The *Trib*:

> But as the worst drought in more than 50 years decimates the nation's corn crop, 25 U.S. senators are asking the Environmental Protection Agency to cut that mandate. Lawmakers blame it for raising the price of corn, which threatens to increase feed costs for livestock producers and eventually saddle consumers with higher food costs. Last week, nearly one-third of the lawmakers in the 435-member U.S. House signed a letter urging the government to ease the mandate.

People have been driving less in this economy, and doing so in cars that get more miles per gallon. The EIA expects gasoline sales (E-10 gallons at the pump) to peak at 138 billion gallons next year, putting the "blend wall" at 13.8 million gallons of ethanol, so you can't keep jacking up the ethanol production mandate at the same time you're running the CAFE wars for more miles per gallon. At some point they'll have to increase the mandated blend to burn all the ethanol they've said the distillers have to produce. Makes no sense.

I've been tracking quarter-to-quarter ethanol carloads for NS and CSX because they keep the eastern half of the country in ethanol, and that's where we see the highest concentrations of drivers. Going back to the start of 2007, CSX hit its peak of 30,890 carloads in 1Q2011, according to the QCS data posted at usraildesktop.com.

The NS peak for ethanol carloads was 21,530 in 3Q2009. CSX loads clustered in the range of 24-25,000 units in 2009 and 2010; NS loads in the same period clustered in the 20-21,000 unit range. Given what the EIA and the *Trib* are saying, it's tough to see any significant forward growth.

**Schwab continues to see little change** in the soft manufacturing environment.

> Recession concerns are again rising in the US and we believe corporations will likely remain cautious in the near term, potentially hurting business investment. Additionally, government budgets are largely under pressure, which could curtail spending on infrastructure projects. As a result, we believe the industrial sector will be a relative underperformer over the next month or two.
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> That said, we continue to believe (as a result of tight purse strings in corporate offices during past years) companies are at the point where they appear to need to start replacing and updating equipment—potentially eventually benefitting the industrials sector. But growing uncertainty appears to be resulting on tighter wallets for the time being. Additionally, we continue to watch fiscal austerity measures that are being put into place, which could dampen growth in the industrials arena.

The fact is that governments around the world are running out of other people's money, meaning there's less to spread around on roads and bridges. And track for short lines. To be sure, it's been a good ride up to now, with $millions to short lines in tax abatements and outright gifts. But I can't see it continuing as long as our national fiscal house is in such disarray.

**Coal continues to be in the doldrums**. Thus week's note from Benjamin Hartford at RW Baird in Milwaukee shows total coal carloads for the seven North American Class Is to be off 5.1 percent year-over-year for Week 31 and down 1.6 percent for the Week 31 four-week moving average. The eastern roads are getting hit hardest -- CSX down 20.4 percent for the week and 11.4 percent for the four-week moving average; NS down 15.4 percent for the week and 10.3 percent for the four-week average.

In the west, BNSF is up 15.9 percent for the week and up 8.9 percent for the four-week period whereas UP is down 12.2 percent for the week and 8.1 percent for the moving average. KCS is off 9.5 percent for the week but up 2.0 percent for the four-week moving average thanks to double-digit positives in weeks 28 and 29. CP and CN have remained in the black for both periods -- thanks, I think, to their strength in export met coal and relatively small exposure to the steam coal market follies.

Norfolk Southern EVP for Planning Deb Butler presented this week at the Jefferies & Co. Global Transport conference in NY, saying that "coal is coming back." To which she adds that even as total tonnage is down a point year-to-date, vols "will continue to be impacted by high stockpiles and low nat gas prices." The summer heat thus far has pushed the utilities to increasing the number of active train sets and NS crew-starts.

And CSX was in Toronto this week to chat about coal with chief rail analyst Cherilyn Radbourne and friends at TD Newcrest. She writes that CSX expects utility coal weakness to continue, but on the gradual mend in the second half. Moreover

> CSX is not seeing a substantial amount of new natural gas plant construction in its territory and is of the view that utilities are wary of becoming over-committed to gas and want to maintain a diversified mix of fuel types within their portfolio. This is consistent with comments made by The Southern Co. on its second quarter 2012 earnings call: "While natural gas appears plentiful and inexpensive today, it is not a panacea and there are many reasons to be cautious about its future. Because over-reliance on any single fuel source is never a good idea, we must continue to preserve existing sources such as coal and nuclear….."

**No Weeks in Review** for the weeks ending August 17 and 24. We're celebrating the last of the August Heat with a stay-cation right here in Philadelphia, availing ourselves of our Museum memberships, a free hotel and no need to buy any gasoline. We're banking the fires, the computers and cell phones as good steam railroaders do. See you next the Sep 7 issue.