RAILROAD WEEK IN REVIEW

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"For 240 years it's been a terrible mistake to bet against America, and now is no time to start." — Warren Buffett, Berkshire Hathaway Chairman's Letter, February 27, 2016, page 8

I've been guilty of lamenting the prospect of mere two percent carload growth for the merchandise sector. Now I'm thinking perhaps two percent carload growth and three percent revenue growth out five years isn't bad, especially with operating expenses held in check.

A million carloads today expands to 1.10 million carloads out five years at two percent CAGR. A million dollars in revenue today expands to $1.6 million at the end of five years at a three percent CAGR. The Buffett Letter is what got me thinking about this. He writes,

> Some commentators bemoan our current 2% per year growth in real GDP – and, yes, we would all like to see a higher rate. But let's do some simple math using the much-lamented 2% figure. That rate, we will see, delivers astounding gains. America's population is growing about .8% per year (.5% from births minus deaths and .3% from net migration). Thus 2% of overall growth produces about 1.2% of per capita growth. That may not sound impressive.
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> But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in real GDP per capita. (Compounding's effects produce the excess over the percentage that would result by simply multiplying 25 x 1.2%.) In turn, that 34.4% gain will produce a staggering $19,000 increase in real GDP per capita for the next generation.Were that to be distributed equally, the gain would be $76,000 annually for a family of four. Today's politicians need not shed tears for tomorrow's children.

I mention this because it's refreshing to have some good news among all the popular portents of doom and gloom out there.

The full-year 2015 BNSF results as reported in the Berkshire Annual Report are anything but doom and gloom. Even though total 2015 revenue slipped five percent to approximately $22 billion, down $1.3 billion, operating income increased ten percent and the OR dropped 490 basis points to a respectable 64.9. Net income grew ten percent to $8 billion.

Total volume in 2015 was approximately 10.2 million revenue units, unchanged year-over-year, though Q4 vols dropped by double-digits in met ores, metals, aggregates, and crude oil. BNSF suggests more of the same could be in store for 2016. System velocity and on-time performance improved significantly in 2015, reflecting the 2014 capacity additions plus 2015 capex and less harsh winter conditions.

Elsewhere in the Letter, we learn that BNSF is the largest of Berkshire's "Powerhouse Five," the other members being Berkshire Hathaway Energy, Marmon [think United Tank Car, UTLX, and Procor in Canada with a combined fleet of 120,000 cars], Lubrizol, and IMC. "Combined, these companies – BRK's five most profitable non-insurance businesses – earned $13.1 billion in 2015, an increase of $650 million over 2014."

Particularly potent, given the CP-NS dynamic: "Berkshire will join only with partners making friendly acquisitions. To be sure, certain hostile offers are justified: Some CEOs forget that it is shareholders for whom they should be working, while other managers are woefully inept. In either case, directors may be blind to the problem or simply reluctant to make the change required. That's when new faces are needed. We, though, will leave these 'opportunities' for others. At Berkshire, we go only where we are welcome."

Buffett's closing comments are encouraging: "For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did."

I bought my first BRK/B shares ten years ago for a split-adjusted $65, now worth $130 and change. The Rule of 72 says a double in ten years represents a 7.2% CAGR. Wish I could say as much for all the other stuff I've bought and sold over that period.

Canadian Pacific said on Tuesday that it has filed a debt and equity shelf prospectus with the SEC and its Canadian counterparts. According to the press release, the equity shelf prospectus permits Pershing Square to sell shares of CP under prospectus supplements, and replaces an older document. So far Pershing hasn't alerted CP of any intention sell shares.

The stock boards are atwitter with interpretations of What It All Means. The filing itself is unambiguous: "Canadian Pacific Railway Limited ("CPRL" or the "Corporation") may from time to time offer Common Shares [and similar instruments]… having an aggregate offering price of up to US$1.5 billion or its equivalent in any other currency," adding that Pershing "may also from time to time offer and sell Common Shares pursuant to this prospectus" as a "selling shareholder."

Writing for the ZeroHedge blog, commentator Tyler Durden asks, "Is Ackman Facing a Liquidity Crunch?" He notes that Pershing Square has taken a bath in Valeant and as a result PS could report a 20 percent 2016 YTD loss in the next weekly update. Burden continues, "Despite the massive performance rout Pershing Square has experienced, so far there had been no hints it may be impacting either the fund's liquidity or, so far at least, redemption requests."

Maybe. The shelf filing could be the vehicle PS uses to ride away from all or part of its current 13.9 million share ownership of CP. At the current $125 share price, Pershing owns more than enough ($1.7 billion) to cover the entire shelf. Burden again: "Why go this circuitous route to sell shares directly? The simplest answer is… Pershing is quietly starting to liquidate positions directly to the market bypassing prime brokers." Stay tuned.

Norfolk Southern continues its weight-loss program, slimming down to two operating divisions from three. Effective March 15, Norfolk Southern's network will be divided into the Northern Region and the Southern Region, while the Western Region becomes toast. Its Alabama and Central Divisions will be folded into the Southern Region; the Northern Region gets the Lake and Illinois Divisions.

Greg Comstock is GM for the North; Todd Reynolds gets the South. Chief Operating Officer Mike Wheeler says the two-region structure will not only cut costs but also, through right-sizing trains and running to plan ("leveraging advancements in train dispatch technologies that support more fluid and efficient movement of freight across the network," in PR-speak). Each of the two consolidated regions will support approximately 1,000 long-haul daily crew starts.

NS is to be applauded for the regional re-org as well as its earlier combo of the Virginia and Pocahontas Divisions. However, most of all NS needs to improve the manifest carload product. Anecdotal reports of fewer, bigger trains on the ex-PRR Middle Division across Pennsylvania, assigning unqualified crews to jobs, loco failures on the road, and taking two weeks to move a car 1000 miles tells me leadership needs to get out there and lead. Wheeler, Reynolds and Comstock are bright, talented railroaders. I know they can do it. Sign me, still long NSC.

CSX makes Fortune's Most Admired Companies list for the sixth consecutive year. The ranking highlights key attributes such as reputation, quality of management, people management, and long-term investment value. CSX was ranked second place within the trucking, transportation and logistics industry, garnering a 5.6 overall score.

Keeping pretty fast company, too, with the top five being Apple, Google, Amazon, Berkshire Hathaway, and Disney. Starbucks was sixth. Union Pacific was the only other railroad on the list, besting CSX with a One in the industry ranking, but with a 6.8 rating overall.

CSX also ranks high with its 240+ connecting short line and regional railroads, thanks in no small part to the Annual Short Line Workshop, now in its 27th year, and the longest-running shortline confab. We're back at World Golf Village March 6-8. See you there.

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