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Touchbase

DECEMBER 2009

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Warren Buffet: Railroads a "100 or 200 year" opportunity

"There will be more things moving around this country 10 or 20 or 30 years from now"

Railroad Updates

Warren Buffett, chairman and CEO of Berkshire Hathaway and arguably the world's most respected investor, recently appeared on The Charlie Rose Show on PBS. In a lengthy interview, Buffett talked mostly about his $26 billion acquisition of Burlington Northern and Santa Fe Corp. He exhibited a profound understanding of the railroad business, how it works, and what he, as an investor, expects, long-term. Following are excerpts.

On why he bought BNSF: "I felt it was an opportunity to buy a business that is going to be around for 100 or 200 years, that's interwoven with the American economy in a way that if the American economy prospers, the business will prosper. It is the most efficient way of moving goods in the country. It is the most environmentally friendly way of moving goods, and both those things are going to be very important. But the biggest thing is the United States is going to do well. I mean, we can't move the railroad to China or India. They haven't figured out how to do that. So you know, it's sort of like if you remember that song about New York—we have to make it here or we can't make it anywhere."

On the railroad industry being capital-intensive and regulated: "You spend money in this business regularly every day. You're spending a lot of money to repair track, add rolling stock, whatever it may be. So it's capital-intensive, and it is regulated, and it will continue to be capital-intensive and regulated. The service provided by railroads is so important in many ways. It's the right way to move goods around the country to the extent that you can do it. And it's far, far more attractive in terms of global warming than using trucks, for example. So it will be here, and if we get a reasonable return on the added capital investment—because it will take added capital investment—we'll do OK.

On what he considers a good return on investment: "A reasonable return is good enough. Fifty years ago, I was looking for spectacular returns, but I can't get them. We have $8 billion or $10 billion to invest every year. And we're in the utility business, and it's the same thing there. When we build electric generation or something of the sort, we shouldn't expect a spectacular return. We're building things that are essential to society, and people need our services. They really don't have any choice in the case of the electric utilities, for example, and sometimes in the case of rail. And we should get a decent return on that—enough to encourage us to keep putting money into the business, but we're not entitled to spectacular returns.

On the importance of coal to the rail industry: "We will wean ourselves off coal over time, [but] we can't change the 40% of electricity generation that comes from coal next week or next month or next year. There will be more grain to move, and there will be more of all kinds—chemicals—or whatever it may be. There will be more things moving around this country 10 or 20 or 30 years from now."

On the inherent efficiencies of railroads: "Take a railroad like BNSF. They're moving far more ton-miles of product with less in the way of people, less in

Railroads have become far more efficient over the years

the way of fuel. Railroads have become far more efficient over the years. There were a million and a half people employed in the rail industry after World War II. Now there are [fewer] than 200,000 in the United States, and they're moving far more goods. So it's really become efficient. You watch those 130-unit trains double stacked."

On why he sold all his shares in Union Pacific and Norfolk Southern: "I've done that just to facilitate the [BNSF] transaction. I think they're good investments, and I would have held them if [the BNSF transaction] hadn't happened."

On why he invested in a major asset like BNSF: "Cash is always a bad investment. When people said cash is king a year ago, that [was] crazy. Cash wasn't producing anything, and it was sure to go down in value over time. And then you always want to be sure you have enough. It's like—like oxygen—you want to be sure it's around, you know. But you don't need to have excessive amounts of it around. We will always have enough cash around. But anytime we have surplus cash around, I'm unhappy. And we found a chance in the last year, thereabouts, to deploy [it]. We came in with something over $40 billion in cash. We have got about $20 billion now, and we've had some earnings. So, we've put a lot of cash to work. And I like that. I'd much rather own a good business than have cash. . . . [BNSF] is not a bargain, but it's a good asset for Berkshire to own over the next century."

Was the investment a hedge against the dollar? "You can say all assets are a hedge against the dollar. All you know is that the dollar is going to be worth less 10, 20, 30 years from now. I say "worth less." Not worthless. You want to watch that. [It's] true of almost every currency I can think of. The question is how much it depreciates in value. But cash is not a place. We'll print more of [it] in relation to the amount of goods that are moving. If we dropped a million dollars of cash into every household in the United States today, everybody would feel very good except the people that invested in things that were denominated in dollars."

On his love of railroads and the model railway in his attic: "I hope they don't make me sell it for antitrust reasons."

Learn more at:
http://www.railwayage.com/breaking-news/warren-buffett-railroads-a-100-or-200-year-opportunity.html

The CSX Fuel Surcharge Will Change December 1, 2009

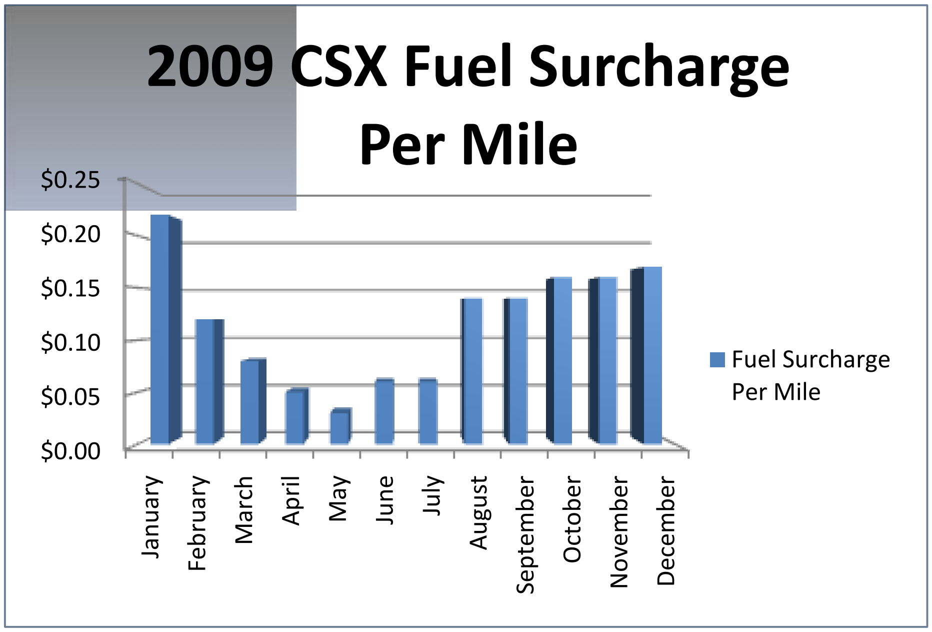
The CSXT fuel surcharge will increase effective December 1, 2009

The highway diesel fuel/mileage based fuel surcharge is published in CSXT Fuel Surcharge Publication 8661 and applies to all regulated linehaul freight rates existing or established by CSXT on or after April 23, 2007. It also applies to all linehaul freight rates and charges with respect to exempt, contract, private or other pricing documents that reference CSXT Publication 8661 on or after April 23, 2007.

The CSXT HDF/mileage based fuel surcharge of 16 cents per mile, which became effective November 1, 2009, will change to 17 cents per mile for shipments having a bill of lading dated on or after December 1, 2009.

The 17 cents per mile fuel surcharge is based on the "HDF Average Price" of 267.2 cents per gallon for the calendar month of October 2009. The "HDF Average Price" is on U.S. No. 2 Diesel Retail Sales by All Sellers, as determined and published by the U.S. Department of Energy, Energy Information Administration at www.eia.doe.gov.

Following are the CSXT HDF/ mileage based fuel surcharge rates for 2009:



Learn more at:
http://www.csx.com/?fuseaction=customers.news-detail&i=50413

KCS the First Class I to Implement New Umler System

Kansas City Southern announced its subsidiaries the Kansas City Southern Railway Co. and Kansas City Southern de México S.A. de C.V. have implemented the new Umler™ system and have been using the equipment registry the past few months.

Several Class I's, including Canadian Pacific and BNSF Railway Company, have implemented the new Umler system

Railroads, rail shops, equipment owners, shippers and lessees use Umler — which also is known as the Equipment Management Information System, or EMIS — to exchange vital rail equipment information, such as the internal and external dimensions, capacities, weight and specific characteristics of freight cars, trailers and containers.

The original Universal Machine Language Equipment Register, or UMLER, system was created in 1968. Now, Umler maintains data for more than 2 million pieces of equipment used in rail, steamship and highway service.

Association of American Railroads subsidiary Railinc, which developed and manages Umler, cut over from the old UMLER to the new system on Aug. 31. Since then, several Class I's — including Canadian Pacific and BNSF Railway Co. — have implemented the new Umler system. KCS was the first Class I to go live in September, when equipment characteristics, car management functionalities, equipment status, re-stenciling support and component group capabilities were introduced, according to an item posted on the "KCS News" Web site.

Read the entire article:
http://www.progressiverailroading.com/prdailynews/news.asp?id=22008

AAR Updates

FRA releases report lauding freight rail fuel efficiency gains

The Federal Railroad Administration has released a report showing that significant fuel savings can be achieved shipping freight by rail instead of by truck.

The report, titled "A Comparative Evaluation of Rail and Truck Fuel Efficiency on Competitive Corridors," compares rail and truck fuel efficiency on corridors and services in which both modes compete. Report findings show a 21.5 percent gain in overall fuel efficiency on Class I U.S. railroads from 1990-2006, or a compound rate of 1.2 percent per year. By comparison, average truck fuel efficiency for long-haul trucks has improved by only about 11 percent between 1992 and 2002

"While all types of transportation are vital to the distribution of goods across the country, this study shows that utilizing America's freight rail system can lead to significant fuel savings," said FRA Administrator Joseph Szabo. "The environmental benefits of these positive changes over the last two decades are enormous. We look forward to working with the freight rail industry to make sure these gains continue."

The report attributes the fuel efficiency gains to more efficient locomotives, changes in traffic mix and improvements to operating efficiency. It notes that the principal barrier to larger fuel efficiency gains over the period has been operations and congestion problems.

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Railroad Traffic

AAR reports freight traffic reached its highest level so far this year during the week ended November 21, 2009

Freight traffic on U.S. railroads reached its highest level so far this year during the week ended November 21, the Association of American Railroads reported.

U.S. railroads reported originating down 6.8 percent compared with the same week in 2008 and down 0.7 percent from the same week in 2007. Volume was up 2.1 percent from the previous week this year. In order to offer a complete picture of the progress in rail traffic, AAR will now be reporting 2009 weekly rail traffic with year over comparisons for both 2008 and 2007. Note that the comparison weeks from both 2007 and 2008 included the Thanksgiving Holiday.

In the West, carloads were down 8.8 percent compared with the same week last year, and 4.8 percent compared with 2007. In the East, carloads were down 3.8 percent compared with 2008, but up 6 percent compared with the same week in 2007.

Intermodal traffic down 3.1 percent from a year ago but up 11.5 percent from 2007. Compared with the same week in 2008, container volume rose 3.4 and trailer volume dropped 26.8 percent. Compared with the same week in 2007, container volume rose 19.4 percent and trailer volume dropped 16.6 percent. Intermodal traffic was up 2.6 percent from the previous week this year.

Increases were seen in nonmetallic minerals, grain, chemicals, waste and scrap metal, grain mill products, and food and kindred product

While 13 of the 19 carload freight commodity groups were down compared with the same week last year, increases were seen in nonmetallic minerals (26.5 percent), grain (8.1 percent), chemicals (8.1 percent), waste and scrap metal (6.5 percent), grain mill products (6.4 percent) and food and kindred products (.4 percent). Declines in commodity groups ranged from .3 percent for petroleum products to 22.1 percent for crushed stone, sand and gravel.

Total volume on U.S. railroads for the week ending Nov. 21, 2009 was estimated at 32.1 billion ton-miles, down 6.1 percent compared with the same week last year but up 4.9 percent from 2007.

For the first 46 weeks of 2009, U.S. railroads reported cumulative volume of 12,325,563 carloads, down 17.3 percent from 2008 and 18 percent from 2007; 8,801,968 trailers or containers, down 15.6 percent from 2008 and 17.9 percent from 2007, and total volume of an estimated 1.32 trillion ton-miles, down 16.4 percent from 2008 and 16.5 percent from 2007.

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Industrial Inside

Mining equipment: out of the pits and set to rise as coal, copper and ore demand increase

Broad capital spending cuts, and curtailed production have landed machinery companies in the pits but mining equipment makers will likely be among the first to emerge from under the recessionary rubble. The reason being that commodity prices are up substantially from their recent lows, at a time when the world is running out of all those precious natural resources. The main commodities driving original equipment and aftermarket parts demand include coal, copper, and iron ore. Developing nations are heavy users of natural resources including copper, coal and iron ore. The developing world is estimated to use roughly three to five times more commodities for every one percentage point of GDP growth than the developed countries.

While coal production in the U.S. has slowed in part because of environmental concerns, such concerns haven't slowed developing nations coal rush to fuel industry and generate electricity.

According to BP Statistical Review of World Energy released in June 2009, global coal consumption rose by a “below-average” 3.1% in 2008, yet coal remained the fastest-growing fuel in the world for a sixth consecutive year. China is the world’s largest coal consumer with a 43% share in 2008.

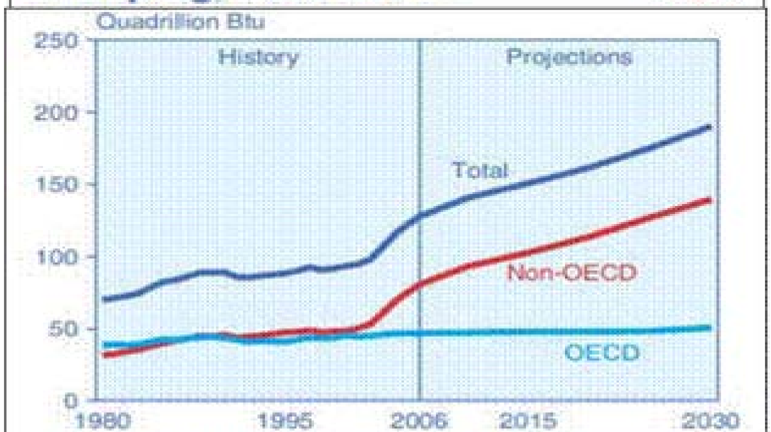
Coal remains the

The main driver of demand for coal (and natural gas) is the inexorable growth in energy needs for power generation. Coal remains the backbone fuel of the

backbone fuel of the power gen sector

power gen sector. In its World Energy Outlook published on Nov. 10, 2009, the International Energy Agency (IEA) projects coal to see by far the biggest increase in demand globally over the projection period of 2007 to 2030. The IEA further expects coal's share of the global generation mix rising 3% to 44% by 2030. China will account for the lion's share of power gen capacity growth.

The US EIA also projects world coal consumption increases by 49% from 2006 to 2030 (*Fig. 2*), and that China's coal consumption will grow at an average annual rate of 2.7% through the year 2030. Because China has limited reserves of oil and natural gas, coal remains the leading source of energy in its industrial sector. As China boasts 13% of the world's coal reserves, the country is expected to continue to meet a majority of domestic demand with coal-fired power through 2030.



World Coal Consumption by Country Grouping, 1980-2030 *Fig. 2*

Sources: **History:** Energy Information Administration (EIA), *International Energy Annual 2006* (June-December 2008), web site www.eia.doe.gov/iea. **Projections:** EIA, World Energy Projections Plus (2009).

"China alone may require five times as much iron ore in the next 15 years as it had in the past 15 years."

Right now, China seemingly is the only buyer of size in the global copper market. China's $586 billion stimulus package, launched late last year, is starting to stir demand, particularly among wire fabricators. In addition, strategic stockpiling and private speculative demand have reportedly also helped push copper prices up by more than 100% in a year as copper imports into China have more than doubled in the first nine months to 2.6 million tons.

State-backed research group Antaike predicted that in 2010, China's real refined copper consumption is expected to rise 8% on the year supported by the power, building and home appliance sectors. This year's consumption is estimated at 5.4 million tons, up 10.2%.

Another bullish sign for copper is the announcement of a technology agreement between Codelco and Rio Tinto (RTP), two of the world's biggest copper mining companies. This type of collaboration would have been unimaginable not so long ago. It also seems to suggest a supply constraint on the horizon for these two rivals to start this joint effort to discover new ways of uncovering more geologically difficult deposits.

Increases in mining equipment demand will partly depend on the effects of government stimulation packages, and the continued stabilization of financial systems

While plastics, fiber optics and wireless have replaced copper in some of the piping and telecommunication applications, wiring for emerging economy's essentials such as cars, motors, and power generation & distribution are seen as fairly protected from substitution.

BHP Billiton (BHP) chief executive Marius Kloppers underlined the scale of demand expected from fast-developing nations when he said China alone may require five times as much iron ore in the next 15 years as it had in the past 15 years. Also fuelling China's resource hunger will be further urbanization, with the country expected to have 220 cities of more than one million people by 2030, compared with Europe's total of 35 now. BHP is the world's biggest mining group.

One interesting trend in the equipment sector is the thriving rental and auction business. Tight credit and slumping demand has incentivized companies to increase their equipment rental budget, thus avoiding large capital commitments, while equipment dealers are forced to farm out their fleet in the auction market.

Although coal and copper prices have declined from relatively high levels in 2008, prices currently remain above the investment threshold for new equipment, which is generally considered to be $1.30/lb for copper and roughly $41/ ton for coal, according to Caterpillar, Inc. (CAT).

Increases in mining equipment demand will partly depend on the effects of government stimulation packages, and the continued stabilization of financial systems. Commodity prices, though tenacious, are extremely volatile. Nonetheless, the rally in commodities prices has led to increased investor optimism in recent months for mining equipment makers such as Bucyrus International Inc. (BUCY), Joy Global, Inc. (JOYG) and Terex Corp. (TEX).

The mining equipment sector also serves as a good alternative to investing directly in the commodity and emerging markets. The sector should continue to benefit long-term from developing countries improving their infrastructure while consuming more raw materials. The valuation discount relative to their machinery peers should continue to narrow as commodity prices climb on developing regions demand and supply constraints.

Learn more at:
http://seekingalpha.com/article/174767-mining-equipment-out-of-the-pits-and-set-to-rise-as-coal-copper-and-ore-demand-increase

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Financial Focus

Bernanke: Weak economic recovery ahead

Federal Reserve Chairman Ben Bernanke said the recovery in the U.S. economy will be modest, with higher than desired levels of unemployment for the foreseeable future.

Speaking to the Economic Club of New York Monday, Bernanke said in his prepared remarks that financial conditions are significantly better than when he spoke to the club a year ago at the height of the crisis in global financial markets.

But Bernanke cautioned that "some important headwinds -- in particular, constrained bank lending and a weak job market -- will likely prevent the expansion from being as robust as we would hope." He didn't offer much immediate hope of a better labor market in the United States either. "Jobs are likely to remain scarce for some time, keeping households cautious about spending," he cautioned.

The latest Labor Department report showed unemployment hit 10.2% in October, the first time it has been in the double digits in 26 years

The latest Labor Department report showed unemployment hit 10.2% in October, the first time it has been in the double digits in 26 years. Employers trimmed 190,000 jobs from payrolls, the 22nd straight month of job losses. "The best thing we can say about the labor market right now is that it may be getting worse more slowly," he said, adding that he didn't hold out much immediate hope for an immediate turnaround. "The unemployment rate likely will decline only slowly if economic growth remains moderate, as I expect," he said.

2010 Job Forecast: Small Raises

In response to a question from the audience, Bernanke said he doesn't see the same kind of jobless recovery in 2010 that the economy went through following the 2001 recession, in which job losses continued for nearly two years after growth returned. But he did say that he's worried job growth will be so meager next year that it won't make a dent in the unemployment rate. Bernanke also said credit for small businesses and consumers is likely to remain strained. And he said that tighter credit will be a significant drag on the economy going forward.

Fed chairman- Bernanke said “high unemployment and tight credit will limit economic growth, but he dismissed worries about another recession and dollar weakness.”

But Bernanke said in his remarks that he did not agree with economists who are worried the economy will fall into recession once again next year.
"My own view is that the recent pickup reflects more than purely temporary factors and that continued growth next year is likely," he said.
In addition, Bernanke said that the Fed is monitoring the recent declines in the value of the dollar, but he suggested that much of the weakness was due more to diminishing fears about a global financial crisis.

"When financial stresses were most pronounced, a flight to the deepest and most liquid capital markets resulted in a marked increase in the dollar," he said. Bernanke added that with the better conditions in markets in recent months, "these safe haven flows have abated, and the dollar has accordingly retraced its gains."

Need to end 'too big to fail'

Bernanke spent part of a question-and-answer period talking about banks and Wall Street firms being "too big to fail" and the problem of valuing assets on their balance sheets. He said he hoped that the "too big to fail" doctrine that led to the bailout of major banks and Wall Street firms following the bankruptcy of Lehman Brothers needed to become a "relic" in the future, but that could only happen through the creation of new procedures for closing such firms in a more orderly manner.

"We need to have some alternative to bankruptcy or bailout," he said. "We need to have another way to close firms that come to the brink of failure without destroying the rest of the system." Bernanke said that he doesn't endorse rolling back the 1999 law that allowed commercial banks to engage in Wall Street trading and investment banking. He said he doubts keeping those restrictions in place would have prevented the crisis in financial markets. "I don't think simply making banks smaller is going to do it," he said when asked about how to get rid of the reality of "too big to fail." "Banks can still be systemically critical, even if they're somewhat smaller," he added. He also said that large bank failures are not the only threat to the economy. "After all, in the 1930s we didn't have too many large bank failures, but we had thousands of small bank failures," he said. But he said that in the future, regulators of major firms needed to be able to place curbs on banks engaging in trading or investment banking activities on a case-by-case basis.

"In the future, regulators of major firms needed to be able to place curbs on banks engaging in trading or investment banking activities on a case-by-case basis."

A year ago Bernanke told the same gathering that what he most wanted was to know what all the so-called toxic assets on major financial firms' balance sheets were worth. Monday he said despite improvements made in judging the value of assets in the last year, "I'd still like to know what the stuff is worth."

Learn more at:
http://money.cnn.com/2009/11/16/news/economy/bernanke_outlook/index.htm

The Edge

Merry Christmas and Happy Holidays! December is our time for giving thanks to the good Lord, our families and friends, those we work with, customers that demand perfection and competition that incent us to be the best at what we do.

A review of 2009 is synonymous with the view from the top of a mountain and the tumultuous course of a double black diamond run at a ski slope. We started out recognizing that the course forward was going to be fast difficult and dangerous. We were right. Railcar storage became a business in and of itself, week over week railcar loadings began to tumble, two major railcar Lessors are in bankruptcy and another isn't sure if it wants to be in the business or not, and TARP monies only resulted in a longer term prolonging of the financial agony beset by many businesses.

So where is the good? Many businesses have survived or gotten stronger. Tealinc is fortunate to work with many companies that are strategically positioning themselves for better times. Renegotiating rates, terms and conditions in exchange for longer term commitments is one example whereas making capital investments more wisely, weeding out the "nice to have" projects and investing in the "must have" projects is another.

We are optimistic about the challenges and opportunities that 2010 will bring with it and appreciate that our clients are taking a hard internal look at how they do business. We look forward to assisting our clients by asking the hard questions and applying our skills to provide both intellectual and practical answers.

We look forward to earning your business!