Overview of BNSF's 2018 performance

A review of safety, service and business performance; 2018 ICP award announced

We have many things to celebrate as we reflect on 2018, including an all-time volume record that topped our previous record set in 2006. Our 4 percent increase, year-over-year, was driven by strong gains in our agricultural, industrial and domestic intermodal business, reflecting a robust freight environment and our ability to capture higher market share.

While we can’t discuss our financial results until Berkshire Hathaway releases its year-end results at the end of February, we can say that we also performed well in terms of revenue and earnings, although our performance on cost control negatively affected our earnings. We also gained ground in receiving appropriate value for our service.

This should feel good. We outperformed the rail industry in attracting more business, and people across the network worked hard to move these high volumes, facing many challenges throughout the year. Your contributions and commitment are essential to our success.

As we look at our performance in 2018, however, we must also consider the overall economic environment and review our results in a balanced way in that broader context. We need to recognize that we are experiencing one of the best freight markets ever; in that environment, we expected to increase our volumes and to be able to charge competitive prices.

We also need to consider how we performed in terms of safety, service and cost control. Our safety numbers improved year-over-year, but fell short of our goals. In service, we were inconsistent in our ability to meet customers’ expectations. In addition, despite the growth, we were not able to extract enough leverage from volume and price to offset increasing costs, which then reduces our margins. So all in all, while it was a record year in some areas, we fell short in some other important areas.

As we begin 2019, despite some economic uncertainty, we expect volume growth to continue at a moderate pace. We also know we need to gear up our performance in terms of safety, service and efficiency, along with continuing to increase the value we receive for the service we provide building on the advances we’ve already made. I know we can do this. We have done it before, and I know our best years are still ahead of us.

Safety

As always, I begin with safety. As we’ve discussed, Joshua Crocram, a 26-year-old trackman with four years of service with BNSF, was fatally injured on Sept. 4, when he fell from a bridge where his work team was assisting on a bridge maintenance project. We know this fatal injury was preventable. Safety is the most important thing we do, and we cannot consider ourselves successful until we have eliminated the loss of life on our railroad.
By the close of 2018, our injury frequency and severity rates were both improved compared with 2017. We remain confident that we have the right safety processes to achieve our safety vision. To reach and sustain the next level of safety, we need to continually assess our approach, keeping the proven safety processes that work while addressing what is not working as well.

Service

After safety, service is the most important thing we do. We were not consistent in delivering the level of service our customers expect. We moved robust freight volumes throughout the year, and we faced challenges including locomotive reliability. We moved quickly to add resources to handle the increase, including adding people and expanding our available locomotive fleet.

We know we can and will do better. We have invested in our railroad, and we have enough capacity to say yes to new business and to handle that business efficiently. Customers are unhappy when it doesn’t go well, but they also know from past experience that we at BNSF will mobilize the necessary resources to improve our service as we need to do.

We had a great indicator of our ability to provide best-in-class service when we delivered another perfect Peak Season. We handled more than 34,000 UPS loads carrying about 70 million packages, nearly matching 2017’s record Peak volume. And we delivered that volume without a single service failure, enabling UPS to deliver on its promise to its customers during the holidays. This was our second consecutive perfect Peak and the third perfect Peak in four years. Congratulations to all work groups for the pre-planning and safe execution, overcoming numerous challenges to accomplish a very impressive milestone. Let’s build on that positive performance in our service across all business areas in the weeks and months ahead.

Volumes

Our volumes increased 4 percent compared with 2017, as the economy continued to improve and we captured new business. Consumer Products volumes were up 3 percent compared with 2017, due to higher domestic intermodal and automotive volumes. The increase was driven in large part by economic growth and tight truck capacity leading to conversion from highway to rail, partially offset by a contract loss that had a negative impact on our international intermodal volumes.

Industrial Products volumes increased 10 percent compared with 2017, primarily due to strength in the industrial and energy sectors, which drove higher demand for petroleum products, rock, steel, and plastics. Early in the year, we also saw higher sand and taconite volumes, which moderated later in 2018.

Agricultural Products volumes increased 9 percent, due to strong export and domestic grain shipments, as well as higher fertilizer and other grain products volumes. These volumes represented an all-time record for our agricultural business. This part of our business will remain strong, but it will fluctuate depending on trade policy, U.S. growers’ productivity, domestic and export demand, and competition in the global grain marketplace.

Coal volumes decreased 1 percent compared with the same periods in 2017, primarily due to plant retirements combined with competition from natural gas and renewables, partially offset by market share gains and improved export volumes. While these declines were actually less severe than we expected when we set our goals at the beginning of 2018, we anticipate additional declines in the years to come.

Efficiency/cost control

In terms of efficiency, our cost structure has always been a strength and an advantage in the marketplace. However, we didn’t live up to that level of performance last year. We have consistently led the industry in having the lowest cost structure and best service. Each year we strive to cover half to two-thirds of inflation with efficiency and productivity initiatives. Over the last three years, we’ve covered about 45 percent of inflation; however, we covered none of our inflation in 2018 and less than 20 percent in 2017. So our efficiency is not where it needs to be.
Having a good cost structure is inherent in being a growth company. Our cost structure allows us to pursue the new business necessary for continued growth. To achieve our overall objectives, we need to find another gear. We can’t stand still while our competitors work hard to drive their own cost reductions and improve efficiency.

The year ahead

Moving into 2019, we expect continued volume growth, but we’ve moderated those expectations based on what we’re seeing and hearing from our customers. We continue to monitor the trade tariff exclusions put forward by the Administration. Tariffs could represent a serious headwind to our volumes and even the materials we purchase, particularly if a prolonged trade dispute begins to negatively affect the overall U.S. economy. As always, we must remain agile and take appropriate actions to protect ourselves to the extent possible.

As you know, growth is an essential piece of our business model; however, we expect modest growth in 2019, which helps us catch our stride in other parts of the business. This includes receiving appropriate value for what we do. As noted above, in terms of execution, we must drive gains in our service consistency and velocity to meet our customers’ expectations and our own high standards while we continue to focus on efficiency. We’ve done it before and we can do it again, and we have the capacity we need to effectively handle the business.

While looking at our annual goals for the year, it is easy to get lost in the numbers and to wonder where you fit into the plan and what you can do to effect change. If you’re wondering where to focus, it’s on the drivers, the things we do every day that move the needle on reducing costs, such as reducing dwell and increasing fuel efficiency and units per train, while continuing to grow volumes and revenues. We’ll have workforce targets as we’ve had in the past, and you should expect us to achieve these targets by behaving the way we have in the past, not through one massive lay-off. As always, the size of our scheduled workforce will match the amount of work we have to do, and we’ll continue reducing the size of our salaried workforce through attrition, considering the need to fill positions where the person has retired or left. We must be willing to take a critical eye to everything we do and make sure we’re making the right choices to best operate our network and serve our customers. We need to sustain our current strengths while continuing to make improvements to ensure we compete successfully going forward.

2018 ICP results

As communicated earlier, our 2018 Incentive Compensation (ICP) award is based on discretion taking into account our performance in safety, service, efficiency and growth. Understanding the factors that determine our collective success, as we discussed above, our 2018 ICP award is 105 percent of target. I believe this is an appropriate payout following this year’s performance in the competitive environment where we operate.

In closing

We can be proud of what we accomplished in 2018 while handling record volumes. Times of growth are both encouraging and challenging, and we responded effectively to market opportunities, while making sufficient investments in our railroad to grow with our customers. However, we know that we have a lot of work to do to preserve and improve upon our position as the industry leader with the lowest cost structure and delivering the service our customers expect. We have already accomplished each one of these goals under similar circumstances in the past. It is not a question of if we can do this, because we already have. That is why I am optimistic about the future and our continued success because I have seen how much we can accomplish together.
ICP online statements available for scheduled employees

Incentive Compensation (ICP) payments for 2018 will be made on Jan. 31, 2019. Eligible scheduled employees can view their target and actual award on their individual Incentive Compensation statement through myTotalRewards, beginning Jan. 29.

Incentive Compensation is shown as a percent of target, to align statements for both exempt and scheduled employees.

To access your Incentive Compensation statement:

- Click on the myTotalRewards Quick Link on the Employee Portal
- Click on "Cash Compensation"
- Click on "To view your Incentive Compensation statements, click here"
- Click "2018"

Incentive Compensation Statements

<table>
<thead>
<tr>
<th>Select the ICP Year for statements you would like to view</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>2016</td>
</tr>
<tr>
<td>2015</td>
</tr>
</tbody>
</table>