



Monday, April 28, 2008

INVESTMENT LETTER

Burlington Northern Santa Fe Corp. (NYSE:BNI) and Polycom, Inc. (NASDAQ: PLCM)

How a few days fighting the traffic in New York City, and a trip on congested Interstates 95 and 91 in New England, headed to New York City on March 20, led to some thoughts about [Burlington Northern, Inc.](#) and [Polycom, Inc.](#)

New York City
Tuesday, March 18, 2008

It is a three and a half hour drive, if everything goes well, from the Hertz rental car office at 222 East 40th Street in Manhattan to the main street of Deerfield, Massachusetts, the home of [Deerfield Academy](#).

I had been in New York City since Saturday, March 15th, seeing my Mom at her rent-controlled apartment on the lower East side, where she had lived since 1964. Retired since 1976, she liked to write poetry, visit museums and art galleries, and usher in off Broadway plays. She was not fazed by the dirt and the noise of the city but, like a true New Yorker, enthralled by the city's vibrancy and adjusted to its inconveniences, she made every irritation of the city a challenge to overcome.

My story is different. After three days in the city, used to the tranquility of Utica Square in Tulsa and the serenity of the Aspen mountainscape, I wanted to get a break from New York's crowded streets and incessantly honking horns. One way to do that, I thought, was to pay a visit to Deerfield, a town of seventy homes and the home of Deerfield Academy, where I had spent four years, unfortunately without girls, from 1957 to 1961. Today Deerfield is co-ed, and has been so since 1987.

The school had featured our firm and my poetry in [Deerfield, the Publication of Deerfield Academy](#), the school's alumni journal, in its fall 2007 issue. [Lee Wicks](#), the head of the school's alumni publications, had asked her right hand person, [Jessica Day](#), to give me two pages to tell the story of our firm in an article titled as follows: [Fighting Jargonitis Soporificia, A fantasy inspired by a hot summer night in Tulsa](#). School was on vacation. [Lee Wicks](#) was out of town but [Jessica](#) was at the school and I wanted to meet her, and thank her in person for her help. (You may read [Fighting Jargonitis Soporificia](#) on our web site, [fredricerussell.com](#). Once on the web site, go to Fredric E. Russell. Should you decide to read this article, be warned: it contains some amateur poetry that I have written.)

It was the morning of Tuesday, March 18. I had been up early and I had walked three blocks from my hotel (the Hotel Giraffe) to the New York Sports Club at 23rd Street and Park Avenue South so that I could get a few minutes on the treadmill and speed up the flow of my blood before my 174.4 mile drive to Main street in Deerfield. After the workout, I walked back to the Giraffe (only in New York City would you have a hotel with such an unusual name) read the Wall Street Journal, The New York Times, and a few pages in a mystery by Peter Robinson, my favorite mystery writer, before I picked up my packed bags and closed the door to my room.

Investment Thesis: Burlington Northern Santa Fe Corp. (NYSE:BNI)

Burlington Northern Santa Fe is on the right track. The railroad industry, rejuvenated by significant deregulation in 1980, now has pricing power. Federal regulations had limited the amount of money that the railroads could charge to ship freight. Deregulation forced efficiency, brought consolidation, created oligopolies and gave pricing power to the survivors.

Compared with trucking, rail transportation looks appealing. Cost-conscious businesses wish to ship product as cheaply as possible, and railroads offer a more efficient transportation solution compared to roadway shipping.

High fuel prices and increased demand for commodities, especially grain from China and India, mean good business for railroads. Also, BNI transports ten per cent of the coal used in this country, and coal will surely take oil's place in many activities, especially in running utilities.

Meantime, congested highways, and highways needing repair, enhance the competitive advantage of railroads. In the last five years the number of vehicle-miles traveled by Americans has nearly doubled, but the number of roadway-lane miles has increased by just 5.7 percent. It is estimated that highway congestion costs the American economy 63.1 billion dollars annually, with this number expected to increase in the coming years. Where does BNSF come into play, you may ask? Railroads consume considerably less fuel per pound hauled than do trucks. One Burlington Northern intermodal train can take 280 trucks off of our highways, which would go a long way toward solving the congestion crisis. (I would think that such a fact would put all railroad executives in a good mode, especially those who are good with people and have superior *intermodal* skills.)

The company has exceptional cash flow from operations which it uses to increase the dividend, repurchase stock every year and restore used track.

It was a little after eight in the morning, about the peak of the Manhattan rush hour. The hotel's front desk had called a cab for me so by the time I had brought my luggage to the lobby and exited through the lobby door, a cab was ready for me. It was less than two miles from The Hotel Giraffe at 26th Street and Park Avenue South to the Hertz location on 40th Street but, as a former New Yorker, I knew better than to expect a trip without incident during the morning rush hour, which lasts from seven to at least nine every week day in Manhattan.

As soon as the cab moved from the curb, there was a problem. A truck had double parked next to a passenger vehicle a few feet ahead of us. The taxi driver honked his horn but it was five minutes before the truck driver moved his vehicle. As he moved his cab from the curb, the taxi driver yelled at the truck driver and used a digital expression, a gesture not part of an ordinary aerobics routine, as the taxi screeched from the curb.

As the driver maneuvered his way through double parked cars and jaywalking office workers I had some time to think about New York City, and its genius in dealing with congestion.

I was born in New York City but it had been decades since I had lived there. Whenever I visit the city I am overwhelmed by the density of people and impressed with the energy of the city as it, without pause or tension, uses its own brand of alchemy to turn, almost without fail, impending chaos into impressive order and efficiency, minute after minute and time after time. Yet with all its creativity, drive, and energy, New York City remains a challenge, especially for the taxi drivers who

navigate its streets, usually without gps systems, using directories of names to find the locations their passengers want.

On this day I was lucky. The driver was cool and nothing seemed to bother him as he drove slowly up Lexington Avenue, avoiding other taxis, the huge city buses, and the defiant jaywalkers. The driver displayed the dexterity of a first string University of Oklahoma special teams' member sidestepping or stiff arming glaring defensemen to return a punt in the Oklahoma- Texas game for a touchdown.

Notice that I did not use a **Swarthmore** football metaphor (I graduated from **Swarthmore College** in 1965) because my college was known for academics, not athletics, and especially not for football. The school's football team was known not for its meaty guards and tackles but for its slim bespectacled linemen who were probably more comfortable doing an experiment in a biology lab than in roughing up an opponent. The linemen, who often weighed no more than one hundred and sixty pounds, could solve a quadratic equation quickly but their speed did not extend to the gridiron: when I was there the fastest time for a forty yard sprint was more than six seconds.

After thirty eight losses in a row, the **Swarthmore** president in 2000 finally declared it quits for the football program, and there are now no more football **Fighting Quakers**. (The **Quakers** founded **Swarthmore**, which sits in a suburban setting eleven miles southwest of Philadelphia.) The decision was prudent: **Swarthmore** was better known for its players studying on the bench than for spectacular punt returns or fierce sacks.

The players could only rarely sack the opponent's quarterback, but, respectful of grammar, style, and syntax, they could tell you, strictly speaking, that if you used sack as a verb, you had made a mistake. (Using nouns as verbs of course is an aesthetically displeasing habit, and it is a habit that chief executive officers of publicly traded companies, or the people who write their speeches for them, are fond of displaying, writing sentences as the following: "...our great company, led by yours truly, who is the smartest, most charismatic leader the firm has ever had, and with forty five million dollars in base salary and one hundred million in stock options this year is the most underpaid executive you have ever had the privilege to work for you as shareholders, has decided to **partner with** ABC widgets, to integrate our core competencies in a seamless organization that practices best practices or best in class." (See footnote 1)

I was captain of the swimming team when I was a senior. During my leadership the team broke every school record, and yet we lost every meet except one, to **Haverford**, another school that placed academics above athletics.

I liked to swim breaststroke, but, unfortunately for me, the coach discovered that I could also do the two hundred yard butterfly, an exhausting event which was held after the diving competition in a meet. I would hope, as the meet progressed, that he would forget that I could do the butterfly, and to facilitate his forgetfulness, I would hide in the shower during the diving competition. Sure enough, he found me every time and I struggled through two hundred yards, the toughest swimming competition I can remember. The last fifty yards were tough but I could always finish the race.

Footnote 1:

partner *n* 1 *archaic* : one that shares : PARTAKER 2 *a* : one associated with another esp. in an action : ASSOCIATE, COLLEAGUE *b* : either of two persons who dance together *c* : one of two or more persons who play together in a game against an opposing side *d* : a person with whom one shares an intimate relationship : one member of a couple 3 : a member of a partnership esp. in a business; *also* : such membership

Merriam-Webster's Collegiate Dictionary Eleventh Edition 2003

Burlington Northern: five years of steady progress

Dollars in millions, except per share data

December 31,	2007	2006	2005	2004	2003
For the year ended: 2007					
Revenues	\$ 15,802	\$ 14,985	\$ 12,987	\$ 10,946	\$ 9,413
Operating income	\$ 3,486	\$ 3,521	\$ 2,927	\$ 1,709	\$ 1,675
Income before cumulative effect of accounting change	\$ 1,829	\$ 1,889	\$ 1,534	\$ 805	\$ 783
Basic earnings per share (before cumulative effect of accounting change)	\$ 5.19	\$ 5.23	\$ 4.13	\$ 2.18	\$ 2.12
Average basic shares	352.5	361.0	371.8	370.0	369.1
Diluted earnings per share (before cumulative effect of accounting change)	\$ 5.10	\$ 5.11	\$ 4.02	\$ 2.14	\$ 2.10
Average diluted shares	358.9	369.8	381.8	376.6	372.3
Dividends declared per common share	\$ 1.14	\$ 0.90	\$ 0.74	\$ 0.64	\$ 0.54

One time, however, I was brazen enough to invite a girlfriend from Wellesley to watch me in the Haverford--- Swarthmore meet, where, anticipating the inevitable, I had volunteered to do the two hundred yard butterfly event. The meet was on a Friday evening. I had great hopes of impressing my date and having a wonderful weekend as she would remember my impressive nautical ability. On the last lap of the race, however, with my arms feeling the way they might feel as if I had been in a weightlifting contest with Arnold Schwarzenegger, I became so tired that I could not lift my shoulders out of the water, and I was disqualified.

While the driver moved in and out of the traffic I had fun, watching some pedestrians wait patiently for the traffic lights to turn green before they crossed Second Avenue. Many pedestrians, however, did not respect the red or yellow of the traffic lights nor even the authority of the policemen who seemed to have the jaded cynicism of a tired parent who knew that the best strategy was to focus on important violations of the peace. A minor jaywalking incident, the policeman must have thought, was not enough to cause alarm. Many of the rebellious and reckless pedestrians dodged the cars, daring the vehicles to hit them in a game that might be called early morning or rush hour chicken. For Utica Square in Tulsa or Main Street in Aspen it would have been chaos. Here, in Manhattan, it seemed to be business as usual.

I arrived, nevertheless, in one piece at the Hertz office. Within a few minutes I had signed the rental car agreement, and I was in my car, or rather SUV, looking anxiously from left to right, as I inched out of the Hertz garage, making a right turn on 40th Street. I drove a few hundred yards to Second Avenue where I made a left turn and headed for the uptown entrance to the Franklin Delano Roosevelt drive, a busy road that would take me to the Triborough Bridge, the gateway to the North Bronx and to New England through Interstates 91 and 95.

BUSINESS SUMMARY (BURLINGTON NORTHERN SANTA FE)

Burlington Northern Santa Fe Corporation: (NYSE:BNI) owns one of the two largest railroad systems in the United States, operating about 32,000 miles of track (excluding secondary track and sidings) connecting the Midwest, the Pacific Northwest, Canada, and the Gulf of Mexico. Consumer products represented 37% of 2007 freight revenues; industrial products, 24%; coal, 21%; agricultural products, 18%. (March, 2008 proxy filed with the Securities and Exchange Commission.)

As I watched the cars jostle for position, my mood grew serious, as I realized that continued dependence on the automobile and the truck could only drive up the price of oil, especially given our acute dependence on oil imports. This was far from an original thought, and I was not the first person to realize that congestion was choking our economy, cutting into our productivity. We would have to do something about the roads. They were crowded and deteriorating quickly. Maybe we would have to turn to railroads to solve our problem. After all, railroads use far less energy than trucks in moving one pound of merchandise. And the gap between the efficiency of rails and trucks would only grow sharper as the price of oil rose.

As the price of a barrel of oil moved from the thirty dollar range in 2003 to a price of over one hundred dollars that morning, we continued to consume huge amounts of imported oil. Moving manufactured goods such as cars, refrigerators, DVDs, laptop and desktop computers, furniture, and other thousands of goods by trucks on highways that were increasingly crowded, and suffered from potholes and ruts, seemed to be an inefficient way of doing things.

But I did not have much quiet time to think about transportation challenges and solutions. As the driver behind honked at me to pressure me to speed up I realized that if I were to get to [Deerfield](#) in one piece and in time for lunch with [Jessica Day](#), I had better conclude my philosophizing and speculation and pay attention to the road. To better concentrate, I suppressed my aggressive macho instincts. If someone cut ahead of me, I looked straight, and I made sure to avoid eye contact. My job, I reminded myself, was to get to the Triborough bridge without incident, and then to drive through the Bronx and to New England and [Deerfield](#).

Once I had moved into the slow lane I took the opportunity to look around. On my left I saw tugboats and barges moving up and down the East River. On my right were the swank apartment buildings of the East Side, but even here in the upscale neighborhoods, where you had the sleek new condominium towers where a studio apartment could sell for more than a million dollars, the conditions were crowded, with parked cars taking up every space on both sides of the street, with trucks making deliveries, and almost always double parked.

The traffic was tight, moving in fits and starts until we reached the Triborough, and it is to be noted that we were traveling away from downtown and the core working areas. Once through the toll at the bridge, the traffic moved into the Bronx where the massive buildings became even bigger, more intimidating, colder, almost making homogeneous, one dimensional, or one faced all the different personalities and histories of the thousands of occupants that lived in each building. I imagined that all the residents wore badges, indicating which building they lived in, what floor, and what unit, a situation similar to the scene at a big corporation where everyone was required to wear a badge.

As I stole furtive glances at the other drivers, I wondered how many of these drivers were commuting and how many were making business trips, sales meetings or meetings with contract negotiations, and meeting with businesspeople they had never met? Were they thinking the same thing, I wondered, that I was thinking, and that was, there must be a better way to do business?

Moving people, whether on vacation or for business meetings, seemed to be the same story. Here we were dealing with debt-burdened airlines with distressingly inefficient hub systems and with an overworked and demoralized workforce that included airline stewardesses and stewards who seemed better suited as penitentiary guards or as health maintenance organization executives, executives who cared little about warmth and customer comfort. On my last United trip the stewardesses and stewards seemed to be quietly gleeful as they enjoyed giving orders to fasten seatbelts, keep belongings out of the aisle, and to turn cell phones..." in the off position for the duration of the flight..." Such an atmosphere was not conducive to the rest and tranquility a businessperson needed for a sensitive and demanding meeting. There had to be a better way, I thought, and I believed that one company in our portfolio would provide that answer, that better way. The company was [Polycom, Inc. \(NASDAQ: PLCM\)](#).

With a one hundred and forty nine dollar [Polycom](#) software package, and a webcam from [Microsoft](#) costing seventy nine dollars, you can see and talk to another person in any part of the United States, or internationally, assuming that that person has the same software and that both have computers.

I remember walking into an [Office Depot](#) store at 21st and Sheridan in Tulsa a few years ago and looking at a video conferencing product offered by [AT&T](#). You could hear and you could see but as far as visual acuity the system was not satisfactory. The picture was pixelated; there was a lot of static, and much delay in transmission, making some movements grotesque and not credible. Certainly, for example, it could not be that it would take two minutes for someone to turn their head.

Things have come a long, long way. The [Polycom](#) system that we have in our office enables us to talk with my architect, [Heidi Hoffman](#), in [Aspen](#), as if I were in her office. I can hear her clearly, see her clearly, and I have no doubt that with the [Polycom](#) installed in both offices, the work on my Carbondale house plans will proceed fast.

We will be able to have many meetings by telephone over the internet, and I will avoid thousands of dollars in airline fares, and lost time waiting in gloomy gray airline lounges as a programmed voice reminds me every five minutes to make sure that I have control of my baggage, and to report any suspicious people.

BUSINESS SUMMARY: Polycom, Inc. (NASDAQ:PLCM)

We are a leading global provider of high-quality, easy-to-use communications solutions that enable enterprise and public sector customers to more effectively collaborate over distance, time zones and organizational boundaries. Our solutions are built on architectures that enable unified voice, video and content communications.

We have established relationships with leading communications and technology firms to work with us in developing, marketing, and distributing our products. We have formed strategic relationships with Alcatel, Avaya, Cisco, Nortel, and others to develop and market Voice-over-IP, or VoIP, and video communications solutions. We also have a co-development and marketing agreement with Microsoft to integrate our respective desktop, conference room, and network hardware and software solutions, and we are one of two vendors that currently provide VoIP phones for Microsoft's new Unified Communications telephony offering launched in the fourth quarter of 2007.

The shift from circuit-switched telephony networks to Internet Protocol (IP) based networks continues to be a significant driver for Polycom's collaborative communications markets and for our business. High Definition (HD) ([Polycom, Inc., 10-K for the year ended December 31, 2007, pages 3 and 4.](#))

I had first heard of **Polycom** many years ago when the company was better known for its funny looking conference call telephone (this device did not allow for videoconferencing) but my interest in **Polycom** picked up in earnest when, scheduled to fly to Aspen on Saturday, March 1st on a 6:45 A.M. flight through Denver, I arrived at the Tulsa International Airport to be greeted by a United agent who nonchalantly, and without apology, told me that United had canceled my flight. (Once in Denver, I had been scheduled to fly to Aspen where I was going to meet my architect.) After that Saturday experience, not the first of many dismal experiences which I have had with United Airlines, I decided to check into the voice and picture method of talking over the internet, a method that uses a software program produced by **Polycom**, installed on my desktop, and a webcam which **Microsoft** sells.

Two weeks later we had the system up and running in our Tulsa office. I had bought another system for my architect in Aspen. It worked well.

So as I moved slowly along Franklin Delano Roosevelt Drive I was glad for the capitalist system: whenever some thing broke down--- for example, roads and airlines---with real economic incentive there would be organizations entrepreneurial organizations such as **Polycom** who would take on the risk of creating a solution, as long as the rewards were significant.

End of Part I



Left to right: **Jim Carnett**, Senior Portfolio Manager; **Meredith Bohot**, Director: Client Relations; **Fred Russell**, CEO; and **Stephen Shepherd**, Portfolio Manager

Clients, officers, shareholders, and employees of the Fredric E. Russell Investment Management Co. have a position in **Burlington Northern Santa Fe Corp. (NYSE:BNI)** a position which consists of **32,205** shares, whose market value, as of the close of trading on April 25, 2008 is **\$3,212,448.75**. As far as **Polycom, Inc. (NASDAQ: PLCM)** goes, clients, officers, shareholders, and employees of the Fredric E. Russell Investment Management Co. have a position which consists of **74,050** shares, whose market value, as of the close of trading on April 25, 2008 is **\$1,683,156.50**.

We may liquidate, decrease, or increase these positions at any time, without notice before or after we do so.

You may read more about us, find other investment letters and the details of our record on our website: www.fredricerussell.com.

