THE RAILROAD WEEK IN REVIEW
APRIL 17, 2009

"*The railroad does a quarter of a billion in net income and earnings are down a paltry 23% y/y. Is this as bad as it gets? If so we'll happily take it." -- Rick Paterson, UBS, on CSX results*

Monday morning's Zacks Earnings Preview had these cheery words for CSX: "More than half the analysts covering CSX have cut their first quarter profit projections leading up to Tuesday's earnings release. The negative revisions have caused the consensus earnings estimate the to fall eight cents to 54 cents a share. The most accurate estimate is even more bearish at 50 cents a share. Earnings estimates have come consistently down from 83 cents three months ago and missed the 91-cent estimate by a penny in 4Q08. CSX has missed expectations once over the past three quarters."

Tuesday night CSX came roaring through like an intermodal hotshot with about a 4:1 horsepower-to-trailing ton ratio: a solid sixty-two cent eps. At Wednesday's opening bell CSX gapped up $3 as investors saw the smaller than expected double-digit percentage drop in year-over-year earnings from 85 cents (80 cents on a comparable basis excluding the effect of an equity earnings adjustment in 1Q08) as good news.

Total revenue declined 17.2% to $2.2 bn; ops exp came down 17.3% and ops income was off 16.6% to $522 mm. Below the line net income decreased 29.9% to $246 mm though EPS was down just 26.2% on a 5% drop in share count. Revenue units declined 17.4%, system RPU was essentially flat at +0.2% and RTMs came down 14.8%. The Operating Ratio was little changed: down 18 basis points to 76.77.

Drilling down into the details, freight revenues declined mainly on volumes as rate/mix and FSC were a wash. Merch carloads ex-coal and IM are 70% of CSX vols yet accounted for 93% of volume loss. Only ag products units did not decline yoy and actually saw a 6% revenue gain. Chief Commercial Officer Clarence Gooden sees some benefit from the government "stimulus" program though revenue unit counts will most likely stay down into 2010.

Pricing gains for the balance of 2009 will be 5-6%; 85% of re-pricing contracts are done for 2009. Gooden noted they are seeing more customer requests for longer-term contracts as the drastic effects of FSC wear off. Moreover, CSX sees itself with "near-truck" pricing on merch carload commodities especially flat-bed products like steel and lumber even though volumes are down.

COO Tony Ingram says they are "streamlining the network" but are doing so in a way so as to keep customer service levels high, aligning train and crew schedules and network ops against volumes. Crew-starts are down 15%, most of which is in local service, and the TYE headcount is down 9%. There are 500 locos stored serviceable and in such a way they can be back in service in a matter of hours. CSX also has furloughed some 2,400 employees though they can get everybody back they want back in two to four weeks.

On-time arrivals and departures are up; velocity is up and dwell-times are down thanks to improved on-time performance. Operating system models have improved to the point they are much better predictors of train performance. Better ops practices combined with better locos, better track, and better tools allow assets to be added to network "in a smart way," so volumes can increase with minimal added cost.

In his financial report CFO Oscar Munoz said half the $522 mm decrease in ops expense was fuel as price per gallon dropped 51% and GTMs per gallon increased one percent. The FSC lag benefits this quarter by $38 mm; derailment and accident came down but car hire went up as payable days per load jumped to 18 days from14 partly due to fewer train-starts. CSX has divided expenses into three buckets from highly dependent on volumes (ST variable cost) to hardly dependent on volumes (Fixed/indirect). Short lines well-positioned to help lower what's in the variable-cost buckets through better asset turns and pre-blocking for the distant node to minimize intermediate class yard stops.

This was one of the best CSX earnings calls thanks to its focus on what's behind the numbers. Follow the presentation slides at www.csx.com/investors as you review these comments (or better yet, listen to the call to get the nuances) and see where you can fine-tune your operation to support CSX goals. And please feel free to call should you wish to discuss further.

Other voices on the CSX call: *William Greene, Morgan Stanley*: "We've maintained that rails will show less negative operating leverage than past cycles given pricing power and greater cost-cutting opportunities through a wave of attrition and incentive compensation. Though a sizeable beat, we view CSX's 1Q09 results as indicative of further positive reports from peers in the coming weeks."

Tom Wadewitz, JPM: "We believe that CSX was probably careful with their tone on the conference call and also in their approach to share buyback because it is a very sensitive point in time with respect to new railroad legislation. CSX's cost-side performance is likely to remain very solid, [providing] support for earnings and the stock even if volume improvement is slow to materialize. We continue to see significant medium-term upside for the stock, and the primary near-term risk remains the introduction and content of new rail legislation."

Ed Wolfe, Wolfe Research: "We expect the stock to react well to CSX's upside report which includes signs of solid cost control and continued firm pricing despite very weak volumes. However, the stock has had a large [upward] move recently and we suspect that with the inflection of its fuel benefit and likely decelerating pricing throughout 2009, CSX will be hard-pressed to continue the OR improvement that it demonstrated during 1Q when operating income was down 16% y/y.

Providence & Worcester reported full-year 2008 results three weeks ago and I was asleep at the switch. The short form is the 10-K is good news and bad news. The good news is they gave more detail on their commodity revenues and carloads; the bad news is you still have to mine other sources (yahoo.com, wsj.com) if you want the full story on the Income Statement.

The way I see it, P&W had a 2008 operating loss of $749,000 on $29.7 mm in railroad-related sales against a 2007 ops loss of $1.7 mm on $26.2 mm in sales. Total carload revenue increased 20% as the mix shifted to 95% carload, 5% intermodal from 91% carload, 9% intermodal. This is good business, too, running $800 per merch carload, up 8% year-over-year. As for intermodal, box count was cut in half to 1,341 and they're only getting $64 a box, up 9% over 2007. Fuel was the killer expense, up 58% for the year, while net car hire, purchased services and equipment maintenance all held in the low double-digits.

Shipments of ethanol, coal, automobiles and steel ingots accounted for substantially all of the increase in traffic volume. These increases were somewhat offset by decreases in shipments of construction aggregates, chemicals (other than ethanol), building materials and certain other commodities during the year.

The decrease in container freight started in the second quarter and continued throughout 2008. Among other factors, rate increases imposed by western rail carriers in the United States resulted in steamship lines using “all water” routings to the East Coast for an increasingly larger portion of container traffic, thereby significantly reducing the volume of such traffic shipped cross-country by rail. The increase in the average revenue received per container is attributable to contractual rate adjustments based upon railroad industry cost indices as well as a change in the mix of containers handled.

Below the line other income (though P&W doesn’t put it here, preferring to artificially goose operating results making it an above-the-line item) came to $1.1 mm chiefly from gains realized from the sale of property, equipment and easements – amounts that can vary significantly from year to year. Once again, proceeds from property sales masked the railroad’s poor performance, producing net income of $133,000 against the 2007 loss of $655,000. At least the railroad operating ratio “improved” to 102.5 from 106.5 in 2007.

Genesee & Wyoming in the first quarter 2009 handled 214,439 revenue units, up 25,000 units or 13% from the first-quarter 2008. My concern is that railroads under the GWR banner for a year or more dropped nearly 16,000 units and it took 41,000 units from roads acquired in the past 12 months to turn the system revenue unit number positive. Not surprisingly, GWR says the decrease was principally due to same-store year-over-year declines in pulp and paper traffic, metals and lumber and panel board. The farm & food category was up 47%, adding 6,400 units to the count.

GWR railroads acquired within the last 12 months include the May 31 acquisition of Roger Bell’s CAGY Industries and the October 1 acquisitions of the Georgia Southwestern and the Ohio Central Railroad System. What these numbers do not include is the car-counts growing number of names under the Rail Link Banner. That is reserved for the quarterly calls and then we only see a lump-sum revenue amount for the lot of them.

It would, however, be helpful if GWR stopped counting intermodal platforms (nobody else does) and put that count in “other.” As is, the “other and haulage” category is the fifth largest category in terms of revenue units. It would add to GWR’s vaunted transparency of reporting to know how much is which. Haulage, as regular WIR readers know, can go away in a heartbeat if the haulee decides to do something else with what’s being hauled. Just ask those who worked the old D&H.

Fort Worth & Western has selected RailComm’s Domain Operations Controller (DOC®) Track Warrant Control system to dispatch its dark territory. This is a web-enabled system so the railroad can be remotely dispatched from any internet-connected computer located anywhere. For instance, in the case of a natural disaster, the dispatch personnel can simply relocate to any convenient location with internet access. This is most encouraging and shows how FWWR has grown since its 1988 start with the purchase of six miles of ex-Santa Fe track through the west side of Fort Worth. As of 2008, the FWWR handled over 36,000 cars, operating over 276 miles of track through eight counties in North Central Texas.