THE RAILROAD WEEK IN REVIEW
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" We believe that 'par' is little more than a psychological way station on the way to a much stronger Canadian dollar." -- Dennis Gartman, The Gartman Letter, April 7, 2010

CSX leads off the railroads' earnings season with record first-quarter revenue, operating income and operating ratio. Total revenue increased 11 percent to $2.5 billion as merchandise carloads (all but coal and intermodal) increased to 55 percent of the total and coal dipped to 30 percent with intermodal treading water at 13 percent from 12 percent year-over-year. Merchandise carload revenue shot up 17 percent thanks in part to jumps of 41 percent and 32 percent in fertilizers and metals. Chemicals, the perennial volume leader for short lines, increased 14 percent over first quarter 2009.

Merchandise carloads increased 12 percent leveraging a five percent gain in revenue-per-unit. Fertilizers and metals were the leading volume gainers, up 32 and 27 percent respectively; chemical car-counts rose seven percent. Of particular interest to CSX short lines paid on the junction settlement model, same-store revenue-per-unit grew six percent in the quarter, a marked change from the seven percent decline posted in the 2009 fourth quarter. On the call Chief Marketing Officer Clarence Gooden cited particular strength in fertilizer, ag, chemicals and metals; housing and construction-related markets continue to be weak. CSX short lines (CSX' largest "customer" touching 22 percent of all merchandise carloads) seem to be following pretty much the same commodity pattern though the sequential quarter-to-quarter story is stronger than year-over-year.

Domestic intermodal increased 10 percent on truck conversions and new service lanes; international increased on export and inventory replenishments. The mix is now 55-45 percent domestic over international. Export coal grew 21 percent on China demand; one short line that touches CSX export coal says March 2010 was their highest volume ever and expects 2010 volumes to be up ten percent year-over-year.

On a sequential basis, first quarter 2010 from fourth quarter 2009, total revenue and revenue-per-unit increased seven and eight percent respectively on essentially no change in revenue units, proving once again that customers will pay up for perceived value relative to alternative vendors. Keeping operating expense under control was a big contributor, up just eight percent. Operating income rose 22 percent to $34 million and the operating ratio came down 220 basis points to 74.6, though it had been below 74 at the bottom of the downturn in 2009's Q2 and Q3. Total revenue ton-miles increased five percent yet fuel burn was up only one percent.

Below the line, other income was $11 mm on real estate and "miscellaneous income" (please note real estate sales do not count as revenue) and CSX took a hit of $7 million related to the retiree health cost mandates under ObamaCare. Net earnings came in at $306 million, up 24 percent year-over-year, ditto earnings-per-share at 78 cents vs. 62 cents. The only down-side was the degradation in operating performance metrics. On-time departures and arrivals, cars-on-line and yard dwells were a bit worse off vs. first quarter 2009, though train velocity and OT arrivals were better than they were in the 2007 first quarter. In sum, I see CSX as being definitely on the right track with the tools at hand to increase earnings per share at a double-digit clip for the rest of 2010 and beyond.

Chris Ceraso at Credit Suisse has good news for CSX short lines that are on the Junction Settlement plan: "CSX proved once again that pricing is a power thing as every point of price is worth about four points of profit growth. As long as the rails can maintain pricing growth of four to five percent, we think quarterly results will repeatedly surprise to the upside as analysts will be reluctant to model persistent double-digit profit growth. Our longer-term bullish view on the railroads remains very much intact."

Class I railroad revenue unit loadings increased 11 percent year-over-year in Week 13 vs. 17 percent and ten percent gains in the prior two weeks and certainly a continuation of the favorable weekly comp trend starting in January. Prior to the quarter just ended the last reported quarterly growth was in 1Q08, which increased by less than one percent over the same period in 2007.

Jason Seidl at Dahlman Rose writes, "Weekly changes in rail traffic were led by a 55 percent jump in metallic ores and minerals vs. 47 percent in week 12, a 29 percent increase in automotive volume vs. the prior week's 44 percent increase, an 18 percent increase in chemicals vs. 17 percent in the prior week, and a 17 percent gain in non-metallic minerals vs. 18 percent in Week 12. Agricultural product volumes increased three percent vs. last week's 11 percent. Coal for Week 13 increased five percent vs. 19 percent in week 12.

Week 13 shortline carloads as reported in the RMI *RailConnect Index* were up nine percent compared with a year ago and up four percent year-to-date vs. the 2009 period. The leading percentage gainers in the week were ore (76 percent), metals (32 percent), waste (22 percent) and automotive (27 percent). Putting this in context, the most important shortline commodities year-to-date are chemicals (17 percent of the total loads), grain (14 percent), coal (12 percent) and aggregates (10 percent).

The real question is how much of a return to those heady days of 2007 the shortline community may expect. Comparing total carloads for the first quarters of 2010 and 2007 we find each first-quarter week of 2010 running 18 to 26 percent behind the comparable 2007 week; total 2010 first quarter carloads lagged the 2007 first quarter by 22 percent. The good news is that chemicals remains the largest single commodity group in terms of carload volumes.

Genesee & Wyoming's March 2010 carloads turned the corner to a seven percent gain over March, 2009 vs. a nine percent year-over-year decline in February. Carloads for the quarter were off four percent. Moreover, GWR lacks the chemicals concentration seen in the industry as a whole (ten percent of vols vs 17 percent) yet does double the business in coal (26 percent of vols vs. 12 percent). In addition, GWR includes its Australian vols in its published car-counts, skewing the food numbers (12 percent for GWR vs. five percent for the North American shortline community) in particular.

RailAmerica March 2010 carloads were up nine percent year-over-year and posted gains in six out of 12 commodity groups. RA rang up double-digit gains (triple for ores) in agricultural products (18 percent), chemicals (24 percent), food and grain (11 percent) and forest (!!) products (11 percent). First quarter 2010 revenue units increased five percent year-over-year. Recent conversations with RA management confirm my sense that the Giles Team is finding new revenue opportunities overlooked by the previous owners and they're not done yet.

The Canadian dollar has once again achieved parity with the US dollar. As noted here last week, both CN and CP posted much stronger gains in the 2010 first quarter over the 2009 fourth quarter than did the US Class I rails. For some of the explanation, read what Dennis Gartman, he of The Gartman Letter out of Suffolk, Virginia writes: "We believe that 'par' is little more than a psychological way station on the way to a much stronger Canadian dollar." Paraphrasing, the Canadian economy and banking system are far stronger than their US counterparts while "the Canadian political system is moving toward the centre-right while the US political system is moving manifestly centre-left. Most important, Canada has the materials... metals; grains; energy; water... that the world wants and needs. Par? It is but a way station and nothing more."

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