THE RAILROAD WEEK IN REVIEW

May 3, 2013

“People in finance ignore infrequent events, not noticing that the effect of a rare event can bankrupt a company.” -- Nassim Taleb, Fooled by Randomness

Genesee & Wyoming reported first quarter operating revenues of $375 million, up 81 percent year-over-year. North American operating revenues more than doubled to $221 million, up 116%, on 395,000 revenue units, up 127 percent. But that’s only half the story. That’s the GAAP story that only lets you run year-over year comps. As a result, you see only GWR results for 1Q2012; look at what happens if you include what RA did a year ago.

First quarter combined year-over-year carloads[1] -- counted as if RA and GWR were one a year ago -- were up just eight-tenths of one percent to 383,000 units. Recall that GWR re-aligned commodity groups so that both RA and GWR results followed the same commodity rules. As a result, the bath that GWR took in Ohio overhead coal went into the “Coal & Coke” group, so that by March year-over-year carloads were off less than three percent. Petrol got counted on its own, up 41 percent in March. And it’s all same-store, excluding carloads from names GWR and RA acquired Jan-Mar 2012.

We don’t have the same comps in other than revenue units, but just taking the North American operating comps we get a good idea of the company’s potential. Non-freight revenue (switching and terminal ops, car repair, car storage, etc.) nearly doubled to $78,249; total operating revenue hit $299,095, up 108 percent. Ops expense increased slightly faster -- by 116 percent -- so NA ops income was $54,794, up 75 percent, with an 81.7 ops ratio, 341 basis points worse. Without RA acquisition costs and asset sales gains the adjusted OR is 76.7, 30 basis points better.

Happily, buried deep in the press release, GWR says RA total 1Q2012 revenues were $143 million. Add that to the $144 million reported for GWR alone a year ago and get combined NA freight revs -- including both freight and non-freight of $287 million, so the year-over-year delta is up four percent on essentially flat carload vols.

GWR world-wide did $76 million in ops income, up 84 percent, net income of $83 million, a near-triple. That comes courtesy of a $25 million tax benefit, and I’m not removing it -- or any of the myriad one-time “extraordinary” events -- to try to get a GWR performance run rate. The way I see it, companies everywhere are taking so-called one-time events out of their income statements to show what the business looks like without the outliers. But life is full of outliers -- like the pitcher hitting a grand slam after the guy before him is walked to get the pitcher to hit into a double play -- and we have to assume “extraordinary events” will continue to happen.

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[1] Don’t look for these numbers in the GWR press release. Go to the March car count released early Apr.

Getting back to GWR, operating expenses were, as I said above, 81.7 percent of revenue. But if you look at what happened line-by-line you can see how GWR+RA will be stronger than either could be by themselves. Compensation as a percent of revenue came down 450 basis points to 31.0 percent of revenue. Equipment rents -- mainly car hire -- was up only 70 BP to 5.4 percent; fuel unchanged at 10.6 percent; casualty and insurance came down 50 BP to 1.9 percent of revs. GWR's Q1 safety record was 0.8 reportable injuries per 200,000 hours worked, "a modest improvement year-over-year;" the 2013 target is 0.45, a 50 percent improvement over the 2012 number for the combined companies.

On the call, CEO Jack Hellmann said the RA integration is on track to result in $36 million of annual savings. They closed RA's Jax corporate office ahead of schedule, expanded their own Jax and Rochester corporate offices, created a new regional office in Dallas and moved three regional offices to larger spaces, and GWR World HQ to a "bigger and cheaper" space directly across from the Metro North station at Darien, Conn. They are still on the prowl for more names and have a $400 million piggy bank to do it with. Sounds good to me.

The ASLRRA celebrated its 100th birthday in Atlanta this week and what a celebration it was. Association President Rich Timmons told me it was the best attendance ever with a record number of exhibitors and railroad members. The show took over the entire lower level of the Marriott Marquis in downtown Atlanta, filling up an acre and a quarter of floor space with 215 displays from wheel sets to loco control stands to bridge flex monitors.

UP President and CEO Jack Koraleski set the tone with his Monday keynote presentation, "Leading with Certainty in Uncertain Times." He opened with household company names from IBM to 3M that had been founded and flourished during uncertain times and segued into how UP has changed, morphed and coped as coal diminished while oil and gas exploration brought on carload volumes never dreamed of five years ago.

Short lines and regionals touch half of all UP's Industrial Products commodities, two-fifths of their ag business and a fifth of UP's chemical carloads including crude oil. UP tracks not only carloads to and from direct connections with Class II and III roads but also those that originate or terminate on the non-Class Is via an intermediate Class I. All told, UP handled 1.6 million cars that touched short lines and regionals, up three percent year-over-year vs UP organic merch carloads up one percent.

His wrap: Now's not the time to hunker down but to be more aggressive and nimble in developing new customers and freight flows. Be comfortable with past successes, get comfortable with change, and be agile. As he said about the drought on the UP first quarter conference call, "Put a fork in it. It's done."

The Convention Planning Committee built on this message beautifully. There were 35 small-group breakout sessions in seven disciplines plus two four-hour sessions covering basic and advanced car hire respectively and a for-fee session on PTC. My schedule did not let me attend either, but one of the car hire instructors told me the session was especially timely for those new to the car hire management scheme.

The sessions on forest products, frack sand/energy, crude-by-rail had a common theme: turn the cars so customers can create the next load. Demurrage and car hire were, of course, discussed, and here again the common theme is two-fold: the rails would rather have the car to reload than run up a demurrage bill; and car-hire eats into operating income per revenue ton-mile.

The Class Is in the 2013 first quarter ran the range from 26,740 RTMs/revenue unit at NS to 57,180 RTMs/revenue unit at UP. The shorter length of haul at NS helped push the OR to 74.8, second-highest among Class Is, whereas UP's longer length of haul contributed to their record Q1 low OR, 69.1, and the lowest ops expense per MRTM of all Class Is. RTMs/unit is a function of revenue per carload and length of haul and is a key measure of railroad efficiency. Yet the number of short lines actually tracking RTMs/carload is, I suspect, minuscule. Which is unfortunate, because the tools are there. And free.

Real-time event reporting is essential, and three exhibitors in particular have solutions: RMI, now the tongue-twisting "GE Transportation Optimization Solutions," ShipXpress and Lat-Lon. The first two run suites of car movement management tools that are cloud-based and run off hand-held devices. RMI uses a purpose-built tablet that synchronizes to the home-base computer; ShipXpress uses any off-the-shelf smart phone or tablet with no resident computer or clerk at the shortline office, reporting every event to Railinc in real time.

Lat-Lon is more on the mechanical side with a suite of equipment management tools. I came away particularly impressed with their ability to track locomotive performance in remote locations, even shutting down units to minimize idle time and maximize operating hours per gallon of fuel. They showed me how, in real time, the locations of specific locomotives in a terminal 800 miles away and whether they were running or not. I can see this as particularly useful to shortline operators with contract switching operations in remote locations.

The 100th Anniversary ASLRRA session was one for the record books and and I for one am glad I went. I sensed a renewed sense of purpose and energy and a realization that being able to run a business without reliance on handouts is crucial. As one CEO said over a glass of Makers Mark, "I can exist without the grants or 45Gs; having them lets me speed up my railroad and improve responsiveness to customer supply-chain requirements sooner." Can't argue with that.