THE RAILROAD WEEK IN REVIEW

August 2, 2013

"Combined company same railroad adjusted revenues increased ten percent led by petroleum products in North America and steam coal shipments in the Unites States." -- Jack Hellmann, President, Genesee & Wyoming

Florida East Coast knocked the cover off the ball with a grand slam home run on Tuesday's earnings call. Revenue, ebitda, non-intermodal carloads, operating income and net income were all up double digits. Merchandise carloads in every category were up 11 percent or more; operating expense was held to a four percent increase against an overall eight percent revenue unit gain. System RPU increased six percent for a respectable 1.27 system revenue/cost multiple. The operating ratio was 72.9, shedding seven points year-over-year.

The scorecard looks like this: revenues $66.9 million on 117,925 units, of which 92,161 or 78 percent were intermodal boxes and 69 percent of them were containers, not trailers. Volume gains brought in four out of every six dollars of revenue increase; operating income was up a jaw-dropping 54 percent, which shows what really knuckling down in cost control can do. FEC averaged $870 per merch carload, up one percent, and $427 per intermodal unit, up four percent. The Personal Injury rate came down one one-hundredths of a point to 1.11 for the quarter.

Year-to-date capex less the four million dollars in 45G tax credits was $10.4 million, about the same as last year, but operating cash flow was $26.3 million, four times what it was last year, and nearly seven times YTD net income. Free cash flow was $16 million vs. minus $3.5 million a year ago. Ebitda margin improved 5.2 points to 37 percent of revenues. Debt-to-cap is 79 percent or 6.7 times the trailing-twelve-month ebitda, a two-point improvement year-over-year.

On the call FEC President Jim Hertwig cited several intermodal service initiatives to extend FEC reach into more markets. The new Cocoa intermodal terminal makes possible next-morning service to both ends of Florida and into South Georgia. The new West Palm intermodal terminal adds capacity for the service area from roughly Fort Lauderdale to Jupiter and west to Lake Okechobee. Finally, FEC features new second morning truck-train service between South Florida and Atlanta, Nashville and Charlotte. Nice.

Genesee & Wyoming second quarter consolidated revenues increased 84 percent to $401 million, operating income grew 71.9 percent to $107 million, and EPS went up 33 percent to $1.20. Of course, these large gains come mostly from GWR's effectively doubling its North American footprint with the RailAmerica acquisition effective at the beginning of the year. Combined company same-railroad revenues increased ten percent, one-third from Australia, led by iron ore, and two-thirds from North America, led by petroleum products.

The company goes to great lengths in its presentation materials to sort out what it is required to say under GAAP from what's really going on. Thus the emphasis on "same-railroad" data and comps with what the combined companies would have done a year had they been operating as one. Where the process becomes challenging is when you try to match up 2Q2012 GWR North American results without Australia with RailAmerica results for that period.

Reported North American Revenue units stand at 417,016 -- a 136 percent increase over what GWR itself had a year ago. To get some sense of what combined comps might be, I added my 2Q2012 RA numbers to the reported GWR vols for the period and got 396,363 units, up five percent.

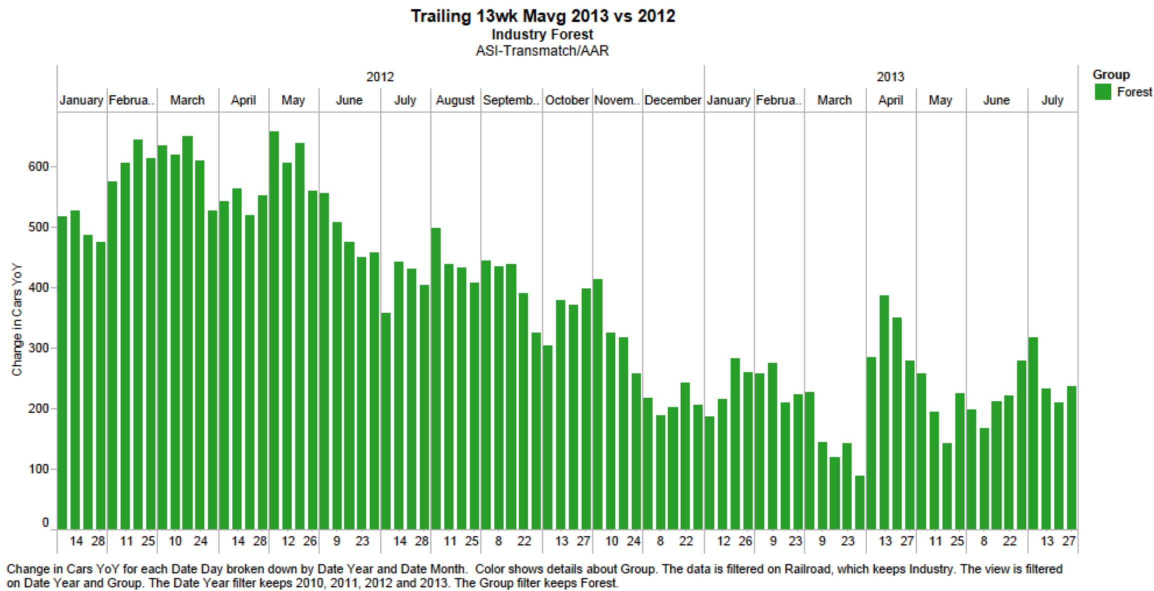
That's a flawed number, however, due to the way RA and GWR broke out commodities. RA had all coal in "coal" whereas GWR had Illinois Midland coal in coal and NS overhead coal in "other." RA reported metals and metallic ores as one; GWR has them as two. Business that moves on both GWR and RA was two carloads -- one for each railroad-- and it's now one. My educated guess is combined comps growth is more like three percent.

Looking at combined-company, same-railroad carload commodity changes, crude oil steals the spotlight, up 10,455 units or 60 percent. North American demand and exports to Asia boosted auto loads by 2,000 units, 25 percent, and lumber was up seven percent or 2,300 units on West Coast housing starts. Higher demand for domestic steam coal added nearly 8,000 units or 11 percent.

North American priorities for the second half include continued tight cost controls for the combined entity, further iron ore expansion in Canada, expanding the energy play, getting the 45G credit pushed out beyond this year and continuing to look for proper shortline acquisitions. GWR second-half guidance calls for revenues remaining in the $400 million range and operating ratios in the 72-73 range for ops income of $110 million, more or less.

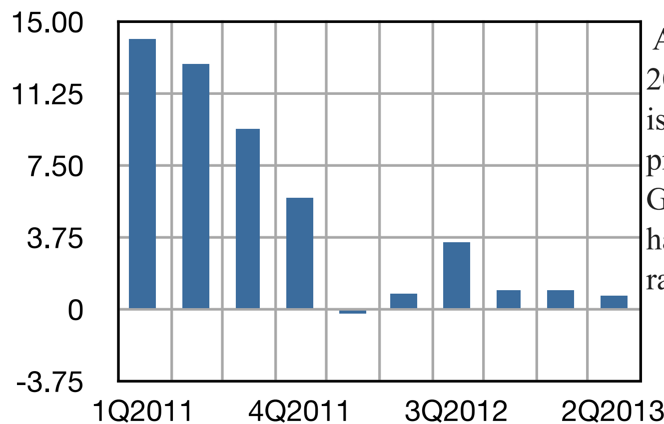
Forest products, lumber and housing starts seem to be on everybody's gains list this season, even though there was a bit of a dip toward the end of the quarter. A note from UBS would have us believe the wobble in shares of home-building company stocks was "overdone." Specifically, "The recent decline in the home-builder stocks reflects concerns over rising rates, [though] we continue to expect a limited impact from rising rates over the next 12-18 months. With expectations moving more in line with our forecast for a moderate recovery, valuations [of shares of home builders -- Pulte, Ryland, e.g.] are increasingly attractive."

Drew Robertson's fine chart, reproduced herewith, shows the reason for the first-quarter hand-wringing and a glimmer of joy in Mudville starting in April. Remember, we're looking at year-over-year changes in 13-week moving average carloads -- a slight uptrend since May.



There can be no doubt the world is slowing down. The *Second Quarter 2013 Earnings Summary* from UBS Research shows graphically and vividly how revenues and consequently earnings have fallen over nine consecutive quarters starting with the 2011 first quarter. The chart represents 280 companies reporting, representing 61.4 percent of the S&P 500's market capitalization.

Revenue Growth (ex-financials)



As you can see, it was downhill all the way in 2011, never got much better last year, and 2013 is hardly starting out as a barn-burner. Now the prognosticators are talking about a one percent GDP growth (!) rate for the balance of 2013. I have to wonder how long the rails can keep raising rates to mask increasing ops costs.

Source: S&P, Compustat, First Call, IBES, Worldscope, FactSet, UBS

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