THE RAILROAD WEEK IN REVIEW

August 9, 2013

"At CN we are reenacting every aspect of what could have gone wrong on this highly unusual accident and are reviewing our policies accordingly." -- CEO Claude Mongeau on Megantic

BNSF revenues for the second quarter 2013 topped $5.3 billion, a five percent gain and the largest percent gain among US Class Is, on 2.5 million revenue units, up four percent, again taking top honors among all Class Is. Operating expense held to a three percent bump, so ops income rose nearly ten percent to $1.6 billion with an operating ratio of 70.4, a 1.22 point improvement year-over-year.

Merchandise carloads (ag and industrial, in BNSF-speak) increased four percent to 695,000 units; RPU was $3,212, essentially flat. Within the merch group ag products suffered a nine percent volume drop due to lower grain exports while Bakken crude added some 130,000 carloads, up from 80,000 units a year ago, to the Industrial Products category. Back out the crude oil to get at shortline equivalent exposure and see merch carloads are still up four percent. Even at 130,000 units, crude oil represents less than a fifth of the merch franchise.

Coal turned the corner, up seven percent, and the "consumer products" group -- auto and intermodal -- was up a mere two percent, mainly on highway conversions. Backing out petroleum shipments leaves the core railroad vols up nearly four percent, showing minimal effect on crude in the gross numbers, its 130,000 carloads being five percent of total revenue units.

BNSF did the second-best job of getting rate increases as measured by percent change in revenues *vs.* percent change in vols. Only CP bested BNSF with a seven-point spread between revenue and unit deltas to the latter's two-point spread. By comparison, CSX may have lost share with revenues up one percent against flat vols; NS clearly gained share at the expense of revs -- vols up three percent, revs down two percent. But the BNSF story is even stronger as they posted a per-unit revenue/cost ratio of 1.37, lowest of the Big Four US Class Is by ninety basis points.

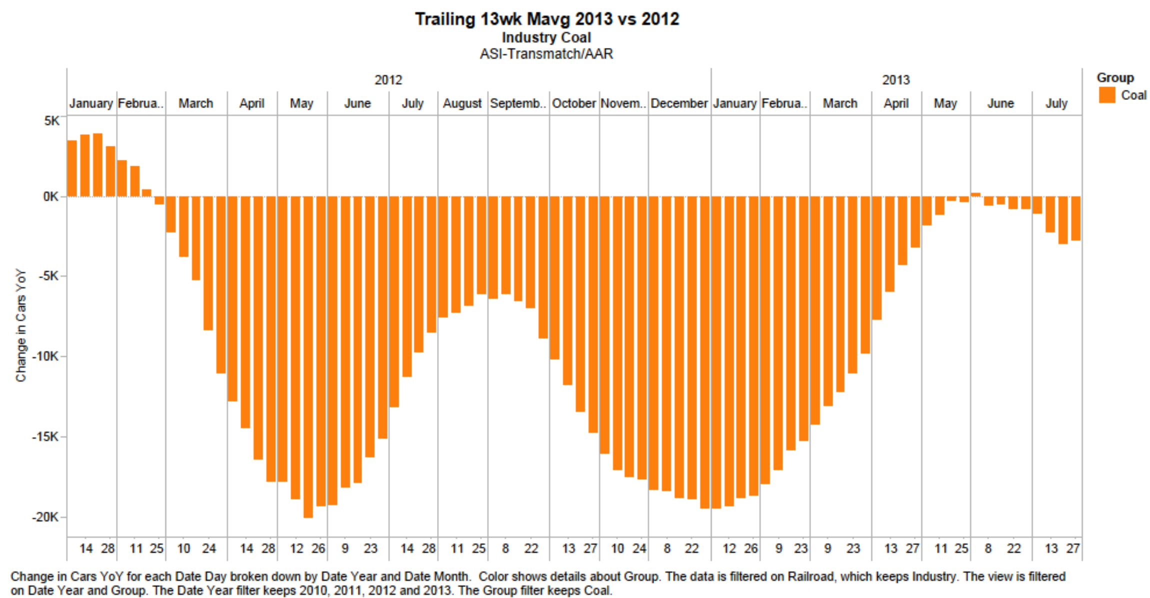
Net income increased ten percent to $884 million, though cash flow from operations was $2.2 billion, off six percent, so the $1.3 billion six-month capex figure took free cash flow down 18 percent to $866 million. BNSF says in the 10-Q that 2013 capex will be $4.3 billion, up $200 million for "more expansion-related spending."

LB Foster sales for the second quarter of 2012 were $149.9 million compared to a $163.2 million in the prior year, an eight percent decrease. The sales reduction was due in part to a ten percent decline in rail segment sales of concrete ties partially offset by an improvement in transit product sales.

Part of the rail shortfall comes from Class I quarterly capex being down five percent year-over-year, which FSTR says "is trending lower than the original Class I projections, even though the Class I forecasted full year spend is still strong." Minuscule merch carload growth and less coal means less wear on the track structure; modest expansion of intermodal RTMs doesn't hammer the track quite as hard.

On the call, FSTR said, "Our business with Class I customers doesn't benefit that much as the wear and tear related to heavy coal traffic declines. That's not all bad news as the change in mix is good for the industry and long term investment in rail certainly has a great outlook. There are still good spending levels at the short lines and the outlook for the sector is good as short lines are clearly benefiting from their ability to reach into the developing gas territories."

FreightCar America (NYSE: RAIL) posted a slight earnings miss for the second quarter, yet shares have rallied on new orders. The total manufacturing backlog was 2,065 units at June 30, which was down from 5,109 units on the same day of the prior year. However, the company noted that after the quarter ended, orders for over 5,500 railcars were received, which include orders for about 4,000 rebuilt coal cars to serve the Eastern coal market, even as freight car demand "remains weak as expected," according to CEO Ed Whalen.



Drew Robertson's ASI 13-week moving average coal chart shows exactly how badly the coal downturn has hammered the Class Is. Fact is, rebuilding coal hoppers for a shrinking market does not a growth business make. The trend is toward cars with lighter tare weights and heavier loading capacity, which means fewer revenue carloads for a given amount of tonnage. At NS, for example, second quarter year-to-date utility coal was off 80 percent from what it was in 1H2011.

On a positive note, the recently opened "Shoals" facility in Alabama has taken in its first order for RAIL's recently introduced five-unit intermodal railcar. Once fully operational, this facility

will broaden the company's product offerings leading to some volume improvements in the second half of the year.

Among the five car builders, RAIL, Trinity and Greenbrier have traded off to the point where share prices are below my Graham Number for fair value and at low book-value multiples. The fourth builder, American RailCar, trades at somewhat more aggressive multiples. Wall Street seems to have noticed because shares of RAIL, ARII and TRN are all flashing technical Buy signals; GBX is just now moving above resistance after a recent dip, though it was the best performer over the last six months. RAIL, unfortunately has lagged over two years.

Montreal Maine & Atlantic filed for bankruptcy Wednesday afternoon both in Canada and the United States. The action will facilitate continuing rail service, payment of post-filing obligations, and ensuring that creditors are treated equitably. MMA says it wants to preserve "going-concern value" and to "maximize recoveries available to creditors."

MMA will continue to serve all stations in Québec, Maine and Vermont subsequent to the court filings (with the exception of Megantic itself). Service to industries at Megantic could be restored as soon as the authorities allow. Court documents estimate clean-up cost at $200 million; MMA says it has only $25 million insurance protection. This is about where most short lines land, insurance-wise, so you can see how hauling hazmats really bets the farm.

The common thread among all such railroad incidents is that the industry immediately rallies around to study what happened and take steps to prevent any repeats. For example, CN President Claude Mongeau said on their earnings call, "Our safety, dangerous goods and environmental leaders were on site from Day One to learn firsthand about the accident and the safety implications for CN, reenacting every aspect of what could have gone wrong on this highly unusual accident and are reviewing our policies accordingly."

Similarly, GWR President Jack Hellman said in his opening remarks, "We've been carefully studying the accident, and will carefully examine the findings of the Canadian accident investigation. Our objective is to determine if there are any additional measures that can make our railroads even safer."

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