THE RAILROAD WEEK IN REVIEW

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"The business of railroads is moving stuff, not supplying storage facilities. Demurrage is not so much a revenue source as a penalty for withholding cars from their proper use. The Uniform Code of Demurrage is there to facilitate equitable car distribution" - paraphrased from the 1940 Freight Traffic Red Book of Transportation

Genesee & Wyoming North American carloads for March are quite strong, considering. Total North American revenue units increased 9.6 percent year-over-year; absent intermodal (0.2 percent of vols) being cut in half, merch and coal vols grew 9.9 percent to 146,960 loads. Putting this in context, GWR total vols, including Australia, were 167,993 units, meaning that NA roads account for nine out of every ten revenue units GWR touches.

North American carloads YTD increased at a rate of 3.7 percent, in contrast to minus 1.2 percent for the 427 roads in the RailConnect report from RMI. Worse, since GWR is about a quarter of those names, the numbers for the non-GWR lines could be down even more. For example, GWR coal was up 14.2 percent to RMI's 1.3 percent. GWR grain (ag products including STCC 01 grains and STCC 20 grain mill products, excluding STCC 20 processed foods) are flat for both; GWR waste is up 4.8 percent compared to down 8.7 percent for the broader community.

For the month, coal - 21 percent of NA vols - increased 26.2 percent due to more steam coal moving in the Midwest and Ohio Valley regions; metals, 11 percent of vols, up seven percent; pulp & paper, ten percent of vols, up eight percent; and minerals & stone, nine percent of vols, up nine percent. All-in, these four of the six commodity groups representing 79 percent of GWR vols (chems and wood products are the other two) increased year-over-year car-counts by more than five percent. Tells me the business is out there if you just go get it.

CSX first-quarter results also look pretty good, considering. The harsh first quarter weather created for CSX "a challenging environment," as CEO Michael Ward said in his opening remarks Wednesday morning. Giving credit where credit is due, he added, "I would like to offer my sincere thanks to the talented and dedicated men and women of CSX who worked tirelessly through one of the worst winters on record to keep the network as fluid as possible. I would also like to thank our customers for their patience and support as we work through the service impacts to meet their needs." Too often that goes without saying, but it ought to be said.

Total revenue ooched up two percent to $3 billion on three percent more volume, with merch carloads up two percent and intermodal boxes up five percent. System RPU was unchanged. Coal was off a point - 4,000 cars and $60 million in billings - mainly in the higher rated lanes as RPU dropped eight percent. Merch carload billings including auto gained $70 million and intermodal sales picked up another $17 million, meaning the sum of the two more than made up for the coal decline and now represent 82 percent of CSX total revenue units. Same-store sales - same commodity O-D pairs, customer and car-type - were 75% of the CSX traffic base in the quarter, a testament to CSC customer loyalty.

Merch carload gains came in ag (feed grain, ethanol), chems (crude oil, LPG,) and forest products (residential housing, packaging paper). Declines were taken in fertilizers (midwest planting delays), food (refrigerated products thru Chicago), metals (construction, partially offset with energy-related stuff) and waste products (MSW, C&D on the weather: you can't tear down or build what you can't get to).

Operating expenses increased nine percent largely on what you'd expect: wages, fuel, and car hire. The killer was in Material, Supplies & Other, up 24 percent or $122 million, half a function of one-time weather hits, the other half a one-time asset-sale gain two years ago. (This one item carries through to both operating income and net income, so you can see how a big one-time event colors all.) Operating income dropped 16 percent to $739 million and the operating ratio jumped five points to 75.5, though I am convinced it won't stay there for long.

The commodity outlook is for continued gains in ag products, energy-related chems, housing & construction, and intermodal, and representing 83 percent of the CSX unit count. Export coal, auto and ferts look soft. Operationally, CSX will keep in service the extra power brought on to cope with the cold and ramp up the T&E training program to stay ahead of anticipated commodity expansion cited above.

Kansas City Southern had a good quarter: Total revenue a first-quarter record $607 million, up ten percent on four percent more units, operating ratio 68.7, down 180 basis points after accounting oddities are backed out, RPU up three percent. Taking some of the bloom off the rose, GAAP ops income dipped two percent, though eliminating "eliminations" from the expense list gives a plus 19 percent: $190 million.

Grain vols leapt by 45 percent on long-haul midwest-Mexico moves against last year's drought-caused easy comps. Other double-digit volume gains came in food products and frack sand, pushing merch carloads up five percent year-over-year. Utility coal, industrial coal and pet coke posed small vol gains and intermodal was up three percent.

On the call, EVP Marketing & Sales Pat Ottensmeyer said he's not seeing a downturn in any business units, leaving the previous full-year outlook intact. The few areas of resistance are new railcars from Mexican manufacturers, scrap paper, and crude oil - this last a result of changes in customer oil-type mix preferences and origins for those products. Cross-border is up 18 percent year-over-year, represents 20 percent of total revenue, and plays a major role in four of KCS's seven "keys to sustainable growth."

The only downside is that, as President Dave Starling puts it, "we now see our business growth curve extending out further than we had projected a few years ago." He appears to ascribe it to commodity lanes and timing, but I couldn't help noticing nothing was said in the prepared remarks about the seeming socialist bent of the Mexican Senate. One has to wonder what the railroad would be worth if access to Lazaro or all those new auto builders were suddenly chopped off or seriously limited. That seem to me the Big Question, more than quarterly carload trends north or south of the border.

I thought Morgan's Gill Greene was going to get into it on the call when he opened, "I know there's still the debate on the legislation," but then shifted his line of questioning. Then Wolfe's Scott Group got to to the heart of it: whether there's a way to make the origin legislation "less draconian."

To which KCSM President Jose Zozaya replied that the measure is still being batted around between the Senate and the House of Deputies and will be in transition for some months. Starling says, "We paid $1.4 billion for the concession. It wasn't given to us. So we're in a very strong position where we're with the government investments we have made. We think we'll come to a good outcome." He adds that he thinks "the worst is behind us," but beyond that he said he's not willing to go. (Francisco dAnconia, are you listening?)

Union Pacific posted a record first quarter, with sales of $5.3 billion, up seven percent; operating income $1.9 billion, up 14 percent; net income $1.1 billion, up 14 percent; and a first quarter record 67.1 operating ratio, down two points. Revenue units gained five percent on three percent more intermodal, seven percent more coal, and six percent more manifest carload moves. Within the carload sector, ag products loads were up 13 percent, auto up two percent, chems off less than a point and industrial products up nine percent. Coal closed the quarter at 17 percent of sales, down a point from last year; carload is now 59 percent, up a point.

Principal ag plays were corn exports to Mexico and China plus wheat exports through the Gulf, pushing grains up 19 percent; Ethanol, feed grains and DDGs added to the upside. ARC was up eight percent. Chems was a mixed bag: shale drilling commodities and ferts gained while crude-oil vols slipped 18 percent. Frack sand (in non-metallic minerals), aggregates, cement and waste materials gained.

The second half looks like more of the same. Crude oil vols are still subject to the vagaries of price spreads and sourcing economics. Frack sand and pipe remain robust and housing starts are showing more life. And last year's strong crop performance ought to work for both domestic and export grain markets. Beer by rail looks good, though the California drought could be a negative for STCC 20 packaged foods.

Out on the road, the cold and snow hampered interline moves, particularly in Chicago. Smaller trains, less switching capacity, and degraded crew availability elongated crew cycles and hurt fuel efficiency. UP was able to minimize some of the worst effects by using alternate yards to build trains and using other interchanges. Adding 500 locos and 550 TY&E staffers helped.

A note from Bill Greene at Morgan Stanley tells me there is less than meets the eye to the latest STB Kabuki show of shipper complaints and governmental posturing. As expected, there were no clear solutions to the many problems aired at last week's outing. Greene reports that the hearing zeroed in on delays in ag and energy product shipments, and the backlog in Chicago.

Proposed shipper remedies: better collaboration among Class in coping with the present backlog, and reporting "real-time train velocity, service metrics by commodity and state, breakdown of rail capex directed towards new capacity vs. maintenance, and estimated timing of service restoration plans." Happily, shippers stopped short of insisting on a Canada-type grain mandate; Greene implies the grownups in the room recognized doing so would only make matters worse.

He concludes, "Overall, most shippers want more transparency and accountability, not necessarily forced rail competition. We think it unlikely the STB implements volume mandates or direct resource allocation, though we acknowledge it's not entirely clear whether the STB will take any specific action at all." No action is the best action. As we've seen in Canada, shippers and receivers can expand car supply just by keeping cars moving. If they need more storage capacity, let them build it.

A final thought from a friend who was there: Mike Behe of USRail.desktop writes, "The commissioners were left with this choice to weigh: lower rates vs. loss of efficiency. I'm uncomfortable with that - makes it a somebody wins, somebody loses debate. Only one shipper speaker mentioned 'market access' - what should be a key argument and one where both sides have something to gain.

"If we're captive to Railroad A at origin but Railroad B serves the destination, we all know the odds are stacked against our ability to use rail in that lane or win business there. And so the captivity not only restricts rail vs. rail competition, it also restricts competition among shippers. The underlying but unspoken assumptions behind the railroad argument about 'inefficient switching' are two. One, the incumbent (captive) route is always the most efficient route and, two, the railroads themselves are best suited to decide what is efficient.

"To the contrary, there certainly will be situations where the competing route is efficient enough to overcome the inefficiency of 'the switch.' Indeed, the inefficiencies that the AAR speaks to will only be incurred if the efficiency of the competing route can overcome the cost plus a reasonable profit of the switch. The marketplace will decide what is efficient based upon the prices involved (incumbent line haul price vs. competing line haul price plus the price of the switch) rather than the railroad deciding what is efficient." Thanks, Mike.