THE RAILROAD WEEK IN REVIEW

November 14, 2014

"The Global Purchasing Managers Index says the recent drop in oil price is unlikely to be a sign that the global economy is hitting a wall." Liz Ann Sonders, Charles Schwab & Co.

BNSF Third Quarter total revenue units are a bit of a challenge. The Railroad 10-Q doesn't go into much quarterly detail in carloads, revenues, or RPU, but it does for nine months. One gets a very rounded hint of the quarter's numbers in the Berkshire Hathaway 10-Q, however:

> Consolidated revenues during the third quarter were approximately $5.9 billion…Revenues from consumer products during the third quarter were $1.8 billion' relatively unchanged from 2013; unit volume and average revenues per car were relatively flat versus 2013. In the third quarter, revenues from industrial products increased 13% to $1.7 billion, reflecting increases in overall unit volume, and to a lesser extent, changes in rates and product mix…

And so on. Taking those revenue numbers and applying year-over-year changes, I came up with a table showing commodity revenue of $5.7 billion vs. $5.5 billion a year ago. To sanity-check this number, I'm looking at the tables I created last year at this time and find total 3Q2013 revs of $5.4 million. Close enough. Using the same process, ag products revs jumped 16.0 percent, merch carloads were up 14.1 percent and coal slipped 8.0 percent.

Neither Q gives any quarterly revenue unit data, so the Week 39 quarterly carload numbers reported to the AAR will have to suffice. Revenue carloads and containers were down 1.0 percent with Consumer Products (intermodal and auto) down 2.5 percent on weather and congestion (not demand, I was assured in Ft Worth at the SL meeting).

Coal vols dropped 6.4 percent. Industrial products (virtually everything else including frac sand, crude oil, petroleum products, and even packaged foods from beer to berries) gained 9.6 percent and ag prods (grains and grain prods including ethanol) dropped 6.2 percent, leaving the merch carload sector, where short lines live, up 6.5 percent.

The AAR doesn't break out STCC 29 petrol products and crude oil so you have to back into a number with the help of the QCS tables from the STB. BNSF has been running a consistent 55,000 carloads a quarter of STCC 29. Back that number out of the reported petrol products number and derive the crude oil change: 94,846 carloads, up 44.4 percent. Back that number out of Industrial Products and find IP less crude oil up 4.6 percent.

Total revenues were $5.9 billion, though based on the data provided, I came up with revs of $5.7 billion, up 4.2 percent from the $5.5 billion reported in last year's Q. Ops expense for the quarter was up up 2.6 percent, for ops income of $1.9 billion, up 7.4 percent, and a 68.2 OR,

down 97 basis points. Net income was $1.04 billion, up 4.7 percent. Interestingly enough, if BNSF had the same share count and forward PE multiple as UNP, shares could be trading at $90+, roughly 63 percent of the recent BRK-B price. In other words, buy BNSF for $90 and get the rest of Berkshire for $55. Surely something to make you go Hmmmm…

Genesee & Western October North American carloads increased 8.5 percent to 157,902, thanks mainly to aggregates, up 27.6 percent and increasing to 12.4 percent of total carloads (ex-intermodal) from 10.6 percent and making it the second biggest commodity behind coal at 18.3 percent of vols. Coal was up 8.0 percent on the Illinois utility business; the aggregates growth was in the Ohio Valley region (I'm guessing frac-related in E Ohio); metals were up in the south and Ohio Valley. No comment on lumber growth, though I'd say it's in the PNW.

Same-store vols increased 4.3 percent after subtracting the Rapid City Pierre & Eastern's 6,116 cars: 60 percent ag, a quarter minerals/stone (bentonite, STCC 14 5xx, I expect), and the other 15 percent, well, all other. Year-to-date cars are up 7.3 percent all-in. This year month-to-month thru May averaged mid-single digits; starting in June w the RCPE addition, monthly increases averaged high single digits.

Though the focus here is to benchmark NA shortline performance, I ought to note that Australia has become a drag on GWR results. Sep carloads there decreased 7.8 percent as agricultural products and metallic ores volumes dipped. And for good reason, too. My friends at Variant Perception write, "The slowdown in China has pushed exports to China from Australia into negative territory for the first time since late 2012."

GWR's Sep 30 10-Q says global iron ore prices are down 40 percent this year, forcing mine closures in Australia. As a result, GWR/AUS iron ore revs are expected to be off $5 million in 2014 and $15 million in 2015. The remaining iron ore base is worth about $90 million a year. Approximately two thirds of GWR/AUS revenue is fixed and the remaining one third is dependent on the volume shipped and the mine location served.

For the nine months ending Sep 30, GWR had total revs of $1.22 billion, of which AUS accounted for 19.7 percent. Last year total revs were $1.18 billion, of which AUS contributed 20.6 percent. The Australian operating ratio this year was 72.0 vs 70.4 a year ago, so you can see the effect of the mine closures on GWR overall productivity.

A client note from JP Morgan says US shale drillers are starting to idle some rigs. Data out last week shows a number of oil rigs coming off-line, dropping active rigs to the lowest number since Aug 22, having peaked during the week ending October 10. The Eagle Ford shale formation in south Texas lost the most as drillers slow their activity to cope with falling crude oil prices.

Cheaper oil impacts the US economy in a number of ways. Transports (air, truck, rail) and auto makers will benefit on the expense side of the ledger while rails will see slowdowns in revenue from input (frac sand, pipe, cement, e.g.), from output in NGLs (GWR in Eastern Ohio), and

crude oil — Iowa Pacific in the Permian, BNSF in the Bakken and both CP and CN in Alberta. Manufacturing firms with big oil support plays — CAT, e.g. — could also her harmed.

Liz Ann Sonders writes (Nov 7) that the recent US gross domestic product (GDP) report eased some fears of a foreign-led US slowdown.

> The manufacturing renaissance remains in force as the Institute for Supply Management's (ISM) Manufacturing Index rose to a surprisingly strong 59.0 in October from 56.6, while the new orders component surged to 65.8 from 60.0. Third quarter forward-looking outlooks have been surprisingly good and there are hopeful signs for the holiday shopping season and beyond. Oil and gasoline prices have fallen; consumer confidence according to the Conference Board reached its highest level since before the great recession at 94.5, up from an average of 73.2 in 2013 and 67.1 in 2012.

As for the rails, heat and eat plus consumer goods in intermodal service continue to provide the most upside. However, should a GOP-led Congress opt for more road-building and infrastructure projects, the bloom will come off the intermodal rose as drivers can cover more miles without running afoul of hours-of-service laws and diesel fuel prices come back to earth. What's more, there are signs of driver pay increases closing the gap between trucker pay and the CPI and improving the loads per available driver ratio.

Traffic trends in the traditional boxcar products group continue to show middling growth, pressuring margins of marginal short lines. More trucks, less congested highways and intermodal poaching of carload lanes do not bode well for the smaller rails.

A terse note in the Miami Herald tells us CSX is offering buyouts to some 300 management staffers, mostly at the Jax headquarters. CSX has about 3,600 employees there and says the cuts "are among other efforts to reduce expenses, delaying raises and reducing so-called nonessential costs such as travel expenses." Buyouts will be available to employees who are more than 53 years old and have been with the company for at least 15 years. Layoffs are possible if there are fewer than 300 takers for the buyout offers. Inquiring minds would like to know if this has anything to do with the recent Hunter Harrison conversations.

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