THE RAILROAD WEEK IN REVIEW

June 19, 2015

“Repurchases make sense when two conditions are met: first, a company has ample funds to take care of the operational and liquidity needs of its business; second, its stock is selling at a material discount to the company’s intrinsic business value.” -- Warren Buffett

Genesee & Wyoming revenue carloads thus far in Q2 have not met expectations. Total world-wide same-railroad traffic dropped 13 percent year-over-year, compared with expectations of a decline of 5 percent versus prior year for the full quarter. Consolidated results including recent acquisitions in the trailing 12-month period were off nine percent.

Though GWR doesn’t break out North American results for quarter-to-date, we are told total units were down thanks to a number of factors. Nat gas displaced steam coal; ag and food STCCS were off primarily due to the timing of shipments; petroleum carloads slipped on lower vols in crude oil and frack sand; and more imported steel hurt the metals franchise.

Based on results through May, G&W expects second quarter 2015 revenues to be approximately $535 million to $545 million (previous guidance was $565 million to $580 million six weeks ago); operating ratio guidance is 81 to 82, up from the earlier 80. As a result, G&W expects consolidated earnings per diluted share in the second quarter of 2015 to be approximately $0.90 to $0.94 compared to guidance provided on May 1, 2015 of $1.05 to $1.10.

As for May, North American carloads including acquisitions were 125,688 units, skidding 22 percent vs. last year; same-store loads came down 17 percent. The main culprits were coal & coke in the midwest; metals in the south and northeast plus Ohio; overhead vols came down as the Class Is routed fewer cars over GWR properties. Each of these commodity groups was down by more than a third year-over-year.

(Re metals, Barclay’s Focus Call note Tuesday says “Over the past six weeks, price increases, declining imports, and stabilizing scrap markets have all provided good news for the U.S. steel mills. Steel Dynamics and Nucor are best positioned among the steel group in an environment of slow, modest improvement, based largely on the mini-mills’ ability to maintain higher profitability through fluctuations in capacity utilization.”)

Norfolk Southern’s 14th Annual Short Line Meeting, its last in Roanoke, drew more than 300 souls representing nearly all of its 250+ regional, shortline and switch carrier connections. New faces from NS included Mike McClellan, VP for Industrial Products (essentially the whole cartload network less coal and auto) and Alan Shaw, EVP and Chief Marketing Officer. In all, about 130 NS staffers from marketing, operations and finance were on hand for the commodity break-out sessions, the trade show and the usual hundred or so individual strategy sessions.

My overall impression is that NS wants to do more business with short lines and all NS staffers who have any short line support role from marketing to ops are being encouraged to be more proactive. Alan Shaw specifically said he wants NS to be the "preferred Class I connection" where there is a choice and he sees short lines as offering "fertile ground" for revenue growth.

There is a strong sense that NS is dead serious about building its shortline carload franchise. Rob Robinson says 81 percent of shortline cars on NS are in the Industrial Products group and run in the Thoroughbred Operating Plan (TOP) network, which tells me that's where NS wants to see the growth.

Measurement is key. Recall the TOP is designed to support the merchandise freight service network by providing customers service consistency and reliability. The TOP uses train schedules and routings to create trip plans covering the entire move for these commodity carloads. It does not include unit trains or intermodal ops, so when the latter get laid on top of the scheduled network, the carload network inevitably slows down.

Blair Hanna, Manager of Customer Service Information, (with Mike McClellan playing *obbligato*) gave a superb rendition of the new *NS Short Line Dashboard*, a graphic tool that gives you everything you need to know about cars coming at you, how long they stay on you and how long it takes to get from you to the shipment destination. It's all part of the renewed focus on execution and efficiency, and, best of all, you can see at a glance which customers are making you the most money after variable costs.

The railroad is getting back on schedule, with NS posting sequentially improved dwells and transit times over the past four weeks. Moorman Yard (the former Bellevue) is now at 76 percent of potential and is on plan to make the goal of 80 percent by July 1. Both COO Mark Manion and McClellan told me that as dwell and speeds get back to where they belong, measurements become more meaningful and total integration of the short lines into the TOP trip planning mechanism becomes possible and essential.

That means running to plan within the ISA limits can no longer be local option, and short lines can use Blair Hanna's Short Line Dashboard to keep score. To reiterate a theme Rob Robinson has mentioned repeatedly, anecdotes don't cut it any more. If you have a gripe, provide date, time, individuals and variance to plan, document it, and we'll fix it. And gave examples.

The NS Shortline group realignment that adds regional NS shortline sales reps (Chad Grinnell in New England, Jennifer Cox in NYC, Denise Bailey in Phila, e.g.) eliminates the perceived conflict between NS Industrial Development reps and the short lines. Better communication and coordination between and among sales, marketing, and operations, is bound to pay dividends in dollars to the short lines' revenue streams.

Railway Age was in Chicago this week for its first-ever *Rail Insights* conference, structured as a series of conversations with industry leaders. No PowerPoints allowed; rather, magazine editors and contributors interviewed industry leaders individually and on panels. Topics ranged from capacity to crude oil, from the railroad/supplier relationship to the Wall Street perspective and from financing to short lines.

The format was unique, harking back to Louis Rukeyser's *Wall Street Week* TV show (1970-2002). For example, I hosted a panel of experienced shortline players to get their views on unappreciated risks, customer portfolio changes, misunderstandings about short lines, measuring profitability by customer, and advice to any would-be short line buyer. My panelists: Ed Ellis (Iowa Pacific), Marty Pohold (GWR Ohio Valley Region), Dennis Miller (Iowa Interstate) and Tom Hoback (Indiana Rail Road).

As to risks, all agree it's risky to pick up a for-sale property because right out of the box you have to fix whatever's behind the seller's reason for exiting. The customer challenge is managing the inevitable loss of some customers and finding better customers to replace them. The greatest misunderstanding about non-Class I roads is they are NOT all mom-and-pop streaks of rust in the sand and have revenue and capital requirements just like anybody else. Determining yield by customer is a bit more tricky, but a good place to start is RTMs by customer. Advice to would-be shortline owner? Bring money, lots of it. In short, what one heard from the panel one never would have gotten from any PPT slide set.

Other insights, sampled in no particular order…Getting the variability out of product delivery at CSX is important as it is at Coke and customer interface (train crew or Coke delivery truck driver) is crucial. (Oscar Munoz, President, CSX)… Having a shipper background is incredibly useful. (Deb Miller, STB Acting Chair)… Four decades of changing railroad approaches to capex, from survival (1970s) to significant (2000s). (Ron Batory, President, Conrail)… Chicago remains the Number One interchange point for Class I rails; not fixing it not an option. (Jason Kuehn, VP, Oliver Wyman Rail Practice)… Rail pricing gains will hold, especially on truck-competitive business. (Jason Seidl, Cowan & Co.)… Rethinking the merch carload network to serve regional needs. (Barbara Wilson, Managing Director, First Union Rail)

The Q&A was vibrant and varied. Railway Age provided a text message phone number for questions, enabling moderators to select questions to fit the conversational thread. Would that more conferences did as well in the dialog and insights department.