RAILROAD WEEK IN REVIEW

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“The trends that made 2015 difficult show few signs of abating in 2016.” — Jack Hellmann, President and CEO, Genesee & Wyoming

Genesee & Wyoming fourth quarter North American revenue units sank 15 percent year-over-year; same-store units are down 16 percent, the difference being in chems (same-store down, with totals up), lumber (ditto) and frac sand (same-store down more than the all-in number). Full-year vols are down eight percent — with key double-digit losses in metals, overhead/other, and coal. (By way of comparison, RailConnect’s full-year shortline vols across 421 names dropped seven percent. Big losers include coal, met ores, waste/scrap, and the metals group.)

GWR’s $226 million in North American fourth quarter freight revenue was off 13 percent, ex-coal 9 percent, though system RPU picked up 3 points. Chief Commercial Officer Mike Miller says they have “pricing freedom” on about 2/3 of vols, which suggests to me these vols exist on ISS roads, not allowance-based properties.

Jack Hellman: “Same-railroad revenues were down 11 percent, due primarily to a 37 percent decline in steam coal shipments and a 23 percent decline in steel shipments. However, our margin loss on same-railroad revenue was just 43 percent despite being high-margin traffic, thanks to cost-cutting efforts that help keep the operating ratio at 75.5 percent.” To which COO Dave Brown adds, “Seven percent of our loco fleet is stored and headcount is down five percent” as GWR trims assets in the field to meet lower transportation demand.

Lower fuel surcharge collections and adverse foreign exchange rates account for 44 percent of the quarterly NA revenue decrease, horribly skewing one’s perception of actual railroad performance. Absent these hits, NA revs would have been down only five percent, quite an accomplishment on 14 percent fewer units. And these artifices mask the admirable feat of the three percent core-pricing benefit.

North American total sales, including “freight-related” and “other,” were $299 million, down 12 percent, and represent 58 percent of the $515 million world-wide total — down from 81 percent of the total a year ago (yet NA still represents 80 percent of total ops income). NA ops income skidded 19 percent even though ops expense was 9 percent less than last year; the OR was 75.5, up 2.2 points YOY.

All-in — North America, UK/Europe, Australia — total Q4 sales increased 24 percent year-over-year; however, the 39 percent ops expense jump caused a 17 percent ops income drop and pushed the OR to 81.6, up nine points. Much of this can be laid at the feet of Freight Liner,

where this new property's safety and expense control records largely lag those of the corporate parent. Reported net was $85 million, off 3 percent.

Toward the end of the call, Cowen's Jason Seidl snuck in a question about acquisitions — certainly timely, given the infrastructure shrinkage programs underway at CSX and NS. Seidl: "Of potential acquisitions, you have Class I spinoffs, you have other short line holding companies, and then you have, let's call it, industrial conversions. Are there any of them that may look more probable? Or is it all sort of evenly dispersed?"

Hellmann: "The only thing that's different today in terms of those buckets is we haven't talked about any Class I spinoffs. I think in the current environment, given some of the dynamics within the Class I railroads and the fall-off in their volumes, you've probably got a slightly higher probability of some Class I opportunities entering the mix. But that's sort of a new ingredient, which is logical, given some of the challenges that we face with carloads, and which the Class Is have faced as well. So these are the times when historically the spinoffs have happened." I'd say GWR managed a decent pitcher of lemonade out of the carload of lemons issued.

GWR January carload numbers continue the downdraft, falling 17 percent. Every single commodity line making up the first 80 percent of total vols is down year-over-year.

• Coal & coke down 12,613 carloads, 41 percent, mostly in the Midwest, Ohio Valley, Central and Northeast regions.
• Minerals & stone down 3,261 carloads, 20 percent, mostly in the Northeast and Midwest regions.
• Metals traffic down 2,187 carloads, 17 percent, mostly in the Ohio Valley and Pacific regions.
• Agricultural products traffic down 1,746 carloads, nine percent, mostly in the Mountain West, Ohio Valley and Pacific regions, partially offset by gains in the G&W's Midwest and Coastal regions.
• All remaining traffic decreased by a net 4,992 carloads.

As Jack Hellmann said on the earnings call, "Two trends drive NA rail shipment weakness: the collapse in global commodity prices (e.g., iron ore, copper, manganese, crude oil) and the strong U.S. dollar impacting our industrial (e.g., steel) as well as agricultural products customers."

However, I'm sure we'll see easier comps later in the year. Coal is clearly the bull in the china shop. But it's not going away completely. Hellmann: "There hasn't been much that's gone away, per se. It's been more reduced volumes to plants that we think are going to be around for the long-term at some level.

"These may be better viewed long-term as peaking plants rather than base load plants, which has historically been their position. There are some smaller plants that kind of fade over the long-term, and which are not the big drivers here. It's just more reduced volumes to existing plants.

"The good news is that we don't think a lot of those plants are going to go away, period. The bad news is that the volumes are lower. And they seem like they're going to be more volatile going forward."

As for what's left, ag products fluctuate on the weather and the vagaries of global trade. Pulp & paper is a packaging story and it'll hold up as long as Amazon is shipping boxes. Aggregates are frac sand and construction which depend on the strength of the economy and the price of oil. Lumber is housing starts and truck-competitive performance and pricing.

As to this last, I think we need better Class I national account coverage of places like Home Depot, Lowe's, True Value, and 84 Lumber, together with more input from short lines as to what the local stores could do if only there were adequate rail service.

The Railway Industry Working Group is alive and well. They sat down together at CN's US HQ in Homewood, Illinois on Feb 5 to discuss, among other things, disposition of paper barrier waiver requests made by non-Class Is, Interline Service Agreement compliance, and interpretation of the Railway Industry Working Agreement itself. ASLRRA President Linda Darr and Keith Borman, ASLRRA VP and General Counsel, were in attendance.

By way of review, the RWIG members include representatives of short lines, regional rails, and switch carriers, plus Class I players. The group is chartered by the Railroad Industry Agreement to review issues of mutual interest that arise under the Agreement, and will meet again right after the April ASLRRA Annual Convention in the DC area.

A key item on the RWIG agenda is its study of the future availability of boxcars in the context of overall car supply within the industry. Having just written a longish piece on the boxcar situation for *TRAINS* magazine, still hearing a litany of complaints about empties going astray *en route* to customers, and seeing transit times in weeks for moves of less than 1,000 miles, I can confidently say Class I operating plan miscues seriously disrupt dependable car supply.

Variability in the portion of the route between the Class I and the shortline customer is one reason intermodal is winning over boxcar. When an intermodal box arrives at the terminal, any drayer can take it the last few miles. If drayer A is unavailable or unstable, there's always drayer B. Not so independent feeder rails. If the short line in the route is a now-and-then mom-and-pop streak of rust 10 miles long, where service is irregular and cars don't turn, you're stuck.

So as long as the item is on the RWIG agenda, they need to solve for accountability and operating-to-plan on the Class Is, and cycle times on the feeder lines. Or else the whole discussion about car supply will be a waste of time for everybody.

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