RAILROAD WEEK IN REVIEW

April 15, 2016

"Our prices are going to reflect what the market allows us to do." — Fredrik Eliasson, Chief Commercial Officer, CSX

"We are looking at technology to create and execute a plan that helps CSX thrive in a rail industry that is fundamentally changing." — Cindy Sanborn, Chief Operating Officer, CSX

The realities of railroading in a soft economy with low forward expectations came home to roost on the CSX call Wednesday morning. Total revenue was off 14 percent to $2.6 billion as revenue units sank 5.1 percent to 1.6 million — manifest carloads including automotive, down 2.6 percent; coal down 30.8 percent; intermodal up 3.5 percent — and RPU shrank 8.8 percent. Auto and intermodal were the only significant positive lines in the volume report, though minerals and waste are up a few thousand cars each. Fuel surcharge collections dropped 73 percent to $52 mm; revs ex-fuel surcharge came down 9.5 percent.

Operating expense came down 12.4 percent; all-in operating income dipped 16.5 percent to $704 mm. The OR gained nearly a point to 73.1. Loco fuel expense was down 44.4 percent thanks mainly to the 35.7 percent fuel price saving, as CSX burned 14.3 percent fewer gallons to run 9.6 percent fewer GTMs. RTMs dropped a whopping 13.1 percent on the 5.1 percent volume shrinkage, so you can see where the 8.8 percent RPU drop hit home. Net income declined 13.5 percent to $2.6 billion.

Drilling down to commodity lanes, agricultural products including fertilizers came down as we've expected. Straight chems held the course but petrol-related commodities headed south on the Brent-WTI oil-price spread, while metals dropped on steel imports and less drilling hurt pipe. No surprises on paper (no CSX comment on lumber) but C&D was up. Domestic intermodal was up 11 percent and international was down 7 percent; however, with domestic having a 62 percent share, total intermodal was up nearly 4 percent.

As for what's next, CFO Frank Lonegro says declines in coal, energy and metals volume are expected to more than offset modest growth in auto and minerals/aggregates, and STCC 28 chemicals. Intermodal goes sideways with international container volume losses offsetting domestic gains. All told, CSX expects second quarter volume to decline in the mid-to-high single digit range year-over-year, though comps get a little easier in Q4.

CSX rang up efficiency gains worth some $130 million from reducing employment numbers, running bigger trains (up16 percent to an average 6,400 feet), lengthening passing sidings Nashville-Cincy, closing now redundant coal-related facilities, consolidating a division headquarters and streamlining mechanical and operations support functions. The milder winter just passed also helped.

The full-year efficiency saving target is $250 million, so getting more than half way there in just one quarter deserves special recognition. Says COO Cindy Sanborn, “The efficiency-savings run rate going forward is $40-$50 million for each of the next three quarters, higher than our historical run rate (with the exception of 2015).”

Even though first quarter commercial results numbers are a sorry lot, at least we see significant gains in operating discipline. This creates a terrific opening for CSX feeder line connecting roads to lean on them to improve merch carload velocity by blocking to skip hump yards, letting you pre-block by destination and even — gasp — getting customers that originate loads to specific hi-vol destinations to release cars to those places by days of the week. I’m encouraged.

Genesee & Wyoming March carloads for North America dropped 8.3 percent year-over-year. The good news is that, among the commodities comprising 80 percent of total volume, coal has dropped to fourth place on 133,300 revenue units, from first place in March, 2011 when it was 19,816 out of 70,665 total loads. Five years ago metals, pulp & paper, minerals & stone ranked 2, 3, 4 — mostly low-rated — and chems was number 5 at 5,182 carloads, a third of what it is now. (And this is just STCC 28; the 13s and 29s are in petrol prods.)

Back out coal and overhead (NS coal, e.g.) and total vols are off 9.9 percent year-over-year. GWR says in its press release that metals were up in the south, no comment on other non-coal commodity changes. Year-to-date NA revenue units are off 9.3 percent, 383,192 vs. 422,713. Sequentially, March was up 6.2 percent from Feb, which was in turn roughly flat from Jan.

The oil patch has hit a rough spot despite the recent rally in WTI prices, and energy industry pundits expect little or no change to the 2016 energy and production (E&P) capex outlook. They cite three reasons: 1) most oil shale plays need WTI running more than $50 per barrel to generate attractive returns; 2) E&Ps need WTI to average about $49/Bbl for the rest of the year just to enable operating cash flow to match capex; and 3) in many instances any incremental cash flows from rising oil prices will first need to go toward debt reduction.

Those in the know are saying oil needs to be above $60 a barrel for producers’ net debt/cap to fall to more healthy levels. Given a lower than expected rig count, the now forecast 2016 US oil production level falls by 740 million barrels per day, vs the prior estimate of 625 million. Which in turn suggests rising prices could mean pumping resumes in places where cash demands were such that some strapped producers couldn’t pump *any* oil. Short lines working the oil fields are advised to know their E&P customer intimately and stay very nimble.

Meanwhile, several companies presenting at the recent Independent Petroleum Association of America conference seem to be “cautiously optimistic.” Representatives from Stifel Nicolaus & Co attended and report that, even though attendance was down more than 40 percent from last year, “Most companies believe they have assets that generate favorable returns at current strip prices. However, few, if any, of them are currently contemplating a boost to their 2016 budgets.”

On a related note, the *PFL Railcar Report* for April 12 confirms the market for tank cars “continues to be soft. With tank cars continuing to come off-line from manufacturers, the need simply is not there as more cars are being diverted to storage and turned back to leasing companies as their leases come due.”

PFL says it’s still a buyers market, but we may be approaching a bottom. “The problem is, as more cars are diverted to storage, the harder it is to get a transaction done. The lessor or sub-lessor is saddled with out-of-storage switching fees and an empty move, while the lessee is expecting low prices for shorter terms.” Here again, short lines storing cars need to keep their eyes on the market and be in position to cope with rapid changes.

Three weeks ago (WIR March 25) I wrote about the need to curb railroad transaction costs in terms of delay and simple ham-fistedness, citing Uber as an example of fixing both. Now comes Steve Sashihara from Princeton Consultants to hold forth on “Digital Disruption in Freight Transportation.” Specifically, he says there are five major categories of technology-based disruptors: self-driving/autonomous trucks, drones, the uberization [sic] of freight transportation, the internet of things, and big data.

Stifel Nicolaus transportation analyst John Larkin interviewed Sashihara, who says Uber in a very low-key way has created Uber Cargo as an experiment in Hong Kong. Right now, it’s just cargo vans and largely not too different from “I’ll pick you up,” but more of “I’ll pick you and your stuff up.” Sashihara continues,

> I think the Uber for freight transportation is about looking at the business model that the Uber company has turned on its head — the taxicab industry — and saying, “How can we take some of those lessons on for here?” If I’m a shipper, why do I have to look on my TMS system? Why shouldn’t there just be an app that lets us [buy and] track my own freight?

That day may be coming to a shipping dock near you. The Florida East Coast Railway is rolling out *FECR Connect - EZ Buy*, and I’m running some trials with it in my iPhone. I’ve seen the demo, and it lets the user pick an origin, a destination, and the desired pick up or delivery time. It’s an intermodal product, and FEC controls every aspect of the move. I like the select delivery time feature because it lets you as a vendor assure delivery at your customer as needed. Do stay tuned as I road-test *EZ Buy* further.