RAILROAD WEEK IN REVIEW

May 27, 2016

"If our RR is to grow, we must free ourselves from the habits of the past and find imaginative new ways of serving customers. - Charlie Bertrand, President, Reading Railroad, 1964

The railroad is a service business; the demand for transportation is a derived demand. - The American Railroad*, Gallamore and Meyer, 2014*

The BNSF stand-alone 10-Q tells us first quarter revenue of $4.6 billion decreased 15 percent on 2.3 million revenue units, down six percent, with revenue per unit off ten percent. Ex-fuel surcharge, itself down 74 percent to $124 million, total revenue was $4.5 billion, down ten percent.

The revenue-unit decline comes on several factors. Oil-related input and output, metals, and taconite helped take Industrial Products down; the Consumer Products group gained on auto, offset by disappointing intermodal results, in spite of easy comps from last year's port strike. In Ag Products, ethanol and beans were in the plus column. Coal vols dropped a third on a combination of high stock-plies, cheap nat gas, and no extreme weather events. RPU dipped thanks to the afore-mentioned lower fuel surcharges and mix.

Operating expense came down ten percent with the biggest deltas in payroll and fuel; operating income was $1.5 billion, down 24 percent from $2.0 billion, with 60 percent of the drop from lower fuel surcharge collections. The OR rose 386 basis points to 67.3; back out fuel surcharge from the revenue line and the OR came down a mere 44 basis points to a respectable 69.1. Net income (no share buy-backs here!!) slipped 24 percent, largely due to the $359 million fuel surcharge haircut.

The 10-Q is content-free when it comes to commodity-carload details. However, the AAR car-count for Week 13 (April 2), is a decent proxy. Merch carloads (ag and industrial) were off five percent to 699,000 units, with double-digit losses in met ores, metals, aggregates including frac sand, and petroleum products (mostly crude oil). Automotive including parts grew 20 percent, though I'm not banking on that being particularly sustainable, and it masks the seven percent drop in intermodal boxes, pulling consumer products volume up nine percent.

Providence & Worcester first quarter freight revenue was $6.6 million, down 2.7 percent, on 9,975 revenue units, down 12.1 percent. Total operating revenue (excluding rents, which I always put below the line) came in at $7.0 million, down 0.6 percent, the spread being additional fees for flagging and other services.

Operating expense increased 2.4 percent to $8.8 million. Payroll expense was up 2.7 percent or $110 million, now nearly 60 percent of operating revenues, an industry high, and up two percentage points vs a year ago. The operating ratio is a record 124.3, an increase of 360 basis points year-over-year. Below the line, P&W posted a common shareholder net loss of $999,000, 21 cents a share, a 19 percent bigger hole than last year. As a result, cash from operations was cut in half to $345,000 — hardly enough to sustain the quarter's $822,000 capex commitment. Free cash flow before dividends was minus $477,000 vs. a positive $459,000 a year ago. (Perhaps that's partly why retained earnings are down $1.2 million, 3.0 percent, since December 31.)

The Charlie Betrand quote comes from the Summer 2016 *Classic Trains* magazine feature on Conrail and its predecessors. The section on the Reading, "Bee-Line for Profit," tells how Bertrand enabled the railroad to run small, dedicated unit trains to capitalize on Reading's predominantly short-haul business in a market dominated by trucks.

> Within two hours notice from a shipper, the Reading would dispatch a three-man crew to the shipper's siding to pick up from 5 to 20 cars, which were then delivered directly to the receiver's siding. The one crew would do the switching at both ends and en route, and would go right through terminals where seniority rules ordinarily would require a crew change. If possible, the crew would make the return trip with the train [as part of the same crew-start].

Benefits abounded. Since trains were limited to one set-out or pick-up in each direction, the brotherhoods bought in to the innovation because it was new business and new jobs. Crews came off the extra lists and usually got back to their own beds at the end of the work day. Bee-Line service matched or beat total-tonnage truck times for a wide variety of commodities from aggregates and chocolate to spaghetti and steel.

Bee-Line began regular service in January, 1967, getting cars six turns a week, a vast improvement on the then-avenge 18 trips a year, and ran for nearly 10 years before the malaise affecting all the northeastern rails caught up with them. But let's fast-forward 50 years, apply the same ideas, and see what works.

I can see short lines originating short-haul moves of 50-100 miles and terminating them either on their own iron or on neighboring short lines, as in the North Shore-GWR limestone move in central Pennsylvania, or the Pan Am Southern bottled water move in New England. There are places short lines could build intermodal trains for other short lines to terminate, using Class Is as overhead carriers. Blocking for the distant node, by-passing hump yards, can accomplish pretty much the same thing. All it takes is following Bertrand's advice. Free ourselves from the habits of the past and find imaginative new ways of serving customers.