RAILROAD WEEK IN REVIEW

September 9, 2016

"A hedge fund manager's biggest challenge is monetizing the best ideas." — Hugh Hendry, Founder & CEO, Eclectica Asset Management, on realvisiontv.com, Sep 2, 2016

"A stock's value is generally dependent on investors' collective perceptions of the future; high-yield bonds have certain dates in the future when they mature." — Connie Bruck, The Predator's Ball*, page 28*

Running a railroad is not unlike running a hedge fund. You have a diversified portfolio of assets (the customer book plus property, plant, and equipment — PPE) and your goal is to generate the best possible return from — monetize — your ideas for using these assets. The equity portion of your portfolio is the customer book: it's worth whatever the customers are willing to pay for your services at the moment. The fixed income portion of your portfolio is in PPE: you know pretty much how much each asset is capable of returning.

Monetizing your best ideas is one thing in good times. It's something else when customers are having their own troubles and you have to go looking for solutions. BNSF, for example, is rolling out a new Portland-Seattle-Denver-Fort Worth intermodal service that will will cut transit times by two days vs. what's now available, and will be comparable in speed to single-driver, over-the-road options.

The key is competitive advantage. Timed to begin in two weeks, the new service targets the southbound fresh produce market out of the PNW. BNSF "monetizes the idea" to tap PNW perishables flows to the southwest by routing boxes over a route that has the capacity and can generate the required returns.

The route uses the former NP route (now Montana RailLink) east of Spokane to Billings, where there is less traffic density than the ex-GN route across the northern tier. From there, it's straight south through the coal fields (talk about re-purposing an asset!) through Cheyenne to Denver, thence south on the Santa Fe through Pueblo, crossing the Transcon at Amarillo, and into the Alliance intermodal terminal north of Fort Worth. From there it's a short highway hop to key markets.

Trains will originate at both ends Mon-Fri and are scheduled for fifth morning arrivals southbound and sixth morning arrivals northbound. Refueling of mechanical reefers mid-route is part of the deal. And if BNSF can do this with reefer containers, they surely can do it with carloads in the Railex mode. All you need is a place to load and a place to unload. And, as in the intermodal model, from there it's a short highway hop to key markets.

BNSF has completed double tracking the three-mile transcon segment that crosses the Pecos River on a 500-foot bridge near Fort Sumner, N.M., roughly MP 718 (Clovis is 655), and at the beginning of a 80-mile upgrade to Carnero — not a place you want to start a westbound train train like this from a dead stop. The original single-track bridge is on the right and US Route 60 is out of the frame to the right. When I was last there a few years ago, trains were stacked up three-deep on either side waiting to fleet across.

No voids in this train! Photo courtesy BNSF Railway

Now, with the second bridge, only four miles of single track remain on the 2,200-mile Southern Transcontinental corridor that runs from Los Angeles to Chicago. The bridge was completed earlier this year and the track was finished this summer. The remaining four miles that have yet to be double-tracked will require two bridges to be constructed at the Salt Fork River on Oklahoma's Panhandle sub and at the Missouri River on the Marceline Sub in Missouri.

The Pecos River bridge project is part of BNSF's $100-million New Mexico capital plan for 2016. Once again, somebody's "best idea" was to build a second bridge at some remove from the first to increase the investment return on the ex-Santa Fe transcon. Four miles to go. Wow.

Larry Gross, a good friend who makes his living measuring railroad performance, picked up on my ratio of 1.7 intermodal units per carload (WIR 9/2). He agrees with that number, but adds that he's looked at the box/carload ratio in terms of actual revenue using AAR data:

U.S. 2015 rail freight revenue: $69 billion
U.S. 2015 intermodal volume: 13.7 million containers and trailers
U.S. 2015 intermodal revenue share of total freight revenue 23%
Rough estimate for intermodal revenue per unit: $1,157
U.S. 2015 carloads excluding intermodal revenue units: 14.3 million
U.S. 2015 carload revenue share: 77% (100% less 23%)
Rough estimate for revenue per carload: $3,724

Revenue per intermodal unit averaged 31 percent of revenue per carload. One carload equals 3.23 intermodal units in terms of revenue. He concludes, "Talking about the change in the total of carloads and intermodal units is as bogus as a grocery store counting the number of apples and individual grapes sold and then combining those two figures to determine what's happening to fruit sales."

Set in those terms, the AAR's first-half intermodal count of 6.7 million units becomes the equivalent of 2.1 million carloads. Total carloads including coal and auto came to 6.3 million units. So, in revenue terms, the single carload generates three times the cash of the intermodal carload-equivalent. Ought to be good news for short lines.

On Sep 20 at 1300 the ASLRRA begins a series of financial webinars designed to provide a basic understanding of financial statements and techniques for extracting key operational and financial data therefrom. First up is *Understanding Financials for the Non-financial Railroader*, hosted by CPA Joe Mocciaro of Bowers & Co, the premier shortline accounting firm.

Joe will review the financial statements that are commonly used in business, and define essential terms to aid in understanding of individual line items. He will review balance sheets, income statements and cashflow reports, how these three documents interact and support each other, and why they are critical to understanding the overall financial strength of any company. The webinar is $25 for ASLRRA Members and $49 for Non-Members.

Regarding the program, Jim Bowers tells me knowing the numbers is the only way to run a short line right. As it happens, says Bowers, "Few shortline managers started their railroad careers in the accounting department of a Class 1. Marketing or Operations was their forte. This webinar is extremely important as it will take the mystery out of any railroad's financial statements."

As one who's followed financials for short lines and Class Is for years, I can only add that understanding the financials of your connecting Class Is will make you a better partner, too.

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