RAILROAD WEEK IN REVIEW
October 28, 2016

"Like Rhett Butler, I have no interest in fighting a war without a cannon factory." -- Ben Hunt, "Anthem," Oct 14, 2016

The BNSF held its Shortline Annual Conference once again at the Worthington Renaissance hotel in downtown Fort Worth October 19-20. Nearly 300 souls took part, split roughly two to one among shortline reps and BNSF staffers. Dean Wise, VP Network Strategy, said in his opening remarks that the BNSF family of some 200 short lines, regional railroads, and switch carriers touches about 1.2 million revenue units a year.

New business is the lifeblood of any industry. As a rule you an count on losing ten percent of your customers a year, and, if you don't replace them you're out of business in ten years. In the first nine months of 2016, BNSF and its non-Class I railroad connections identified more than a thousand potential new traffic lanes of some 175,000 revenue units (more than ten percent on short lines) and have closed on nearly half.

Commodity-wise, short lines rank highest in ag products from whole grains to ethanol, building products from lumber to cement, industrial products from metals to minerals, and petrochemicals from asphalt to LPG. Thus it was appropriate to begin the conference Wednesday afternoon with hour-long commodity breakout sessions where shortline reps could meet, hear, and question commodity managers.

It was on Thursday morning we heard from Carl Ice, BNSF President and CEO, who gave his usual stand-up, notes-free, Q&A-friendly briefing about the safety culture, why PTC is the right thing to do, the capex program, and the cumulative impacts of increased regulation. Roger Nober, Chief Legal Officer, fleshed out more of the regulatory themes, and Mike Smythers, AVP for Federal Government Affairs, offered some views on the upcoming elections.

Dave Garin, Group VP for Industrial Products, and Chief Commercial Officer Steve Bobb did a back-and-forth conversation on where the traffic is and isn't, how BNSF is coping with the changes wrought by low coal and high grain loadings, and how everything from the price of oil to Texas housing starts affect carload density. Matt Igoe, VP Service Design, showed how service design, capex repair/replace, and railroad capacity are all connected. Finally, he touched on steps short lines can take to improve equipment turn times.

In short, there was something for everybody and if you didn't get your questions answered it may be because you didn't ask. I've been going to this session for some 20 years (about as long as Garin's been running the IP desk), and every year seems to have more than the previous year's session. The 2017 edition is in the same place, at the same time. Hope to see you there.

Canadian National President and CEO Luc Jobin opened Tuesday's call saying. “We overcame a weak macro environment with solid bottom-line performance.” Truly. Even though Q3 revenue slipped six percent to C$3.0 billion, RTMs came off only three percent, operating expense dropped seven percent, and the resultant 53.3 OR was a quarterly record.

Revenue units were off four percent. Coal skidded 21 percent and intermodal lost five percent. The manifest carload sector including auto lost a little more than a point, continuing the pattern seen elsewhere: carload freight losses are less than the system average, making up for larger losses elsewhere. Grains and fertilizers — 11 percent of the CN franchise — gained five points; automotive — five percent of total vols — was up eight percent.

The forest products category, both wood and paper, is another eight percent of the franchise and slipped but two points.The petroleum/chemicals group, 11 percent of total units, dropped seven percent, mostly on crude oil out of the Alberta oil sands area. Revenue units for CN’s largest single carload commodity group, metals & minerals, were off just four percent, thanks in part to a frac sand recovery — up a third from the Q2 trough.

Once again, CN sees operating improvement where it counts for adding value to the supply chain, a constant refrain at CN. The railroad posted handsome train and yard productivity gains, improved car and train miles per day, and generated more trailing tons per available horsepower. Fuel burn dropped five percent on four percent fewer GTMs, and a point better GTMs/gallon -- beating out CP for the gallons/KGTM prize: 0.89 vs. 0.93.

Net income was C$972 million, off three percent; diluted EPS was C$1.25, off less than half a point due to the three percent drop in share count. Year-to-date free cash flow, after capex and dividends, was C$923 million, down 11 percent but still a healthy positive number. Like Max Bialystok says, you can’t produce plays without cash. Neither can you run a railroad. Nice to see CN has lots.

Norfolk Southern rounded out the Class I Q3 calls on Wednesday, the only Class I with no appreciable ops income decrease. All others are down five percent or more. Total revenue, $2.5 billion, dipped seven percent year-over-year on four percent fewer revenue units. Operating expense came down fully ten points, taking the OR to 67.5, down 220 basis points. Operating income, $820 million was, as a result, essentially unchanged from a year ago.

Below the line, net income gained two points to $460 million. Year-to-date net income was $1.3 billion, generating $2.3 billion cash from operations, 185 percent of net (always a good sign), leaving a cool $billion free cash flow after capex, 18 percent of revs. CFO Marta Stewart pegs FY 2016 capex at $1.9 billion.

Merch carloads were off four percent. Chems took the biggest hit, down 13 percent, though, absent the 30,000 car decline in crude oil, straight STCC 28 Chems were off one percent. The ag/consumer/government commodity group came down four percent mainly on ag shortfalls in feed grains, wheat and corn. Forest products lost carloads to the trucks while the metals/construction category ticked up two points on steel and aggregates. Carloads of coal took another 15 percent slippage on lower utility and export tonnage.

Auto carloads were down three percent. On the call Chief Commercial Officer Alan Shaw explained that production declines were a contributing factor (something Stefanie Pomboy warned about months ago). Intermodal posted a six percent volume drop, though, excluding Triple Crown boxes, actually gained five percent. Shaw showed how the improved service product produced an eight percent domestic box-count gain; international scored a mere point gain due to strong year-over-year comps. The Q4 outlook is for more of the same.

Doing more with less is a key ingredient. The 2016 productivity savings target is now $250 million, up from $200 million, and NS has already exceeded its goal of rationalizing 1,000 miles of secondary track. Whereas GTMs were off five percent, crew-starts dropped seven percent, train length grew three percent, re-crews came down 24 percent and yard dwells improved three percent. Total railroad employees now number fewer than 28,000, down eight percent.

During the Q&A, CEO Jim Squires said, “The shortline strategy is about putting the right player on the field for the business and providing the best service provider we can for the customer.” How refreshing. Here we have the CEO of a major class I saying we can't be all things to all people, and where somebody else can do better, we’re inclined to let them.

One final note: Revenue ex-fuel surcharges (FSC) was off five and a half points vs. the reported seven percent, and it’s useful to see how FSC is spread among the three main commodity groups. Ten percent of Q3 intermodal revenue is FSC, vs. a quarter of a point in then merchandise carload group and two percent in coal. This pleases me. We can tell shortline carload customers that the rate you see is pretty much what you get, never mind FSC. Can their truckers say as much?

Norfolk Southern will lease 162 miles of its Delmarva secondary line in Delaware and Maryland to short line operator Carload Express. The new railroad, the Delmarva Central, will be the fourth Carload Express short line, and doubles the mileage under the company's control. NS says Carload got the nod because of its proven ability to bring back volumes to under-performing line segments.

Carload Express, based in Pittsburgh, operates three lines in Pennsylvania and Ohio: the Allegheny Valley, 77 miles on three lines that radiate from Pittsburgh; the Southwestern Pennsylvania Railroad, 66 miles from Greensburg to Smithfield, Pa.; and the Ohio Terminal, 13 miles in Monroe County, Ohio.

The new railroad comprises two segments of the former Pennsylvania Railroad on the Delmarva Peninsula. The main track runs from Porter, Del., to Pocomoke City, Md. At Harrington, Del., a second line extends east and south to a coal-fired power plant near Dagsboro and a feed mill at Frankford, Del. STB approval is expected next month.

RailTrends returns to the W Hotel on Lexington Ave in NYC Nov 17-18. Thursday's session kicks off with a broad-based State of the Industry panel discussion including AAR's Ed Hamberger, ASLRRA's Linda Bauer Darr, RAC's Michael Bourque, NRC's Chuck Baker, IANA's Joni Casey, and Tom Simpson of the RSI. Oliver Wyman Partner Rod Case presents the case for Digital Transformation in Surface Transport, and we hear from GWR and KCS on plans, procedures, and outlook. And that's just the morning.

The afternoon features CSX, Union Pacific, the STB, the Wall Street view, and the Conrail Shared Asset story from its CEO, Ron Batory. Friday we hear from the FRA, Watco, the FEC, and CN's President Emeritus Claude Mongeau, the 2016 Rail Innovator Award recipient. The event is still three weeks away, and there will be program tweaks I am sure. Stay tuned.