# RAILROAD WEEK IN REVIEW

## August 10, 2018

*"It is easier for chief executives with a shelf life of three years to try to please investors by jacking up short-term share prices than to invest in things that will grow a company over the long haul." — Danielle DiMartino Booth, Fed Up.*

*"You can observe a lot by just watching." — attributed to Yogi Berra*

**BNSF reported Q2 revenues of $5.69 billion** on units up five percent, largely from merchandise carloads (industrial plus ag products).[1] Merchandise revenues increased 14 percent, powered by a 16 percent gain in the industrial side. "Consumer" (auto plus intermodal) units were up five percent and posted revenues up 14 percent. Coal, alas, dropped 60 basis points in volume, posting essentially flat revenues. Of the 17 merch and auto commodity groups reported, 15 posted gains — miscellaneous ag products and "other" were the only downs.

Operating expense climbed 15 percent, most of which came from the 44 percent jump in fuel expense. Operating income was $1.9 billion, up six percent, and the OR came in at 68.0, 180 basis points ahead of last year. Net income before the tax break was $1.7 billion, up eight percent. Free cash flow after capex including equipment was $2.5 billion, a gain of 23 percent. Capex was 11 percent of revenues, down from 14 percent a year ago.

As noted in the footnote, BNSF doesn't get very granular about the quarterly numbers; however, I think giving good color on the YTD results paints an excellent picture of the railroad's overall health. Our business is a continuous flow of goods, with a broad selection of commodities insulating the business from the degree of cyclicality seen elsewhere. I'm encouraged by the freight traffic trends because they bode well for the carload-based short lines and regionals.

Six month total revenue increased ten percent to $11.5 billion, though without the 60 percent jump in fuels surcharges, the total would have been up eight percent. Industrial Products volumes increased primarily due to strength in the energy and industrial sectors, which drove demand for sand, petroleum products, taconite, steel, and plastics. Agricultural Products volumes increased due to strong export and domestic grain shipments, as well as higher fertilizer and other grain products volumes.

---

[1] BNSF doesn't report quarterly revenue units in its 10-Q; These numbers are from the Week 26 volume report to the STB. Dividing these rev units into the reported revenues produces RPUs that are generally in-line. Therefor I take this liberty. All other Q numbers and the YTD results are from the 10-Q.

Consumer Products volumes increased due to higher intermodal volumes, which were driven by economic growth and tight truck capacity leading to conversion from highway to rail, as well as strength in imports and containerized agricultural product exports. Coal volumes dropped thanks to plant retirements partially offset by market share gains and improved export volumes.

That BNSF doesn't have to play the Way Street sell-side game allows then to focus on the customer and cash flow. To me, commercial success from a shortline viewpoint depends on five things: total revenue, revenue units, system RPU, merch carloads, and merchandise revenue. BNSF gets the gold star in four out of five, taking second place to NS in percentage total revenue unit growth.

With no single carload commodity group dominating (grain is #1 at six percent, followed by STCC 28 chems at four percent), BNSF clearly wants to generate revenue wherever it can make customers happy and make money in the bargain. Uncle Warren must be pleased.

**CSX carloads have stagnated** at 2017 levels. The AAR Week 31 tallies on csx.com show YTD loads virtually unchanged. Granted, the non-metallic minerals 30,000 car drop is due to a phosphate plant closure (WIR July 20). Coal gains make up 2/3 of the ferts loss YTD, but I see the strong export coal trade as mainly short term.

As I make my rounds visiting short lines and watching Class I mixed freights, I'm struck by the fact that boxcars are shrinking as a portion of the total consist. Moreover, the strongest short lines are the ones with the fewest boxcar commodities, and given the present mix,  CSX ought to be able to support this trend easily.

Boxcar commodities made up less than ten percent of CSX second quarter carloads with something like 150,000 loads. My short line hosts say CSX service between terminals is much improved and that cars are spinning faster to/from the customer. (Except where they're not. I know one customer who could easily add 1,000 cars to his annual rail usage if local turns were better.) But the fact remains that faster turns on leased equipment, the lower the number of cars needed to run the supply chain, and the lower the per-ton lease cost of the tonnage moved.

Elsewhere, CSX has reorganized its operating leadership under COO Ed Harris. Bob Frulla becomes Senior Vice President, Operations East, and Jermaine Swafford is now his western counterpart. Jamie Boychuk assumes the role of  Senior Vice President, Network Operations., and Amy Rice is the new Vice President, Intermodal Operations

Ostensibly the changes are meant to "push decision-making closer to the day-to-day field operations and eliminate bureaucracy and long-standing silos." The idea is to create "an East and West structure with leaders responsible for all three major operations functions including transportation, mechanical and engineering."

Makes sense, but it will take strong leadership to overcome the embedded hierarchy that has traditionally stood between CSX running a sharp railroad and business as usual. Frulla and Swanford get the East and West ops gigs. Frulla has been in CSX ops for 28 years. Swafford has likewise come up thru CSX ops having signed on as assistant TM in 1998.

Boychuk came to CSX from CN as a Hunter protege, so his CSX experience is minimal. Let's see what he brings with his 20 years at CN. Rice has served mainly in admin/finance support since joining CSX in 2011; she most recently -- and I believe briefly -- was VP Strat Planning where the line-sale program was under her. (So far there has been no movement on that one.)

As it happens, this week also marked some serious changes in the way CSX and UP do business in the intermodal arena. A press release from the latter tells us that, due to CSX interline intermodal service changes, "Union Pacific is no longer able to offer a number of interline intermodal services to the eastern U.S."

UP then provides a 314-line matrix showing original OD pairs, the interchange points, and the new CSX destination terminals. We see, for example, 12 western origins with Baltimore destinations. As a result of the change, six pairs will lose interline service and all of the remaining pairs will go to Chambersburg, not Baltimore. Buffalo loses interline service completely. As a consolation prize, UP provides for an alternative NS Harrisburg service or for a UP-Chicago local pickup option. Both will add to inconvenience and higher drayage costs.

UP says the current plan remains in effect until midnight September 16, after which the new matrix OD pairs will apply. This puts UP in an awkward spot, having to acknowledge that these service changes can be "inconvenient and untimely."

To which a seasoned intermodal operator comments, "Frustrated shippers can't/don't see or understand why the deck chairs are now being rearranged [referring to the above changes]. My guess is that shippers themselves will feel prompted to look for ways to rearrange the deck chairs to their own liking.  And that likely will be done at the expense of the railroads."