RAILROAD WEEK IN REVIEW

November 9, 2018

"According to data compiled by Yardeni Research, the S&P 500 has been up in the 12 months following every midterm election since the middle of the last century, with gains from 1.1% in the post-1986 vote stretch (which included the Oct. 19, 1987, crash) to 33.2% in the year after the 1954 election." — Barron's November 2

BNSF Q3 freight revenue increased 14.8 percent to $5.8 billion; total revenue including logistics services and other increased 15.8 percent to $6.1 billion. Operating expense increased 19.7 percent to $4.0 billion, so ops income increased 8.7 percent to $2.1 billion. Below the line, net income was up 33.7 percent to $1.4 billion. Year-to-date cash from operations increased 24.6 percent to $5.9 billion, capex dropped 9.7 percent to $2.2 billion -- 12.2 percent of revs, down from 15.2 percent of revenue a year ago.

Industrial Products revenue for the Q was $1.6 billion, up 24 percent on 13 percent more revenue carloads plus higher RPU, with greater demand for petroleum products, rocks, steel, plastics, sand, and taconite. Ag products revenue was $1.2 billion, up 17 percent on a 16 percent increase in volumes and higher RPU. Grain (both export and domestic), fertilizers, and grain mill commodities contributed. Thus the combined merch carload sector brought in $2.7 billion, up 21 percent. Based on AAR carload reports, I'd say the carload sector car-count was up 11 percent.

Coal revenue increased six percent to a $billion even, reflecting higher RPU, though carloads drifted south by five percent in the Q. Blame plant retirements and nat gas/renewables completion, partially offset by market-share gains and a bump in export carloads.The Consumer Products commodity group combines intermodal and auto. Revenue was $2.0 billion, up 12 percent, thanks to higher RPU and smallish volume increases.

Compared to year-to-date results for its Class I railroad peers, BNSF scored the only double-digit revenue increase, beat out second place NS by 10 basis points in percent volume gained, and has the only double-digit gains in merch carload revs and units. The OR remains highest of it's peers, 67.5 -- a 110 basis improvement -- against the second highest, NS at 66.4.

Though BNSF doesn't do quarterly revenue units, you can use the Week 39 AAR carload report to see the carload trends by commodity. BNSF reports 18 merch carload commodity breaks and posted gains in all but one -- farm products, whose 19,000 carloads represent barely a rounding error on the eight million loads reported to the AAR. Grain and chems are BNSF's largest single carload groups at six percent and five percent respectively. Petrol products and aggregates tie for third at four percent each.

My take-away is BNSF is building revenue first and tending to ops expense second. That's why they have the best volume gains and fare not as well in the OR dept. After all, this is a service business that exists to create new customers and build results for the existing book. Eight million revenue units over 39 weeks, up five percent, prove their approach works.

Postscript: BNSF contributed $6 billion in Q3 revenue to the Berkshire coffers. That's about ten percent of the total — three times the Financial Products operation, roughly equals the Utilities and Energy revenue stream, and is slightly more than half the Insurance business total sales.

Norfolk Southern has tapped Mike Farrell SVP Transportation, effective now. Based in Atlanta, he reports to COO Mike Wheeler and will be in charge of all transportation operations, division mechanical, and rail terminal management functions. For more than a year, Farrell has served as the NS lead consultant for their "Clean Sheeting" initiative (WIR Oct 26) to redesign local operations without preconceptions – starting in terminals and local serving yards where cars accumulate – to increase network velocity and generate efficiencies.

Prior to joining Norfolk Southern, Farrell ran CP's US operations west of the Mississippi, and before that the US ops center in Minneapolis. He had moved to CP from CN, where he ran the latter's Chicago terminal operations. His railroad career began in 1990 at the UP.

I think this is the right hire at the right time as terminal operations has never been a strong NS suit, and not running terminals to plan plays havoc with customer supply chains —- not to mention shortline ISAs. As a result, NS is in no way ready to practice even the basic tenets of PSR. So Farrell's having gone up the PSR learning curve at CN and CP will serve NS well.

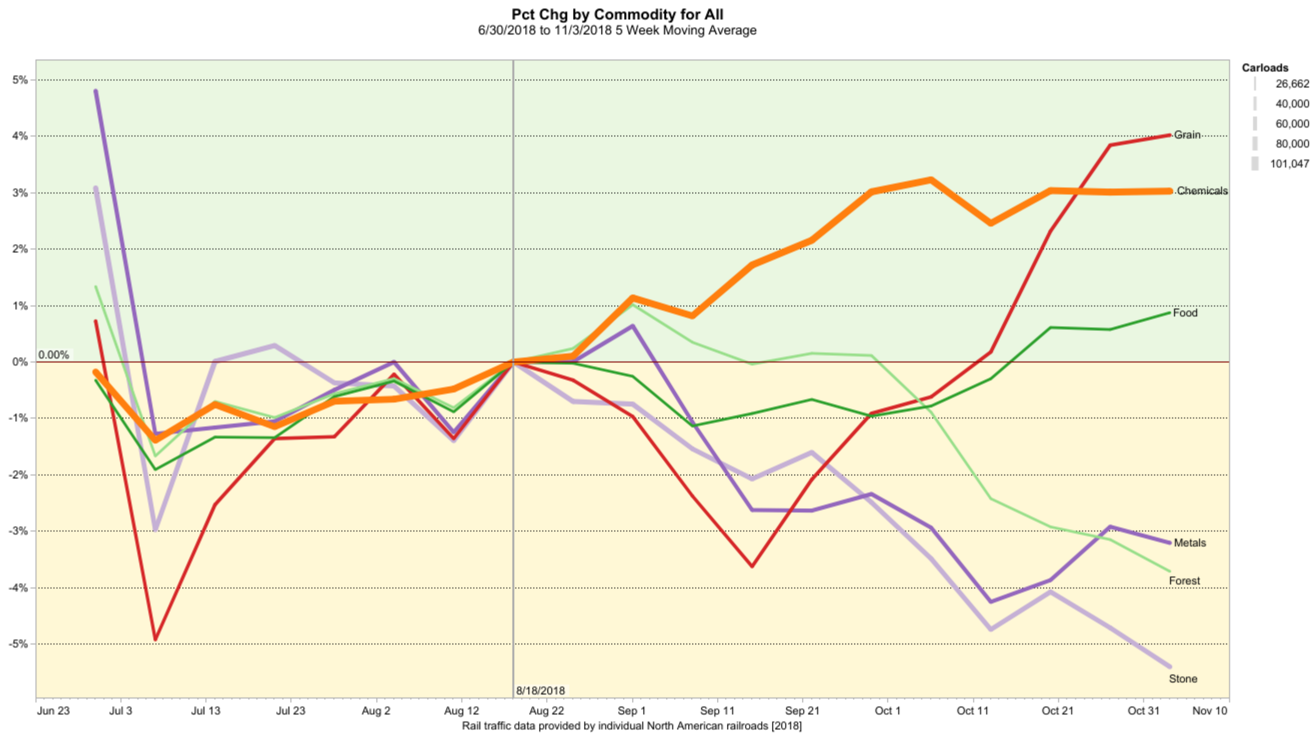
Genesee & Wyoming presented at the Stephens Fall Investment Conference in NY this week. After laying out the usual who-we-are stuff, GWR provided an excellent overview of how it has grown through acquisitions and investments. Starting on page 11 of their slide deck, GWR walks the reader through five sources of acquisitions, why the acquisitions work, and how, for example, the recent Providence & Worcester acquisition ties together GWR's southern New England operations.

It is refreshing to see how the GWR capital program makes no distinction between acquisition and organic investment. In North America alone, it's easy to see how GWR can take a property with potential, fix the infrastructure to support existing operations, win back customers, and make further infrastructure (organic) investments to build further on the organic customer base. One of the best examples is the Rapid City, Pierre & Eastern in South Dakota.

Originally built by the CNW 150 years ago, it was divested to the DM&E in 1986 and spun to CP in 2007. That lasted until 2012 when CP sold the western 660 miles to GWR. Thus the RCP&E was born, with (as I wrote in my *Trains* feature on the road) "GWR vowing to maintain the capital upgrades CP had put in place and to build the local freight business."

At the outset, GWR upgraded the power and added cars to the grain fleet to give customers greater reliability and breathing room for the 52,000-car base load of traffic. Today, the RCP&E runs nearly 70,000 annual carloads of grain, grain mill products, ethanol, fertilizer, cement and bentonite clay on 739 route-miles, mostly 286. This is how you employ capital according to the needs, not according to what bucket it goes in. Do look at the slides.

From Drew Robertson's Railfax report showing commodity trends against each other:



I've omitted auto, intermodal, and coal as they are less germane to the shortline scene. The jump in grain is notable if only because farmers are trying to sell off stocks before the Trump bean tariffs kick in. The spike in chemicals is partly due to an uptick in crude oil shipments, though the shift in frac sand sourcing has hurt the stone category.

Your mileage may vary, but be sure to check your trends against these.