RAILROAD WEEK IN REVIEW

February 8, 2019

"North America represents 80% of our operating income. We had uniform strength in our carloads with key drivers including coal, metals and petroleum products."— Jack Hellmann, President, GWR, February 6 earnings call

"In January 2019, 11 of the 20 carload commodity categories tracked by the AAR each month saw carload gains compared with January 2018. These included: petroleum & petroleum products, chemicals, primary metal products. Commodities that saw declines in January 2019 from January 2018 included crushed stone/sand & gravel, coke, motor vehicles & parts." — AAR Feb 6.

Genesee & Wyoming adjusted Q4 net income was $55.6 million, up 14.3%, on consolidated revenues of $575.6 million, up 70 basis points, with an 81.6 consolidated OR, up 20 basis points. For the full year, North America contributed 57.9% of revenues on 52.8% of operating expense, and 81.0% of consolidated operating income, up from 77.6% a year ago. And North America is by far the largest contributor at 74% of consolidated EBITDA.

Total Revenues in North America (common carrier freight, contract operations, other) increased 5.6% to 338.0 million; freight sales alone increased 7.1% to $258.8 million. Merchandise carload revenue including auto gained 6.5% to $237.2 million. The North American core price increase in the fourth quarter was around three percent, reduced to the reported 1.2% thanks to mix changes and a weaker Canadian dollar.

Same railroad North American traffic for the fourth quarter increased 6.5% year-over-year, with strength across most commodity groups, the largest of which were in coal, metal and petroleum products. North American operating expenses were held to a 2.2% gain, propelling a 16.7% gain in operating income with an OR of 74.2, a slip of 247 basis points.

The 2019 outlook for North America calls for railroad revenue growth of approximately three percent, driven by two percent volume growth, with the weaker Canadian dollar and the projected mix of business slowing the overall growth rate. Core consumer and industrial traffic, which represents 60% of NA carloads, are expected each to grow by four percent, with uniform increases across most commodity groups.

GWR's various technology initiatives will continue in 2019. The mobile tracking and railcar visibility app has cut avoidable cost by seven percent at just one customer facility and will be rolled out to four more sites this year. Operational dashboards are in place on 110 short lines to enhance local decision-making and unlock daily efficiencies — how many cars are on the property, where are they, and what's the next move.

AAR revenue units were up a mere 1.2% through Week 5 (February 2). Intermodal was unchanged, auto was off five points, and coal was up a point. But — surprise — merch carloads gained 3.3%. In its press release the AAR says,

> 11 of the 20 AAR carload commodity categories saw gains compared with January 2018. These included: petroleum & petroleum products, up 23.9 %; chemicals, up 2.5 %; and primary metal products, up 7.2 %. Commodities that saw declines in January 2019 from January 2018 included crushed stone, sand & gravel, down 2.2 %; coke, down 9.9 %; and motor vehicles & parts, down 2.7 %.

Putting all that in context for non-Class I carriers, merch carloads posted greater gains than coal, auto, or intermodal:

AAR NA Class Is	2019	2018	Change	Pct Tot
Total Carloads	1,730,510	1,692,439	2.2%	100.00%
Intermodal	1,717,190	1,715,473	0.1%	49.81%
Total Rev Units	3,447,700	3,407,912	1.2%	
Auto	113,164	118,370	(4.6%)	6.54%
Coal	445,964	440,612	1.2%	25.77%
Merch Carloads	1,171,382	1,133,457	3.3%	33.98%
Source: AAR thru Feb 2				

That said, Week 5 by itself has total vols down 9.2%. Every commodity line but Chemicals, Petroleum and Other is running red. I suspect a major factor is the ISM Manufacturing Index falling lower, dropping 1.3%, as new orders dropped 5.0%. And, in the latest nod to deteriorating global activity, export orders fell nine points to 50.5, marking the largest sequential decline and lowest level in two years.

With over half of S&P 500 constituent companies having reported earnings thus far, there has been no change in the deceleration trend. Aggregate Q4 year-over-year sales and earnings growth rates are tracking up seven and 14 percent year-over-year respectively, and up 8.1% and 24.2% respectively in the prior quarter.

Negative revision trends continue to characterize the forward outlook with 1Q19 EPS growth estimates now negative 90 bips year-over-year. It is logical to expect that trend to extend as we traverse the back side of the domestic growth curve [observations courtesy of hedgeye.com this week]. My take is that inventory bins are full because production is slowing on weaker demand, so there's less need to move stuff from here to there. Ergo AAR numbers are down.

Anacostia Rail Holdings and Global Information Systems co-hosted the second "Short Line Railroads - GIS Opportunities Workshop" in Overland Park, Kansas, Jan 30. The event, held at the National Academy of Railroad Sciences (NARS) facility, seeks to define the means for short lines to capitalize on new info-based techniques now in use in many industries.

This is the second such workshop, following the success of an initial workshop co-hosted by Watco Companies and Global Information Systems LLC in January 2018. This year Anacostia Rail Holdings and Global are co-hosting the two-day workshop with the main goal of having railroad people talking to railroad people.

In addition to Anacostia, several other short line railroads agreed to present their current and planned GIS applications on their properties. These range in scope from emergency response to real estate management to enterprise GIS. Railroads actively involved in GIS and those considering GIS initiatives were encouraged to attend.

OmniTRAX, for example, ran three sessions: *GIS User Group Developments* with Tim Harrington; *OPEN for business - Using GIS to Grow and Manage Holding Companies* with Tim Harrington, Kelle Williams and Karen Tinkum; and *OPENing the Railroad with webGIS Architecture,* John Farrell presenting.

That OmniTRAX should take a lead role is quite fitting. GIS is a central element of the *O*mniTRAX *P*roperty *E*ngineering *N*etwork, or *OPEN*, which is a functional system that allows users to gather data pertaining to track, mileposts, locomotives and even weather across the OmniTRAX network. A special thanks to all for their initiative and leadership.

Continuing its PSR push mentioned on the recent earnings call, KCS has appointed Sameh Fahmy to EVP, Precision Scheduled Railroading, reporting to Pat Ottensmeyer. I wrote in WIR Jan 18, Fahmey will "assist in the design of the company's PSR rollout and operational strategy." He brings to the table 12 years of work with Hunter Harrison plus another two decades in CN engineering and mechanical management roles. He retired from CN in 2013, around the time Jim Vena was named COO, and will be working with Vena in the latter's new UP capacity — highly appropriate as UP is the largest Class I interchange partner with KCS.

Says Ottensmeyer, "Sameh's knowledge of PSR and demonstrated ability to improve network efficiency will be an important asset to KCS. He will work alongside my executive team to develop strategy and drive operational changes that will result in sustainable improvements in customer service and cost structure. These improvements will help us realize the tremendous new business growth opportunities we have identified, while enhancing profitability and shareholder returns."