THE RAILROAD WEEK IN REVIEW

May 17, 2013

“We believe there is significant value in the premier, niche railroad that we operate.” -- FEC first quarter 10-Q.

Here we are four-plus months into the year and I don’t see the current trend of minuscule year-over-year changes getting any better.

Short Lines			Pct	2013	Units
Commodity	YTD 2013	YTD 2012	Delta	Pct Tot	Delta
Total	2,502,784	2,343,652	6.8%	100.0%	159,132
intermodal	360,761	215,061	67.7%	14.4%	145,700
Net	2,142,023	2,128,591	0.6%	85.6%	13,432
auto	55,535	57,222	(2.9%)	2.2%	-1,687
Net	2,086,488	2,071,369	0.7%	83.4%	15,119
coal	245,188	238,145	3.0%	9.8%	7,043
Net	1,841,300	1,833,224	0.4%	73.6%	8,076
Petrol/coke	92591	92664	(0.1%)		
SL Commodities	1,748,709	1,740,560	0.5%		
AAR Class Is	NA Rails			2013	2012
Commodity	YTD 2013	YTD 2012	Pct Chg	Pct Tot	Pct Tot
Total Units	12,034,610	11,880,168	1.3%	100.0%	100.0%
intermodal	5,386,789	5,174,629	4.1%	44.8%	43.6%
Net	6,647,821	6,705,539	(0.9%)	55.2%	56.4%
auto	452,515	449,369	0.7%	3.8%	3.8%
Net	6,195,306	6,256,169	(1.0%)	51.5%	52.7%
coal	2,137,367	2,245,133	(4.8%)	17.8%	18.9%
Net	4,057,939	4,011,036	1.2%	33.7%	33.8%
Petroleum	374,850	260,856	43.7%	3.1%	2.2%
SL Commodities	3,683,089	3,750,180	(1.8%)	30.6%	31.6%
Sources:	RMI, AAR				

AAR traffic in that category has dropped 100 basis points. The top half of the table shows merch carloads on shortlines ex-petrol are up half a point; petrol is down a tenth of a point, which tells you how much of the crude-by-rail surge short lines share. (The sharp-eyed observer will note RMI combines petrol and coke for its 426 roads reporting; the AAR isn’t saying where it is. But

with AAR mets down 4.5 percent, you can bet coke is weak.) This is what the Slo-gro Economy looks like to the rails and the economists are predicting more of the same.

At the recent ASLRRA conference in Atlanta I asked some of my fellow industry-watchers what they saw ahead for Class II and III roads plus switch carriers. The full-year 2013 consensus is for vols a point or two up or down and revenues the same. Operating and regulatory expense continue to creep up, putting pressure on margins and thus the ability to repair and replace. I'm guessing some 50 to100 names depend on grants and tax credits to keep running; absent these financial helps, they could become fallen flags.

Genesee & Wyoming April same-store carloads increased 4.4 percent on a pro-forma basis, counting RailAmerica carloads from April, 2012 as if the two railroads had been combined at the time. Of the total units, 137,086, petroleum accounted for half the increase; coal and other were half the petrol gain. Six commodity groups -- coal & coke, ag products, metals, chemicals (STCC 28 only), pulp & paper, minerals & stone -- make up 70 percent of the traffic base. Coal/coke and ag were down, metals flat, pulp/paper and minerals/stone were up.

Year-to-date the pro-forma combined vols increased 4.0 percent to 532,057 units, 21.3 percent of total shortline carloads in the RMI report (top portion of the table above). Even more telling is the sequential year-over-year changes by month: March up 3.1 percent, Feb up 3.6 percent and Jan up 7.8 percent. The month-to-month changes are uneven at best: down 11.6 percent, up 9.5 percent, up 2.2 percent.

Florida East Coast first quarter 2013 revenue increased 20 percent to $68.8 million as revenue units grew 15 percent to 127,786 and RPU went up 10 percent to $517. Operating income was $20.3 million, up 68 percent; the operating ratio came down 8.5 points to a respectable 70.4. However, ops expense includes $3 million in 45G credits *vs*. zero for last year, taking the "other" expense line to a 43 percent decrease. As stated in the 10-Q,

> The track maintenance tax credit was not renewed until January 2013; however, the extension did include retroactive tax credit reimbursement for 2012 and 2013. Therefore, no 45G maintenance reimbursement was reflected in the 2012 financial statements. For the three months ended March 31, 2013 and 2012, the Company has recorded $3.0 million and zero, respectively, of maintenance expenditures.

FEC recorded double-digit gains in its carload commodity groups, with crushed stone (23 percent of total units) nearly doubling on short-haul business relating to the FLL airport expansion; RPU dropped 19 percent as a result. Intermodal (73 percent of units) was the slowest gainer, up five percent, with RPU increasing ten percent. RPUs decreased slightly in food products, chemicals and other. That said, FEC sees further gains in auto and new carload service products.

Elsewhere, FEC continues to shift its intermodal business more to containers and away from trailers, a trend we are seeing in the Class Is. And since much of FEC's intermodal business is to and from beyond via CSX and NS, that's reasonable and expected. Here again, the 10-Q provides valuable further insight:

> Because we believe there is significant value in the premier, niche railroad that we operate with high efficiency, we will continue to focus on yield management efforts that reflect the value of our freight network. This focus may allow us to improve our freight RPU. As a consequence, our operating ratio, which we define as total operating expenses divided by total operating revenues, continues to be a key metric which we evaluate. We deem operating ratio as an important metric to measure our operational performance.

Efficiency is the key word here. Direct labor cost per unit is down seven percent and fuel burn per thousand GTM is down 10 percent. Fuel expense increased seven percent thanks mainly to a nine percent increase in the price of diesel fuel. Unfortunately, the personal injury rate per 200,000 hours worked increased to 1.43 from 0.75 a year ago, though it's still better than the Class I's 1.67 average.

Cash flow from operations turned positive, though still only a third of net income. Capex was up five percent to $5.7 million and free cash flow was a negative $3.7 million, a vast improvement over the negative $19 million a year ago. Net debt is more than three times equity, 79 percent of capitalization and about seven times ebitda.

At the end of the day, I have to say FEC is very much a Work in Progress. The elements are there to build the intermodal and auto franchises; the aggregates business will be what it is. The FEC's heritage includes being a low-cost operator with industry-beating operating ratios. The pieces are in place to take that lead again.

The Railroad Week in Review, a compendium of railroad industry news, analysis and comment, is sent as a PDF via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 mm annual revenues $150. Corporate subscriptions $550 per year. To subscribe click on the Week in Review tab at www.rblanchard.com. © 2013 The Blanchard Company.