

THE RAILROAD WEEK IN REVIEW

August 23, 2013

“No Key Train will be operated by a shortline or regional railroad on BNSF trackage with fewer than two qualified Transportation craft persons handling the movement.” -- BNSF Safety Bulletin, August 20, 2013

Providence & Worcester second quarter freight revenues increased 11.8 percent to \$8.1 million. Conventional carload volume surged nine percent to 9,380 units and average RPU gained three percent to \$837. Stone, metals and ethanol were the major contributors, partially offset by declines in coal and automotive. Intermodal container volume dipped one percent to 4,202 units and RPU came down four percent to a mere seventy bucks a box.

Other freight-related revenues brought total quarterly revenues up four percent to \$8.6 million. Once again, I've moved rental income to “other income” below the operating income line to get a better feel for how ops expenses stack up against rail operations. Operating expense before one-time adjustments for the 2012 Amtrak track agreement was \$9.2 million, down one percent, and the resultant operating ratio was 107.7, down 3.2 points. As usual, comp & benefits consumed 50 cents out of every revenue dollar -- 30 cents is the norm for rails this size.

The Amtrak numbers -- \$1.7 million in this quarter and \$2.4 million a year ago -- so distort year-over-year numbers that one must back them out to get a true set of comps. That done, adjusted net income for the quarter was a negative \$1.2 million vs a positive \$675,000 a year ago. You can see the effect in the balance sheet, too. Retained earnings at the end of 2006 stood at \$37.6 million. By the end of 2012 they were down four percent to \$36.0 million and down another three percent to \$35.0 million by the end of June.

PWX has no debt per se; however, it carries \$23 million in deferred income taxes and grants. This is, in effect, money due others and represents a third of equity and 13 percent of capitalization. The PWX share price at the end of June was \$15.82, creating a market cap of \$77.8 million. EBITDA was \$1.5 million so even if you annualize it to \$6 million, we're looking at 13 times. Somebody must see value in that number, though. As of Monday's close shares were \$18.36 per.

CSX got some good creds from Barclay's Monday, being cited as a “Best Idea.”

[Solid domestic intermodal growth, pricing discipline and a relatively cheap equity valuation are the primary attributes that make CSX one of our top long-term opportunities. The negative outlook for eastern U.S. coal remains the focal point for CSX investors and the debate has shifted to potential 2014 outcomes. Bearish proponents point toward further softness in U.S. export coal demand in 2014.](#)

While we agree that U.S. export coal will likely be challenged, we are optimistic that positive trends in domestic utility coal consumption are driving stockpiles lower. As utility coal represents ~50% of CSX's coal tonnage, a further improvement in domestic coal consumption and replenishing of utility stockpiles could be a powerful catalyst to stabilizing the coal revenue outlook.

Outside of coal, CSX's domestic freight businesses in the chemical, energy and consumer-oriented intermodal segments are expanding at a healthy rate and pricing discipline in the non-coal businesses should continue to outpace cost inflation. We are encouraged that CSX can meet our annual EPS growth estimate of +10% in 2014, even with a flat coal revenue. We believe that as the market grows comfortable with an improving earnings growth outlook, the current equity multiple discount CSX receives will narrow, driving equity appreciation.

CSX, in my opinion, is relentless in its drive to run a more efficient core railroad and create a strong customer-advocacy presence in its local service, as personified by Cindy Sanborn, VP Transportation. CSX alone among Class Is emphasizes "same-store" sales, meaning the same commodity between the same O-D pairs in the same car-type in year-over-year comps. What solid same-store sales say is that customer loyalty is alive and well, and repeat business is the hallmark of a thriving franchise. Kudos to Barclay's for picking up on it.

Union Pacific's annual shortline meeting starts next Monday, so here's an update of how the railroad is running. Year-to-date revenue units through Aug 17 are off one percent, remaining unchanged at a rounded 5.7 million units.

If we back out coal and intermodal to zero in on commodities where the short lines live, we see units up 1.3 percent at a rounded 2.3 million units for both periods. We also have to back out auto and petroleum since the number of short lines with significant business in these groups is also small.

You can find the raw numbers with much greater commodity detail on the up.com Investors Page under the AAR and STB Reports tab. I have merely attempted to line up the commodities listed with the commodity groupings that UP uses in its analyst reports.

Any way you slice it, the tea leaves are not showing a particularly robust environment for growing the single-car commodity O-D pairs that non-Class I roads depend on to earn a living.

Revenue Carloads/units (thous.)			
YTD Thru Aug 17			
	2013	2012	
Industrial Prods*	818,222	803,226	1.9%
Agriculture	441,398	483,889	-8.8%
Chems	740,971	682,891	8.5%
Auto	292,844	293,120	-0.1%
Total Mdse	2,295,448	2,265,138	1.3%
Coal	1,053,113	1,153,740	-8.7%
Intermodal	2,304,134	2,298,071	0.3%
All-in	5,652,695	5,716,949	-1.1%
Mdse ex-petrol	2,090,051	2,265,138	-7.7%
Mdse ex-auto	2,002,604	1,972,018	1.6%
Mdse ex-both	2,304,134	2,298,071	0.3%

The ASLRRA Eastern Region Conference in Norfolk Sep 7-10 will kick off a security training program to help Members meet new FRA and TSA rules on security standards and security training. As a direct result of Lac-Megantic and other “human factor events” in the United States, the new regs require that each railroad designate a Security Coordinator per 49 CFR 1580. The security training offered at the Norfolk session will prepare attendees with the tools they need for compliance with all requirements.

The meeting bulletin says, “The crisis management training will help you in the management of a horrific event should one befall your railroad.” A key part of “managing a horrific event” is damage control, and -- as we saw in Megantic -- the local first-responders may not be up to the task. Another key element of damage control is having enough insurance. A mere \$25 million just won't do. Happily, there are ways to skin both cats. Drop me a note if interested.

Meanwhile, BNSF sent a Safety Advisory to its short lines this week. The topic is, naturally, the new safety regs. The note deals exclusively with “Key Trains,” defined in BNSF Hazmat regs as any train with 5+ TIH cars or 20+ cars of gases or hazardous liquids. As a result of the Megantic findings, BNSF has modified some Key Train operating practices and these changes will impact shortlines and regional railroads operating on BNSF tracks. To wit:

- No Key Train will be operated by a shortline or regional railroad on BNSF trackage with fewer than two qualified Transportation craft persons handling the movement.
- BNSF is equipping its locomotives with locks. We will need to work with our connecting roads that utilize BNSF locomotives in run-through train operations to provide keys to your employees.
- BNSF is also making its “Emergency First Responder” training available to our connecting roads that handle the commodities covered by the new requirements, specifically crude, gasoline and related flammable commodities. We are developing a training schedule and will be sharing details on available times and locations soon. If you have a training need, please contact us and we will work toward establishing training as soon as practical.

Questions are to be directed to your shortline contact or Dick Ebel.

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