RAILROAD WEEK IN REVIEW

January 17, 2020

"EBITDA does not fall under generally accepted accounting principles (GAAP) as a measure of financial performance. Because EBITDA is a 'non-GAAP' measure, its calculation can vary from one company to the next. It is not uncommon for companies to emphasize EBITDA over net income because it is more flexible and can distract from other problem areas in the financial statements" — investopedia.com

"Trumpeting EBITDA is a particularly pernicious practice. Doing so implies that depreciation is not truly an expense given that it is a "non-cash" charge. That's nonsense. In truth, depreciation is a particularly unattractive expense because the cash outlay it represents is paid up front, before the asset acquired has delivered any benefits to the business." — Warren Buffett, 2002 Letter to Shareholders, page 21

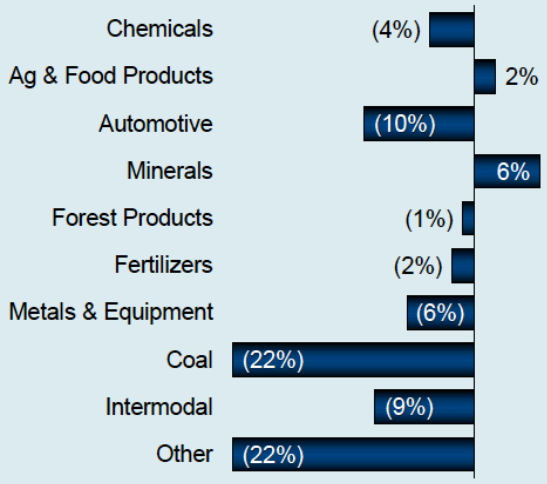
"CapEx is a good measure of corporate investment activity, yet buybacks, now eclipsing CapEx, are doing so partially because interest rates are as low as they've been in many, many years. It doesn't bode well for the economy and it comports with one's view of recession potential." — Josh Wolfe, Co-founder Lux Capital on Real Vision, Aug 21, 2019

CSX revenue units finished Q4 down nearly seven percent. This slide from Thursday's call spells it out in detail. Yet if you drill down to the merchandise carload sector, you'll find it was intermodal and coal that did the most damage; merch carloads and revenue were down but three percent. Merch RPUs were essentially unchanged.

Revenue Declines Led by Export Coal

- **Chemicals** declined due to lower natural gas liquids, fly ash and sand shipments
- **Agricultural & Food Products** growth driven by gains in ethanol, sweeteners and oils
- **Automotive** declined due to lower North American vehicle production
- **Minerals** increased on highway and paving project activity growth
- **Forest Products** decreased as a result of lower pulpboard shipments
- **Fertilizers** declined as growth in short-haul phosphate shipments was offset by reduced long-haul fertilizer shipments
- **Metals and Equipment** declined due to lower metals demand, primarily in steel, construction and scrap markets
- **Coal** decreased due to declines in export coal markets from lower global benchmark prices, as well as domestic volume declines
- Domestic and International **Intermodal** decreased, primarily due to the impact of lane rationalizations

Fourth Quarter Revenue Down 8% Percent Year over Year



As regular readers know, I generally exclude the automotive category from my merchandise carload commentary. Maybe I shouldn't. QCS data confirms that just under 20 percent of CSX' auto group is parts by the carload, but that's been on a steady quarterly decline since early 2016. And Union Pacific confirms that roughly 40 percent of the reported "motor vehicles" carloads are STCC 3714 parts.

I think can safely said that CSX used this lull in volumes to get its house in order. New all-time records were achieved for both velocity and dwell, though CSX cautions that calculations for both "differ from the methodology described by the STB." Which means sequential changes can be measured only within CSX and not to compare with other railroads.

Says CEO Jim Foote, "The combination of these improved metrics helped significantly increase car miles per day (now a record 138) as we continue to translate incremental operating efficiencies into higher asset utilization across the network." He adds that Trip Plan Compliance (TPC) performance set new records again — 83 percent of mech carloads hit arrival targets (+/- two hours of plan) whereas it was 30 percent two years ago.

The greatest cause of late arrivals is late departures, and CSX hit 92 percent OT departures and 85 percent OT arrivals, both double digit percentage improvements year-over-year. CSX finally has its arms around fuel burn, hitting the Holy Grail of less than one gallon per 1000 GTMs (OK, it's 0.99 gallons, but it still beats all the other US Class Is). GTMs were off six percent, but fuel consumption in gallons came down 11 percent and GTMs/gallon rose six percent. The net result was a respectable 17 percent decline in locomotive fuel expense.

In sum, it's been a rough year to be in the railroad business, especially when one is going through significant change in one's approach to the business. Says Foote:

> Our ongoing refinement of the operating plan continues to drive savings from fewer crew starts, enabling a nine percent year-over-year reduction in the active train and engine employee base, and driving a seven percent [T&E] improvement in crew utilization. Overtime was down nearly 15 percent sequentially, or approximately 30 percent versus the fourth quarter 2018.
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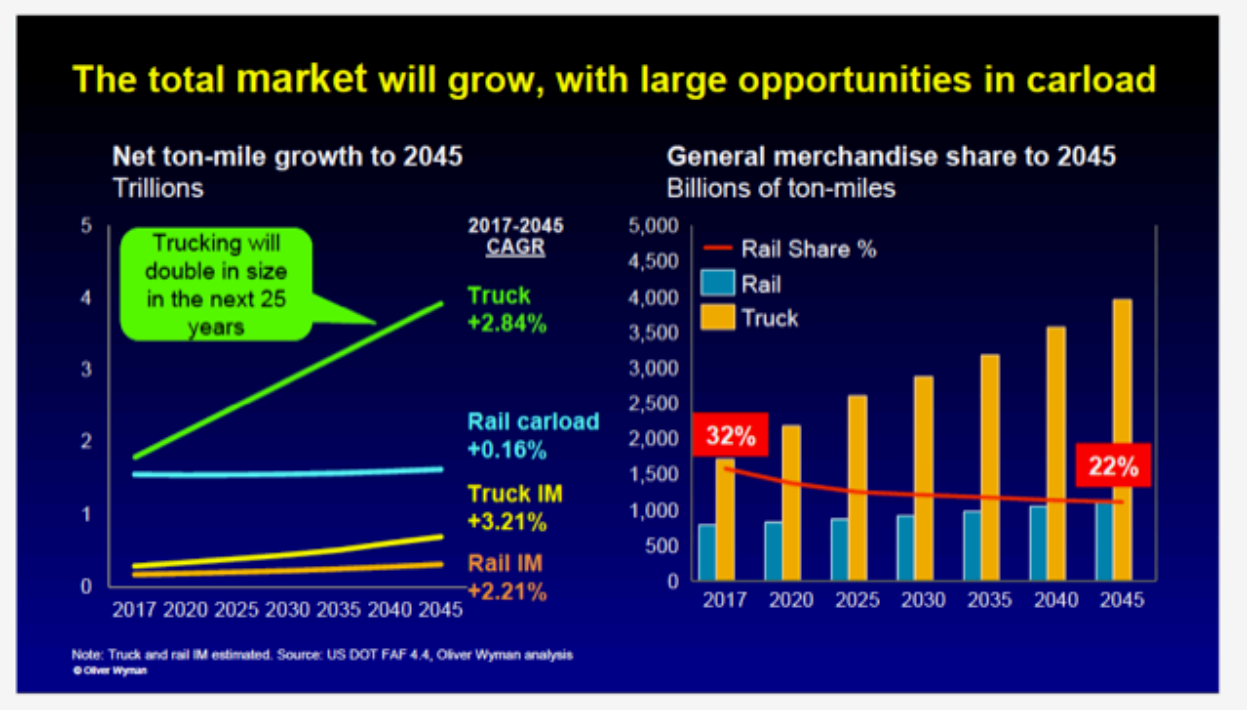
> Additionally, the average active locomotive count for Q4 was down ten percent year-over-year. The smaller fleet, combined with fewer cars online and freight car repair efficiencies, help drive a nine percent reduction in the mechanical workforce, while also reducing mechanical overtime expense by more than 40 percent.

So, even though revenue units and revenues are down, and maybe total ops expense didn't come down as much as I might have liked, I'm sure that Hunter Harrison would be quite pleased with the CSX story thus far.

A recent Wall Street sell-side note opens with a discussion of what OEM sales portend for the trucking business and then goes into many pages of detail on truck design, etc. The fun starts on page 78 -- Technology Race: Trucks vs Rail. "We believe that electric and autonomous technologies are likely to gain more relevance in the long term. This should lead to lower transportation costs and higher capacity on the highway, two important threats to railroads."

The writers estimate at least 30 percent of present railroad revenue units are at risk of conversion to smarter trucks. Better use of PTC data and one/no person train crews could stem the tide. This Rod Case exhibit of freight volume trends from November's RailTrends is telling — the green trend shows truckload growth rate; the blue bar chart shows continued flat railroad ton-miles. Stuff to think about the next time a class I takes weeks to get back to you with a rate quote.



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