THE RAILROAD WEEK IN REVIEW
May 8, 2015

"BNSF will spend $6 billion on plant and equipment in 2015, nearly 50% more than any other railroad has spent in a single year." Berkshire Hathaway Chairman's Letter, Feb 27, 2015

BNSF first quarter results really knocked the cover off the ball. Among the US Class Is, in terms of percentage change, BNSF racked up best increase in total year-over-year total revenue; best increase in merchandise carload revenue, including crude oil and auto; biggest change in merchandise carloads; and biggest gain in operating income among all Class Is, including the Canadians.

Fuel expense dropped 38 percent and, rather than squandering the savings on other expense line increases, BNSF posted decreases in every expense line but payroll, and that up less than 10 percent. Total ops expense dropped 13 percent, propelling a 37 percent ops income gain year-over-year. Net income was up 49 percent.

So much for the hyperbole. Total revenue including fuel surcharges (FSC) came to $5.5 billion, up three percent; absent FSC, freight sales and other operating income was $4.9 billion, up eight percent, never mind FSC dropped by a third in the period. Operating expense dropped 13 percent and ops income jumped 27 percent to $2.0 billion for an OR of 63.4, down an impressive 1106 basis points.

Intermodal resides in consumer products and is 96 percent of the number you see; the rest is auto. Crude is in the IP group but BNSF doesn't separate it from the STCC 29 chems like LPG and asphalt. The petrol prods group is 25 percent of IP vols for Q1. From the most recent QCS, I'm guessing NGLs are a consistent 55,000 cars a Q, more or less, so the variations from that are probably crude oil. The category was actually down a point in the Q.

The Industrial Products (IP) car count was up three percent on double-digit gains in metallic ores and aggregates, offset by similar losses in metals and ferrous scrap. Ag vols gained 15 percent with particular strength in grain. As a result, merch carloads did OK with a seven percent volume gain. Coal held its own with a seven percent increase, but consumer products (96 percent intermodal, the rest auto) dipped six percent, mainly on west coast port foolishness. Total revenue units were up just a point to 2.5 million units. System RPU was up a point.

Railroad investment analysts are fond of annual comps; I prefer the longer view, measured in terms of the compound annual rate of growth, say over five years (the minimum time to own Berkshire Hathaway, says Warren Buffet). Here's the BNSF carload CAGR-5 from 1Q2010.

Commodity Grp	1Q2015	1Q2010	Pct Chg	CAGR
Industrial Prods*	467	336	39.0%	6.8 percent
Agriculture	271	234	15.8%	3.0 percent
Total Mdse	738	570	29.5%	5.3 percent
Coal	600	579	3.6%	0.7 percent
Consumer Prods*	1,128	1,001	12.7%	2.4 percent
All-in	2,466	2,150	14.7%	2.8 percent
*Auto+Intermodal			*Source: BNSF data*	

With the economy stuck in two-percent mode, one must agree BNSF has at least kept its head above water. I'm particularly impressed with the IP sector and, no, crude oil and frac sand couldn't have done it all since it only got cranking in 2013.

The merch carload leadership ought to be particularly good news for BNSF short lines. Perhaps BNSF's leadership in extending the AIM (Assess, Improve, Maximize the Carload franchise) program and the demurrage management tool to short line applications are paying off.

***State of the Freight* is an annual publication** from Wolfe Research in NYC, published each May in advance of their Annual Global Transportation Conference May 19-20 (details at www.wolferesearch.com). But I digress. *State of the Freight* is a 60-page tome available as a PDF, which makes it handy for filing in your iBooks section and dipping into as needed.

Highlights from the Rail Section:

* "Less than 60 percent of shippers cited tight truckload capacity, down from 95 percent last quarter. This is the biggest sequential drop in our survey since 2006." Coincidentally, 2006 is generally considered peak year for rail vols.

* Wolfe's outlook is for lower shipper transport spends AND higher freight rates on rails. For me, that implies fewer carloads for the same money and still fewer carloads for less money.

* Shippers predict two percent vol growth, about even with GDP, and a tub I've been thumping for a while.

* Inventory levels are falling, which, Wolfe says, can lead to more frequent shipments as smaller levels of supply require more frequent replenishment. It also implies smaller shipments: more LTL, less truckload, and surely less carload. Why have four trucks' worth on hand when you only need one?

* CSX has been the most aggressive rail in raising rates; NS the most capacity-constrained.

* 40 percent of surveyed firms are in “manufactured” products. Rail ex-intermodal has 15 percent share; Intermodal has 8 percent. [*And, if AAR weekly car-counts are any indication, intermodal is gaining on carload. See below. — rhb*]

My take: The merch carload sector will be happy to take what volumes it can get, with more emphasis on bulk and high weight-to-mass ratios and less on fabricated parts and finished items. Appliances and autos out of Mexico will be the exception. I’m worried about paper, ex-packaging and office machine writing paper, though the volumes of junk mail and grocery store promo items doesn’t appear to be slowing. Operating ratios will stabilize in the mid-60s as shippers push back on rate increases, slowing the RPU rate of increase nearly to the point where it matches ops expense deltas.

Intermodal boxes accounted for nearly half of all North American railroad revenue units year-to-date through May 2, 2015. And the way things are going, intermodal could beat out carload in percentage of revenue units before we know it. Consider the commodity trends:

In Week 17 (ending May 2), carload commodities, including crude oil and automotive, decreased by five percent from a a year ago. Just four of ten commodity groups showed percentage increases: chemicals (0.4), grain mill products (1.0), metallic ores & metals (0.7), and Other (4.2). Chems include crude oil and we know from the individual railroad reports that straight STCC 28 chems are flat to down; grain mill includes soy meal and ethanol; metallic ores and metals include scrap and coke; other includes municipal waste and overhead. In other words, anything that can move by truck or intermodal, by and large, does.

The RailConnect Index of Short Line Traffic from GE Transportation, tells much the same tale. Year-to-date revenue units, including intermodal, coal, and auto are down 3.6 percent. Of 14 commodity groups in the weekly column, only three are up: STCC 24 lumber, automotive including parts, and intermodal. Lumber is the only one with significant shortline exposure; intermodal and auto short lines can be counted on the fingers of one hand.

The merch carload trends do not amuse.