RAILROAD WEEK IN REVIEW

May 4, 2018

"A blockchain is like a database — it's a way of storing records of value and transactions. For logistics and transportation, it promises to shake up the $8 trillion industry." — Blockchain in Transportation Alliance

Genesee & Wyoming finished its first quarter 2018 with consolidated revenues of $575 million world wide, up 11 percent; operating income $87 million, up 15 percent; and $60 million in net income, up 22 percent, before the tax windfall. Free cash flow per share was 69 cents, down 16 percent, thanks mainly to the 67 percent jump in capex, to $58 million from $35 million, a year ago.

In his opening remarks, CEO Jack Hellman said their NA business outlook is more encouraging, though "we are anticipating a continued carload drag from Class I congestion into the summer." He is concerned about the the impact of U.S. trade policy and countermeasures by other countries. For example, the outlook for diminishing overseas grain flows due in part to the new agricultural tariffs in China.

North America freight revenue was $245 million, up three percent even, on 406,013 revenue units, up 0.7 percent. Same-store units were up just 0.4 percent, which shows how smart acquisitions can help even out the wobbles among the same stores. Merchandise carloads including auto and overhead increased nine tenths of a point to nearly 341,000, bringing in 4.1 percent more revenue ($225 million) as merch RPU increased 3.1 percent to $690. (Other regional operators take note.)

NA same railroad traffic for the quarter was relatively flat year-over-year. I was pleased to hear on the call that forest products (both STCCs) in particular have been successful in highway-to-rail conversions, partly as the result of ELD, driver shortages, and not enough trucks where they were needed.

On the other hand, Ag products were down, primarily due to poor grain market conditions, higher levels of barge competition, and the lingering effects of the 2017 drought in South Dakota. Chemicals and plastics volumes were lower, primarily due to lower ethanol shipments in the Midwest, lower acid shipments to a copper mining customer in the Southwest, and a customer plant closure in the Northeast.

GWR says that Q1 will be the low point of the year. As Class I car supply begins to loosen up enough to meet rising demand, more customers can be accommodated and results will improve going forward. That's good to know. GWR estimates the Class I car supply hiccups and service irregularities meant a hit of some 6,000 carloads.

GWR has two other North America revenue lines beyond freight revenue: freight-related and all other. The former, according to the 10-K, "includes revenues from railcar switching, track access rights, crewing services, storage and other ancillary revenues related to the movement of freight." Other Revenue brings in "revenues from third-party car and locomotive repairs, property rentals, railroad construction and other ancillary revenues not directly related to the movement of freight." These items brought in nearly $80 million, roughly two-thirds freight related.

Putting it all in context, North America revenues accounted for 57 percent of the consolidated world-wide revenue, down from 62 percent a year ago. However, North America brought in 84 percent of operating income, down from 89 percent a year ago. As for the rest of the year, GWR estimates that North America full-year vols will more than offset weaker Q1 results, says in essence that Europe is still a Work in Progress, and that Australia's weaker dollar is now trading five percent weaker than it was in February.

As an aside to the NA story, GWR has declared its ERS Railways of The Netherlands a "non-core asset" and has an agreement sell it for €10.4 million. Says CEO Jack Hellman, "ERS is the rail operation that Freightliner purchased from Maersk just prior to our acquisition and which we have restructured into a smaller profitable freight-forwarding-focused operation."

Credit Suisse railroad analyst Allison Landry seems encouraged: "While this business had been ascribed a value of $20 million at the time of acquisition of Freightliner, GWR has justified its decision to sell the business at a loss, citing the difficult operating environment as well as its lack of defensibility against competition, which is atypical of a traditional rail operation."

Canadian National will buy 350 center-beam cars to meet the growing demand from lumber-producing customers across its North American network (WIR 4/27). Together with CN's recently-announced acquisition of 350 additional box cars, the center-beams will add more capacity to meet growing lumber and panel demand, particularly in the US housing market.

These Plate F, 73-foot "riserless" center-beams can carry 112 tons of lading while meeting a maximum load capacity of 286,000 pounds, and are expected to be delivered starting in September. This car, from National Steel Ca Ltd of Hamilton, Ontario, is ideal for customers using integrated dunnage and shorter package lengths. The entire load can be concentrated over the center 60 feet of the car, and the center-beam posts are designed to reduce damage in route.

As part of CN's record $3.4 billion capital program in 2018, the company is investing in new trade-enabling infrastructure and equipment. In addition to rail cars, CN expects starting in June to take delivery of the first of 60 new GE locomotives due in service in 2018.

KCS and Railinc have joined the Blockchain in Transport Alliance (BiTA), in their respective efforts to advance blockchain technology and its transportation and logistics applications within the supply chain. BiTA is a consortium of more than 250 transportation and logistics companies with the goal of developing a standard framework, educating the market, and encouraging its widespread adoption.

KCS says it's joining up to "to create transparency and efficiencies throughout the supply chain to better serve the interests of our shippers and partners," Railinc's interest is in adding value to the railroad industry by "working to advance blockchain technology and its transportation and logistics applications."

The whole blockchain concept has always been a mystery to me, so the BiTA concept applied to railroad transportation is a special motivator to learn more, especially since KCS and Railinc have taken a pioneering interest (other participants include such players as BNSF Logistics, Navistsar, JB Hunt, Fed Ex, Werner Trucking, UPS, and Schneider). Happily, BiTA explains

> To put it simply, a blockchain is like a database, it's a way of storing records of value and transactions. In May 2017, Deloitte tweeted that ten percent of global GDP would be built on top of blockchain applications. For logistics and transportation, it will have a bigger impact promising to shake up the $8 trillion industry.

The short form is BiTY is a futures market for transportation services. There is a precedent for freight being exchange traded as futures — the Baltic Exchange has been listing dry-bulk futures contracts for over 30 years. So far, the US truck market has remained aloof because, until recently, there has been no agreed upon spot-market index that accurately tracks the market.

Load board technology has evolved to the point where it matches millions of loads with available trucks, follows $billions in freight rates and pricing trends, and tracks loads for beneficial owners and third party logistics providers. It's a short step from there to tracking railroad equipment availability (see GWR complaint, above), shadowing carload rates, and detecting pricing trends.

The railroads have always done this, but with their own proprietary systems whose output remains a closely guarded secret. The Amazon-fication of global transportation will allow this no longer. To be competitive in supply chain management and inventory control, transportation suppliers must allow customers to eliminate time-consuming tracking calls, know where their loads are 24/7, and have those loads tracked through the vendors' event-recording systems.

So the input technology is there. Seems to me the BiTA bloc chain technology can collect the data, massage it, and give freight customers the management tools that add value to their customer offerings. For railroads, the very survival of carload transportation is at stake. And congrats to BNSF, KCS, and Railinc for stepping up. Next: implications for short lines.

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