Mining Rail Nuggets from Annual Reports

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It's the season for corporate reporting, and pity the poor soul searching for comparative data. Much like other mining, it is often necessary to dig through considerable overburden to reach the valuable stuff. This is certainly true of reports to shareholders by the class I freight railroads. Beyond the obligatory SEC 10-K financial numbers, there is little consistency in content. Apples-to-apples comparisons between the roads are difficult, because they chose not to present the same information, certainly not all of it, and not in the same format. Nevertheless, there are valuable rail industry insights to be had, even from the chairmen's letters, and summary financials.

It was certainly remarkable that the "big three" of surviving publicly-traded freight rails (CSX, NS and UP) were able to perform so well, financially, during the recent business collapse which began with freight traffic falling off a cliff in Q4 of �08, and then continuing through 2009. Overall, '09 traffic volume, measured in units handled, was off 15% to 20%. Freight revenue was down 20% to 25%. Yet operating ratios ranged between 74.7% and 76%. This speaks very well for management, as well as for their immediate predecessors. This would not have been possible two decades ago.

Also amazing, and perhaps unprecedented, was the decision by the three CEO's to essentially maintain their previous level of annual capital investment in basic network track infrastructure, e.g. ties, surfacing, rail, and related work. This certainly would not have happened three to four decades ago. That it was done this time speaks to the fact that each of these roads was stronger going in, and their leaders were obviously more optimistic about the business prospects coming out. The other thing, which only long-time observers are likely to recall, is the fact that so much of this work can now be capitalized, rather than being "expensed" as was the case historically, prior to the 1960's.

Everybody this year boasted about improved operating and service "metrics", even though none of them fully disclosed their performance in all categories. While this is welcome news, the skeptical observer wonders whether this improvement was accomplished primarily because of less traffic, and whether the positive trends can be maintained when traffic volume picks up again to pre-recession levels? We shall see!

Finally, it is troubling to watch the shrinkage of freight car fleets owned by these roads, including the aging of such equipment. The fact that the freight rails have handed off, to shippers and others, the burden of supplying equipment may be a good financial decision, but what does it say about doing business with these roads? It suggests that one can only be a favored customer of the rails if one brings their own rail equipment to the party. That raises a very interesting question about common carrier status. If fewer and fewer shippers can use rail, even if they wish to do so, that's not necessarily a good thing in a country that seems to want to "reinvent" rail transportation as a highway reliever. If the public sector is to be a rail investor and promoter, must the rail option be limited to the big guys? Intermodal is not always enough!