THE RAILROAD WEEK IN REVIEW
November 22, 2013

"Carload is a lot more trouble but a lot more lucrative too, and despite all the intermodal shucking and jiveing, here we are in the carload business again." -- a long-time WIR reader

The latest Wolfe Research note on the state of the transports predicts volume growth of 0.5 percent this year, 1.5 percent next year and 2.6 percent in 2014. This ties in with my "90 percent economy" thesis, wherein 90 percent of the population that has a job is making enough stuff to keep 100 percent of the population fed, warm, with a roof over their heads and a way to get around. People are hunkering down as shown by decreasing household debt and buying less "stuff"that has to be transported from manufacturer to consumer. And the rails know it.

AAR data for the last ten years shows carloads up less than five percent to 34 million units (an intermodal box is a carload unit) and track-miles owned stagnant at 117,000, yet freight revenues have nearly doubled to $69 billion from $37 billion. And even though mix has changed -- coal to crude, boxcar to container, etc. -- the fact remains that the single-carload franchise is still roughly half the business.

So if numbers are stagnant, the only way to make money at it is to do what you have better. A friend who has earned his chops with both regionals and Class Is writes, "Carload is a lot more trouble but a lot more lucrative too, and despite all the intermodal shucking and jiveing, here we are in the carload business again. I guess when we begin making enough stuff again and a lot size can't be jammed into a container or tank trainer, well, here we go again."

The Poster Child for making money in the carload business is, without a doubt, CN. They posted a third-quarter OR of 58.9 with with 62 percent of its revenue and 50 percent of revenue units in the carload sector; Union Pacific at 64.8 was the next-best OR among Class Is. Some will argue that CN is a simpler network than UP — or any of the US roads for that matter— but the fact remains CN is ahead of the curve in reconfiguring its carload network to be more efficient.

A common impediment to an efficient network is, I think, local custom. Whether I'm out on NS, UP, BNSF or CSX (don't spend that much time trackside in Canada -- sorry), I see trains out of place, shortline interchanges missed, and loads delayed because the local management had his own agenda and didn't Run To Plan.

I'm also afraid market-managers and route-planners are not helping, either. Channel checks with short lines reveal that some traffic has been lost to highway due to circuitous Class I routings. Says one contact, "It's sort of a creeping disease where routings get progressively more circuitous to concentrate traffic on main routes into and out of major terminals. Eventually the costing programs discover all the extra miles and costs jump for the market managers. This frequently affects the viability of shorter lanes that tend to be disproportionately represented in the SL traffic mix." Moreover, long transit times increase rates and make them non-competitive.

So, whether it's not running to plan or bulking up trains with non-progressive moves, the solution is obvious: run to plan, and if the plan isn't working, fix the plan. That's the only way the rails can remain profitable in a no-growth economy, I'm afraid.

Arkansas & Missouri Redux. I wrote in late September (WIR Sep 27, 2013) about the A&M's three new SD70s. This week I asked A&M President Reilly McCarren for an update on how they're doing so far. He writes,

> They're pretty impressive and have been absolutely transformative in terms of their impact on the railroad. Our operating plan has traditionally been strung pretty tight, trying to cycle the road power twice a day, make all the car connections, crew rotations, etc., all while finding time to fuel the power twice a week. Now the trains get over the road faster and that's relaxed the tension in the system, and one refueling on the weekend lasts all week.
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> Fuel savings are noticeable and the maintenance benefits should be just as substantial. We have a bit of an advantage with a highly scheduled operation that allows two units to get about 100 hours of utilization each week, although the third unit is well less. Our mountainous profile, particularly on the south end, lends itself well to AC traction and radial trucks.
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> The A&M is a unique road, with a diverse customer base, rugged terrain, connections to the inland waterway system, and three Class I connections. Our sister company is heavily involved in transloading, warehousing and local distribution, so we don't have to rely on third parties to reach customers beyond our rail line. Of course, being in a business-friendly environment helps quite a bit, too. On average we've added one new customer annually.

Recall the A&M makes interchange with KCS, BNSF and Union Pacific. All three stressed at their 2013 shortline meetings the need for regional connecting roads to invest in their properties to provide predictable customer pull/place and turn the cars. A&M sets the example.

The EPA has relented on its ethanol blending requirements. According to the *Wall Street Journal*, the EPA has "for the first time" suggested that blend levels set six years ago "are difficult, if not impossible, to meet." The 2007 law set the 2014 blend at 14 billion gallons, based on annual use projections of 140 billion gallons of gasoline with a 10 percent ethanol blend.

New, more fuel-efficient cars and changed driving habits have brought the annual burn by 10 billion gallons or so. Thus the EPA proposal "would require between 12.7 billion and 13.2 billion gallons of corn ethanol in the nation's fuel mix—a level that is not only lower than what was originally intended for 2014, and also lower than the levels of the last two years."

A billion gallons of ethanol at a nominal 30,000 gallons per car works out to some 33,000 carloads. QCS data for ethanol carloads by quarter show loads with a sharp run-up in early 2010, a bit of a peak in late 2011, and a flattening curve since. BNSF, UP, CSX and NS were the heavy hitters. I'm not sure about the western roads, but I'm pretty sure a number of eastern short lines working off NS and CSX are heavily into ethanol, if not entirely dependent on the stuff.

Watco is taking an equity position in the Michigan-based, 400-mile, Great Lakes Central Railroad through its owner, Federal Capital Holdings. Federated Railcars, Inc. (FRI), owner of a fleet of refurbished passenger cars, is part of the deal. GLCR runs between Ann Arbor and Cadillac, with branches to Thompsonville, Traverse City, and Petoskey. Grain, sand and plastics are among GLCR's principal commodities.

The railroad interchanges with the Canadian National and Huron Eastern in Durand, CSX at Anne Pere and Howell, the Ann Arbor Railroad at Ann Arbor, and the Mid-Michigan Railroad at Alma. FRI, through the GLCR's shops in Owosso, rehabs and upgrades its passenger car fleet to be used for the Michigan Department of Transportation's proposed "WALLY" service as well as for other potential commuter agencies.

The 2013 RailTrends conference proves another winner. By the time I got there a little after nine Thursday morning it was SRO. Once again the Tony Hatch-Progressive Railroading team brought together a stellar line-up of speakers in a first-class venue, the W Hotel (again) in midtown NYC.

Highlights: Hunter Harrison says consistent, reliable service is bringing back the vols; expect resolution on DME west end and D&H in the 2014 first half. NS President Jim Squires on how NS is positioned to reap benefits from the shale-field sector. Rick Webb (Watco), Tom Hoback (Indiana Rail Road) and Jack Hellman (GWR) team up to show how to win more business from old customers. Brian Bowers, KCS Intermodal/Auto SVP on the Mexico trade; Rich Timmons and Ed Hamberger on the states of the short lines and Class Is.

A side benefit as always is to reconnect with old friends and talk about new things. You also get some one-on-one opportunities with the CEOs. Much of what we talked about is what I call "business car talk," but these chats are invaluable for connecting what I see in the field with the strategic goals of the company. I also got to close loops with many of the analysts I quote here in WIR and elsewhere, making the whole RailTrends experience very much worth while.