THE RAILROAD WEEK IN REVIEW

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"Traffic growth is in areas not subject to intensive infrastructure investment; terminals are proving incapable of handling increased traffic." — Rod Case, Partner, Oliver-Wyman

The D&H saga continues. NS and CP have agreed on a proposed transaction under which NS would acquire 283 miles of D&H rail line between Sunbury, Pa., and Schenectady, N.Y. The $217 million sale is subject to approval by the STB, expected in the 2015 second quarter.

It's a natural end-to-end fit. CP now serves short lines in the Sunbury, Scranton and Binghamton areas via either rights over the NS Southern Tier out of Buffalo or its own extension south from Binghamton, part of the original D&H expansion under the USRA Final System Plan dating from 1975. CP acquired Wilkes-Barre to Sunbury as part of the 1999 Conrail transaction.

Undoing the FSP and subsequent changes puts Sunbury to Wilkes-Barre back under PRR-successor control, and puts the ex-D&H Wilkes-Barre to Scranton and Schenectady bridge route under the control of its historical Pennsylvania connection. The former Erie Railroad Buffalo-Binghamton connection with the D&H reverts to a single owner with no overhead tenant, simplifying operations in an increasingly congested railroad world.

The proposed transaction lets NS retain and modify overhead trackage rights on the line between Schenectady and Mechanicville via Mohawk Yard, thus giving NS single-line routes from Chicago and the southeastern US to Albany, to the Mechanicville intermodal terminal, and to the Pan Am Southern serving New England markets beyond. The D&H (CP) would retain local access to serve customers in Schenectady and would maintain its access to customers in Buffalo.

As for what happens to traffic now interchanged between the area short lines and CP, well, the devil is in the details. A close reading of the filing, FD 35873, is in order. Stay tuned.

RailTrends 2014 opened Thursday morning on New York's Lexington Avenue for a two-day stand and it was, as expected, another SRO crowd. Some Day One highlights: AAR President Ed Hamberger cited the need for a "strong and robust freight rail network to meet the country's transforming business challenges head on." He noted a number of factors, including the industry's going from comparatively light to very heavy traffic in a short period of time. Though Hamberger suggested shippers may not have forecast the sudden shift, anecdotal evidence suggests conservative forecasts within Class I marketing and sales forecasts may have contributed to the lack of sufficient resources to meet the demand.

That was a perfect segue for Oliver Wyman's Rod Case. His excellent slide set (e-mail me if you want it) makes the case for a service plan that coordinates the inputs from finance, marketing and sales. As is, each rolls its own, indicating a need for higher control of operations; better integration of commercial, operating, and customer supply chain plans; and tighter allocation capital. Too much money is going into line capacity, says Rod, and not enough money goes into terminal capacity, a contributing factor in today's congestion snarl-ups.

The NS Bellevue Yard expansion is one antidote, well-documented in the presentation of Deb Butler, EVP of Planning at the railroad, essentially recasting the Investors Day Bellevue trip (WIR Sep 28, 2014). Pat Ottensmeyer, Chief Commercial Officer for KCS, delved into his railroad's $3 billion Mexico investment, representing half the KCS franchise and concentrating its service offerings in the part of that country that receives about 85 percent of total foreign direct investment.

Canadian National COO Jim Vena talked about the role of safety in an environment where half the company's 24,000 employees have been hired since 2010 and where rail safety may not yet be sufficiently top-of-mind. Moreover, 70 percent of everything they move is local to CN, giving CN a unique opportunity to insure a high degree of rail safety awareness among all it customers.

Jim Hertwig, Florida East Coast President, demonstrated how to make money in short-haul intermodal. The trick, says he, is triangulating loads the way truckers would, mixing over-the-road and intermodal moves to meet specific market objectives, and investing in sufficient assets to keep keep everything fluid. Together, these four provided levels of insight and analysis rarely heard outside investors' calls.

Matt Rose, BNSF Chairman, closed Day One with a candid look at how one copes with the rapid passage from peak to trough and back to peak. Customers want to grow their businesses, he said, and BNSF has to have the capacity to allow them to do it. The $6 billion capex program for 2016 is just part of the picture. He calls it a virtuous cycle: make money, reinvest, make more money; lather, rinse, repeat. During the Q&A I asked him about his outlook for the manifest carload franchise. In a word, says Matt, margins. He sees healthy growth in the industrial products sector in an economy increasingly driven by manufacturing coming home. Can't argue with that.

Norfolk Southern's Brosnan Forest hosted another in its series of running-extra short line meetings this week. Roughly 120 souls representing short lines and customers met with counterparts from the NS marketing and commercial development departments to consider the opportunities in the carload sector. And while energy — in the form of crude oil and ethanol and the related inputs in the form of frac and piping — took center stage, the rest of the manifest traffic menu from paper to plastics got equal time.

The presentations and conversations around them were largely of a proprietary nature, so I'm reluctant to get into much detail. However, the camaraderie and candor you get with a bunch of people hanging out in their hunting and fishing togs is truly unique. A day spent in the field with a shotgun was a nice change from the usual series of meetings indoors with nary a chance to even get outside. This was my third or fourth Forest visit in the last 20 years, and every one of them was memorable — like the time we did a skit involving the Norfolk Stubborn and the Pinch Penny & Eastern, with NS folks playing the shortline parts and the shortliners being the NS-ers.

At this year's Forest session, NS set us three challenges: to make at least one new friend, to develop at least one new business opportunity, and to enjoy ourselves. A brief show of hands over Tuesday's dinner showed all three challenges were adequately met. Thank you, Norfolk Southern.

Providence & Worcester third quarter freight revenues increased 2.5 percent year-over-year to $8.5 million; other freight-related revenues brought the total to $8.7 million, up 1.7 percent. Demurrage and similar items were cut by more than half and increased maintenance billings to third parties recovered those losses and then some.

Operating expense after capitalized costs increased 2.2 percent, so operating income went south by 17.7 percent to $317,000. Once again I have to note that P&W's comp and benefits line remains at more than half of revenues vs. the usual Class II and III realm of 30 percent. As a result, the operating ratio post-capitalized expense was 96.5, an improvement of 80 basis points. Rentals and other below-the line income less taxes put net income at $453,000, down 23.7 percent.

The railroad handled 15,292 revenue units, of which 95.3 percent were conventional carloads with the modest intermodal business accounting for the balance. P&W makes a respectable $823 per revenue carload, up 3.6 percent, and only 71 bucks a box for intermodal, down half a point. Sometimes I wonder why they even bother. I'd love to know the incremental margins on the service. They also continue to pay Amtrak and Metro North right around $300K a quarter for trackage rights to Fresh Pond, Long Island for their aggregates service. Here again, incremental margins?

But in spite of it all, P&W continues to be the Little Engine that Could, building a respectable carload franchise and running some fantastic railfan excursions. A class act to watch and chase.

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