

# RAILROAD WEEK IN REVIEW

April 12, 2019

*“2018 was a record year for OmniTRAX and we know there may be some difficulties ahead in the economic landscape. Our leadership event helps us shape our strategy to take advantage of hidden opportunities within those challenges,” — Kevin Shuba, CEO, OmniTRAX.*

*“Over the next three months, we expect steel prices to remain stable with marginal upside risk due to seasonality. However, the current market oversupply puts a cap on near-term price momentum, in our view.” — UBS note to Clients, April 8*

*“Simply put, Artificial Intelligence is helping us turn our employees from finders into fixers, working to prevent a problem. These advancements in technology are not only making us a safer railroad, but making us better able to deliver on our service promise.” — Muru Murugappan, VP Technology Services, BNSF*

*“As freight volumes have been falling on the rails, inventories have been rising. While normally a disturbing trend (last seen in 2015), it is currently being explained away by ‘pre-shipping’ in 4Q18. The question is then how long it will take for inventories to get worked down in order to get back to a regular freight pattern.” — Stifel on Trucking, April 9*

*“Yesterday new factory orders were really rather ill, for they fell 0.5% in February following no change in the January figures and a 0.1% upward revision in December... Stripping out aircraft and other transportation equipment, core durable orders have fallen 0.1% in the last two reports.” — Dennis Gartman, April 9.*

**BNSF first quarter results will come out** with the Berkshire annual meeting May 4. By then we'll have heard from all the others, so it seems as good a time as any to give an estimate of what BNSF will report. The numbers are directly from the BNSF Week 13 AAR carloads report which lists 18 separate carload commodities from Automotive (finished vehicles and parts in freight cars, not intermodal) to Waste and Other.

BNSF aggregates these groups into just four categories in its financial reports: Industrial, Agriculture, Coal/Coke, and Consumer Products (auto plus intermodal). I've taken the AAR categories and sorted them into these four reporting groups, mainly because looking at results this way gives one a sense of what's driving the ups and downs of the four reporting groups.

Total revenue units were off 5.2 percent year-over-year. The Consumer Products segment was off 5.3 percent, while Coal/Coke, not surprisingly, dropped 11.0 percent. Merchandise carloads (combined Ag and Industrial ) slipped only 1.2 percent, with Industrial Products -- where most short lines live -- actually gaining two points.

The AAR sort also highlights the commodities making up the top twenty percent of volume. This is important because it gives a sense of where BNSF makes its money, given the old Rule of Thumb that eighty percent of sales come from the top twenty percent of customers. At BNSF, these are, in order of share of total carloads, grain, chemicals, petroleum products, aggregates, and automotive.

Of the five top commodity groups by volume, all but petroleum products were off in the first quarter. Recall BNSF said in the 4Q2018 narrative that agricultural carloads are affected by export volumes and so driven by external events. Industrial carloads go up and down with frac sand, crude oil, building products, and construction. And since we are in the latter stages of the business cycle, slow-downs here are not unexpected. At this stage of the game, there are too many moving pieces to make any 2019 predictions.

**OmniTRAX has taken recognition** of individual and team performance to new levels. At their recent individual National Leadership Meeting OmniTRAX awarded ASLRRRA Jake Safety Awards (one year with no injuries) to 13 of its 20 individual short lines, no mean feat in shortline land. To qualify, an ASLRRRA member railroad must perform better than the Class II and III industry average injury frequency rate as reported by the Federal Railroad Administration (FRA) during the prior year.

In addition, OmniTRAX has its own OmniSAFE awards, which go one step further. This prize goes to all OmniTRAX operations that had zero injuries in the previous calendar year, including FRA reportable *and non reportable* first aid injuries. Eleven roads were so recognized. And finally on safety, OmniTRAX has its Culture of Safety award. This year it went to Bryce Anderson, General Manager of the Nebraska, Kansas & Colorado Railway, for operating the railroad without a reportable derailment for over seven and a half years, while handling 60 percent more carloads than forecast in 2018.

Then there's the Railroad of the Year, the Brownsville & Rio Grande International Railway. The BRG had a 25 percent year over year increase in carloads, almost a 20 percent year-over-year increase in revenue and the last FRA reportable derailment was more than 16 years ago. The award is based on safety improvements and asset utilization.

The OmniTRAX Energy Solutions Terminal of the Year went to the Cotulla Terminal, centrally located in the South Eagle Ford Basin, 90 miles southwest of San Antonio, TX. The award is based on overall operating and safety performance, which Cotulla won using Precision Transload Techniques, handling more than 1.3 million tons last year with a best in class operating ratio of 21 percent.

The Arrows Up Basin of the Year, which is awarded to the highest performing and safest basin in North America, was given to the Permian. Despite dramatic headwinds like some of the highest labor, lodging, and professional services costs, the Permian had the lowest operating ratio of all basins and had no reportable incidents in 2018.

The OmniTRAX Best Metrics awards, which are presented to the top operators based on the 24-hour report switch and on-time performance, went to Newburgh & South Shore Railway, Stockton Terminal and Eastern Railroad, and Kettle Falls International Railway.

By way of review, OmniTRAX is one of several shortline holding companies and terminal operators, very much in the same league as GWR and Watco. Core capabilities range from providing management services to railroad and port services and to intermodal and industrial switching operations. OmniTRAX is affiliated with Denver's Broe Group and the website is [www.omnitrax.com](http://www.omnitrax.com).

**Regional Rail LLC**, owner of several shortline railroads, principally in Pennsylvania, and owner of Diamondback Signal LLC, has been sold to London-based investment manager 3i Group. The announcement says 3i will own "100% of the company and that Regional Rail's management will "share in growth plans for future acquisitions." Financial terms of the transaction were not disclosed.

Run by Al Sauer, formerly of RailAmerica and one of the savviest shortline guys I know, Regional Rail is based in Kennett Square, Pennsylvania. Properties include the East Penn Railroad LLC (ESPN), Middletown & New Jersey Railroad, LLC (MNJ), Tyburn Railroad, LLC (TYBR), and Diamondback Signal, LLC, a highway crossing DBOM covering 20 states.

According to *Railway Track & Structures*, Regional Rail was formed in 2007 as a shortline and transload terminal operator; Diamondback was picked up in 2012. RR did 13,000 carloads in 2018 across markets including heating, fuel blending, agriculture, chemicals, and metals. 3i is a private equity and venture capital firm founded in 1945. It trades on the London Stock Exchange under the ticker symbol "III."

**Demurrage has become** enough of a railroad customer concern that it's been brought to the attention of the STB, according to a note at [rsilogistics.com](http://rsilogistics.com). "Companies are getting monthly rail demurrage bills in the high five figures or even in excess of \$100k." Not surprising. Class Is are getting aggressive on demurrage and in 2018 collected some \$937 million in demurrage fees.

In November the STB sent letters to select railroads asking them to evaluate their planned accessorial rate increases from the standpoint of commercial fairness and reciprocity. Then in December the STB sent letters to each of the railroads asking for quarterly demurrage revenue for 2018 and 2019. Hearings are scheduled for May 22; film at 11.

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