RAILROAD WEEK IN REVIEW

November 1, 2019

"Our short line and regional connections and our transload operators are key extensions of the CP franchise that allow us the scalable reach to new markets and destination choices for our customers. Our goal in bringing together these companies annually is to find efficiencies and opportunities — something of critical importance in today's economic climate." — John Brooks, Executive Vice President and Chief Marketing Officer, CP.

"Progressive Rail has its own parcels of land and buildings for sale or lease that may be the ideal match for your exact specifications. As a railroad we offer a unique perspective into the markets we serve with prime properties that quite often are quietly available, but not officially listed on the open market." — Progressive Rail, Inc.

"Automotive companies have announced 43,025 job cuts this year, 197 percent higher than the 14,489 announced through the same point last year. It is the highest total in the first ten months of the year since 2009, when 164,440 cuts were recorded." — Daniel Ruiz, Blinders off LLC

Canadian Pacific held its "Connections" shortline and transload conference in Calgary this week. This was the second annual session after a ten-year hiatus and the energy in the room was palpable. The reason was, I think, that there were more conversations to be continued and friendships to be built upon; last year was mostly a getting-to-know-you session.

Some 100 individuals representing more than 50 different companies (CP has about 80 non-Class I connections) were on hand to — as CP puts it — "nurture collaboration and develop efficient service offerings to customers, with the goal of fostering sustainable, profitable growth."

Roughly 30 CP managers mingled with the multitudes. In addition to John Brooks, there were Joan Hardy, VP Grain and Fertilizers and Jonathan Wahba, VP Intermodal and Automotive. Coby Bullard, VP Merchandise and Energy, Chemicals and Plastics also took part in the event; Mike Foran, VP Market Strategy and Asset Management, ably emceed the proceedings. Then there were another 20 or so presenting at the break-out sessions.

If there were a theme, it would be getting to trip plan compliance through pre-blocking and other tactics and being persistent both in building new business opportunities and keeping them in front of one's CP counterparts. They welcome more transload footprints on short lines and are especially interested in opportunities in liquids. They might even JV a project, given CP's skill set in getting across all the hurdles.

In ag and ferts, Joan Hardy says short lines have brought in new business worth more than C$20 million and there's another C$8 million in the works. Though short lines don't play much in the phosphate business, they account for nearly half the US grain. Colby Bullard's merchandise franchise has increased car counts (ex-frac sand and crude) by more than ten percent across the last three years; over the past year, two-thirds of the growth in that space has come from short lines. The trend toward Rule 11 is bothersome because you don't now how much you don't know and is therefore to be avoided where possible.

GK Kharla, AVP for transloads, says these facilities are crucial for accessing customers who are not next to the railroad. Key is leveraging available assets to expand the service offering— think of unused yard and side-track locations. There are already 47 CP transloads on short lines and, as noted above, CP has the resources to help short lines expand their transload footprints still further; more eastern destinations are eagerly sought.

The focus of the session was short lines *and transloads*. Which is appropriate since CP works with more than 100 such facilities across North America to reach rail and non-rail served customers everywhere. Some are adjacent to and served directly by short lines or regional railroads; others are railroad entities in themselves.

Exhibit A is the Progressive Rail Inc., a 13-railroad holding company based in Lakeville, Minn., just south of the Twin Cities, that began operations in September, 1996, initially to serve the Airlake Industrial Park. Since then, the railroad has not only expanded locally, including the "Dan Patch Line" — the Minneapolis, Northfield & Southern — but also has added properties in seven states from Washington to North Carolina, a mix of classic line-haul short lines and terminal or industrial park operations.

The company's approach to transloads and office parks has been so successful that they received an award for "Eastern Entrepreneur of the Year" at the CP conference. As one would expect from the Progressive Rail profile, the award was for finding new marketing opportunities and at the same time expanding and continuing CP's geographic expansion beyond its own track side. And, based on the energy and candor in Calgary, I'm willing to wager we're just seeing the start of more such entrepreneurial awards.

Merger mania continues. The Pinsly Railroad Company, a Massachusetts-based shortline operator, is selling its three Florida properties to the Pennsylvania-based Regional Rail Company, a wholly owned subsidiary of London-based i3 private equity firm. Last July's Regional Rail acquisition was its first foray into US shortline ownership.

The three Pinsly properties are the Florida Central (FCEN), Florida Midland (FMID) and the Florida Northern (FNOR). Together they operate 208 route-miles of railroad and do 13,000 revenue units annually. All three are former CSX lines acquired by Pinsly 30 years ago. Commodities include building products, chemicals, food and agriculture, and scrap metal.

At 13,000 loads, that's only 63 carloads per mile per year, falling well short of the 100 cars per mile rule. If they generate $300 in revenue per carload, that's $4 million per year. Track expense alone to keep 200 miles of FRA class 2 track at class 2 is a $million. Comp and benefits at the shortline average of 30 percent of revenue is another $1.2 million. That leaves $1.8 million for everything else.

As for multiples, $4 million in revenue ought to yield $2 million ebitda. If Pinsly gets three times sales, $12 million, that's 6 times ebitda, which is a reasonable number for a railroad such as this. Anything north of that could be problematic, especially given then way CSX has been cutting back on lower-rated commodities. Price was not disclosed; the transaction needs STB approval.

Block-swapping was a Hot Topic at the CP meeting. Readers will recall previous thoughts on the theme and its MOP origins. Even though that was 30+ years ago, we still see the organizational chimney (resistant to change) mentality that everything has to go over the hump at every class yard. Receiving yard, hump shove, bowl, departure yard. By contrast, block swapping is simple: receiving yard to departure yard track for the next train to the distant node. That way the outbound gets small blocks for its train to set out along the line of road for other trains destined to a different yard.

On the MOP, they'd make blocks for a Distant Node train to set out at intermediate junctions. Each block would be maybe 10 to15 cars. They would then be picked up by respective trains for beyond and their respective destinations. In the process, block swaps become so refined that all incoming manifest traffic could be shot directly to trains for distant nodes all over the system. What killed block-swapping? Everybody else's chimneys.

On the equipment side, FreightCar America (RAIL) took a Q3 net loss of $2.83 per share, including a goodwill charge of $1.74 per share, expanding on a $0.50 per share net loss during the same quarter last year. Revenue dropped to $40.7 million from $79.0 million during the year-ago period, lagging the $54.1 million analyst mean.

Their expectation is to finish their 24-month 'Back to Basics' initiative at year-end with more than $5,000 savings in material cost per average railcar on a run-rate basis, $12 million in future cash savings from fixed cost reductions, and four key new or redesigned products. Focus now shifts to completing the Company' s recently announced joint venture plant in Mexico and weathering industry headwinds.

Wabtec (WAB) Q3 revenue rose 86 percent to $2 billion. Off-shore performance of WAB's installed base offset North America freight market softness. Third quarter eps was 48 cents; full year GAAP eps will $2.05 to $2.10 range; cash flow from operations should hit $900 million.