THE RAILROAD WEEK IN REVIEW

May 23, 2014

"As expected, our survey respondents this quarter reported very weak service levels from the rails." — Ed Wolfe, Wolfe Research

The Number One item on the Shipper Wish List at NEARS was knowing exact arrival times for specific departure times. For what's possible, let's set the way-back machine to the mid-50s. Grab a copy of the July, 1954 *Official Guide* and turn to page 735.

Staring you in the face is a set of Missouri Pacific freight schedules with day of the week and times of departure and arrival for nine O-D pairs. For example, the best transit time is 1900 Monday out of East St Louis, arriving Houston at 0210 Wednesday. What I'd like to know is why don't we have this now, 60 years later?

The just-released Wolfe Research Shipper Survey says customers perceive railroads as beset with capacity and congestion problems that lead to inconsistent service. AAR performance metrics — train speed, dwell time, cars-on-line — are all averages, and specific operating patterns vary considerably from region to region and train-start to train start. Says Wolfe,

> Our survey respondents this quarter reported very weak service levels from the rails as expected. We asked shippers to rank the service improvement or deterioration for the rails compared with year-ago levels, with 1.0 indicating a strong decline in service and 5.0 indicating a strong improvement. The average score of 2.4 dropped dramatically this quarter and reached its lowest level in our survey in ten years.

The way out of this is for the railroads to start publishing freight schedules, as the MOP did in 1954. Then there's a commitment to service and something specific to measure against. I know it can be done. A few years ago a customer in Chicago was sending boxcar loads of custom-cut steel coils to five UP destinations. Transit times varied considerably and we wanted to know why. So I went to Omaha and sat down with the trip planning staff to see what we could do.

Turns out local trains out of some destination serving yards didn't work weekends, so a car arriving at the serving yard Thursday evening through Saturday noon didn't get to the receiver until Monday, adding a day or two to the trip plan. We fixed that by setting departure days for these locations for days that would hit the serving yard 24 hours before the local's departure. And our transit times looked a lot like the MOP's *Official Guide* ad, above.

Yes, I know stuff happens. It snows, knuckles break, locos can't get train air up in the cold. Or the river rises and takes out the main. But these are exceptions, and you can't manage a complex operation by exception. Publish a schedule and stick to it. Then maybe you'll start getting 5.0s in Wolfe's Transportation Survey.

Speaking of Wolfe Research, I had the opportunity once again to attend this week's annual Global Transportation Conference in NYC. And, once again, the shortline and regional railroad community was well-represented, with OmniTrax a first-time presenter. Some highlights:

Florida East Coast CEO Jim Hertwig says the company is betting big on the Panama Canal Expansion to bring new all-water traffic flows to the Port of Miami from the Pacific Rim. FEC provides on-dock rail service with trains built right there for both the northern connections and the FEC's container shuttle service to the new South Florida Logistics Center adjacent to the runways at MIA. This 1.5 million square-foot, temperature-controlled, Free Trade Zone facility gives customers access to 70 percent of the US population on one to four days.

On the Shortline Panel, OmniTRAX CEO Kevin Shuba says they're big in energy (frack sand, crude by rail), run grain to Hudson Bay four months a year, and are looking to expand by acquiring smaller, family-owned properties and industrial short lines owned by industries where railroading is not their core business. Indiana Rail Road CFO Mike Engle cites a banner year in 2013 with more than two billion GTMs, mostly coal, and they're building a non-coal commodity base for inevitable day when coal vols begin to shrink. Watco's Rick Webb touts their 20+ percent 10-year revenue and ebitda CAGRs and how the total service package - move, clean, repair - can create that enviable record.

GWR's Jack Hellman points to the DME acquisition as "the new paradigm," where a fixer-upper short line is taken over by a Class I that invests significant capex, and GWR comes along to continue the process. Jack expects to close deal in early June. At the same time, the railroad is increasing its revolving credit line to $600 million from $400 million for better terms and longer maturities. Further acquisitions will most likely be "within the current footprint."

CN Chief Commercial Officer Jean-Jacques Ruest reports nine percent quarter-to-date carload growth and 12 percent RTM growth. There is greater focus on yield - take or pay, making sure customers don't sit on cars, letting poor performers go to the other guy and see how *he* makes out. The second quarter is shaping up to be "very strong," though they'd like to see the ex-IC increase its share of CN revenues. Southern Region short lines take note.

KCS presenters Bill Galligan, VP Investor Relations, and Kelley Anderson, VP Auto sales, say year-to-date carloads and revenues are up six and 11 percent respectively on grain, frack sand and autos, continuing to high single-digit revenue gains for the rest of the year. The legislation in Mexico relating to railroad access is stuck in the Senate, which does not meet again until September. Galligan says shippers are good with the status quo and want no changes. Having cross-border vols settling in at 40 percent per year growth is a positive sign.

I missed CP's Hunter Harrison because it was either him or Hertwig, thanks to event scheduling. Wolfe's notes say CP is beginning the transition to a revenue story, citing potential for double-digit revenue growth, potentially doubling the size of the business in seven years. There was some speculation that a D&H sale may be next, as HH himself had hinted at a first-half 2014 decision. I haven't a clue as to who would buy the top end because there's so little on-line biz, and NS is the natural for the south end.

My take on the day is that the presenters are confident the sun will come out tomorrow and 2015 will be even better than 2014. However, the federal government remains the big cloud overhanging all. The AAR reports April YTD North American vols up three percent and the RMI short lines are up less than a point. Grain and petrol products are the big AAR gainers; in short lines it's ag products and coal, the latter mostly likely a function of GWR's restocking gains in the midwest. The rest of the year will have to be a real barn-burner for rail shares or multiples to gain any traction.

The Central Maine & Quebec begins operations this month over the rails formerly operated by the Montreal, Maine & Atlantic and before that Iron Roads, Canadian Pacific and Bangor & Aroostook. John Giles is President, and he brings with him a strong and talented staff of folks he's worked with before or who are to the Maine manner born.

Chief Operating Officer is Ryan Ratledge, who ran the P-SAP and IORY for RailAmerica under Giles. Sashi Mishra, CFO, worked with Giles at the Great Lakes Transportation US Steel roads spin-off and at RailAmerica. Jay Lander dons the Chief Commercial Officer hat, and is another RA alum, having run the pricing desk there. And Gaynor Ryan, who started in customer service with the BAR 20 years ago, takes on the admin duties associated with comp & benefits and human resources. Welcome all. And do visit their website, www.cmqrailway.com It's clean, readable and inviting.