THE RAILROAD WEEK IN REVIEW

May 30, 2014

"Santa Fe published freight schedules in the same [1954] time frame and they were committed to following their schedules." — Tom Hoback, President, Indiana Rail Road

"**The Number One item** on the Shipper Wish List at NEARS was knowing exact arrival times," I wrote here last week. Within days no less than five regular readers, all with considerable Class I railroad experience in the field, had responded. Excerpts:

A former Class I automotive marketing exec recalls the internal fights over running a scheduled railroad. The guaranteed-service auto parts contracts "mandated scheduled train starts which by the 1990s our operating people hated. They only wanted to run manifest carload freight trains when they felt like it and with 100 cars or more. For some reason they could never seem to understand that on a revenue basis our auto parts trains were some of the most profitable business on the railroad!"

Susquehanna's Jim Howarth forwards a copy of the 1922 *Official Freight Shippers' Guide and Industrial Directory of the Delaware and Hudson Company* that he found in Google Books. This amazing work is more than 350 pages long and, as Howarth puts it, "proves that great information was available to railroad customers long before the so-called 'information age.'" I particularly like this bit on page 74: "Time schedules may be obtained on application... These schedules are adhered to with great regularity."

Tom Hoback, Indiana Rail Road President, writes that the the MOP was not the only road touting freight schedules in the 1950s. "The Santa Fe published freight schedules in the same time frame and they were committed to following their schedules." Having framed the historical argument, Tom continues: "inconsistent and generally unreliable service by the Class Is hampers our ability to increase rail market share (usually at the expense of trucks)." The biggest challenge is getting the Class Is to do the last-mile work "within a narrow window of time." Consequently, "we are missing opportunities to add profitable merchandise traffic to the system."

A regular critic of mine who know the Class I mindset quite well recalls John Kneiling's *Trains* writings in the 1970s concerning the importance of consistent rail service. He asks rhetorically, "Why are we still talking about the importance of consistent rail service in 2014? Why hasn't this deficiency been corrected in over 40 years (especially considering all the technological advancements that have made railroading more efficient)?"

In a similar vein, Tom Erickson, a former Conrail marketeer now working in the shortline space, writes, "The complexity of railroading and the sea of daily tactical problems makes us lose sight of the huge strategic issue: the *quality* of railroad service in an era of just-in-time shipping."

> It wasn't just the MOP that published schedules in the 50's. Most of the large carriers did, and if they weren't officially published, at least the big customers knew that regular freight-train schedules existed internally (had to, when you were running scheduled passenger trains on the same R-O-W) and they could get info unofficially. By 1999, the fastest schedules between origin-destination pairs of terminal areas were only *half* as fast as those in 1954, and the frequency of service was only one-third as much."

Today, all the Class Is talk about service performance in their quarterly earnings calls. The Canadian roads show charts of GTMs per trailing horsepower, cars switched per hour and car-miles per day. UP talks about Customer Satisfaction scores. NS has its Composite Service Performance measuring how well the road meets certain internal goals. CSX still provides the most predictive measure, core-train on-time arrivals and departures from the main terminals (I remember Michael Ward saying the biggest cause of late arrivals is late departures.) But nobody is saying anything about freight car trip plan compliance between end points.

The crude-by-rail business is increasingly in the public eye. A press release is making the rounds with a list of oil train incidents; where, when, whose railroad, what happened. Of the 13 incidents, six resulted in fires. One of them (Megantic) has been linked to crew failure to follow the rules. The BNSF side-swipe may be the same. So we've had four bet-the-farm, possibly track-related, accidents over the past year.

The AAR says through 2010, 99.9977% of *all* rail hazmats moved without a release caused by a train accident. That's still 23 cars, half the number that derailed at Lac Megantic. But consider the odds, especially if all 23 cars are in the same event. Sam Goldwater, one of the country's leading experts in rail-related oil fire emergency response, writes,

> We've found that in a typical mixed freight train of 100 cars, on average six of them will be hazardous. We also know the typical freight train derailment is seven cars. That means in a mixed freight derailment you have a pretty good chance that a small number of total cars and and no more than 6 hazardous cars will be involved.
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> On a unit train of 100 cars, all of them are hazardous and all are at risk. [*Bakken crude is now STCC 49 101 91, a hazmat number. - rhb*] The typical seven-car derailment is guaranteed to be *all* hazardous, which means that derailments can be that much more dangerous. The statistics don't matter. It was one train that killed 47 people. *One train*. Every crude-by-rail train has the same odds of being that one train. As in craps, rolling the dice does not follow numerical order. Each roll has the same risk. Each train could be the next one.

So even though the railroad safety record in crude by rail has by and large been good, the odds are still the odds and that's where the popular press is coming from. "We're prepared" press releases don't cut it with the South Philadelphia resident who sees the oil trains out her window.

The rails have to be able say the odds of an incident are minuscule, but if there is one, here's what we'll do. Then do a show-and-tell and invite the press.

The USDA Corn Crop Report is in. A Wednesday note from UBS has 2014 USDA corn plantings 88 percent in the ground, ahead of last year (84 percent at this date) and the same as the five-year average. "To the extent that the corn crop progresses in-line with historical averages (no weather-related disruptions that limit yield or harvested acreage), we expect corn prices to remain subdued relative to year-ago levels. "

UBS concludes lower corn prices could lead to a singe-digit drop in farm incomes and possibly depress ag equipment sales, possibly down double-digits year-over-year. Moreover, "We expect Deere share prices to revert to more historical norms relative to corn price performance." The good news is cheaper corn means more for chicken feed, ethanol and HFSC. The bad news is lower Deere sales means fewer loads in that rail commodity segment.

Credit-Suisse has added Canadian Pacific to its US Focus List as a Top Investment Idea, with a DCF-derived $205 target price, up 24 percent. Analyst Allison Landry writes,

> Canadian Pacific is one of our highest-conviction ideas in the transport sector. The company is on the precipice of its next leg of growth: the transformation from a cost-turnaround story to one of controlled, sustainable, and profitable revenue generation. The company should see significant earnings growth over the next few years.
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> Contributing factors include continued margin improvement, an acceleration in revenue growth (specifically in more profitable commodity types), improved capital efficiency, continued shareholder returns [*dividend now an industry-trailing 0.8 percent — rhb*], and opportunities to improve the capital structure and dispose of surplus assets.