THE RAILROAD WEEK IN REVIEW

January 9, 2015

"Our baseline assumption is Brent averages $84 per barrel in 2015." — Goldman Sachs 2015 Outlook, January 5

AAR Week 52 combined North American rail volume hit 37.2 million units, up 4.4 percent; of that, intermodal containers and trailers accounted for 17.0 million units, up 5.4 percent and representing 45.7 percent of the total. Merchandise carloads, including ag products but ex-coal and auto, the most important commodity groups to shortlines, increased 4.9 percent and represented 33.7 percent of total railroad revenue units.

Within the merch carload commodity groups, the only double-digit gainers were grain (10.4 percent) and petroleum products (12.5 percent). Next up was non-metallic minerals, up 9.5 percent and which includes frac sand. Industrial chems including ferts as well as metallic ores and metals gained less than two percent while forest products (wood and paper) shed two-tenths of one percent.

That jump in petroleum products deserves some explanation. First of all, it combines crude oil STCC 13111, with petroleum products, STCC 29xxx. Second, readers will recall I've shown in the past how all the growth is in crude oil and the 29s don't vary that much according to the STB's QCS tables. Take the CSX-NSC comps, for example. Starting in the 2010 first quarter and running through the 2013 second quarter, both roads stayed in the 8,000 to 10,000 car range. By the second quarter of 2014 (the STB tends to lag by two quarters) NGLs had reached the 12,000 car level.

Crude was virtually zero for two years and didn't start to tick up for either road until first quarter 2010 when they took off at a 45-degree angle, averaging 28,000 cars each by the end of last September. So as the 29s grew by 4,000 units on both CSX and NS Jan 1, 2012 thru Sep 30, 2014, crude oil went from nothing to nearly 30,000 carloads a quarter on each. The take-away is that while NGLs have a big shortline presence, the Class Is dominate the crude-by-rail business. So the AAR's petroleum products gain doesn't reflect Class II and III road participation the same way forest products might.

Among the seven Class Is, fourth quarter year-over-year volume changes are a good indicator of the State of the Industry. CN led the pack, up ten percent; KCS brought up the markers at less than one percent. Average train speed deteriorated four percent, with only CN and BNSF posting gains. NS slowed the most, down 14 percent. Terminal dwell hours improved one percent with NS posting the greatest improvement, 22 percent. For that, NS gets high marks for getting trains out of the yards promptly after they got in. I suspect bringing on Bellevue played a major role.

As for 2015, the Jan 7 note from Wolfe Research puts it this way: “Volume comps are easy the next three months, but then get very difficult in 2Q-4Q. Rail service should improve, but headcount and non-fuel costs will still likely increase. Lower oil prices seem positive for consumer demand, but crude-by-rail vols could start rolling over in the next 6-12 months.” The biggest concern for non-Class I roads is sustainable service improvements followed by protecting merch carload vols.”

Auto shipments are going to be up. Dennis Gartman writes (Jan 6) total vehicle sales are running at a 17 million unit rate. “Apparently, Americans are once again falling in love with pick-up trucks at the expense of smaller vehicles. Low priced gasoline will do that sort of thing.” More bigger vehicles on showroom floors means fewer vehicles per auto rack and thus that many more carloads for the rails.

Because crude oil prices will affect so many purchasing decisions, I’ve been watching the debates about why petrol prices are behaving as they are. The best summary I’ve seen comes from Thomson/Reuters:

> The impact of a fall in the price of crude oil depends on its cause. If an increase in supply had driven down the price then this would be unambiguously good news for the global economy, as it would represent an increase in potential output. It would benefit oil consumers more than oil producers.
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> However, if the reduction in price were instead a reflection of weaker demand, then the consequences would be quite different. Such a fall in price would not tend to be associated with a pick-up in economic activity – quite the reverse. In our view, the fall in the price of crude oil through 2014 reflects gathering evidence of a dramatic slowdown in China. If we are right, then oil producers will be hit hard, though oil consumers outside of China may feel some benefit, in the short term.

As if in support, Morgan Stanley’s Adam Longson writes,

> Deteriorating oil fundamentals only reinforce our bearish 1H15 view. We’ve noted a number of worrying signs: 1) Oil physical markets and structure have weakened to better match flat price. 2) An inventory overhang is already emerging with storage economics only improving. 3) New supply has entered the market, offsetting Libya outages. 4) A potential framework agreement with Iran lifts the potential for more OPEC supply. 5) Few signs of capitulation on output from Saudi Arabia.

And though the main-stream press focus has been on crude oil, there are signs the price of nat gas and NGLs could be slipping, affecting carload vols of cement, pipe, and sand, among other things. Short lines in Wisconsin, eastern Ohio and North Central Penna will see it first.

The pricing thread (Dec 19) brought forth a number of thoughtful comments. A class I friend of more than 20 years asks, "Have you considered that some of the mystery and/or 'high science' that permeates the RR pricing environment is fomented by shippers who refuse to pay simplified published rates that exist today? Or don't even know how to find such rates?"

Yes, I have, and I conclude that customers push back because they can. Buyers make their in-house bogeys by getting more for their transportation dollar this year than they did last. In my world, they'd have to get used to the concept that price in front of them is the price, just as when you buy an airline ticket. It's a great opportunity for railroad sales staffs to practice some consultive salesmanship. And where a second Class I participates in the move the only requirement is getting the other guy to give you a single number for the customer.

Another reader says I'm "dead-wrong on the pricing issue. The complexity of current pricing tends to reflect all sorts of market forces, all of which drive specific prices to fit specific market and operational conditions." I'm still not dissuaded. My point is simply that freight rates are complicated because shippers want to haggle. Make that unacceptable behavior and the haggling will stop. There may be many decision points going into a rate, but each decision point is a yes or no decision box. If the rate covers this line-item cost, go to next step. If it doesn't, stop.

Short lines can cut the haggling short with a little homework. You want to move 100 tons of widgets from Akron to Atlanta. The QCS tables at the STB website tell you NS moves 1,000 cars of widgets a month at an average RPU of $2,000. You also have a connection with CSX and from QCS learn they do 2,200 cars a month at $1,900 each. You call NS and say, "Look. I know NS does 1,000 cars of widgets a month and average $2,000 car. CSX gets $1,900 and the truckload equivalent from my customer is $1,800. Can we do it for $1,900, yes or no?" End of discussion. No need for anybody to get back to you.

There is no doubt the Class Is have the databases to facilitate changing rates in a heart-beat, based on congestion, lane demand, car availability and so forth. Then it's up to the customer to select the degree of customization he's willing to pay for. To continue the airline example, if first class is full, buy coach. If non-stops are full, buy a route with a change or go when non-stops are available. As I'd said here before, rails are batch processes and are priced accordingly. You want a custom move, take a cab or hire a truck and pay accordingly.

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