RAILROAD WEEK IN REVIEW

September 16, 2016

"Not only is the US economy looking at lower growth for longer, but also financial engineering is deeply destructive for the real economy, stretching out the pain. -- Bob Janjuah, Senior Independent Client Advisor, Nomura International Plc

Genesee & Wyoming August 2016 carloads slipped 2.8 percent year-over year. Coal continues its decline, due mainly to utility customers in the midwest and northeast burning less of the stuff, though, happily, coal also continues its decline as a percent of total carloads.

GWR NA units							
August				2016	2015	YOY	
	2016	2015	% Chg	% Total	% Total	Chg	Cume
Coal & Coke	21,993	25,099	-12.4%	15.9%	17.6%	-1.7%	15.9%
Mins & Stone	17,936	18,715	-4.2%	12.9%	13.1%	-0.2%	28.8%
Ag Products	17,559	17,632	-0.4%	12.7%	12.4%	0.3%	41.5%
Chemicals	14,933	14,987	-0.4%	10.8%	10.5%	0.3%	52.3%
Pulp & Paper	14,426	14,856	-2.9%	10.4%	10.4%	-0.0%	62.7%
Lumber, FP	12,269	11,319	8.4%	8.9%	7.9%	0.9%	71.6%
Metals	11,383	11,587	-1.8%	8.2%	8.1%	0.1%	79.8%
Petroleum	8,728	8,902	-2.0%	6.3%	6.2%	0.1%	86.1%
Food, Kind.	5,312	5,142	3.3%	3.8%	3.6%	0.2%	89.9%
Waste	4,528	3,705	22.2%	3.3%	2.6%	0.7%	93.2%
Auto	2,447	2,455	-0.3%	1.8%	1.7%	0.0%	94.9%
Metallic Ores	1,752	2,174	-19.4%	1.3%	1.5%	-0.3%	96.2%
Other	5,246	5,998	-12.5%	3.8%	4.2%	-0.4%	100.0%
Carloads	138,512	142,571	-2.8%	100.0%	100.0%	0.0%	
Intermodal	18	0	na	0.0%	0.0%	0.0%	
Total rev units	138,530	142,571	-2.8%	100.0%	100.0%	0.0%	

The yellow highlight represents 80 percent of revenue units. It's an admirably balanced list, with forest products and paper comprising a quarter of the 80 percent. Frac sand lives in mins and stone, and piping for drilling lives in metals. Petrol products from oil to asphalt are down two points, so you can see the fit among these three commodity groups.

The bump in lumber is a bit of a surprise, though the prospect for increased housing starts (per the AAR's *Rail Time Indicators* for August) "remains very positive. Sales are up, despite a shortage of homes on the market in many cities and rapid price appreciation. Thus, builders have every incentive to get as many new homes built as they can." And since the wood comes from the PNW and the houses are being built in the southwest, GWR stands to benefit.

Year-to-date looks weak. Total revenue units through August are running 7.4 percent behind where they were at this time last year. Looked at another way, August loads are actually 11.3 percent ahead of Jan; a year ago August carloads lagged Jan vols by 4.5 points. But because 2015 monthly loads were generally more than they've been in 2016, quarter-to date this year lags 2015 by 4.3 percent — better than the earlier guidance, off six, at least.

Nearly every week this summer, I visited a non-Class I railroad to see how they were doing and what was working best. What I saw and heard leaves me more convinced than ever that there is a strong demand for merch carload service done right. Some examples:

* A plastics customer with 16 spots wants to add a track so he can bulk-transload product for a nearby satellite facility. At present, product comes from another bulk-transload 100 miles away. He's figured he can get better turn-times for all his leased cars and exert better control over his supply chain if all his cars come to the same place.

* A lumber receiver can double his center-beam inbounds if the Class I rails can take three days out of the present transit time. He buys FOB origin and three days inventory carrying costs make rail uneconomical.

* A bulk terminal for NGLs can support another two trains a week, filling a void left by the crude-oil carloads lost as a result of the spreads.

* Irregular Class I service to a short line interchange jeopardizes significant boxcar volumes that could very well go truck. The customer prefers boxcars, but is wary of supply-chain interruptions.

* A short line could cut car cycle time, increase Class I car contribution per day, and improve Class I car-miles per day if the serving Class I would make interchange at both ends of the 150-mile short line with the interchange point determined by the origin.

* An automotive after-market supplier is consolidating several truck-served DCs at one new, centrally located, rail-served DC on a short line with access to two Class Is.

Meanwhile, a loyal reader — with whom I shared the above — tells me he was at a metals conference in Chicago last week and heard similar comments about wanting more rail action. Not knowing whom to call is a particular sore point because the turnover in railroad sales and

pricing staff members provides no continuity in coverage. Worse, the newbies are unfamiliar with the business at hand, lacking even basic knowledge about specific customers, the customers' customers and competitors, where the commodity OD pairs lie, and cost margins.

The customers with whom he spoke in Chicago get the impression that there is a broad push on transactional selling — get the order and get out — as opposed to consultative selling, where you try to figure out what the customer is buying and why. At which point you recommend the railroad product — carload, transload, intermodal — that best fits the need.

And that's where short lines and regional railroads are so exceptional. I'm just saying that if we look more at the business case and less at How We've Always Done It, I think we can breath new life into the merch carload sector.

So how is the short line and regional railroad community doing? Nine years ago, in 2007, the GE RailConnect index for Week 43 (Oct 25) showed 5.2 million loads with 339 roads reporting. This year, the Week 36 (Sep 10), RailConnect shows 4.6 million loads with 412 roads reporting.

Using an average carloads-per-week factor, the 2016 Week 43 ought to come in at 5.6 million carloads, up one percent. By comparison, for the same period, AAR revenue dropped 23 percent — from 11.3 million units in 2007 to 8.7 million units this year (AAR *Rail Trends Indicators*, 9/9/2016, page 6), down 23 percent. (Even though we have 21 percent more names in the RailConnect mix, we're still flat, not down.)

To be sure, we have some apples-to-oranges comps. GE counts US and Canadian non-Class Is; the AAR number is just U.S. rail revenue units. But the trends are revealing nonetheless: Non-Class I volumes are holding their own while the Class I units are coming down. Worse, most shortline cars move over Class Is at some point in their journeys, thus masking some Class I organic losses.

The WIR mantra continues: the shortline community is closest to its customer base, and is thus in a better position to grow organic volume and find new business. Up a point in nine years is hardly a strong selling point, but it's a lot better than down double-digits.

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