RAILROAD WEEK IN REVIEW

March 30, 2018

“Passenger trains are the canary in the coal mine. When they cannot make their achievable schedules, it usually means the host railroad is also in a world of woe.”— Fred Frailey, Trainsmag.com

“The Dow Jones theory was based on the assumption that the Dow Jones Industrial Average and the Dow Jones Transportation Average have a symbiotic relationship, because transportation companies take and deliver what industrial companies make.” — Barron’s

The AAR’s *Rail Time Indicators*, a monthly compilation of railroad commodity and economic trends, provides invaluable clues as to where the carloads are and are not. And to get an up-to-date sense of where your target commodity falls in the general scheme of things, you can always check the weekly traffic data on the AAR website.

For example, take the 12/31/2017 US Rail Traffic Report. The table sorts the AAR 2017 merch carload commodity list by individual commodities and commodity groups. You can see what’s in each commodity group and how well each line scores in relative importance to Class I railroads. In 2017, grain, STCC 28 chemicals, and STCC 14 aggregates made up 50 percent of all Class I merch carloads. The more-inclusive ag products, chemicals, and non-metallic minerals groups made up 75 percent of class I merch carloads.

When a non-Class I carrier calls its Class I connection for rates and trip plans, it’s generally selling something -- I have this move; let’s do business. And if you’re selling moves of grain, STCC 28 chems, or aggregates including frac sand, your chances of success will be better than if you’re selling wood chips, MSW, or lumber. You want to go where the volume is — where additional carloads can be added at low incremental cost, helping the Class I’s OR story.

You can sort out your Class I connections’ carload commodities this way if you take their weekly AAR carload reports right off the website, probably under the Investors Tab. Doing so, you’ll find that there isn't much of industrial America left on the railroads anymore — metals including scrap, ore and coke, and forest products all under 10% of the total merch carloads.

We can see the higher-rated commodities’ share of total carloads shrinking inexorably. That’s not good. Fact is, as the time-value goods go away, and there are no more highly rated commodities to haul, then the Class I RPU starts to drop. A railroad traffic base comprised mainly of low-rated commodities, with rates that will barely cover fixed costs, can’t do much for contribution to overhead. This is what drives railroad to spin off marginal branch lines to others.

Happily, the non-Class I community has an excellent track record for reviving moribund branch lines with aggressive customer contact and supply-chain involvement. Doing so stems the exit rate of the higher-rated business, and can bring back what was lost. I'm hopeful the folks bidding on the upcoming CSX line sales will be able do precisely that.

Writing in *Railway Age*, University of Tennessee economist Mark Burton posits that "Most of what is really broken or threatening to the railroads can be addressed with good industry management. What lies ahead is hard work, not imminent disaster." He concludes, "the quality of Class I freight rail service is not even close to what it can be and must be... Customer favor is rooted in the reduced variability of transit times. The post-Staggers railroads in 1986 were finally able to deliver what they were selling. If our predecessors could do this using SD40s over jointed rail, surely it is possible now." He has a point.

We've managed to run off most of the higher-rated boxcar traffic, trading it for low-rated "one lump is like every other lump" bulk commodities with little or no time value. The difference, I think, between then and now is that then railroads ranked customers' logistical needs as Job Number One, whereas now sequential improvement of quarterly results ranks first.

Independent short lines have no Wall Street following and so can focus on delivering what the customer wants, while delivering annual carload growth north of 10 percent, with no help from intermodal or automotive trade to speak of. Moreover, they do it with ORs in the 80s, tops (many are in the 60s, with incremental margins in the 80s), and they have very sticky customers.

For example, just this month a short line customer posted an 11 percent increase over the previous four-year average in railcar volume; another customer brought in a 21 percent gain in 2017 railcar volume over 2016, representing a 17 percent increase over the previous four-year average. Yet a third customer handled the most railcars ever over its 20-year relationship with the short line. Carloads here last year represented a 38 percent increase over 2016's total and a 100 percent increase over the previous four-year average. The railroad as a whole increased 2017 carloads by 19 percent year-over-year.

So what's wrong with the Class Is? A shortline friend of some two decades is fond of saying, "The Class Is must lead, follow, or get out of the way." His point is that even as the Class I railroads say they want more carload business, it seems too many offerings of potentially decent-rated shortline business are pushed away.

Worse, the big roads seem not to know what business they lost to the trucks or where tariff rates make would-be customers look elsewhere. Or that a pricing manager is so green he doesn't know how his commodity business really works. The Class Is are in the way.

A possibly apocryphal tale of a Class I's inward focus concerns branch lines in the deep South in the 1960s. The two biggest commodities were short log pulpwood and feed corn. The railroad decided margins were too thin on the pulpwood and so it was "de-marketed." Trouble is, the

pulpwood margins were at least enough to cover avoidable (variable) costs and make some contribution to cover the fixed expense. Losing the pulpwood meant increasing the rates for the remaining corn, making it non-competitive. The line was abandoned in short order.

Look at it this way. The One Train Railroad has four cars: plastics at $4,000; clay at $2,800; paper at $2,400; and aggregates at $1,800. Operating cost per car, $1,000; train cost per car $500; fixed overhead cost per car, $600. The plastics and clay are profitable, whereas the aggregates and paper cars lose money. Take away the low-rated cars and all the variable costs of the train and fixed overhead are more than the high-rated cars cover. Another line in the dust-bin.

Pennsylvania has approved $32 million for 27 freight-railroad improvement projects, through the Rail Transportation Assistance and the Rail Freight Assistance Programs. The state, with 67 operating railroads — more than any other state — covering some 5,600 route-miles, has instituted these programs to assist in maintaining and improving these privately-owned properties. Among the largest grants (owners in parentheses):

** *Allegeheny Railroad* (Carload Express) — $2.9 million for CWR and surfacing 10 miles;
** *W&LE* — $2.3 million to rehabilitate 18 bridges;
** *RJ Corman Pennsylvania Lines* — $4.2 million to upgrade 36 miles in the Clearfield Cluster;
** *Buffalo & Pittsburgh* (GWR) — $2.1 million to upgrade 20 miles of track around Brookville;
** *Southwest Penna Railroad* (Carload Express) — $1.8 million to CWR and surface three miles in Fayette County;
** *Westmoreland County Industrial Development Board* (Carload Express) — $1.7 million to CWR and surface three miles Radebaugh-South Greensburg;
** *Norfolk Southern* — $3.9 million to improve track clearances in Middletown;
** Steelton & Highspire (Mittal Steel) — $2.0 million for running track and turnout upgrades near Harrisburg, plus another $900,000 for similar work at the Mittal Coatesville plant, formerly the *Brandywine Valley* RR.

Other railroads receiving grants of less than $1 million: East Penn, Tyburn, Oil Creek & Titusville, Western NY & Pa, Delaware-Lackawanna, and Lehigh Valley Rail Management. Given the success short lines such as these have had in expanding existing customers' railroad operations, and in creating new customers, it is only fitting the state support these infrastructure improvement projects. It's good to know my tax dollars are at work in this manner.

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