RAILROAD WEEK IN REVIEW

September 7, 2018

New home sales fell 1.7 percent in July to a nine-month low after a 2.4 percent drop in June according to the Commerce Department; existing home sales fell 0.7 percent in July according to the National Association of Realtors, to the lowest rate since February 2016.

Week 35 merch carload numbers for the quarter to date are encouraging. There's an accelerating trend toward increased volume growth and short line commodities are playing a strong role. For the last four weeks commodity carloads are up 7.3 percent vs. 3.3 percent year-to-date.

Within the group, grain surged 19.7 percent in the trailing four weeks, vs. a quarter of that rate year-to-date. Forest products (paper *and* wood) jumped 7.9 percent over four weeks compared to 2.8 percent for the year so far. Metals gained 8.0 percent over four weeks vs. 6.5 percent for the year. STCC 28 chems gained 9.9 percent vs. half that for the year. (Petroleum products gained 32.3 percent, but that's mostly crude oil — which bypasses most short lines — as the STCC 29 volumes remain pretty steady year-to-year.)

At the same time, terminal dwell times are increasing and system train speeds are decreasing. But carloads are up anyway. What would happen if dwells decreased and speeds increased? The opportunity is there. Cowen's Jason Seidl observes,

> The industrial economy is strong, trucking capacity is tight, and fuel prices remain high. In other words, *it's a good time to be a railroad*. One could argue that it has almost been too good of a time to be a railroad as service levels have been (to put it modestly) subpar this year. Earlier in the year, the rails could point to weather as being a main culprit, but now the service level difficulties are a combination of stronger than anticipated volumes, lack of manpower, and the need for some structural upgrades. (italics mine)

Seidl concludes, "Investors would like to know when the rails will be able to fully take advantage of this strong market by maximizing their pricing power and operating in a more efficient manner." So would the feeder railroad community.

Canadian National is buying 60 more GE units, building on their 200-unit order placed last December. Similar to the 2017 purchase, this order includes Tier 4 Evolution™ Series locomotives equipped with GE's latest software to enhance power distribution, train handling, brake control and fuel utilization. The entire order will be produced at the GE Manufacturing Solutions facility in Fort Worth, Texas.

The rationale for the expanded locomotive order comes from customers' increasing demand for the CN transportation product. Year-to-date CN revenue units are up 4.1 percent; in the last four weeks alone grain jumped 20.7 percent, and other merchandise grew 7.5 percent, while intermodal boxes actually came down a point and a half.

None of this comes as a surprise. CEO Ruest said on the Q2 earnings call just six weeks ago,

> Demand is currently strong, and the demand outlook for the remainder of this year is strong and broad-based as well. This is why we are adding capacity and resiliency to our network. Volume in revenue ton miles was up seven percent. Same-store price for Q2 was up a solid four percent; sequentially from the the last quarter it was up 2.7 percent.

Kansas City Southern has released its 2017 sustainability report, "For the Long Haul: Delivering Prosperity, Valuing People, Protecting the Planet". The report, according to CEO Pat Ottensmeyer, lays out the reasons KCS' sustainability priorities are important to its business. Highlights include a summary of the railroad's value in its cross-border rail network; highlights of the PTC implementation progress; showing why employee training hours are up by approximately 55 percent; and meeting a corporate fuel consumption reduction target of four million gallons.

At the same time, total KCS revenue units (US+Mexico) are up 6.4 percent for the trailing four weeks vs. 1.6 percent for the year, further strengthening the late-surge argument, above. To be sure, comps are easier the rest of the quarter before getting much tougher again in 4Q. However, KCS sounds very positive about the NAFTA progress, as well it should. See you in KC Sep 18-19 for their shortline gathering.

OmniTRAX has sold the Hudson Bay Railway and Port of Churchill to the Arctic Gateway Group LP and a consortium of First Nations and communities in association with Missinippi Rail LP. The sale closed Aug. 31.The Arctic Gateway Group consists of Fairfax Financial Holdings Ltd. and AGT Food and Ingredients Inc. The Missinippi consortium gets a 50 percent ownership stake, giving participating communities preferential employment and contracting opportunities. No word on how much was paid to whom.

The acquisition will allow for the repair and restoration of the rail line — the only land link to Churchill — which has been shut down between Gillam and the port for the past 15 months due to flooding damage that occurred in spring 2017. Work will begin immediately to repair the line and all efforts will be made to restore service before winter 2018. Cando Rail, a Canadian short line and services operator friendly to CN, and Paradox Access Solutions won the contract.

For its part, OmniTRAX has successfully resolved an awkward situation that has gone on too long. It appears to me that the Canadian government has not been consistent in its OmniTRAX relationship across successive administrations, thus providing one more reason for shortline operators not to get involved with government entities where the success of the relationship depends on the kindness of strangers.

Eyal Shapira has morphed his Raritan Central into the Rail Enterprise Group with the addition of two new properties. Both will open their doors for business next Jan 1 and are in the commercial zones of Department of Defense facilities. The Iowa & Middletown Railway will serve the Commerce Center of Southeast Iowa in Middletown on the river just west of Burlington. The Wolf Creek Railroad is northwest of Memphis. BNSF and CSX respectively are the serving Class Is.

Separately, Shapira's railroad customers in the Raritan (NJ) Center Business Park can now receive and dispatch 286 equipment. The limiting factor had been an Amtrak weight restriction on their ex-PRR northeast corridor between Oak Island and Metuchen, New Jersey. Conrail Shared Assets is the serving Class I, giving Raritan Center Access to both NS and CSX.

I'm off to CP/Calgary at oh-dark-thirty Saturday for what ought to be an instructive meeting of short lines and the Creel management team. It'll be the first such session in ten years, and much has changed for the better in the interim. Look for my remarks here next week.