RAILROAD WEEK IN REVIEW

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“We are not currently meeting customer expectations. Unified Plan 2020 is our path forward to secure our place as the industry leader in safety, service and financial performance.” — Lance Fritz, UP Chairman, President, CEO

“One of the key ingredients in the KCS long-term growth strategy is to further develop those rail relationships with business partners such as short-line railroads.” — Pat Ottensmeyer, KCS President and CEO, Barron’s Letters, September 14

KCS held its annual “Strategic Partners Conference” in KC two days ago. Roughly 300 souls from the US and Mexico representing short lines (KCS has 50 direct shortline connections), customers, ports, transloads, and warehouses filled the room nicely. The session opened with a reception and dinner at a nearby sports bar, No Other Pub, featuring games from shuffleboard to bowling and a well-stocked bar with generous pours. KCS President Pat Ottensmeyer stuck around for the entire evening — usually CEOs put in a cameo appearance or none at all.

Wednesday was devoted to power-point presentations in the morning and booths and tables for exhibitors and the various KCS commodity groups. Recall that KCS said on its 2Q2018 earnings call that they saw second half growth for 90 percent of the total revenue unit count. Only coal, crude oil, and frac sand are in the other ten percent. The cross-border intermodal product has further room to grow, and the railroad supports an admirably low leverage ratio of just 2.2 times ebitda.

Ottensmeyer opened his remarks saying that KCS business partners — shortline railroads, ports, transload operators, and others — represent “a key ingredient of the KCS long-term growth strategy.” Moreover, says he, they’re in no hurry to hit a 60 OR, opting instead to focus on the business at hand, of which Mexico is an important part.

“KCS is a Mexican company,” says Ottensmeyer. “We’ve invested more than $5 billion there since 1997 (NAFTA was signed in 1994), and, unlike international companies like GE and its ilk, we’re not going anywhere.” KCS spends more than 20 percent of revenues on capex (several points higher than the industry) and it’s about a 50-50 split between the US and Mexico.

Ottensmeyer is passionate about KCS being a Mexican company. Last July, testifying before a House subcommittee on NAFTA, he said he backs the extant international arbitration process as a way for US interests to protect their investments in Mexico. Then in a November WSJ interview, Ottensmeyer said, “Yes, NAFTA is good for my children” because it creates millions of US jobs, benefits farmers and ranchers, and helps support more than 100,000 small US business with customers in Mexico. In fact, if NAFTA went away, it could cost up to a million US jobs.

As it happens, cross-border traffic is growing so fast that dwell times in yards serving the Laredo crossing are “elevated” and that negotiations are underway to get the handoff between US and Mex crews in serving yards rather than on the border-spanning bridge itself, doubling bridge capacity and cutting transit times by a day or more.

KCS Mexico President Jose Zozaya said in his remarks that NAFTA represents 25 percent of the world GDP, that the exchange of goods between the US and Mexico grew more than six percent last year, and that the railroads handle nearly 16 percent of the commodity exchange between the two countries. The outlook for the petroleum products sector is especially bright. Transit times are short, there are fewer permitting hurdles, and bi-directional moves offer better market access.

Brian Hancock, currently EVP Marketing and soon to be Chief Innovation Officer, overseeing the Block Chain relationship among other such critical initiatives, opened his remarks saying that their shortline and regional railroad connections effectively double the KCS route-mile footprint, and that, not only are a fair number of the current 135 transload locations on short lines, but also that they’re looking for more feeder railroad participation.

The merch carload sector (everything but coal and intermodal and it’s here short lines live) accounted for roughly 50 percent of revenue-unit volume as of the end of June, 2018, and innovation is critical for high-velocity terminals that yield faster car-cycle times for customers. The Block Chain initiative, with its instant data transparency for all participants in a move, coupled with a more autonomous railroad and driverless drays, is a start toward getting underutilized assets fully employed.

The Precision Scheduled Railroad is a start, but must focus on the customers’ perceived ease of doing business with KCS. Running more and bigger trains more frequently requires not only scheduling but also using PTC (87 percent complete now, 100 percent in a month), predictive analytics, artificial intelligence self-learning solutions, and clearing cross-border stuff before it gets on the train will all contribute to Ottensmeyers’ goal of “achieving long-term superior performance.” Well done all, and thanks.

Union Pacific on Monday announced its Unified Plan 2020, a new operating plan that implements Precision Scheduled Railroading principles. Unified Plan 2020 will launch Oct. 1 and will be rolled out in phases across the entire Union Pacific rail network. Like the original Unified Plan of 20 years ago (and patterned on the NS Throughbred Operating Plan and copied by CSX and CP), UP 2020 starts with a clean sheet, charging the people who will have to operate the plan to design a plan that creates a better transportation product at lower cost to UP.

On the call, UP speakers referred several time to “Precision Scheduled Railroading” in so many words. Key principles being incorporated into Union Pacific’s Unified Plan 2020 include a focus on moving cars, not trains; cutting the number of unit trains; and balancing train movements to improve the utilization of crews and rail assets.

In a departure from the Shock and Awe approach Hunter used at CP and CSX, UP will roll out UP 2020 first on its eastern North/South corridor, creating more streamlined operations between Wisconsin and Texas. Further rollout will occur in phases, with initial implementation across the entire rail network expected by 2020.

Some wags are calling this “Precision Railroading Lite,” but I will be more charitable. The CSX experience of simultaneously cutting down yards and curtailing services dug deeply into customer supply chain processes and was unnecessarily disruptive to field employees. Instead, UP wants to work this process into its “Blend and Balance” initiative — running merch and bulk trains as one — introduced at last spring’s Investors’ Day; doing the same with auto racks and parts was about 70 percent complete in May.

In the press release, the company acknowledged that it was “not meeting customer expectations,” something that Precision Railroading should help rectify along with improving productivity and efficiency, ultimately creating a clearer, less uncertain path towards UP’s unchanged goals of a 60 operating ratio by 2020 and getting to 55 farther out.

Some analysts were unmoved. Says RBC’s Walter Spraklin, “We have had a cautious view on UNP as a result of lackluster progress toward its financial targets. While the company has now announced a new plan...we believe it lacks the key components that has made prior implementation of precision railroading a success.”

To those who say implementing PSR could slow down the railroad, I say visit Calgary and see how CP’s merch RTMs are growing twice as fast as revenue units, and how cars are getting through Alyth Yard faster even though the hump is gone (the retarders and bowl tracks have yet to be removed).

Fewer, bigger trains going farther without classification does wonders for car cycle times and supply chain reliability. Just this week at the KCS shortline meeting (see above) an economist said supply chain pressures are a major headache for manufacturers.) I also say ask CSX short lines about transit times and car-turns on some of the longer lanes — Atlanta to New Orleans, for example. I’m sure UP will follow the same path.

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