# RAILROAD WEEK IN REVIEW
## January 4, 2019

*“The Vicksburg Southern (VSOR) recently welcomed its newest customer to the line. Vicksburg Forest Products reopened a lumber mill after converting it from a hardwood mill to yellow pine mill. The VSOR team helped train the mill’s crew on loading and billing outbounds as well as ordering and receiving new cars.” — Watco Tweet, December, 2018*

*“No Sprayer, No Mower, No Tractor, No Problem! Today our MOW Gang completely obliterated the weeds at Bell Storage using weed-eaters and hand tools. I wish I had a before picture — it looked like a jungle this morning!” — Santa Maria Valley Facebook, September, 2018*

*“This year was the most successful US Marine Corp Reserve Toys for Tots drive we have hosted in the past 15 years. We collected toys in our Northumberland office and concluded the drive with the North American Railcar Operators Association (NARCOA) motorcar train - which ran from Northumberland to Berwick and returned. Families waited along the railroad tracks to make donations.” — North Shore Railroad On Track PDF magazine, Winter, 2018*

*“In the last 3 years our average number of daily crew starts has doubled from 9 in 2015 to 18 in 2018. Most of these increases can be attributed to increased demand for anthracite coal, significant growth in our freight business, and additional passenger operations. In order to meet these demands, RBMN has purchased and rebuilt additional locomotives and hired a number of additional train service employees. This has put RBMN in a good position to handle our current and future record-setting crew needs. We are all very proud of our continued growth and look forward to breaking our own records.” — Reading & Northern in-house magazine, summer 2018*

**The Railroad Week in Review focus** this year is on the economic drivers of railroad success or failure. As in the past, I am looking for the railroad and commodity trends and events that will determine the direction of the shortline industry. I will spend less time on Class I weekly revenue unit counts and put more emphasis on what’s behind the trends and how short lines can capitalize on them. And I will continue to use the term *short line* to include all non-Class I railroad and switch-carrier names. If your name is on a loco, you’re in here.

The short lines’ competitive advantage and unique selling point are direct results of the companies’ intense customer advocacy. Facebook and Twitter posts, in-house magazines — both in hard-copy print and on-line PDFs — serve a dual role. Not only do they keep customers, communities, and co-workers abreast of events but also inform their Class I contacts of the short lines’ progress.

The ASLRRA advises that short lines touch 20 percent of North American railroad carloads. I think that number is bound to grow as the Class Is de-market certain commodity lanes and focus more on intermodal and unit trains. More tonnage demands better track, and the ASLRRA leadership in the shortline effort to extend the 45G track-related tax credit is crucial.

I will continue to rely on Class I railroad financial reports as a means to figure out what they're doing, where they're going, and why, as it affects shortline operations and results. I will lean hard on the Class I railroad tendency to say one thing on conference calls and in presentations and do something else in the field. I will report faithfully on the Official Utterances and will look forward to shortline input on where word and action don't match.

**The core theme,** I fear, is that we're getting to the point where earnings growth depends more on rate hikes goosing ORs, or on share buy-backs goosing earnings per share, not because we're moving more freight. We've got to get back to building income by increasing service quality, revenue units, ton-miles, and revenue. As a long-time reader writes,

> My outlook calls for considerably tougher competitive conditions for intermodal in 2019, as the truck capacity crisis is rapidly normalizing and intermodal will have to fight for every load (as usual) instead of just having to have available capacity in order to make the sale.
>
> Intermodal costs are rising by virtue of more rubber-tire transfer and longer average drays, while at the same time I fear that railroad management may have unrealistic expectations of future rate increases based on this year's patterns (which will not be repeated). No "doom and gloom," but we'll have to make money the "old fashioned way".

There is hope. BNSF out-going Chairman Matt Rose says in his December *Railway Age* interview, "It's in the public's interest to move more tons on the railroad network, not to move tons off the railroad network." He goes on to say that every carload offered is worth handling and that "railroads will have to expand their offerings to bring more freight to the railroad. You can't shrink yourself into a virtuous-cycle model that works." Say Amen to that.

**The just-released *AAR Railroad Facts*** 2018 edition shows revenue ton-miles peaking at 1,771,897 million in 2006, declining to 1,585,440 million in 2016, down 11 percent (2014 was an outlier peak at 1,851,229 million). Operating income 2008-2016 (2006, 7 not provided) increased 43 percent to $13.0 billion from $9.2 billion. Operating revenue 2006-2016 rose to $65.8 billion from 42.2 billion, up six percent. Revenue/RTM 2006-2016 rose from $2.84 to $4.00, up 41 percent.

One could argue it's more money, less work. On the other hand, it's safe to say the the industry did an amazing job at weathering the extreme reversal in coal, its biggest commodity, and in encountering the volatility in a possible replacement commodity, oil, and still continued to prosper. Moreover, I have to wonder whether ton-miles is still a relevant measure.

A million ton-miles of intermodal yields a whole different set of data for track wear, personnel productivity, tonnage per available horsepower, car-cycle time and so on. The Class I core routes are in better shape than ever, PSR can take variability out of customer freight transit time, and car-miles per day are on the increase. The drop in coal tonnage is a big factor: coal generates a lot of ton-miles at a lower RPU, so less coal would statistically raise the average revenue per revenue ton-mile.

Lastly, a reader notes that rail management has been very quick to react to the AAR's reported drop in tonnage by cutting the labor force and storing locomotives. The dramatic increase in shipper-leased cars has reduced railroad-owned car down time and maintenance expense. And "average annual price increases have continued even in the face of some traffic outright loss in coal and in crude oil by rail."

Then there's the track infrastructure. We're getting the best-ever look at its condition with the help of technology that provides a deep analysis of the car geometry. There also are ultrasonic digital data inspection records collected at train speed. Of course, all this operating data is inside baseball information and kept proprietary by each class I, meaning we mere "outside" mortals have zero access to these rich data streams. Our only measures of track condition are capex per owned mile of railroad and the accident ratios.

Bottom line: the AAR booklet confirms that since 2006, railway profits have increased while non-intermodal traffic volume levels stagnated. And yet, the six Listed Class Is have sent in order of magnitude maybe $40 to $50 billion as cash out to investors (dividends and buybacks) because railroad management and its boards didn't see the need for spending more capital to grow the business.

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