RAILROAD WEEK IN REVIEW

March 15, 2019

"It's time for the industry to create or be a part of supply chains that always use 'the beast'— the railroad." – JJ Ruest, CEO, Canadian National, in Railway Age

The business of moving freight on the railroad is a complicated one, but shrinking the business to get more profitable at the core is unsustainable." — David Nahass, Railroad Financial Corp.

With Precession Scheduled Railroading the buzz words in the industry, we are seeing a flurry of new short lines, and as class one railroads cast off mileage, it's a new bonanza time to be the big boss of a little railroad." Jim Wrinn, Trains, April 2019

"Be at least as intrigued by the story no one is telling as by the story everyone is telling." — Liz Ann Sonders, Charles Schwab & Co.

CSX held its 30th Annual Shortline Workshop last week. It's entirely appropriate CSX gather its feeder line partners for an update annually. After all, CSX says these non-Class I railroads touch some 22 percent of CSX revenue units. Putting things in context, CSX in 2018 reported 11.7 million total revenue units, up 6.3%, so partner roads contributed 2.6 million units. CSX averaged $2,774 per carload in the merchandise sector where most short lines live. So, on the average, the non-class Is brought in $7.2 billion in revenue. Not a bad partner to have around.

The session theme was "Sharing a Commitment." From the opening remarks by Mark Wallace, EVP Sales and Chief Marketing Officer, to the afternoon's energetic and educational trade show, it was clear to me that CSX wants to increase the shortline contribution. The hotel itself was decked out in CSX images like translucent locomotive fronts on the elevator windows, door stickers in strategic places, and huge wall plaques on the Guiding Principles and how the transportation product is being improved.

Says Wallace, merchandise carload numbers ex-autos have slipped 3.5 percent 2014-2018, lagging both the economy and CSX' transportation peers. Short lines have not been unaffected, suffering the same rates of decline as CSX as well as others in the Class I community. One of the remedies is "a focus on developing meaningful partnerships." The time is right, too, as CSX in 2018 made record service metrics gains, improved asset turns, and gave more accountability to field managers.

The four breakout sessions covered shortline aspects of all the major commodity groups. I found the energy segment particularly useful. Framed by the "changing landscape," the presenters covered the latest developments in, among others, frac sand, NGLs, and crude oil. Waste products (MSW, C&D) got particular emphasis as 40 percent of the loads touch short lines at origin or destination or both. Yes, it's a low-rated commodity but it adds volume and fills out trains at low incremental cost.

A major conference take-away was the focus on seamless service, which in turn requires "Sharing a Commitment" to make it so. It starts with the carload trip plan that is initiated when the loaded car is waybilled at the customer dock. Even though a car may be delayed en route, the original trip plan stays with it so that there is a ready measure of trip plan compliance.

Cars waybilled on short lines are not yet captured by the trip plan as such, so the actual plan against which performance is measured starts at the time the shortline transfers accountability to CSX at interchange, though I've been assured plans are afoot to make trip plans start at customer release on short lines. Putting the short line in the carload trip plan makes ISA compliance absolutely essential, so if you don't have an ISA you'd better get one. And measure CSX performance against it.

The CSX energy and sense of commitment to short lines in a PSR world is quite evident. And at the end of the day I think the CSX-short line partnership will emerge stronger than ever. Moreover, As Jim Wrinn so aptly writes in *Trains*, "this could be bonanza time for short lines."

CSX wants to right-size its railroad as to track-miles and the capital to maintain them. Yet if it can preserve car-counts by letting somebody else do the first/last mile work (and build the franchise in the process), CSX comes out ahead. Layering the PSR discipline on top of the carload network can yield positive supply chain benefits, as CN and CP have amply demonstrated. Done right, CSX will follow the same pattern and connecting non-class I railroad will reap the rewards of their patience.

The AAR reported February vols this week — 2.1 million conventional carloads and intermodal boxes, down 1.8 percent. Eight of the 20 AAR carload commodity categories posted YOY gains. These included: petroleum products (STCC 29 and crude oil), up 20.5 percent; primary metal products, up 3.7 percent; and pulp & paper products, up 5.5 percent. Commodities with YOY declines included coal, down 6.7 percent; crushed stone, sand & gravel, down 6.9 percent; and grain mill products, down 5.9 percent.

John Gray, AAR's SVP for Policy and Economics, noted that the February "sluggishness in rail volumes" was partly due to weather and partly due to "weakness in the overall economy." However, Grey continues, "Perceived softness in parts of the economy plus the trade-related uncertainty hasn't helped." Perhaps.

Looking only at year-to-year results can be misleading. In the railroad industry, where you're investing in non-fungible stuff like track, locomotives, freight cars, and people, the five to fifty year outlook ought to be more the rule. The the above two-year look-back can be useful (see my Hedgeye chart in 3/1 WIR).

AAR Week 9	Carload		Intermodal		Total	
	Current 5 Wks vs.		Current 5 Wks vs.		Current 5 Wks vs.	
	Previous 5 Wks	Same 5 Wks '17	Previous 5 Wks	Same 5 Wks '17	Previous 5 Wks	Same 5 Wks '17
UNP	-1.40%	-6.30%	-0.20%	2.30%	-0.90%	-2.60%
NSC	2.60%	-6.30%	0.90%	-0.60%	1.60%	-3.10%
CSX	1.80%	1.30%	1.60%	-6.30%	1.80%	-2.10%
CNI	-0.30%	-2.00%	0.20%	-4.70%	-0.10%	-3.20%
CP	-1.00%	-4.10%	1.50%	-6.50%	-0.10%	-5.00%
KCS	1.30%	12.90%	1.60%	-5.80%	1.40%	4.80%
KCSM	2.10%	-1.00%	13.80%	-16.80%	6.70%	-8.20%
BNSF	0.00%	-3.40%	-0.60%	-7.30%	-0.30%	-5.40%
Average	**0.64%**	**-1.11%**	**2.35%**	**-5.71%**	**1.26%**	**-3.10%**
Source: transmatch.com						

GWR Jan revenue units increased 3.6 percent to 138,532, excluding 2,442 cars from short line leases in Canada (GEXR and SOR), which expired in the fourth quarter of 2018. Eighty percent of carloads are in bulk commodities where, in most cases, there is little time-value and the load contents are fungible — one lump of coal is no different than any other. More specifically, petroleum products increased 18.7 percent on NGLs; metals were up 12.2 percent on scrap and finished steel shipments. All remaining traffic increased by a net 1,732 carloads.

On Tuesday word on the Street emerged that GWR is in play, seeking either buyers for the whole entity or for equity partners as it did with Carlyle ($800 million) for the 2012 RailAmerica acquisition. Scott Group of Wolfe Research says succinctly, "We don't believe there are any transformational acquisitions left for GWR in the U.S., while acquisitions outside of the U.S. have had a mixed track record more recently." My thoughts exactly.

The agreement to acquire RA came in July, 2012 and shares had rallied to $94 by the next January. A high of $105 came in June, 2014. From June, 2015, until this announcement shares traded in the $60-$80 range, so the growth was perhaps less than expected. By this time next week we ought to know more.

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