RAILROAD WEEK IN REVIEW

March 29, 2019

"Economic growth encourages inefficient businesses to absorb resources that would be better deployed in more profitable companies. If this continues, the allocation of resources becomes increasingly irrational. When this irrationality is protected by state intervention to avoid short-term political problems, the economy deteriorates." — George Friedman, Geopolitical Futures

"When the price of northern white sand (long the preferred sand type for hydraulic fracturing) took off, the frac sand market responded by developing 'local' sand mines much closer to shale production areas, especially in the Permian." — PLG Consulting

"The Institute for Supply Management's Purchasing Managers Index (PMI) was 54.2 in February 2019, down from 56.6 in January 2019 and the lowest it's been since November 2016. The new orders component of the PMI fell to 55.5 in February from 58.2 in January, the second lowest it's been (behind December 2018) since late 2016." — AAR, March 8

"We can be better investors. Not by playing the cards we're dealt any harder. But by playing the other players at the table a lot smarter." — Ben Hunt, Epsilon Theory

Genesee & Wyoming subsidiaries Toledo, Peoria & Western Railway (TPW) and Central Railroad Company of Indianapolis (CERA) have signed long-term agreements to lease and operate the Winamac Southern Railway (WSRY) and Kokomo Railroad (KR) — 57 miles in all.

Here we see GWR perpetuating its long-standing “contiguous railroad” model, stitching together formerly independent operations and its existing network. This makes a lot more sense than what I call the “any railroad anyplace” model of the former RailTex and RailAmerica. Thus by combining these two lines with the operations of the Illinois & Midland, the TP&W, the smallish Tazewell & Peoria Railroad, (TZPR), the new leases create a contiguous 400-mile, four-railroad footprint from Eastern Indiana to Western Illinois and with connections to six Class I railroads.

WSRY and KR started operations under the GWR banner March 22 with with five employees and two locomotives. TPW and CERA are expected to handle approximately 5,000 carloads per year over the new lines, consisting primarily of agricultural products, chemicals, plastics, and metals, of which approximately 60 percent of carloads are currently interchanged with CERA. WSRY and KR share common ownership with Kokomo Grain Co., which is a large customer of WSRY and the only customer of KR.

TPW and CERA are managed with GWR’s Midwest Region railroads under the leadership of Senior Vice President Martin Pohlod. GWR plans immediate upgrades to the WSRY and KR lines to support the business and further enhance “customers’ routing options, interchange locations and geographic reach through the GWR footprint of contiguous railroads.”

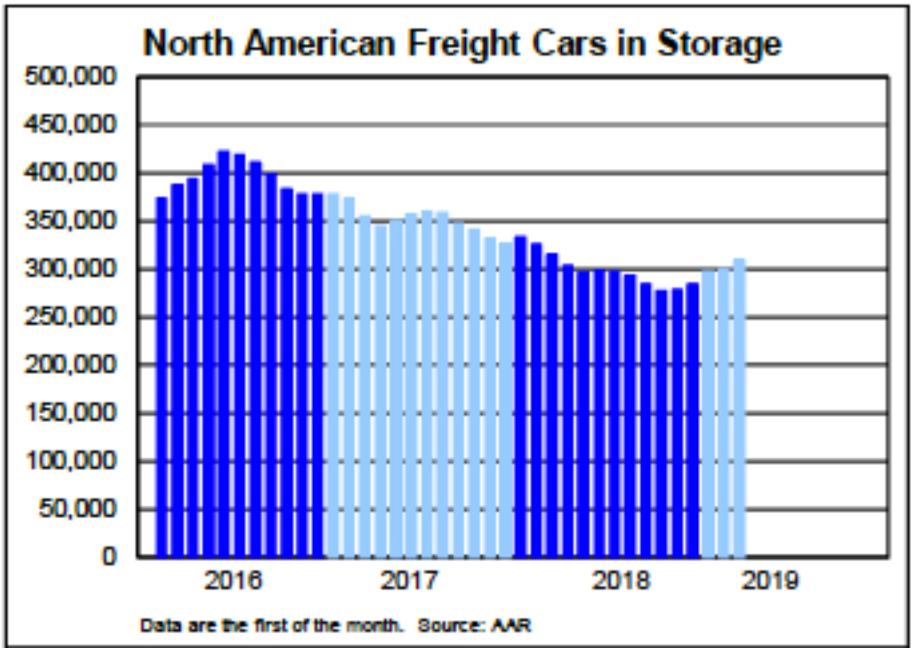
Greenbrier this month has brought in orders for 3,800 new fright cars — chiefly tank cars, auto racks, and covered hoppers. Commenting on the news, Wells Fargo analysts said orders in the quarter were off 30 percent, though “not unexpected given the multi-year orders likely embedded in the prior two quarters.”

Tank cars and covered hoppers easily fit the non-cyclical category for chemicals, energy, and grains. Not sure about auto racks. You’ve seen my previous notes about the downward trend in the SAR estimates for 2019. We are still on the down side of the business cycle with growth rates slowing and the GDP with it.

Re autos, the AAR says, “Estimated U.S. new light vehicle sales were an annualized and seasonally adjusted 16.5 million in February 2019, down from 16.7 million in January 2019 and the lowest for any month since August, 2017. There was hope that the end of the government shutdown and warmer weather would lead to higher sales, but that didn’t happen.”

The AAR’s Dan Keen writes in his March *Rail Time Indicators*, “Few economists think the U.S. economy will grow as fast in 2019 as it did in 2018. Many economists think GDP growth in Q1 2019 will be around one percent, or even less. The most recent GDP Now forecast from the Federal Reserve Bank of Atlanta says Q1 2019 growth will be 0.5 percent; the most recent Nowcasting forecast from the Federal Reserve Bank of New York says 1.4 percent.”

Dan continues, "Growth is expected to recover to 2.0 percent to 2.5 percent the rest of 2019 — about equal to the post-recession norm. Headwinds hindering faster growth include weak growth in Europe and China, uncertainty regarding trade, and the winding down of stimulus from 2018's tax cuts." The three successive quarters of increased cars in storage underline the case.



Tony Hatch is on the road again, this time to Savannah for the spring gathering of the South East Association of Rail Shippers (SEARS). He has good news for the STCC 26 crowd.

> It is clear that the paper/forest products business is back. It's not the return of print media, but what the *NY Times* calls "The Great American Cardboard Comeback." This is an area not just of secular commodity resilience but also of market share recapture potential; it's also a further sign that e-commerce is, so far, an opportunity for rails.
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> Elsewhere, there seemed to be no panic about PSR and current rail service, though greater use of assessorial charges is more than a thorn in shippers' sides. Norfolk's claims to be more collaborative on demurrage, say, than CSX are not fully believed by big paper shippers. We could see some of this play out in DC as it's clear the STB has this issue in their sights, with reports and rumors suggesting 200-400 percent increases and demurrage as a "profit center."

Thanks, Tony. This will play well with quite a number of non-Class I railroads.