RAILROAD WEEK IN REVIEW

April 5, 2019

"The 45G short line tax credit has worked as intended and when you find something that works, the best thing to do is let it work. I very respectfully encourage the 116th Congress Ways & Means Committee to fix the unintended but real suboptimal policy consequences of sporadic attention to the Short Line Tax Credit and make this credit permanent." — ASLRRA President Chuck Baker, Ways & Means testimony March 12

"Opportunities signaled by a yield curve inversion often mark a reversal in long-term market performance trends as leaders and laggards change places. Examining the relative performance of growth and value stocks, large and small cap stocks, and U.S. and international stocks, we can see that reversals in long-term trends were often marked by inversions in the U.S. yield curve." — Jeffrey Kleintop, Charles Schwab & Co., April 1

Agricultural commodity prices remain low, with spot corn and soybean currently fetching $3.62 and $8.99 per bushel, respectively, each roughly 22% below their respective 10-year average prices. The U.S. Department of Agriculture reports that soybean deliveries to China fell more than 80% year-over-year since September. That helped push soybean stocks to a record 3.7 billion bushels as of year-end 2018. — *Almost Daily Grant's, April 2*

"We're raising shares of Norfolk Southern to 'buy' from 'neutral' on its rapid gains from its precision scheduled rail (PSR) overhaul. This is the first tangible evidence that NS is gaining on its PSR goals. The Street's outlook is 'too conservative' versus the company's improvement potential." — Bank America Merrill Lynch, April 1

Canadian National has committed to invest some C$320 million in Ontario this year to expand and strengthen the company's rail network across the province. Thanks to prior capital programs creating a faster, more reliable network, CN has been winning market share. Says Doug MacDonald, Vice President of CN's Eastern Region, "Following a record capital program in 2018, CN has been able to take on more traffic from different commodity sectors based on contracts with our customers."

He says 2019 is a continuation of the program to boost capacity and network resiliency and to meet growing traffic patterns across Ontario. These investments are part of CN's 2019 record $3.9-billion capital investment focused on enabling growth from all commodity segments, including consumer goods, grain, agricultural, forest, and energy products.

CN is currently deploying important safety enhancing technologies across its network, such as the Autonomous Track Inspection Program, Distributed Air Cars, and Automated Inspection Portals. These innovations, combined with CN's investments in locomotives, capacity, infrastructure, and train crews, will support the safe and efficient movement of customers' goods to their end markets.

Over my two decades of working with CN on shortline matters, I've seen first hand how CN's shortline partnerships extend the CN network reach and provide added flexibility with a focus on local interests to provide a transportation with a strong supply-chain orientation. So not only will these capital investments help CN's half dozen or so Ontario-based short lines, but also the rest of the CN shortline community will gain improved competitive access for their customers' customers in Ontario.

Vital intelligence for short lines is everywhere. Just as we found shortline benefits in the CN Ontario news above, the UP presentation at the recent JP Morgan transportation conference is rife with ideas for more shortline business with Union Pacific. President & CEO Lance Fritz ran through a 14-slide set that really highlighted geographies and commodities where short lines can make a difference.

By way of an overview, Fritz said the industrial carload franchise is at present the best performer with ag faring less well. Reading between the lines, I believe the ag shortfall is due in part to the soybean trade row with China, so the grain situation is temporary. That said, between and and industrial, the shortline outlook with UP is encouraging. Drilling down further…

UP shortlines are particularly active in the STCC 29 nat gas liquids and plastics feed stocks. They have a play in both frac sand origins and destinations, though the increased reliance on Brady Brown and other local sands in Texas are biting into the longer distance white sand moves. The ag potential is significant. For example, short lines in the upper midwest will focus on grain and ferts; the Texas panhandle and Central California will do feed grains, the Gulf Coast players will take part in export grain, and so on.

Technology will contribute greatly. The Unified Plan 2020 is designed to turn cars faster and with greater transit-time consistency. These can be Unique Selling Points when selling railroad service to area customers and prospects. Learn how their supply chains work and show how UP 2020 and your short line can be part of that supply chain. Thus UP has set a table of food for thought. Make a meal of it.

You may recall that for their quarterly reports Union Pacific sorts all its commodities into just four groups: Ag (what it sound like plus ferts), Energy (coal, crude oil, frac sand), Industrial (all the carload commodities not in the two previous categories), and Premium (auto and intermodal). For our purposes, it is useful to disaggregate the lot using the AAR carload reports every railroad prepares every week.

Through March 30 total revenue units were down one percent, essentially unchanged. Intermodal being up four percent couldn't mask coal's being down 13 percent. Merchandise units including automotive (both finished vehicles and parts) are 42 percent of the UP franchise. Back out auto and crude oil (most of the deltas in petroleum are crude oil; the STCC 29s are pretty constant) and what I call shortline commodities are 34 percent of the total volume. These were down four percent year-over-year.

Chemicals (STCC 28 only, includes ferts STCC 28 71x) at 11 percent of total volume is the largest single commodity group. Auto is a distant second at five percent. The AAR list has 18 commodity lines and UP is down in 12 of them, with positive deltas in petroleum products, metals, the paper group, non-metallic minerals, waste, and ferrous scrap.

Railway Age is not known for editorializing on AAR traffic numbers, but March 2019 data merits an exception. From Editor Bill Vantuono:

> We traditionally have reported the Association of American Railroads weekly compilation of freight traffic statistics as "straight news," with commentary restricted to what the AAR may include in the release, which is rare. In this case, there's a lot going on here, enough to warrant some analysis.
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> The AAR took special pains to back coal and grain out of its U.S. monthly calculation for March, 2019. Excluding coal, carloads were down 28,812 carloads, or 4.1%. Excluding coal and grain, carloads were down 16,975 carloads, or 2.8%. Bear in mind that coal and grain are important bulk commodities for railroads. But more important, grain (ag products in general) will always be there, and railroads are the best way to move it.
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> Coal? It's generally acknowledged that coal has a limited long-term lifespan and will at some point disappear altogether. That's good for the environment but not good for the railroads, unless they are able to grow other business lines and take more volume away from trucks. People have to eat, but there's more than one way to generate electricity (natural gas, solar, hydro, wind).
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> The gyrating traffic figures have left many economists and industry observers scratching their heads. I'll leave it up to the experts to decipher what's going on. You know how to reach me. Just let me know if you're on or off the record.

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