RAILROAD WEEK IN REVIEW
June 7, 2019

"People who say they are rational [should] know how things work, what works and what doesn't, and why. That's rationality. It doesn't help if you just know what's worked before, because if you know why, then you'll be better at it." — Charlie Munger

"Magical thinking is a term of art in both clinical psychology and cultural anthropology, and it refers to the common belief among both children and 'primitive' societies (yes, intentional quotation marks there to show my arched eyebrow at the word) that thinking the right thoughts or saying the right words can control the invisible forces that shape our world." — Ben Hunt, epsilontheory.com, "Magical Thinking," Sep 1, 2016

"The economy continues to send out conflicting signals. On the positive side, a preliminary 263,000 net new jobs were created in April — that's amazing for a recovery that's almost ten years old — and the unemployment rate fell to 3.6%, the lowest it's been since 1969… Other recent economic indicators were less positive." — AAR Rail Time Indicators, May, 2019

The Union County Industrial Railroad, a member of Pennsylvania's North Shore Railroad group, has been selected by White Deer Gas for a new light petroleum products terminal and bulk storage facility in New Columbia. The UCIR provides access to both NS and CP; the facility is close to Interstate 80.

The White Deer terminal will have more than two million gallons of one of the largest facilities of its kind in the eastern United States.

The eight-car industrial siding will serve five receiving racks with an eight-car-per-day unload rate. The fully-fenced and secure site features a card-access system and a certified truck scale.

White Deer is the second major company to set up shop along the UCIR in New Columbia in recent months. GAF materials last November hosted an inaugural railcar ribbon cutting at its new roofing materials manufacturing plant here. The site was previously occupied by the New Columbia Joist plant and in 2016 sold to GAF. When completed, the facility will manufacture two different roofing products utilizing automation throughout its production facilities.

Twenty-six employees have already been hired – 23 locally – and the company is looking to hire an additional 26 employees over the next couple months, with a starting rate of $21 per hour. Moreover, GAF will bring in 30 to 40 contractors every month as they become certified installers of its TPO roofing system, meaning more money spent at area hotels, restaurants, and other businesses.

As so often happens, the railroad and GAF first crossed paths at a shippers meeting. It was the fall 2015 Northeast Association of Railroad Shippers (NEARS) event in Providence, Rhode Island. GAF's North East Rail Manager was there, and after chatting with the North Shore folks over lunch, and after that, many emails, phone calls, and site visits ensued. An expansion to the facility is already in the works. Here again the short line creates customers the Class Is would not have had were it not for the short line's local presence.

Reader response to last week's screed on the state of the short lines garnered a number of helpful observations from some fairly serious folks who've also been around a while and who do their homework. A sampling:

> ** That was a sobering newsletter! Usually you are pretty upbeat. I certainly cannot disagree with you, unfortunately. Even more depressing is that I see our entire economy more or less going that way. Everybody is worried about grabbing their share and not worried about really growing the pie any more. And this is certain disaster. And it is very depressing. I cannot remember a time when I have been so negative about the rail industry, and the country as a whole.
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> ** I find some of your observations completely in line with what I have seen in my class I and short line days. Many of the shortlines created when I was in Class I marketing were just like you said: doomed to fail; ok as long as major customer remained; and those that prospered and continue to do so today.
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> ** I am in full agreement on your points. For those of us who would like to participate in the short line railroad business, asking (and transaction) prices are at such a point that cash flow cannot pay for both the property and for operations and maintenance. And, there's no point in attempting to purchase those that are on life-line (45G) support as those surely can't be made into a viable business case. Yes, the times they are a-changing!

CSX has yet to define what they mean by "transit time" and "trip plan compliance." The October 5 press release says, "Transit times for scheduled merchandise trains have returned to a normal range, and are lower than transit levels at the outset of CSX's Precision Scheduled Railroad implementation in first quarter 2017."

The first quarter 2019 *Financial Review* tells us On-Time Originations show the percent of scheduled road trains that depart the origin yard on-time or ahead of schedule. On-time arrivals is the percent of scheduled road trains that arrive at the next yard on-time to two hours late (30 minutes for intermodal trains).

It would also be helpful to know more about “transit time.” Slide 8 in the STB deck on demurrage and other charges shows a 28 percent reduction in transit times since 2017. Is that dock-to-dock, train symbol time end-to-end regardless of intermediate stops, or terminal to terminal exclusive of dwell? There is no way of telling what kinds of trains (merchandise, intermodal, bulk, other unit) are counted.

Chief Commercial Officer Mark Wallace talked about trip plan compliance in his remarks at last month’s Wolfe Transport Conference. Here again a clearer picture of what’s being measured is in order — origin dock to destination dock, class yard to class yard, class yard to interchange-off point for a connecting Class I, etc. And for shortline OD pairs, we need to know if trip plans begin and end at the shortline station or at the CSX interchange.

Regarding the Charlie Munger quote above, you’ve seen how the railroad analyst community zeroes in on the operating ratio and earnings per share; commodities and revenue units get much less ink. And, as EPS goes up, so does price — usually. But to me, the railroad is a service business that depends on customers to demand that service. And so it is I prefer to follow the Buffett/Munger model of finding good companies at a good price.

How much must I pay today to realize a dollar of cash tomorrow? The Morningstar Fair Value metric is based on a discounted cash-flow model, which I think is the only sane way to decide what you want to pay today for a stream of cash tomorrow. You know how EPS numbers are massaged with “below the line” items and share buy-backs. Tough to do that with free cash flow per share. Buffett himself cites Aesop’s fable about a bird in the hand being worth two in the bush (Q&A, Annual Meeting a month ago).

I ran some comps of share price vs the Morningstar Fair Value metric table and found I can pay 85 cents today to get a dollar tomorrow from one B share of Berkshire. Or I can pay a dollar-five for a buck of future NS cash flow. By comparison, 59 cents today for a share of AAPL today gets me a dollar tomorrow. Draw your own conclusions.