

RAILROAD WEEK IN REVIEW

August 28, 2020

“Precision Scheduled Railroading, as we know it today, is rapidly reaching an inflection point. Escalating trade disruptions, rail strikes, blockades, weather events and the COVID-19 pandemic have highlighted the urgency to make supply chains more resilient.” — PSR: The Next Generation, Railway Age, August 2020

“When you split the market down to see those that have debt, and particularly high debts, or involved in debts, banks or BBB rated equities, none of those shares are going up. When you look at anything with a lot of free cash flow, no debt, it’s a whole different world. It’s like there’s infinite appetite for this stuff.” — Raoul Pal on Real Vision, August 24

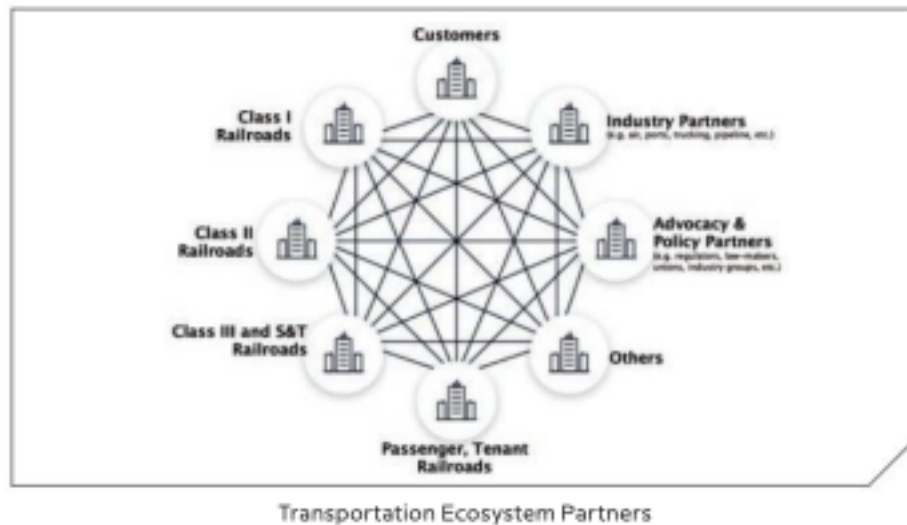
Railroad shares seem to have been mired around the 200-day moving average for the past year, the March dip excepted. Take CSX, for example. CSX was sporting a debt/equity ratio of 116 percent and the shares are going nowhere:



Starting in September 2019, shares traded in a \$70 range before the March tumble, and are now back at the same range. (The thin blue line is the S&P Equal-weighted index that strips out the effect of the FAANG stocks on the broader index.) Canadian National, on the other hand, had at the same time a debt/equity ratio of 73 percent and shares are up nearly 20 percent after emerging from the first quarter bottom.

We’re not seeing any meaningful volume growth of late, and the predictions for 2021 and beyond are muted. The street projections for earnings fare better, but I fear that’s based on lower operating ratios and fewer shares. As noted last week, PSR isn’t really working the way it should — right car, right place, right time, customers happy. Enter PSR 2.0.

Railway Age is running a three-part series on “PSR for the next generation” in the June, July, and August issues. Part I, *The Case for Mainstream Adoption*, lays out the case in June. The principal argument is that PSR 2.0 transcends PSR 1.0 by embracing entrepreneurship and partnerships across *all* railroads and related transportation ecosystems — drayers, supply chain managers, train crews, customer dock operations managers. Graphically,



A unified PSR platform is a mechanism to protect the railroad industry’s relevance in the future. In fact, at a recent NEARS conference, a participant on a shippers panel specifically asked what the railroads are doing to stay “relevant.” To date, not much.

We’ve all seen how each Class I has pursued the PSR theme, and the results have been uneven. PSR, as such, has yet to make a dent in non-Class I railroad operations, though there are exceptions. Which is unfortunate inasmuch as this gap in PSR deployment represents about 40 percent of north American route miles, says *Railway Age*. And so it is that one PSR 2.0 goal is to “create a foundation for extending PSR across the full ecosystem of rail and other transportation stakeholders.”

PSR 2.0 brings the focus of the entire supply chain back to the original Hunter Harrison purpose: having the right car in the right place at the right time (WIR August 21). The stakeholders are many, as shown in the illustration above. That’s why PSR 2.0 goes beyond the individual Class I, where PSR 1.0 changes were made mainly to satisfy the railroad and its stakeholders.

Customers and short lines are stakeholders, too. One of the PSR complaints one hears from short lines is that Interchange Service Agreements are ignored, causing irregular performance and creating havoc for customer supply chains. It appears to me that nobody at the Class I is really responsible for making sure ISAs are followed. PSR 2.0 creates a new mode of operation, in which it is no longer acceptable to overlook downstream impacts.

In short, there is accountability for downstream events. This includes, naturally, what Oliver Wyman's Rod Case calls "unplanned events," (hold-outs, locomotive failures, crews going on the law, etc.). Fact is, productive partnerships involve all players and PSR 2.0 raises the bar for all, reinforcing the point that ISAs are about the car, not the train.

Whereas Hunter's Precision Railroading tenets are one or two words, the Guiding Principles for PSR 2.0 must be somewhat wider in scope:

Reward entrepreneurial culture: Establish a work space where everyone can be innovative, be resourceful, and create value for the customer and railroad;

Exercise business rigor and relevancy: Precisely match services (supply) with markets (demand) and business objectives/obligations;

Forge productive partnerships: Strengthen performance and viability;

Safeguard end-to-end flow: Establish accountability for downstream events, planned and unplanned;

Foster a learning organization: Create an environment to nurture and encourage mastery of and improvement in the tasks at hand.

These guiding principles serve as **enhancers**, raising value; **accelerators**, making progress occur faster and more effectively; and **sustainers**, maintaining gains. The focus is on being entrepreneurial, collaborative, and productive with an eye for creating new customers and revenue streams, and where bureaucracy creep is thwarted.

The residential real estate market is flourishing in spite of the effects of COVID-19. One wouldn't think that jobless benefits would be filtering into the residential real estate market. But they are. While existing home sales are strong, they create a lack of inventory, pushing up demand (and prices) for new-builds. The Managing Director of ERA Forest Products Research says, "You've got buyers who care more about just getting product than they do about price."

Unfortunately, lumber prices have hit a two-year high, up 50 percent since April, according to the NAHB. The Random Lengths framing composite price rose above \$500 per 1,000 board feet for the week ending July 10. Last week 2 x 4 eights hit a mind-boggling \$760/1,000, easily adding five figures to the cost of a new house.

As for places to unload all this wood, a loop track supporting a grain origin or destination could work well as you can access both sides of the center beam from this configuration.

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