RAILROAD WEEK IN REVIEW

September 4, 2020

"The weak dollar is a boon to a whole host of 'old economy' manufacturers, along side a future where globalization reverses course toward localized supply chains." — Rosenberg Research, August 31

"We remain positive on the rails as volumes should continue to improve, and we expect strong labor productivity in 3Q as volumes rebound. The rails seem set up for strong volume and margin improvement next year, along with improving yield trends. — Scott Group, "Transport Trader," August 31

"The Class I's year over year comps took a slight hit, down (6.9%) from (5.1%) in the week prior. While traffic volumes did suffer a minor setback, we regard this as a temporary disruption and maintain the belief that lost volumes will return in near term. Although much uncertainty is still looming, we remain cautiously optimistic that a recovery will persist in 2H20." — Wells Fargo research note, August 31

PSR 2.0, Part II, continues the *Railway Age* series begun in the July issue. Whereas in Part I we laid out the basic considerations, in Part II we begin to see its top-line effects. First, the authors argue, is to establish a culture that can embrace change and pivot, rather than rejecting the change and failing. I think this is where NS is coming from with their "reinventing NS" theme, starting with a top-down framework that aligns all the elements from creating value for customers to running a smarter railroad.

Doing so requires a "cultural maturity" (authors' term) combined with the leadership skills required to pull all the elements together. A chimney culture just won't work. Take safety. It's a key measure of cultural maturity as the railroad makes the transition from "stuff happens" to "I am my brother's keeper." In the stuff happens stage a lot of leadership energy goes to policing individual activity. As individuals take more responsibility for their own activity and those around them, operational effectiveness improves because there's less energy spent making sure everybody is following the rules.

There are those who say PSR makes the railroad less safe. This shows a lack of cultural maturity and indicates a need for stronger leadership. Getting away from ad hoc processes where everything is made up on the spot and there is no accountability makes the railroad safer through root cause analysis. Processes are continually improved based on taking notes and studying root cause trends, eliminating same as you go.

The US Class I railroads initially approached PSR as a bottom line measure to justify cost cutting. Implementation focused on rapidly achieving PSR-attributable gains, but that's a risky business because success and failure are binary outcomes. That's why a "time to market" structure is needed. The idea is to track the time it takes from the time you first think of a process improvement up to the time it's in the field. You'll know pretty fast if it's working or not.

One way to run a successful time to market approach is to do what Union Pacific did: start small with an isolated region with supporting technologies and systems. As you get better at, it roll it out across bigger and bigger pieces of the railroad. This way you can identify the root causes of what doesn't work and fix the failures quickly through the analysis of facts and data.

A shortline parallel would be to start with one customer, setting up a specific service schedule. As you get the process for one customer right, you can move onto the next one. You also can start tweaking the operating plan so the crews have predictable work patterns, minimizing day-to-day surprises.

Some years ago, I did something like this on a Midwestern short line where nobody knew from day today what job they would have and what the customer requirements might be. We went to the customers, got their service requirements, put operating schedules together to meet these requirements, and assigned crews specific jobs, running the same trains the same way every day. The dissatisfaction many employees felt from not knowing what they would do from day to day went away and we became a much more efficient railroad in the process. Best of all is that consistent service added value for the customers and they used the railroad more as a result.

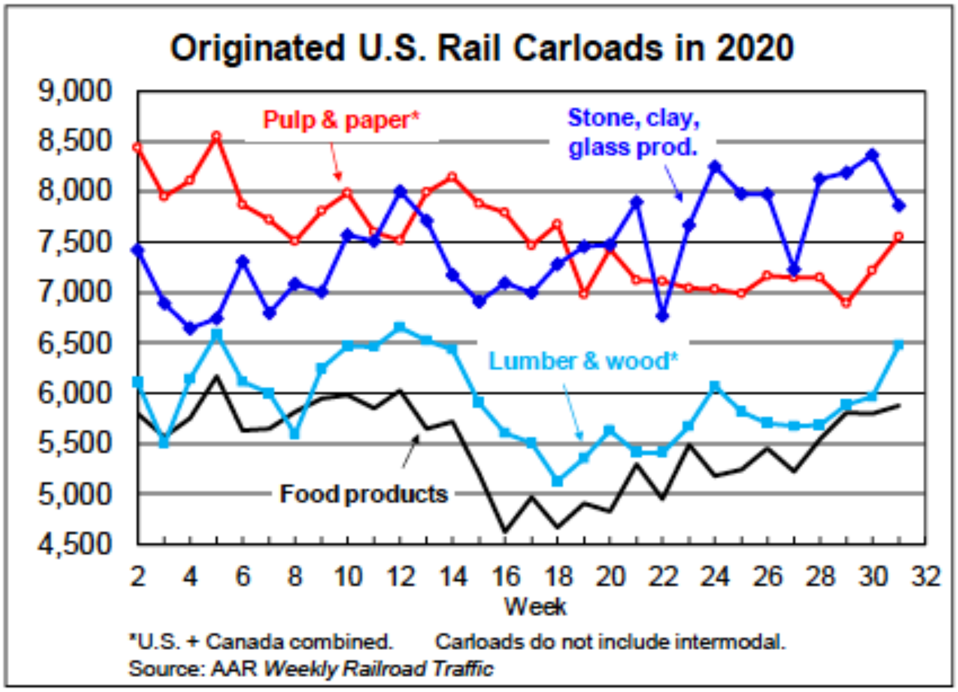
PSR 2.0 Part III in *Railway Age* for August, 2020, provides an action plan for building on the theory and guidelines for Parts I and II, pushing the envelope, if you will, for getting beyond present comfort levels. You start with a clear vision of where you want to be and develop a step-by-step process for getting there, with a "how did we do" evaluation at the end of each step.

The authors warn that "continuing on the familiar, comfortable path is self-limiting and counter productive." This brings to mind two shortline success stories. In the first, the new owner of a 25-mile stretch of 85-pound rail on failing ties and no real ballast set the goal of 100-pound rail on good ties and proper ballast. Rather than starting at MP 0.0 and moving up the line, he started at the most derailment-prone spots and achieved his goal of fewer derailments. By the time he was done he had a 25-mph railroad and no derailments. Crews and customers were delighted.

In the second case, track was first rate but as the customer base grew and daily carloads increased, trains were getting in each others' way and the track warrant and Form D system was deemed inadequate. The owner made the decision to install wayside signals and CTC along the corridor with the highest density. The owner told me, "I'd rather spend a couple of $million once and forego $millions in derailments over time."

These examples came before PSR as such was ever invented, but they show how a deliberate process to achieve certain end results pays off. And they also show PSR 2.0 isn't only for Class I railroad. This shoe fits every foot.

The Scott Group and Wells Fargo quotes in italics at the opening of this Letter convey two brief but encouraging observations about railroad traffic trends. Enlarging on that, the August AAR *Rail Time Indicators* shows graphically how a number of key commodities for the non-Class I community are looking.The trends are generally up from weeks 16-18 and are approaching Week 2 levels. Seems to support what the above quotes are saying.



And on Wednesday a note from Susquehanna's Bascome Majors shows "consumer goods" — intermodal, automotive, forest products — on the increase. That may be true, and lumber loads are growing nicely on home building (WIR Aug 28), but the curve above has the paper side of forest products lagging.

As a relatively low-rated commodity that travels from many origins to many destination, paper has margins that may be thin, but you can literally make it up on volume — if you can assemble blocks running from one origin to one destination, avoiding hump yards in the middle. It's not going to work in every case, but you can start there as a PSR 2.0 type of goal and develop a process to get there.

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