RAILROAD WEEK IN REVIEW
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"Do not take yearly results too seriously. Instead, focus on four- or five-year averages."
— Warren Buffett

"The most important communication that we need to focus on is the day-to-day communication that happens between, for example, our commercial folks and a customer—again, back to listening, understanding what our customers need." — Katie Farmer, President and CEO-elect, BNSF

"Asset-based truckers on the call agreed that the driver market was extremely difficult and that increased salaries were not going to solve the problem (although are needed to tread water)." — Jason Seidl, Cowen & Co.

Norfolk Southern has written the STB to express its concern with what appears to be a discussion between Pan Am Railways and CSX about "establishing a voting trust with regard to the acquisition of Pan Am and, by consequence, its subsidiaries." Norfolk's particular concern has to do with the Pan Am Southern, a joint NS-PAR venture established in 2009 "to strengthen competition with CSX." NS writes,

> Indeed, as the Board noted in its approval of the 2009 NSR/Pan Am Proceeding, the transaction "would significantly increase competition between railroads by providing an upgraded east-west main line route to compete with a parallel main line route operated by CSXT." Any CSXT effort to acquire Pan Am would threaten to materially undermine this existing competition.

NS observes that the competitive harm would begin as soon as such a voting trust is established and requests that the Board "immediately open a proceeding to consider the deleterious effect of such a transaction." Even though the original PAS agreement mentions a voting trust as a means to manage any "change of control events," NS, in this letter, says it will "defer its change of control rights until the Board's resolution of that issue."

The way I see it, Pan Am Rail and NS have worked diligently to convert the former B&M/MEC from a property largely reliant on the paper industry to one supporting the expanding manufacturing and distribution network of companies from central Massachusetts to northern Maine. Customers have single line access to both NSHR and CSX which keeps rates down, dependability up, and lets PAR service design find the best fit for the Class I partners. I'm hopeful the competition remains, regardless of how it all turns out.

BNSF third quarter revenue came in at $5.2 billion, down 14 percent from last year's $6.0 billion, on 2.4 million revenue units, down eight percent from last year's 2.7 million. Merchandise carloads were down 14 percent as industrial products dropped 25 percent and agricultural products gained one percent. System RPU slipped six percent to $2,021. Merch RPU pretty much held its own — down 40 basis points to $3,489.

The AAR revenue unit breakout shows that only five of the 18 carload commodities were up and four of these were in the ag sector, roughly 12 percent of all rev units. Met ores, metals, sand/aggregates, petroleum, and non-metallic minerals took the heaviest hits. Operating expense came down 18 percent to $3.2 billion; operating income was $2.0 billion, down eight percent, and the operating ratio was 61.1, down 265 basis points. Net income was $1.3 billion, down eight percent from last year.

All the merchandise carload categories took hits from the COVID-19 pandemic. Industrial Products volumes decreased primarily due to a pandemic-related industrial production decline, such as reduced production and demand in the energy sector, which drove lower sand and petroleum products volume. Agricultural Products volumes also saw pandemic-related declines. Declines in ethanol, sweeteners, and export beans were substantially offset by higher grain and meal exports.

Steelmaker Cleveland-Cliffs announced its attention to acquire ArcelorMittal Steel in late September. Now comes official notice that Cleveland-Cliffs wishes to formally acquire all six of ArcelorMittal's railroads. According to the STB filing, FD36449, the railroads are the Brandywine Valley, Upper Merion and Plymouth, and the Steelton & Highspire in Pennsylvania; the Cleveland Works Railway in Ohio; the Lake Michigan & Indiana and South Chicago & Indiana Harbor in Indiana. Looks to me like about 155 route-miles of railroad. Cleveland-Cliffs already owns the taconite-hauling Lake Superior & Ishpeming Railroad in Michigan, some 25 route-miles in length.

Wells Fargo railroad analysts recently hosted a call with former STB Chair Dan Elliot, where he provided insights into the issues that are top of mind at the STB concerning the railroads. The conversation centered on service-related issues and impacts stemming from the election outcome. Excerpts:

With election season nearly concluded, the STB will likely see a new Chairman as Democrats likely take over executive power. While Democrats as a whole are typically in favor of increased regulation, the partisan stereotypes do not typically hold true for the board. Political motivations within the STB have primarily been determined by geography as opposed to partisanship. As a result, shippers would likely benefit.

As for railroad service matters, shippers believe that there are underlying issues primarily related to PSR, as there hasn't been a lot of flexibility during this rapid development while going through across the industry. They note that the cuts in employees have been significant and remain concerned that once demand returns the service challenges could become more pervasive.

And if that's what shippers think (me editorializing here), they're going to be super-sensitive regarding trip plan compliance, bunching, constructive placement, rate-making delays, and the quality of equipment offered for loading. Short lines can help by making sure ISA commitments are met on both sides, and holding shortline dwell to four days max — a day to the customer, two days to load/unload, and a day back to interchange.

Shortline ownership gets curiouser and curiouser. The Pioneer Railways group of 17 short lines, total just under 700 route-miles, was acquired in July, 2019, by Brookhaven Rail Partners (part of Denver-based Brookhaven Capital Partners) in conjunction with Related Fund Management and Stephens Capital Partners, LLC.

The official acquirer was BRX Transportation Holdings, and bought Pioneer as a "platform for investment" under the leadership of BRX Partner Alex Yeros. Last month Boston-based hedge fund operator and "activist investor" Baupost Group and US Infravest Managers signed a Letter of Intent "to indirectly acquire the majority equity interest in BRX Transportation Holdings." I count seven entities involved.

By way of review, Pioneer was started by Guy Brenkman in the mid-1980s with the former PRSL Salem Branch in New Jersey, acquired some properties in the deep south, and really set up camp in the midwest. All the short lines were relatively small, serving local markets that had specific railroad needs. I've always felt that these properties never attained their potential and I have great hopes that the Yeros (former Broe Group) team can help that potential be realized.