RAILROAD WEEK IN REVIEW

January 8, 2021

"The XLB Materials Sector Fund includes securities of companies from the following industries: chemicals; metals and mining; paper and forest products; containers and packaging; and construction materials." — Prospectus

"This was a huge accomplishment for the Englewood team to complete this project in close to eight hours, it's just never been done before – in the past, this would have been a 16-hour project."— Michael Azzarello, Union Pacific superintendent-Terminal Operations, on the Englewood retarder replacement, January 6

"Greenbrier recorded a backlog of 23,900 units at the end of FQ1, which ended in November, continuing to provide a baseline of support for FY21. New orders remained tepid as expected with the rail supplier reporting 2,900 new railcar orders, with around 30-40 percent generated internationally. We expect to see increased activity as cars continue to come out of storage and rail traffic continues to recover." — Wells Fargo, January 7

"As we enter 2021, we see more of a mixed backdrop for transport stocks as some of the COVID winners face risk of becoming vaccine losers. We also see a mixed bag from the Blue Wave with potential tailwinds from infrastructure & stimulus, but potential headwinds from corporate tax reform." — Scott Group, Wolfe Research, January 7

Week 52 carload reports are in. I need to say up front that my only interest in week 52 is whether it's better than YTD and in what STCCs. For our purposes the YTD trend is more meaningful. Total NA rev units were down seven percent with only CP and KCS faring slightly better.

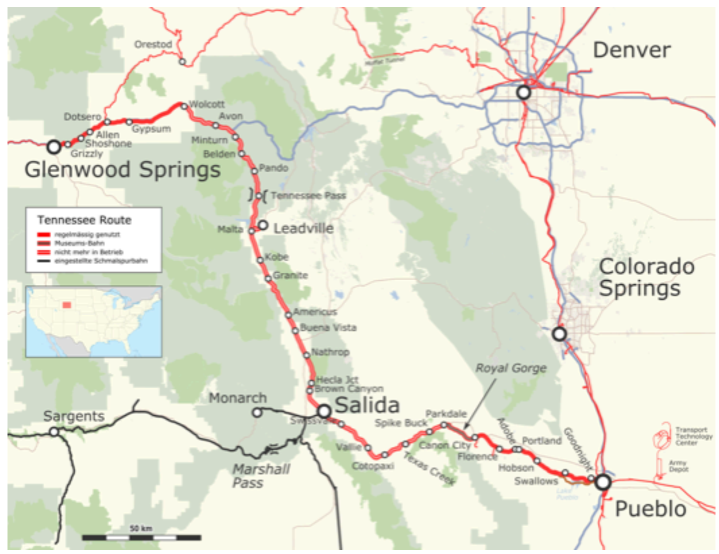
Looking at the major carload categories ex-coal, ag/grain was the big winner. The dip in chems is from crude oil's decline; paper and wood both slipped four percent; non-met mins were taken down double digits by the frac sand fall off. (As a reminder, the AAR Metallic Ores category includes all STCC 10 raw materials. Non-metallic minerals STCC 14 includes phosphates and rock salt except that STCC 142 frac sand is in aggregates.)

NS among Class Is has the biggest YOY decline. Every commodity group is down, including grain. Industrial chems/ferts fell nine percent; paper and wood were down nine percent and seven percent respectively; aggregates and frac sand, the biggest sub-category, sank 28 percent. All of which further reinforces Alan Shaw's remarks about going after "quality revenue." Maybe he ought to revisit the One Train Railroad slide set.

As is always the case, the year-end financial reports emphasize share price trends, though the insights one can draw about revenue unit volume trends can be quite helpful. The margins are a hot-button, though it seems improvements are very much a function of rate hikes, reduced head-counts, and the national decrease in fuel prices. IMHO, a continued fall-off in revenue units is going to hit margins sooner or later, ultimately affecting share prices.

Over the holidays I got to thinking about relative returns on shareholder equity 2011-2020. My target is seven percent CAGR as that gives you a double every ten years. I suspect it isn't happening. Take CSX. Year 2011 SHE $8,468 million; 3Q2020 SHE $12,727 million, CAGR 4.2 percent from my trusty HP 12-C. Since my quarterly financial reviews go back that far, it'll be a simple matter to do the same for all the Class I railroads. Stay tuned.

Colorado, Midland & Pacific Railway Company (CMPR), a wholly owned subsidiary of Rio Grande Pacific Corporation (RGPC), has entered into a commercial agreement with Union Pacific for the majority of the Tennessee Pass rail line in Colorado owned by UP, filing with the STB last week.



According to the filing, CMPR is "a non-carrier that was formed for the purpose of leasing and operating a rail line; RGCP owns 100 percent of the issued and outstanding stock of the CMPR." Once the deal is done, CPMR will become a Class III carrier.

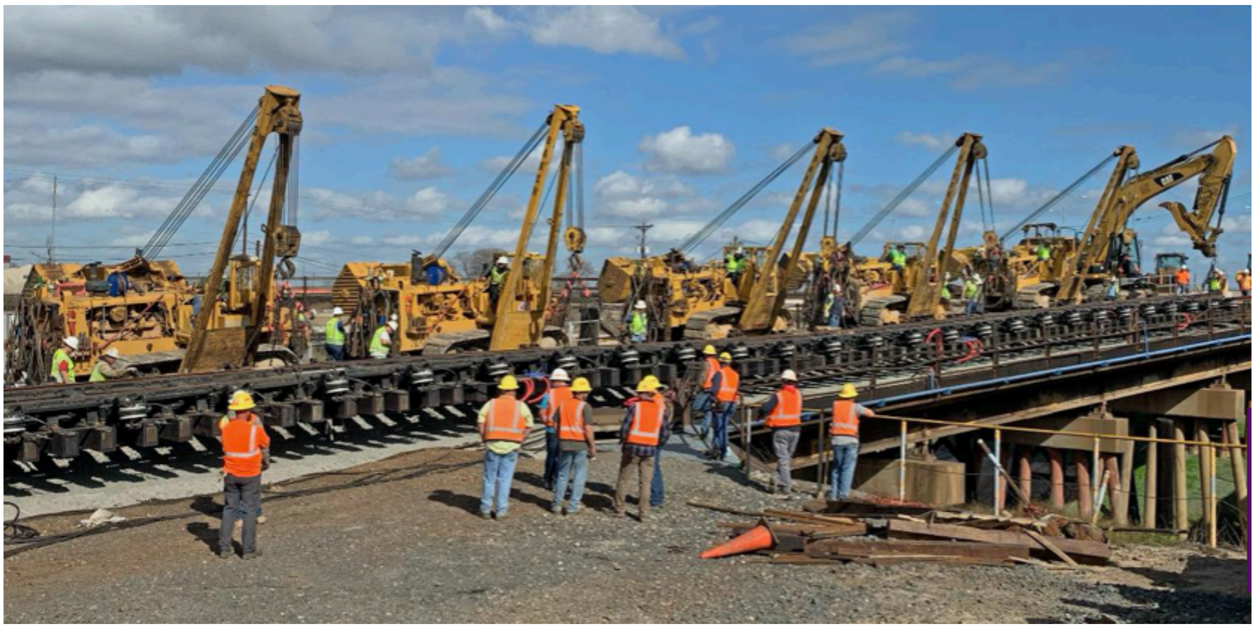
An item on the *Trains* magazine newswire reminds us that the line has been out of service since August 1997, when UP redirected the traffic here to the more direct Moffatt Tunnel Route, running due west out of Denver and where the grades are more forgiving. Tennessee Pass in contrast sports grades of up to three percent and when operating was highest mainline route in the U.S. with its summit at 10,240 feet. Extensive rehab work will be in order.

The STB filing, FD36470, says CMPR will operate the 163 miles between Parkdale, about halfway between Pueblo and Salida, and Sage, timetable east of the Moffat Tunnel main junction at Dotsero. The namesake pass is just a few miles timetable west of Leadville.

The XLB Materials Sector Fund is important because it covers most general merchandise categories ex-agriculture, as you can see from the lead italics quote, above. As of Wednesday morning XLB was up 75 percent from where it was in April as COVID hit. Leading companies in the index include Air Products, DuPont, Freeport-McMoRan, Dow, IP, Vulcan Materials, Nucor, FMC, Mosaic, and Sealed Air.

There is a lot of interest in these shares and they are cheap. US Steel, Freeport, Cleveland Cliffs and DuPont, for example, all trade more than 10 million shares a day and most shares are priced at less than twice book value. Railroads would do well to track the XLB, its sub-industries, and the companies represented to stay ahead of their customers in these industries.

Hump yards don't die. They get rebuilt — fast. Union Pacific last week installed a new master retarder in Englewood Yard in close to eight hours. The railroads objective is to make Englewood an example of what can be done in a yard now processing 2,700 cars a day.



Doing so took planning, thinking outside the usual boxes, pre-building the new master retarder at another location, and then doing a practice run on the actual process to be used. It took six side booms and two track hoes to provide enough horsepower to lift the 283,000-pound retarder. Usual practice is to install new master retarders in three sections utilizing a crane; at Englewood, they used a new bridge extension to stage heavy equipment, saving a lot of curfew time by pre-welding it and installing it in one piece. (*Photo courtesy of Union Pacific*)

The timer on the eight-hour track curfew started December 29. They took out the old retarder in less than an hour and then completed extensive grading work to accommodate drainage and ensure the new master retarder would be properly seated. Finally, the new device was installed in just under an hour. As a result, yard through-put capacity increased by some 11 percent to 3,000 cars a day or more than 100,000 cars processed per year. Worth it, I'd say.