RAILROAD WEEK IN REVIEW

June 11, 2021

"Learning information that is going to stay relevant for one hundred years is a better time investment than trying to digest information that will expire next week." — Charlie Munger

"Approximately $400 million of this year's capital plan will be for expansion and efficiency projects. On its Southern Transcon route between the West Coast and the Midwest, BNSF will continue a multi-year effort to add several segments of new double-track in eastern Kansas. Once fully completed, BNSF will have 50 miles of additional main track to support traffic growth."— BNSF, January, 2021

"Any time we can offer local customers access to rail via transloading (rail to truck OR truck to rail), we make our market more competitive for producers and consumers. Thank you to the transloaders and truckers who are meeting needs in our communities." — North Shore Railroad, On-Track newsletter

"Chemical shippers are experiencing widespread and persistent rail service challenges. These failures and delays are harming manufacturing operations, supply chains, and our ability to compete globally… We believe the current issues reveal systematic capacity constraints caused by cost-cutting and major operational changes over the past several years." — American Chemistry Council CEO Chris Jahn letter to the STB June 9

Obfuscation is a waste of time and annoying. When you read something from or about your favorite railroad you really want to know what's happening, why, and how it's going to affect your customers. I really don't care about system train speed or the horsepower-tonnage ratio. I do care about service outages and other unplanned events, reported in such a way as to leave no doubt as to how service is affected.

BNSF meets this test admirably. Their "Industrial Products Network Update for Friday, May 28, 2021" tells us

> We experienced a derailment Tuesday night in the Texas Panhandle, on our Southern Transcon route approximately 75 miles west of Amarillo. The incident impacted both main lines at this location. Service was restored on one main track within 12 hours, and both lines were back in service by Wednesday evening. Rail operations through this portion of the Transcon have since normalized.
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> Key service metrics for the week were negatively impacted by these disruptions. While down slightly, total volume on the railroad remains at a strong level. BNSF has moved 200,000+ units in 10 of the 20 reporting weeks thus far in 2021. Operating teams continue to focus on

> aligning resources with freight volumes as well as engage in collaboration with customers to drive greater network productivity and efficiency.

What, where, when, and what's being done. Note the comment about "collaboration with our customers" which tells us they recognize there are people depending on BNSF to perform as advertised. You can tell instantly that if you have carloads moving over this route, your customer's supply chain will be affected. You can win buckets of points by forwarding the BNSF language verbatim.

In contrast, here's a content-free statement from another railroad…

> We continue to realize the positive benefits of our ongoing initiatives as they relate to operating performance. By increasing qualified crew counts and improving locomotive availability, through the end of the 3rd quarter, we have achieved year-over-year improvements of three percent and six percent in our Train Speed and Terminal Dwell measures respectively.

None of this says anything that your customer can use to strengthen his supply chain story for *his* customers. So train speed and dwell have improved across the railroad, but how does that affect reliability and consistency of *my* service?

The purpose of "precision scheduled railroading" is to create consistency and reliability. I remember a conversation with Hunter Harrison some 20 years ago when he was running the Illinois Central. He was getting five turns a month on grain trains from Illinois to New Orleans and was verging on six. Asked how he did it, he said by scheduling everything from train crews to track maintenance. Cost-cutting was never an issue as lowered operating expenses flowed naturally from the scheduling process.

The best short lines and regional railroads have such precision in their operations that customers can set their watches by their cars arriving when they're supposed to. The savings in everything from fuel burn to overtime, support superior track and related capital enhancements, among other things. Moreover, crews are happy because they can go home the same time every day to watch their families grow up.

Unfortunately, there are a few in the shortline community that see PSR as a means to cut costs, regardless of the effect on their customers' businesses. And because there is no consistency in operations from day to day, crews never know when they're going to get home or how to schedule family events. But, boy, is management getting ops costs down.

I remember one railroad where it got so bad train crews were talking about unionizing. Once they started running the same trains the same way every day such talk stopped. Then there was the *ad hoc* short line where the irregularities were such that mechanical crews couldn't keep the power going and do the 92-day inspections at the same time.

As a result, the talented shop guys quit and the railroad was left hiring the dregs of the community to turn the wrenches. Truckers to the rescue for the customers.

The American chemistry council letter to the STB is only the tip of the iceberg. And it's so needless. The railroads in their Wall Street presentations tout having the capacity to move 30 percent (or more) freight. Yet I suspect that railroads may struggle to maintain today's level of financial performance when their two largest levers for the past decade — rate hikes and bigger trains— flatten out even as trucking competition is outpacing on tech innovations.

The trend in carload volumes is down. Fewer, bigger trains is the norm. I think it was Bill Stephens at *Trains* magazine who noted CSX train-starts are down 46 percent but revenue units are off only two percent. Fewer trains means fewer "paths" filling up the railroad. Yet another reason we see double-tracks reduced to one, locos being parked, and employees furloughed.

Fewer revenue units mean lower total revenue — you can only increase per-car rates so far. And there will be some point where revenue units will reach some *de minimis* level. There go the "two largest levers" cited above.

There's a certain hen house story that fits here. Hens weren't laying enough so the farmer brought in some ostrich eggs, saying, "This is the competition." The railroads are the hens and the truckers are the ostriches. Yet railroad managements continue to focus on how to lay eggs at lower cost, not increasing the number of eggs available to customers. Here endeth today's reading.

The STB on Wednesday set a "procedural schedule" for the CN/KCS Voting Trust, in which they set a comment period ending June 28 and named July 6 as the CN reply date. Allison Landry at Credit Suisse notes "There is not a set timeline in which the STB must issue a decision on the VT following the comment period/subsequent response from CN/KCS. If we use the CP voting trust approval as a rough proxy, a decision could come by the end of July (at the earliest, when considering that the review under the new merger rules may be somewhat longer)."

The tea leaves suggest CN and KCS expect an approval; the cautious approach the Board is taking elsewhere tell me this is no slam-dunk. A major stumbling block is the financial impact the transaction will have on CN. The question of revenue adequacy has been raised, shippers fear rate hikes to absorb some of the cost, and the remaining Class Is seem spooked by the prospect of further industry consolidation. Cowen's Jason Seidl puts the odds of STB approval at 60-40 against.