THE RAILROAD WEEK IN REVIEW

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"The pillars of a strong and surviving business are innovation, leadership, and sustainability." - - Larry Pulley, Dean, Mason School of Business at The College of William & Mary

Sustainability: Responsible and proactive decision-making and innovation that minimizes negative impact and maintains balance between social, environmental, and economic growth. (*from Costanza, R. & Patten, B.C. (1995). "Defining and predicting sustainability." Ecological Economics 15 (3): 193–196. via Wikipedia*). What Pulley is talking about is The Mason School's initiatives in maintaining W&M's scholastic excellence through "Design Thinking."

The process entails getting more mileage out of the assets at hand and exponentially expanding the ratio of unit of output per unit of input, something the railroads have been doing so well, especially post-Staggers. Southeast Florida is a case in point. The area needs more container space but there just isn't room. The infrastructure footprint has to pack more activity into the same or slightly larger footprint. I-95 is jammed, yet the Florida East Coast Railway can handle more trains; they just need more space to assemble such trains.

Happily, innovation and leadership on the part of Port Everglades, the City of Fort Everglades, Florida DOT and the FEC have found a sustainable solution in their brand-new Intermodal Container Transfer Facility (ICTF) at Port Everglades, slated to open for business this summer. Once the terminal is completed, FEC will have the on-site capacity to build 9,000-foot unit trains within the ICTF without blocking any city streets. New through-trains and dedicated drays will put containers in Atlanta and Charlotte in two days and Nashville and Memphis in three days.

The $53 million construction cost is funded with an $18-million grant from the Florida DOT's Strategic Intermodal System program, a $30 million FDOT State Infrastructure Bank loan to FEC and $5 million cash from FEC.

Lord knows the area needs it. FEC President Jim Hertwig recently walked me through a time-line for international, water-borne traffic growth in South Florida and the *sustainable* infrastructure they're sponsoring to handle it. Henry Flagler would be proud. (*photo credit: Port Everglades*)

Kansas City Southern shares took a serious five percent hit Tuesday after the lower house of Mexico's Congress approved a bill to increase rail competition. According to Bloomberg, KCS gets nearly half its total revenue from Mexico so this proposed legislation - which would give third-party companies access to KCS-owned rails - is cause for concern. The legislation goes next to the Mexican Senate for a vote. If passed, the bill would nullify the 1997 operating concession KCS secured from the government and which runs to 2027.

Bloomberg figures KCS and Ferromex (of which UP has 26 percent) have a combined 90 percent share of Mexico's rail traffic. My cynical self sees the rapid rise of near-shoring to Mexico from the Pacific Rim largely made possible by KCS and the UP, and now the new Mexican administration wants a piece of the action.

Rail analyst Allison Landry at Credit Suisse doubts the bill will pass in its present form and doesn't see it as a priority for the Mexican Congress, anyway. Allison writes that the reform bill's open access provisions provisions would "open a can of worms," reducing incumbent rails' returns, discouraging further rail investment and ultimately making Mexico less attractive for further foreign investment. However, she is keeping her Outperform ratting because:

> Our channel checks in Mexico indicate the following: 1) a small (but powerful) group of mining companies is aggressively pushing the bill; 2) current industry players (i.e. the rails) will be heard in the Senate, where we expect the bill to be changed with their interests considered; and 3) local media suggest there is no consensus to pass the bill at the Senate level, as 2 out of the 3 most influential political parties have made public their intention to vote against the bill.

And, even if *does* pass, it won't be for another two or so years and that user fees for non-owners will reflect owner investments plus a mark-up and therefore "will not have a substantial effect on pricing, profitability, or returns."

Union Pacific's Jim Young passed away Feb 15 following a two-year bout with pancreatic cancer. He was 61. A true gentleman, Jim was aways welcoming, never giving one the sense he had had more important things to do than put one at ease.

He was a *bona fide* customers' and employees' man. UP chronicler Maury Klein, in Volume III of his UP trilogy, recounts the time in 2004 when the railroad began filling up and they feared a repeat of the1997-98 difficulties. Klein quoting Young: "During my first year as president I spent half my time with customers and about 40 percent of my time in front of employees. It was brutal." Talk about trial by fire! Something clearly rubbed off and it benefitted us all.

Jim will be missed, to be sure. However, Jack Koraleski, railroad CEO, and Lance Fritz, railroad president, will not only carry the baton forward, they will also build on Young's legacy. *Requiem aeternam dona eis, Domine, et lux perpetua luceit eis.*

Wabco has to be the real sleeper of the railroad group. They ended the 2013 calendar and fiscal year with a $1.7 billion backlog against annual sales of $2.6 billion, and a share price of $87.54, double what it was a year ago on a split-adjusted basis, and, says WAB, it is the only North American company that has increased its year-end share price for 13 consecutive years.

The full-year transit/ freight rail mix is about 45-55 vs. 37-63 a year ago. On the earnings call Wabco said transit was the big grower thanks to greater market share in emerging markets, while freight rail loco and car build were off slightly year-over-year. That is expected to change in 2014 with tank car OEMs increasing production and the broadening of railcar demand in general.

A note from Wolfe Research says the estimated 60,000 unit freight car backlog, up 13 percent over 2012, "should support solid rail car delivery levels through at least the end of 2014." The rate of production has the potential to "accelerate sequentially" because, should the pace of tank car builds slow, "the backlog mix becomes less concentrated (more covered hoppers, box cars, gondolas etc.) and the pace of deliveries should pick up going forward."

On the other hand, both CP and CN have said they're going to start charging more for movements of crude oil in older tank cars. A note in *Railway Age* tells us, "CN is charging a higher rate to move crude oil in DOT-111 tank cars built prior to October 2011, when Association of American Railroads CPC (Casualty Prevention Circular)-1232 safety standards took effect. These standards include head shields, top-fitting rollover protection, half-inch-thick normalized tank steel (for unjacketed applications), double-shelf couplers, and bottom skid protection." Though no official number has been given, a ball-park five-percent premium is n the street.

Canadian Pacific, says Reuters, will add a $325 "general service tank car safety surcharge" on each car of crude that is shipped in any container other than the CPC-1232 model, effective March 14. And the *Calgary Herald* picked up a Hunter Harrison speech in which he told the Calgary Chamber of Commerce the older cars must either be retrofitted or retired. But it's not going to be cheap. I'm hearing numbers north of 70,000 cars to be retrofitted at a cost of $30-70,000 a copy. (New builds run $100-150,000.)

Shippers of crude oil are already stepping up to the plate. Last week U.S. refiner Tesoro Corp. said it is moving to phase out use of the older models proactively. This week Canadian refiner Irving Oil did the same and went further, telling suppliers and marketers of crude oil they won't be able use the older cars for crude oil after the end of this year. And BNSF on Thursday said it's putting out bids for its own fleet of 5,000 up-to-spec tank cars. What better way to make sure what's moving on your railroad is moving in the right equipment?