THE RAILROAD WEEK IN REVIEW

June 13, 2014

"One must look for the invisible risks of serious loss in any portfolio." - Nassim Taleb, Fooled by Randomness, page 33

The scheduled railroad thread continues. A reader who started his career eons ago with a Class I then retired as a shortline guy writes, "When I was in grain marketing I'd spend much of my time checking to see if my unit grain trains were making their schedules." But he ran into a brick wall with a particular ops guy who didn't want marketing "telling him how to operate his railroad," sometimes stopping trains in their tracks "and confiscating the power."

He allows as how "things are better now, with centralized planning and the field responsible for executing the plan." However, he suggests the Class I rails need to do a better job of including customers in unit train schedule planning. He concludes, "I am looking forward to railroads again planning their schedules with a clock instead of a calendar. In trucking, the customers plan the schedule and the trucker meets it or loses the business. A significant difference!"

Happily, the short line can make the scheduled arrival time work as long as the Class I shows up at the right time with the right train at the interchange. [*Short lines say advance consists can be either wrong or missing and seeing local service jobs missing ISA windows entirely is not unknown. - rhb*] The top dog at another short line that has won prizes for its customer service and business development acumen writes, "We negotiate a guaranteed two-hour service window with each customer and then schedule our ops to meet those commitments." They measure everything and confidently say they make their commitments 98 percent of the time.

Union Pacific has opened its brand new 2,200-acre logistics center in Santa Maria, NM a year ahead of schedule. The $400 million facility includes two main-line fueling stations, crew change buildings, and an intermodal ramp with an annual lift capacity of around 225,000 containers. It's at the top of the 13-mile hill you climb westbound out of El Paso and not five miles off I-10. It's at the east end of the Sunset Corridor double-track project, so it gives UP a logical place to land all those trains the added track capacity lets them run.

It's one thing to double-track a railroad or to take sidings up to 10,000 feet from 6,000 or so. But if your merch freight yards can only take 6,000-foot trains, the big trains won't fit at crunch time. Then trains are held out, missing not only core-train connections but also connections to the secondary serving yards that support the local network.

As long as cars-on-line stay within a manageable range, that's OK and the AAR performance metrics are within tolerance. But when cars-on-line begin to creep up, local service can begin to lose its edge. Average train speed, for example, only counts core trains to and from core yards.

Go a level below the core and Wall Street never sees it. That's why I say we need to build more Santa Marias for the carload network, so there's a runway where you can bring in these 10,000-foot trains without parking them out on the main.

Not all carload business is created equal, and you need to know not only what business can move on the rails but also what equipment is required. Take boxcars. RMI's RailConnect Index shows paper did 112,294 cars through the 2007 Week 13 and only 99,365 in in the same 2014 period. That's a 13,000 car spread. If the cars average 12 trips a year, that's three a quarter, so 13,000 carloads in 2007 would require 4,300 more cars than today's vols. Where are they?

The boxcar fleet is shrinking, no doubt about that. RailSolutions, Inc. in Williamsburg says by 2012 the US boxcar fleet was down to fewer than 100,000 units from 120,000 in 2008. Moreover, "Traffic volumes in the paper and forest products markets still have a long way to go to return to their pre-recession levels."

But say you're one of the fortunate few who can use Plate C, 100-ton, 60-foot cars. You go to your friendly Class I market manager for a rate quote. Meanwhile, he's got rate requests for moves requiring 600 boxcars *en toto* and he's only got 500 cars available. Who gets the cars?

The cars will go to the moves with the best metrics: meeting replacement cost, cycle times, car-miles per day, and the users' (origin and destination companies) records for turning cars. And local service histories affect all these factors. So the third-tier yard master who holds trains for tonnage or the short line that takes ten days to turn a car will not be a first choice.

Being "fooled by randomness" means taking established practices for granted and not considering what happens when they "blow up" or take a series of serious negative hits in a short period of time. The relatively rapid decline of the eastern steam coal business is one such; the Lac Megantic event was a short sharp shock whose effects are still being felt; my sense is the present level of railroad ethanol volumes could be very fragile.

Because these moves look like they have (or have had) good long-term prospects, the risk of their blowing up to the detriment of any single player tends to be invisible. Yet the risks are there, even if the odds of their happening are on the way-out tail of the bell curve. Going back to the boxcar example, you need scarce boxcars for a key customer and you know how market managers allocate cars. And so you minimize the blow-up probability of having no cars by maximizing the probability that the business meets or exceeds Class I thresholds.

Genesee & Wyoming North America carloads for May, 2014 increased four percent to 151,468 units, up five percent year to date and even with April. Overhead Class 1 traffic was the biggest gainer, up 29 percent; among commodities making up 80 percent of GWR vols in North America, the STCC 28 chemical group was the biggest loser, down four percent.

The coal & coke group was up seven percent, due chiefly to steam coal moves in the Midwest and Ohio Valley regions. Metals were up ten percent on strength in the Northeast, Canada and Southern regions; carloads of petroleum products were off 13 percent as crude oil vols fell in the Southern, Pacific and Canadian regions and LPG went south in the Mountain West region.

The Class Is as a group across the four weeks ending May 24 grew total revenue units by eight percent all-in; ag products, frack sand and crude oil were the big carload drivers while intermodal jumped eight percent all by itself. The RailConnect Index doesn't break out vols by the month, but year-to-date revenue units increased a point. Coal, STCC 28 chems, grain and aggregates account for half of all carloads and all but chems were up in the mid-single digits.

As an aside, total RailConnect year-to-date revenue units came to 2,974,230 and GWR's comparable number was 677,392 units, 23 percent of the total. My shortline universe has about 550 road names, of which 108 are GWR's in North America. Call it 20 percent of the total. From this it is safe to say that GWR's North American carload percentages are fairly representative of the entire shortline community.

Norfolk Southern tees up its annual shoreline meeting this week, literally. The festivities open with a golf outing Wednesday followed by the reception and Thursday's presentations. Of particular note, Paddy O'Neill (whom we heard from at the Rail Equipment Finance conference in March) will address car utilization. In my experience, short lines are notoriously uneven in their performance in this arena and I'm hopeful Paddy's remarks will encourage those behind on the learning curve to catch up.

At REF, Paddy zeroed in on boxcars — how many, where and how used, performance, and which commodities are best-suited for which cars. He cited four particular challenges for the boxcar trade. Trucks and intermodal are siphoning off vols big time, loading diagrams and limitations strike fear and loathing in the hearts of warehousemen, shippers themselves are not always at their best in turning cars, and as a result boxcars still get just 12 trips a year average.

The Plate F, 60-foot, 100-ton car is the most popular car type and makes up more than half of all the cars in the North American boxcar pool. These cars have the best empty/loaded miles ratio and represent 40 percent of all boxcar loads. Interestingly, the Plate C, 50-foot car also handles 40 percent of boxcar loads, with half its volume in paper-related commodities.

A recent note from Scott Group at Wolfe Research says NS sees "strong growth this quarter and is very optimistic about long-term growth." Merchandise levels are on an upward trend so far in Q2, with metals, crude oil and frack sand in the lead. See you in Roanoke.