THE RAILROAD WEEK IN REVIEW
December 12, 2014

"You nailed it on the ISA front. They are important to commercial/marketing. But over in the ops side of the house, I am not so sure how much emphasis is placed on them." — Shortline Manager

Interline Service Agreements between short lines and Class Is got their start, if memory serves, back in the Conrail days to address the TRRA. Fast forward today, and even mentioning ISAs generates a good deal of impassioned discussion, pro and con. It seems to me, however, that at the Class Is it's shortline departments that are pushing ISAs. We don't hear much about ISAs from the operating departments, though local ISA compliance appears to be optional.

A good friend of more than 20 years, and with whom I've collaborated on a number of shortline tasks, writes, "Your discussion of scheduled railroading in the latest WIR reminds me that to run trains on time, you need enough rested crews to operate them. From what I am seeing, the critical issue is not enough manpower, whether it's on NS at Conway or BNSF at Minot.

"Hiring - and retaining - more people than what you have now to run your trains is extremely difficult. I can only imagine how hard it is for BNSF to attract new employees in a sparsely-populated area when so many other high-paying jobs exist nearby in the oil fields. We are familiar with the truckers' issues in getting enough drivers (part of what's driving intermodal growth, exacerbating the rail crew shortage). There is a counterpart issue on the rails."

To which I reply, we're running short of power and crews because trains can't get where they're going. Class yards get plugged because the departure tracks are full of trains the inbound power and crews are supposed to get out of town. But they can't because they're held out on the main waiting for space in the receiving yard. I'm hopeful the NS doubling of Bellevue Yard capacity and the UP's new Santa Teresa Terminal are harbingers of what's to come.

Yard capacity can be freed up if you can speed up hump ops. That's where I was going with last week's thread on short lines pre-blocking their outbounds. Mail on the matter suggests that I wasn't sufficiently specific in my remarks. I didn't mean irregularly blocking the odd cars, I meant blocking for commodity-OD pairs with enough regular volume to warrant the effort to put the pre-block in the plan. Sometimes the shoe fits; sometimes it doesn't.

For example, suppose a short line interchanges a two-car block of traffic for East Podunk to the connecting carrier along with some other traffic. Later on, this tiny block finds itself in the middle of a 120-car through freight train. Upon arrival at a hump yard, the entire train will most likely go over the hump; I don't believe any sane Terminal Super would tear apart a large train solely to get a cut of 2 cars that would otherwise be humped along with other traffic.

However, it's another story if there are six cars a day scheduled three days a week for East Podunk. They can be put on the head end of the short line's outbound consist. At the Class I receiving yard the trim crew pulls the pin at the end of the cut and ferries these cars over to the lead position on the designated outbound track in the departure yard. Since the typical merchandise move goes through as many as five class yards between OD pairs, and spends a day in each, skipping the hump in each yard could be worth five car-days times, in this example, six cars. I'd say 30 car-days is worth it.

Things are looking up for BNSF grain shippers. DTN/Progressive Farmer analyst Mary Kennedy writes (Dec 8) that BNSF's weekly service update says, "Milder weather and lower freight volumes have helped improve railroad service across the country. BNSF operations remained fluid over the past week with strong gains in on-time performance across all business groups. Freight volumes are returning to their traditional levels, locomotives are becoming more available and favorable conditions exist for improved velocity and network performance."

In Canada, writes Kennedy, "Small single-car grain shippers on short lines in Western Canada perceive the original [government carload] mandate as helping only the multiple-car shippers, leaving the single-car shippers short of cars most of the year with no recourse to the railroads." She reports that even though the government mandate seems to hold the Class Is to account, her sources feel the mandates just give the majors "another excuse to not service small shippers."

I'm not surprised the short lines are singled out. The inherent lag between interchange/on and placement always adds some hours, as does the interchange lag on the outbound side. As CP noted last winter, not all shippers and receivers work weekends, adding more days to transit time. To address the shortline dwell matter, BNSF for one is measuring not only shortline interchange-on to interchange-off but also dwells between place and pull. It thus appears to me the "small shippers" on short lines may be at risk due to their own behavior and that of their serving short lines. To reiterate: turn the cars and fear nothing.

Don Seale, Chief Commercial Officer at NS, held forth at last week's Credit-Suisse transportation confab. His remarks were essentially a repeat of the third quarter earnings call, adding some crucial fourth quarter to-date observations on slide 8. There's been a slight downward drift in revenue-unit counts this quarter, down two percent year-over-year whereas a year ago they were up six percent.

His chemicals group includes crude oil and nat-gas liquids and metals/construction includes frac sand. To get a closer look, go to the Nov 28 YTD volume numbers on the NS website, with your own spreadsheet and a little knuckle-drilling, sorting them into the commodity groups on Seale's slides. The biggest gainer is petrol prods: crude oil plus the NGL family. Past QCS studies suggest the STCC 29s stay about the same year-over-year and all the growth is in crude oil. Excluding petrol prods and auto, merch carloads are up three percent year-to-date.

In sum, NS short lines will do best in hunker-down mode unless they have direct plays in petroleum E&P, though the current oil price slide may hurt some smaller drillers. Ag products vols are mostly weather-dependent; paper ought to continue in the GDP-plus range with a two percent volume growth rate. Lumber is mainly housing starts in the southeast, though the sorry employment situation for millennials doesn't encourage starting families or buying houses.

From the Financial Times comes word that the US shale industry faces an "endurance test" with new well permits down 30 percent in the Bakken and Eagle Ford territories. FT continues, "That may overstate the likely drop in activity because companies will have a backlog of permits they can use, but it is clear the industry is responding to a steep drop in the oil price."

Even if, as expected, oil recovers to the $70- range, the major players — EOG, Marathon, Apache, e.g. — will be OK. Not necessarily so for smaller producers like Range Resources, SandRidge, and Exco. It appears drillers vary widely in debt levels, financing, hedging against price falls, product mix, location, asset quality, and so forth.

At $90, one could afford to spend more drilling and completing wells than generating free cash flow. As a result, smaller outfits have amassed some $163 billion worth of high-yield junk bond debt. But even as these guys succumb, those with solid oil-shale assets will aways find buyers. Lower crude oil prices thus could have but a modest impact on US oil production; the present rate of growth may slow but isn't going down. And the nat gas plays seem relatively unaffected.

Morgan Stanley says in a note this week that much of the early 2015 production process is already underway and will be hard to curtail at this point. Momentum and improving capital efficiency should keep US growth elevated in early 2015 despite lower prices. Hedges, incentives and other obligations can also support activity beyond what economics would suggest; however, the Morgan base case assumes a reduction in new drilling activity into 2H15. My take from the above is that short lines in the oil and gas space must focus not only on forward shale and pipe consumption estimates but also on the financial health of their E&P customers.

Indiana Rail Road Founder, President and Chief Executive Officer Tom Hoback is retiring June 30. This is a property Tom and his team have rebuilt from a broken-down branch line into a thriving regional railroad. Peter Mills, currently vice president of finance operations at CSX, will assume the position formerly held by Hoback effective July 1. IRR has been a regular subject in these pages over the years, and I have to thank Tom for his friendship and forthrightness for same. I'm looking forward to a visit to see the Latest and Greatest at the Indiana Rail Road before he pulls the pin. More anon.