THE RAILROAD WEEK IN REVIEW

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"The risk is that workers in high-skilled, blue-collar manufacturing jobs will be replaced by machines before the dust settles." — Nouriel Roubini, economist.

Genesee & Wyoming November carloads in North America increased nearly seven percent year-over-year to 142,374 units. Of this, the Rapid City Pierre & Eastern transaction boosted results with 5,087 carloads: 3,190 agricultural products, 1,123 minerals/stone, 619 industrial chemicals, and 155 all other commodities. System-wide in North America the three top volume producers are coal (22 percent), agricultural products (13 percent), and aggregates (11 percent).

Excluding RCPE, North American same-store loads increased four percent. Coal/coke grew ten percent on steam coal shipments in the Midwest and Ohio Valley regions. Minerals/stone traffic leapt 15 percent system-wide, and overhead Class I moves, the "other" category, were up 18 percent, also system-wide. Lumber and wood dipped four percent while petroleum products including crude oil slid 18 percent with the losses predominantly in the Pacific, Canada and Southern regions.

Year-to-date carloads including RCPE increased seven percent, though November units were down sequentially ten percent vs. October. It's instructive to note GWR North American month-to-month results tend to wide swings — up 18 percent one month, down ten percent another.

Elsewhere on GWR, it looks like they're finally pulling the pin on the Cape Breton & Nova Scotia's Sydney line. *Trains* magazine **Newswire** reports the line has received provincial financial support of some $23 million over the last ten years, having been first acquired from CN by RailTex in 1993, absorbed by RailAmerica in 1999, and then rolled into GWR when they bought RailAmerica in 2013. This road has been on my Kill List for years, so I shed no tears.

The sudden southward drift in crude oil prices has ethanol players scratching their heads. Farmdoc.com, a web-based ag info center out of the University of Illinois/U-C, published this note recently: "Prospects for Ethanol Production Profits Dim as Gasoline Prices Plummet." Their analysis suggests current high ethanol prices relative to gasoline prices might slow the growth in domestic ethanol consumption, but would not likely result in consumption that is less than the 10 percent blend wall.

The calculated price of Chicago wholesale ethanol ranges from $1.12 per gallon to $1.70 per gallon, all well below the current spot price of about $2.05 per gallon. At the current price of corn ($3.65 per bushel), these ethanol prices imply returns below estimated variable and fixed costs of production except for the highest crude oil price and the highest ratio of ethanol to

gasoline prices considered. Consequently, farm.doc expects the curtain to come down on the current period of exceptional ethanol production profits fairly quickly.

A recent price of RBOB gasoline was $1.62. The UI study doesn't mention the fact that smaller cars now dominate the highways and people are driving less. Low gas prices aren't likely to make folks drive more so it's entirely possible ethanol producers will hit the blend wall with demand for their product topping out.

Continuing the thread, Stifel's "Breakfast Links" note from last Monday cites remarks of officials with The Andersons, Inc, an ethanol producer. "Despite the decline in oil prices, we remain relatively upbeat on U.S. ethanol production." Given the current logistical and economic framework for the U.S. fuel system, ANDE does not believe any action by Congress to reduce the mandate would have a material impact on domestic blending. The main hurdle for blending above 10 percent remains potential liabilities associated with older vehicles. But as the pre-2001 vehicles leave the fleet, ANDE believes increased blending rates will result.

In other words, there ought to be no sudden big changes in the amount of ethanol riding the rails. QCS stats say the rails are on track to do around 460,000 loads this year, up four precent year-over-year but down three percent from the 2010 total.

Economist and financial blogger Nouriel Roubini held forth recently on the future of automation and work. The occasion was the *Bloomberg Business Week* 85th Anniversary dinner where Nourbini was asked to speak on what he saw as the most disruptive innovation over the past 85 years. He chose the microchip because of the way it's changed the relationships between humans and their things. "We now live in a digital age where personal computers, super-computers, robotics, and artificial intelligence are everyday features of our world." And here he launches into the brave new world of "The Third Industrial Revolution."

As he ticks off the changes and opportunities to come, I'm thinking about how to automate the myriad routine tasks of Running a Railroad, starting with rate-making. Differential pricing has its roots in the original ICC Act of more than 100 years ago. (See my article in *The Railroad: What It Is, What It Does*, Fifth Edition, page 289), and there's no reason to keep it as written.

The ICC invented the "what the traffic will bear" concept, recognizing that not every commodity could cover its own direct costs and that those that could should subsidize those that couldn't. The railroad was the only option to reach distant markets so some regulation was needed to "prevent unjust discrimination between competing places and commodities." Today, however, super trucks on super highways dominate the inter-city transport market and pretty much determine "what the traffic will bear."

So why do we need elaborate pricing schemes for loads of widgets moving from A to B? We know what it costs the railroad to move a ton of stuff from here to there and we know the truck rate. We also know what goods sell for at origin and in distant markets and that the spread is

transportation cost. Thus we have a one or zero question: can I move a ton of widgets from A to be at a price that covers my cost and makes me a reasonable ROI? Yes or No?

One or zero. That's the binary language of computers and to a great extent computers can decide yes or no for themselves based on rapidly changing inputs (the Google self-driving car is one extreme example). For my widget move, I punch in origin, destination, car type and owner, weight, and release date. The system returns my price, departure time, route and arrival time. In seconds. No need for one human to wait a week for a rate-response from another human.

Out on the railroad, the car is either where it's supposed to be or it isn't, and if it isn't, the computer will write its own instructions for what to do about it. Norfolk Southern's Thoroughbred Operating Plan and Local Operating Plan Adherence metrics take this approach. A classic example was in preparation for Hurricane Katrina. NS asked the TOP to show how the railroad could run if there were no New Orleans and had solutions at hand in a matter of hours.

LOPA is useful in managing ISAs. Either the window is met or it isn't. If not, why not, and what are the alternatives to get things back where they belong? If Google can make a car drive itself based on data it collects as it moves, why can't we keep trains moving the same way? Roubini concludes, "The massive technology revolution will sharply reduce jobs over time. Low-skilled jobs and medium-skilled white collar jobs will be the first to go, as they always have been." And that includes yardmasters, rate clerks, and pricing analysts.

Kansas City Southern gets a mixed message from Mexico. UBS rail analyst Tom Wadewitz writes that the rail bill has passed muster in both the Lower House and the Senate and the tea leaves point to a presidential signature. He adds the bill itself "appears benign," albeit with provisions benefitting captive shippers.

The rail bill does not open up access to the railroad systems, although it does have a provision that could support an increase in interline business that runs on both KCSM and Ferromex. The bill also creates a Railway Transport Regulatory Agency, similar in a number of ways to the STB here in the US and "providing a mechanism for captive shippers to dispute rates." Tom concludes the full effect of these changes "could take a few years." A bullet dodged, at least for the nonce, and for that I'm relieved.

This is the last WIR for 2014 and I'm taking my usual Christmas break Dec 28-Jan 4. Next WIR Jan 9. Thanks for your patience and forbearance in 2014. Looking forward to continuing the conversation in 2015.

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