

# RAILROAD WEEK IN REVIEW

November 11, 2016

*“Given improved long-term coal prospects and potential tax reform, we still favor U.S. over non-U.S. rails and most investors we’ve spoken with agree.” — Scott Group, Wolfe Research*

**Now that all the Q3 results are in**, it’s useful to compare strengths and weaknesses. Short lines, switch carriers, and regional railroads depend almost entirely on the merchandise (everything but intermodal and coal, including automotive) sector, and here Union Pacific was the best performer among US Class Is, down only 1.7%. BNSF doesn’t report quarterly details, but using Week 39 (ends Oct 1) as a proxy, merch carloads by the same sort were down 1.9%.

In both cases, coal is shrinking as a percentage of total revenue and the carload is increasing its share of total revenue. My sense is, watching how non-Class Is use their local presence and customer knowledge (see below) to increase merchandise carload volumes, the smaller roads could enhance Class I results by zeroing in on the commodity lines with the latter’s best growth opportunities.

Let me suggest a conversation with your connecting Class Is along these lines, using the UP 3Q earnings call as an example. UP spoke of “robust grain supply and lower commodity prices” on the 3Q earnings call. How can my short lines help with the “robust grain supply” and how can we use commodity prices (Dept of Ag says corn’s been \$4 a bushel for two years and is likely to remain there in 2017) to our mutual advantage? We also heard about “strength in LPG and industrial chemicals,” which are particularly strong shortline suits. What can my short line do to add value in these areas?

More generally, UP’s Industrial Products group was off 11%, with declines in minerals, construction, and metals. What would UP like to see short lines do more/less of? And how can short lines contribute to a Class I’s new business initiatives? Are there ways my short lines can help improve UP margins? Ought we to put more emphasis on commodity lanes with higher yields (revenue/variable cost ratios), faster turn times, improved contribution per day? In sum, how can my short line use its local presence and knowledge of the UP traffic trends to enhance results for both of us?

**Reading & Northern’s success story** shows what you can do if you go see the people. Through October, R&N carloads are ahead of the full-year record set in in 2015. Merchandise carloads ex-coal are up nearly 15%, and to handle these volumes the railroad is adding assets. First, power. R&N picked up four 1500 horsepower EMD MP 15s at a Norfolk Southern auction, a first of this type for the short line. They also acquired a pair of GP39RNs rated at 2500 horsepower. These six units brings the total active loco fleet to 36.

Second, track. Crews put down 15,000 ties, laid 10,000 feet of new rail, added 10,000 feet of new passing track, and surfaced 89 miles of main line. And, where some railroads are taking down wayside signals, R&N is investing upwards of \$10 million to reinstall and upgrade more than 100 miles of CTC to be run from the Port Clinton dispatch center. This includes adding 15 miles of CTC and a remote-control mainline turnout in previously dark territory.

Third, equipment. To handle anticipated expansion of the road's anthracite business, R&N just closed on a deal to purchase 156 used steel open-top hopper cars. This acquisition brings the total car fleet to 1179 cars — open-top and covered hoppers, flat cars, box cars, and gondolas. Fourth, personnel to make it all work. In the past few months, R&N has hired some two dozen full-time freight railroad employees, continuing a decade-long traffic growth record that has seen a doubling of the Reading & Northern's full-time workforce.

The R&N two-hour customer service window guarantee plays a major role. Not only does the railroad have a 99% delivery-to-plan record, but also offers customers additional switches on request and has industry-low ancillary charges for demurrage, etc. Clearly, it takes money to make money, and the days of the 10-mile streak of rust short line are gone. I've been out on this railroad multiple times over its 20+ year history, and it's a *serious* operation. Do take note.

**Anacostia's New York & Atlantic Railway** has promoted current vice president Jim Bonner to President, effective last Friday. Bonner succeeds Paul Victor, who moves into the role of managing director for Anacostia. Also at NYA, Marlon Taylor is tapped full VP for AVP. from assistant vice president to vice president.

Bonner, a 19-year rail veteran, joined NYA as director of sales and marketing in 2013 and was promoted to VP 2015. No stranger to the shoreline business, Bonner worked for RailAmerica and GWR, most recently as GM for the Connecticut Southern, one of the lines going to GWR as part of its RailAmerica acquisition.

Taylor joined NYA more recently, coming on board in April 2016 from Pacific Harbor Line, Inc. (PHL), another Anacostia affiliate. He has 17 years of rail experience, beginning as an engineer/conductor for PHL. Taylor later worked as train dispatcher, trainmaster and chief dispatcher, advancing to director of operations prior to joining NYA. Victor has served as president of the NYA since 2007, following 18 years during which he managed railroads in Latin America and Africa. Good moves, all.

**The jewel of Eval Shapira's Pennsylvania & Southern**, a 30-mile short line in Central Pennsylvania, is the Cumberland Valley Business Park. Here, transloader and warehouse operator Franklin Logistics plans a major expansion to more than 1.3 million square feet of inside storage in two adjacent buildings. Each of the buildings is to be rail-served with sufficient car spots and doors to facilitate transloads to truckload and LTL service alike. Located on Interstate 81, the facility puts the NYC metro area and points along the I-95 corridor south to DC within an easy day's drive.

Meanwhile, Shapira's Raritan Central in Edison, New Jersey, has expanded its cross-dock facility to more than 50,000 square-feet, sporting 10 railcar spots on two rail sidings, and twelve truck doors. The tracks that access the building are paved flush to the rail, affording two-side unloading of center-beam cars; the paved area so includes three additional car spots on the running track. Edison is 15 miles from the Newark seaport.

**Second call: Don't forget RailTrends**, the annual NYC shindig hosted by Tony Hatch and *Progressive Railroading*. The 2017 event happens Nov 17-18 at New York's W Hotel on Lexington Ave at 49th. I'm particularly looking forward to Thursday with Amtrak's Wick Moorman (our Boston trip last weekend on Amtrak couldn't have been better), Pat Ottensmeyer of KCS, and Dave Ebbrecht, GWR's Sr VP for the Northeast.

After lunch, highlights include Dan Elliott of the STB, VP Dean Piacente on CSX Intermodal, UP's Jon Panzer, VP Finance - Planning and Analysis, and Conrail's Ron Batory as closer. Mike McClellan, VP Industrial Products for NS, opens the Friday program. Watco President Rick Webb brings us up to speed on his latest, FEC President Jim Hertwig provides the FEC update, and Claude Mongeau, recently retired CN CEO, receives the Rail Innovator of the Year Award.

**The 31st annual Railway Equipment Finance Conference** gets under way at the eponymous La Quinta resort near Palm Springs March 5-8, 2017. To many in the business, this REF event is the premier industry meeting specifically relating to the North American railcar and locomotive fleets. REF provides the most current information on fleet demographics as well as proven accurate predictions for the future.

The registration fee is \$1,695 and once again, REF offers 50% discount to members of the shortline and regional railroad community. See <http://www.railequipmentfinance.com> for details. You'll get three days of presentations from and conversations with industry pros, paired with information on the leasing and finance industries that support these fleets. Our attendees receive not only the experience of REF, but presenters' statistics, diagrams, and presentations on a 4GB flash drive.

REF founder Tony Kruglinski and I started our respective businesses about the same time, and I've been to a number of very worthwhile REF sessions at La Quinta. The only shortline conflict I know of is the CSX Shortline Workshop March 5-7. Tough call. But I think this would be great for non-CSX short lines if you can get there by car or a two-leg plane ride to Palm Springs.

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