

# RAILROAD WEEK IN REVIEW

July 14, 2017

*“Buffett didn't think of Berkshire as a textile company, but as a corporation whose capital ought to be deployed in the greenest possible pastures.” -- Warren Buffett: The Making of an American Capitalist, page 135*

**The Buffett quote above applies doubly** to railroads, and, to their credit, the Class Is have been deploying their capital into the very stuff that makes the railroad run better, from track to locos. (We'll forgive the insane rate of share buy-backs for now.) The Class II and III railroads, too often running with ORs in the 90s and with cash from operations not much better than operating income, have tapped the 45G tax credit program as well as local grants to upgrade track.

In the book, the context is Buffett's conversion of Berkshire Hathaway into an investment house from a textile manufacturing operation. “Buffett increasingly believed that [success in] textiles amounted to the same sort of wishful [thinking]. No matter how much they invested, manufacturers couldn't raise prices — the product was a commodity and usually in oversupply.”

With the capital available, Buffet made his first foray into the insurance business, buying National Indemnity in Omaha, which in turn generated “a stream of funds to play with.” Whereas textiles required a continuing cash-consuming replace-and-repair capex stream for plant and equipment, insurance was cash-generating. Premiums are collected up-front; claims are paid out only later. The cash reserves become “the float,” which can be invested elsewhere.

Of course, the proof of the Buffett pudding is Berkshire's BNSF Railway ownership. Second quarter units are up nine percent, more than any other US Class I, and nearly double the increase at rival Union Pacific. I remain convinced that the Berkshire acquisition is the best thing that ever happened to BNSF, if only because it frees management from having to worry about Wall Street's perceptions and the impact on share prices. Clearly, Berkshire has found green pastures with the capital deployed at BNSF.

**Looks like Ron Batory could be** the next FRA Administrator. On Monday the White House said it intends to nominate Batory. Good move. Assuming the Senate confirms the appointment, the FRA will have an Administrator who knows a lot about railroads. Says *Railway Age* Contributing Editor Frank Wilner, “Not since Canadian-born Reginald Whitman was administrator (1969-1970), following a 40-year career at Great Northern Railway (1929-1969), has there been one with as comprehensive a rail operating background as Batory,”

Batory retired March 31 as President and COO of Conrail, following a 46-year rail operating career that included the presidency of the Belt Railway of Chicago and senior positions at Class I and regional railroads, including general manager in Chicago for Southern Pacific. His

accomplishments at Conrail in large part led to the railroad's selection as Railway Age's 2017 Regional Railroad of the Year.

My good friend Jim Blaze, himself a veteran of Big Conrail right up to split date, had a ringside seat as auditor of Conrail Shared Assets in its formative years. He writes, "We could see clearly how Conrail's safety-first corporate culture improved even as economic productivity achieved new heights. Ron tested and then introduced step-by-step science and GPS movement technology for both more network precision and the train origin and train destination ends. The long term results were on-line traffic volume growth."

I too have had the pleasure of working with Ron and his group on a number of projects, and wish him well with the FRA appointment. He'll be a breath of fresh air

**Pennsylvania short line Reading & Northern** announces another banner season for its Fall Foliage outings. The R&N handles more than 30,000 freight carloads a year, tripling its core business over 20 years with its focus on the Four Cs of a successful shortline franchise: Customers, Co-workers, Communities, and Class Is.

The railroad will run a record nine October Fall Foliage trains out of the railroad's newly-opened Outer Station in Reading, proceed north over the R&N main line, pick up more passengers at the Port Clinton headquarters, and head north to the ride's terminus at Jim Thorpe. The trips on Oct 7, 8, and 15 will be with the 425, a classic coal-fired 4-6-2 of Gulf & Ohio heritage; Oct. 1, 22, 28, and 29 will be diesel.

All trains leave Outer Station at 9 am and stop at Port Clinton at 10 am. The trains will arrive in Jim Thorpe by 12:15 pm and depart for return trip at 3:30 pm, pulling into Outer Station by 6:30 pm. Fares start at \$39 per person for the coaches and open cars on the diesel trains, \$69 a head for the steam trips. A buffet lunch is included with the ticket.

This is a great opportunity to see what the Reading's double-track coal lines looked like before The Troubles of the 1960s and subsequent mergers — heavy, well-blasted rail with good wood ties, and even some new CTC laid over for additional dispatching flexibility and safety. And, except for some 45G credits over the years, all this work is privately funded. See the Reading and Northern Railroad's passenger [website](#) for more about the trains and the railroad.

**OmniTRAX-owned Sand Springs Railway** near Tulsa, Oklahoma has won BNSF's coveted "Premier Transload Facility" designation. OmniTRAX President Kevin Shuba notes that three attributes tipped the scales in its favor: a comprehensive service offering, a sufficient level of capacity, and superior performance. BNSF awards just a limited number of Premier Transload designations in any year, so hats off for the Sand Springs.

A former trolley line (see my OmniTRAX feature in the June 2017 *Trains*), Sand Springs has direct connections with both BNSF and UP, with a base load of steel, pulp-board, scrap iron, scrap paper, petroleum products, plastics and lumber. OmniTRAX is also leasing 100,000 sq. ft.

of covered warehouse space with heavy lift equipment to serve the transload needs of steel and building products customers throughout Oklahoma.

**The Class I railroad scene** continues to be somewhat of an enigma. Here we are trying to grow a business by attracting new customers and generating new revenue streams from old customers. The customer mantra is a continuous “cheaper, better, quicker” drumbeat, yet railroad managements continue the age-old focus on cost cutting and increasing rates.

Neither works very well, which is why carload volume gains are stuck in the two-percent range, about the same as the Consumer Price Index Change. The way to grow the top line is to increase ton-miles, and in a two-percent economy the only way to do that is to win market share from the competition. Yeah, “trucks off the highways” has a nice ring to it, but it isn't happening.

The biggest roadblock to creativity is the silo culture permeating the industry, and that's a function of leadership. Moreover, perpetuating the silo mentality is an army of marketeers who are younger than my kids, trying to make pricing decisions with no institutional knowledge to guide them as to why things are set up as they are.

For example, just the other day a shortline operator told me his connecting Class I commodity manager wants to change a 20 year old interchange agreement to his employer's near-term advantage. But that advantage evaporates in the long term and leaves the customers, his Class I, and the short line worse off. There is no institutional knowledge left to guide the poor sod.

As for leadership, one that is content with status quo instills a reluctance towards change throughout the organization it leads. Leadership that is not content with status quo instills an urgency towards change throughout the organization it leads. Too much of the former environment can ultimately breed the latter on an accelerated basis.

The key is leadership that can both seize and create opportunities that offer a sustainable business culture of ongoing growth and operating improvement. The style of execution among the personalities involved are key to the sustainability issue. It's absolute: either Notch 1, restricted speed, prepared to stop short of any obstacle, or Notch 8, full speed ahead.

At the moment, my sense is the publicly-traded Class Is are someplace around Notch 4, largely to keep the share prices up, and where Loose Cannons need not apply. My overall preference with some tactical exceptions is staying in the eighth notch, based on my 20+ years working with all kinds of railroads to create customers and do it profitably.

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