RAILROAD WEEK IN REVIEW

February 23, 2018

"CSX improved revenue per unit by two percent in the fourth quarter, but some is from greater fuel surcharges, as the cost per gallon of diesel fuel rose 23 percent. Our fair value per-share estimate is $51." — Morningstar, Feb 6

"At the moment, the market is forecasting a CSX perpetual growth rate of about 6 percent, which is ludicrously high given the history. With carloads down pretty dramatically, now might be a time to take profits and wait for the inevitable pullback. The company is worth $45 to $50. — Patrick Doyle on Seeking Alpha Jan 25

The Spring 2018 Meetings season is upon us. Here's my list:

March 4-7, CSX Shortline Workshop 2018, World Golf Village, St Augustine. This is 29th consecutive outing, the longest running of any Class I annual shortline gathering. I have yet to see a schedule of events, but, with all the changes at CSX, it's a mandateory event.

CSX has some 8,000 route-miles of railroad "under review," and has begun to identify specific lines such as the ex-L&N between Tallahassee and Jacksonville; the former SAL south of I-4; certain lines in the Terre Haute area; the former Boston & Albany (including by extension the former Boston-area NYC and New Haven lines connecting thereto); and the coal network including the Clinchfield.

As I wrote here two weeks ago, there are line segments that CSX has yet to identify as "on the block," but my money is on the ex-NYC route to Oak Point and on to Fresh Pond; the Metro North freight franchise east to New Haven; one of the two Jax-Birmingham routes; and, as a reach for serious operators with lots of money, the entire ex-L&N Cincinnati-Nashville. The former Western Maryland — all of it — would better off in other hands.

Please note CSX is merging the Short Line support team with its Joint Facilities Agreements team. The new shortline group will be renamed Intercarrier Agreements & Services. Tony DiDeo is the Director of Intercarrier Management, office phone (904) 359-7637, cell (904) 923-0124, email Tony_DiDeo@csx.com. Elsewhere, of interest to non-Class I connecting carriers, CSX will not accept equipment without proper billing at shortline interchange locations. That means short lines need to be sure cars are waybilled at the customer before release and pull.

Finally, as potential buyers position themselves for playing in this game, it is well to review what Hunter Harrison wrote about "Precision Railroading." In his book, *How We Work and Why,* Hunter writes that Precision Railroading comprises five elements: safety, service, asset management, cost control, and people. Precision Railroading at CN has over the years brought its operating ratio down 30 points from the 90s to the 60s, and has built revenue unit volumes consistently and at generally faster pace than the other Class Is.

My chief take-away aim at Workshop 29 is for a better understanding of how the partner non-Class Is can employ the principles of Precision Railroading to enhance the CSX relationship.

April 8-11, ASLRRA Annual "Connections" Convention, Nashville. Framing the event will be ASLRRA President Linda Darr's State of the Industry address and remarks from Chairman Judy Petry. *Wired Magazine* Editor-In-Chief Greg Williams will deliver the opening keynote, touching on technology trends and the ways they impact business and society. BNSF's Matt Rose is on tap for the closing, reflecting on his 24 years of leadership.

Shining stars of the shortline industry will be recognized during general session award presentations. Highlights: the ASLRRA 2018 Distinguished Service Award; shortline marketing awards for new-business creativity; the Richard Timmons Veterans Award; and safety-related awards. Hearing the details of what those recognized did to merit their selection is an education in itself.

Education is the cornerstone of every ASLRRA convention. In Nashville, attendees may choose from nearly 40 breakout education sessions covering key aspects in the disciplines of finance, operations, safety, engineering, personnel management, and, in the It's About Time department, web-based communications. I hope to hit several, particularly in finance and marketing.

An Expo Hall with more than 250 exhibitors and industry suppliers will provide great networking and social activities, including a Pinewood Derby, silent and live auctions, a scavenger hunt, and cash drawings. Not-to-be-missed special off-site events include an evening at the Grand Ole Opry House, the Hermitage golf tournament, and a party on the General Jackson Showboat. My bags are packed.

April 18-20, NEARS is next, in Newport. I've been a regular attendee to this relatively small gathering (tens rather than hundreds) for many years and always find value in hearing how railroad customers in the Northeast — a special and rare breed in themselves — use the railroads to add value to their supply chain services.

The theme is "Harnessing Technology for Rail Efficiency" and the Thursday agenda features such topics as Short line Railroad/Shipper Success Stories; The Role of Intermodal in meeting supply-chain needs; how the Tier-4 locomotive emission rules can affect customers; and an equipment panel. Friday will wrap with The Freight View from Canada.

May 21-23 Norfolk Southern Shortlines, Norfolk. The agenda hasn't been released yet, but you can bet on lively discussions about how the changes at CSX affect NS and non-Class I connections, whether there will be further NS line sales (I rather doubt it as several thousand miles of redundant lines were shed after the Southern-N&W merger and the Conrail split with

CSX.) I've heard some glimmerings of hope that NS may be getting close to instant iPad pricing, and we already know why their loco rebuild program is the envy of the industry.

What I want to know is how they can make shorter-haul, higher-rated commodity moves attractive to customers. Every week I hear yet another anecdote about an unmet customer need for truck-like carload service. And there are surveys out there that say there are customers who are willing to try railroad carload services given the increasing shortage of trucks and, with that, higher rates. How can NS and its shortlines make hay while this sun shines?

Let's face it. Today we have a situation where the newly-available traffic is at considerable odds with what the railroads can do easily and conveniently and at maximum profit. As is, new traffic on the railroad (not same-store — commodity, OD pair, car type) is but a tiny portion of the total carloads out there.

Shipper preference is largely for small volumes to multiple destinations — good for intermodal, not so hot for carload. The Class I railroad trend, unfortunately, appears to be away from carloads and toward intermodal boxes. And so, rather than try to make the carload franchise more user-friendly, the Class Is seem to prefer a going-out-of-business sale for carload freight. No more need for class yards, industrial sidings, way freights, and — perish the thought — short lines.

Thus it remains that shrinking revenue unit volumes and shrinking the revenue base leads to shrinking the outstanding shares/capitalization with stock buy-backs. And if the truckers ever get to the autonomous vehicles stage to ease the driver shortage, then the railroads will find themselves going out of business — perhaps faster than they can shrink their capitalization. And that brings me back to the idea that Meetings Season, properly used, can help stanch the flow of traffic away from the carload model.

Watching railroad carbuilder results is a good way to take the forward pulse of the railroad industry. This week Trinity reported 4Q2017 Rail Group deliveries and orders totaling 6,150 and 3,180 railcars, respectively, compared to 7,435 and 1,985 railcars, respectively, in 2016. The backlog increased 3.7 percent sequentially and was 1.8 percent points better than previous estimates. Railcar leasing revenues increased 11 percent year-over-year.

Understandably, Trinity is short on car-type details, but we know just from standing track-side that covered hoppers represent a good chunk of their business. We also know that plastics and petro-chems are up nicely. For that reason alone I find the Trinity report encouraging.