RAILROAD WEEK IN REVIEW

December 13, 2019

“We have diligently explored all possible options to restructure Celadon and keep business operations ongoing. However, a number of legacy and market headwinds made this impossible to achieve.” — Celadon CEO Paul Svindland

“The only thing really within your control is to become more efficient. The great needs are for scale and to merge with other institutions. Because there's two of everything, you can eliminate half of one of them or three quarters of one of them across the board… We have a preference for consolidators who are great guardians of shareholder capital.” — Sy Jacobs, Managing Partner, Jacobs Assset Management, on regional banks but I think the shoe fits short lines.

Last week’s WIR comments about PSR and how it relates to the railroad business in general and the manifest carload business in particular drew several useful observations. For example, this well-regarded railroad practitioner and friend of many years writes,

> Precision Scheduled Railroading addresses the industry cost-competiveness challenge, but PSR does not directly address the industry growth challenge. The economy has been in a slow secular trend toward “the consumers” — AKA intermodal. Still, it is important to note that PSR does help carload growth. And since carload is manufacturing, it is, as Rod Case says, the canary in the railroad coal mine.

Even as PSR addresses the cost competitive challenge, it creates a railroad product better suited to customer supply-chain needs. I think there is a niche for the scheduled carload product that PSR will help the industry fulfill. Says Gil Lamphere, MidRail Chairman and PSR pioneer, “Long-term railroad valuations will be driven by growth.” He cautions that that the present focus on intermodal and coal — two extremes of the margin spectrum” — ignores everything in the middle, “otherwise known as merchandise.”

Jim Foote at CSX gets it. He sees a substantial opportunity for the railroads to regain market share of moves “that should move over the railroad but don’t due to decades of poor and inconsistent service.” The current truckload sector malaise of too many trucks should play well to the strengths of a consistent railroad with competitive rates, including all the supply chain costs from inventory to time *en route.*

Apropos of the current truckload sector malaise, long-haul trucker Celedon Group filed for bankruptcy last week with the intent of closing the doors December 9. The company has assured customers what’s on the way will get delivered and says “drivers will not be stranded; everybody will get home and be paid.” RW Baird’s Benjamin Hartford writes,

> The company operates a network of ~3,300 trucks across North America, or <1% of the addressable US truckload market. While small (and a reminder of how fragmented the industry remains), a shuttering of operations would be a step toward improving the supply/ demand imbalance that has developed in 2019 given soft underlying demand trends and incremental supply growth.

Talk about canaries in coal mines. These economically uncertain times are causing companies to minimize inventories, make smaller and more frequent shipments, and use less long-haul freight. It showed up first with the near-demise of the long-haul 100-ton boxcar and is now working its way down to the 25-ton dry van.

Drivers are collateral damage. Consider: A two-person train crew can move 200 dry-van containers 400 miles in 8 hours. You'd need 200 drivers and their truck cabs to do that on the interstates. But with distribution centers being placed closer together you need less long-haul freight of any sort. Which leads me to shortline intermodal schemes a la CN-INRD to Indy. I think it could work in an Amazon environment, but I'll get back to that another day.

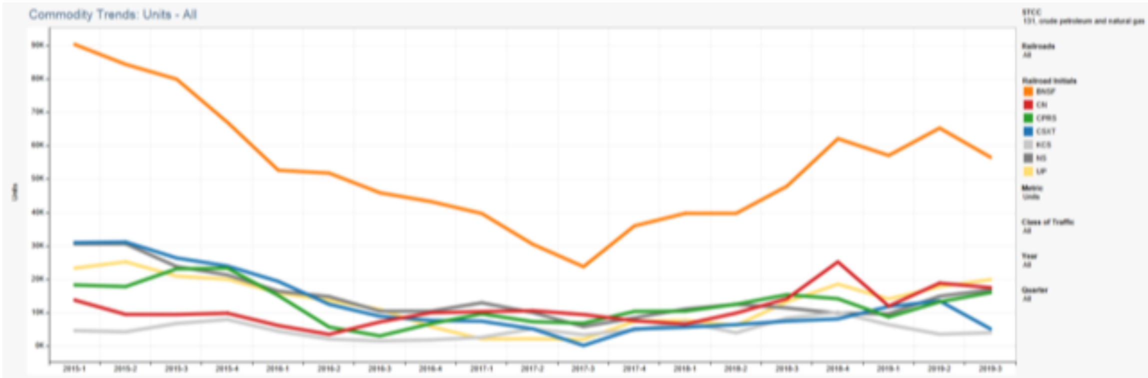
A container of Chinese coffee tables is off-loaded in LA, and is drayed to a local intermodal terminal. There it gets on a train destined for a DC in, say, Kansas City. Half of it is transloaded to a box for MSP and the Twin Cities & Western, the other half goes in a Syracuse box for the Finger Lakes.

BNSF drops off the MSP car at the TCWR interchange and CSX makes the drop for FGLK. Yes, it means both short lines will need intermodal lifts, but enough of these block swaps could be new profit centers. And, even if it puts long-haul truckers out of work, it creates new work for short-haul truckers.

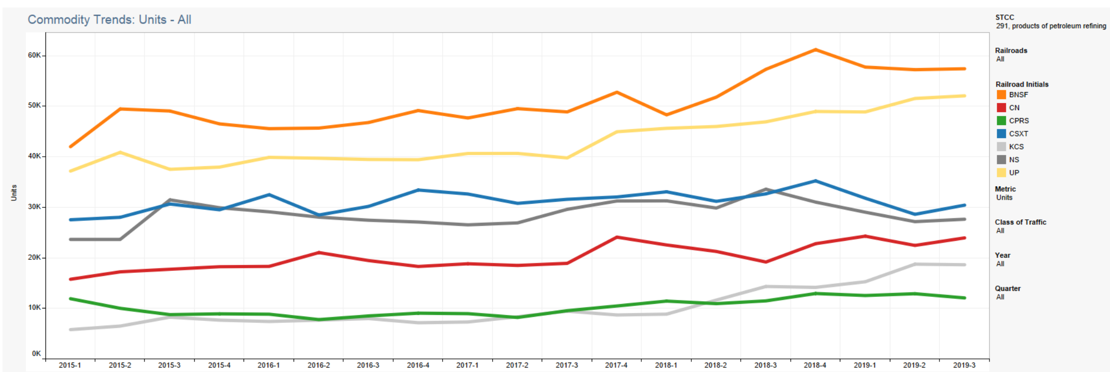
The AAR Week 49 carload commodity report shows all merchandise carload commodities in the red for the year — except for petroleum products. This is a tricky one because it includes STCC 131 crude oil as well as STCC 291 "refined products" — LPGs, fuel oil, lubricating oils, aviation and other fuels, etc. It also includes asphalt, but not plastic resins.

The wide swings in the "petroleum products" category are largely due to crude oil, in which short lines participate but little. On the other hand, short lines are big players in oils and LPG, and they can use this analysis to see where connecting railroads stand vis a vis the other Class Is on any commodity STCC up to three digits. Here's a *link* to the source of these charts.

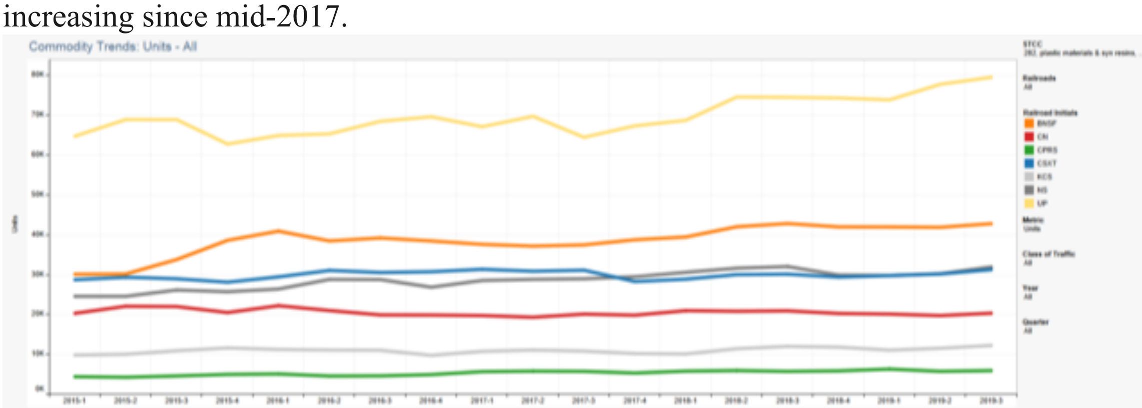
First, the crude oil curve on the next page. You can see BNSF (orange) as the clear leader but the trend has been down for all (CN and CP are US only).



Exclude crude oil and you can see the STCC 291 curve still has BNSF on top but the individual railroad volume levels over time are more consistent.



Plastics are STCC 282, so are in the chemicals universe. Here we see even less YOY volume variation for all the railroads, though the aggregate carloads for ALL railroads has been increasing since mid-2017.



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