THE RAILROAD WEEK IN REVIEW
July 10, 2015

"There clearly is a nexus between business realities and stock picking." — Larry Kaufman

I still see good news out there, even if rail vols and share prices are in a sideways rut. The good news comes in two forms: youngsters who not only love trains, but also who understand the business, are hiring out on the railroads, and a growing number of Old Heads who like what they see in the youngsters and the management support they get to be active and make things better.

Just recently I was with two 30-somethings who, respectively, run a 200-mile division, and manage IT functions for the entire railroad. The former comes from three generations of T&E guys and has a photographic memory when it comes to track charts and operating plans. The latter hails from a family background of bankers and bishops, and who never would never have thought of a railroad career were it not for a chance meeting of a railroad-family friend of a friend while in school.

As for the Old Heads, it is my wont to sit in the Amtrak cafe car whenever possible, and to position myself near the table commandeered by the train crew. Riding backwards up against the window with a track chart and a timetable is a sure conversation starter, and the subject of management then and now invariably arises. Lately, instead of the litany of kvetching about what's wrong with the railroad, I'm getting an earful about what's right and the youngsters who are helping to make the railroad a better place.

The late, lamented E.M. Frimbo once famously said, "We must always maintain our best bedside manners when with our favorite patient, the passenger train." I would extend that to the freight railroads that, for the time being at least, may not be fully recovered. Yet what I'm getting from the young hires, the Old Heads, and my management friends, we have but stumbled. Once we get past the current unpleasantness, it'll be off to the races once again, assuming the leadership leads.

Iowa Pacific Holdings President Ed Ellis a few weeks ago held forth at Norm Carlson's monthly Sand House Gang session at the Northwestern Transportation Center in Evanston, Ill. His talk, "Restricting Signals Ahead," argues that the railroad business remains largely as it was a generation or more ago — running coal down hill and boxcars slowly. That will no longer do.

As a railroad community, we spend a lot of time talking about what's wrong with the business and never any time talking about how to fix what's wrong. As noted above, today's youngsters are the Men Who Love Who Love Trains (thank you, Rush Loving) and they're hungry for the history to put it all in context. I think Ed's remarks can help.

At the outset he says that much of the present day rail network “exists to support coal, and without coal the network withers, yet a great deal of throw-weight is aligned against coal and will be for some time.” Coal vols today are half what they were two years ago, he says, and crude oil/frac sand will never make up the difference. Concludes Ellis, “Railroad management has been lulled to sleep by the need to move energy.”

Making matters worse, “The truckers are are eating our lunch and government priorities have not only made it worse, but are about to really muck it up. (See **Rod Case**, below). And so, unless the leadership in the railroads and the government embrace radical change, parts of the rail network will soon become as unmaintainable as our highway system.” That’s the prob.

Now the solution. Ellis proposes Five Things the Railroad Must Do, and can do them without any government intervention or funding if the government would just get out of the way. To start, learn how to make money on shorter short hauls while developing a profitable carload network, including the low-volume branches. Then figure out how to make money running passenger trains and at the same time create a scheduled fresh and processed food franchise. Finally, with all these pieces in place, you can create an inter-railroad, non-stop, truck-like intermodal service.

I’d say the short form for Ed’s talk is Repurposing the Railroad Network. Failing to do so in short order means we’ll all be presiding over the world’s biggest Going Out Of Business Sale.

Rod Case, Rail Transportation Partner at Oliver Wyman Group’s transportation practice, has kindly forwarded a terrific slide set called, “Pot Holes or Tolls?” The Feb 2015 creation of Northwestern’s Joseph Schofer, Professor of Civil and Environmental Engineering, the paper lays out perspectives on transportation finance in general and highway funding in particular. I think it’s an important topic for small railroads and the communities they serve and it makes an eloquent case for continued investment in freight rail.

The professor notes that freight railroads have invested $575 billion in their own networks over the past 35 years. While “private sectors (usually) produce direct cash flows; public sector arguments are less direct — find the benefits and monetize them.” In other words, think up a highway scheme and create the financial model to justify the expenditure.

He then brings public and private interests together in a couple of slides on Public Private Partnerships, where Other People’s Money (OPM) leverages private funds to achieve the desired results more quickly and more efficiently. I think here’s where TIGER grants and RIFF loans can be of great help, and “Pot Holes or Tolls” needs to be seen by every state agency that has anything to do with shortline railroads.

What’s needed most all is to turn politicians heads from meds *for* grandma to getting the meds *to* grandma. Let’s face it: governments are broke and there isn't enough money to satisfy every constituency. Transportation infrastructure funding isn’t sexy and any threats to existing entitlements won't get you the votes. Meds for grandma trumps transport every time, so we need got get the priorities changed. I have the slide set if you want it.

The Railway Association of Canada publishes a quarterly magazine, *Interchange,* with stories written in both French and English (what a great way to brush up your French: read the French copy and go find the English when you find yourself at a loss for words). The Summer/Été issue carries a delightful article about the contribution Canadian short lines make to the national rail transportation system. Like their US counterparts, Canadian short lines touch some 1.3 million first mile/last mile carloads a year, 20 percent of all Canadian railroad traffic, and across the same wide variety of commodities that we see in the U.S.

Contributor Lee Jeb, VP Operations for Cando Rail Services, a three-railroad shortline operating company, says recently-imposed Canadian regulatory measures threaten the short lines' viability. With operating ratios typically in the 90s, generating adequate cash flow to replace what wears out is already a challenge. Now come the feds with hiked insurance requirements (and higher premiums) plus new regulatory record-keeping requirements (and the staff to track same) and grade-crossing upgrade mandates worth C$millions nation-wide. Says Jeb,

> Shortlines can't simply pass these costs on to their customers. In most cases, they have existing rate agreements with Class 1 partners, so that isn't even an option. But rate increases would also make their services less competitive, or even prohibitive, for their customers. In the U.S., shortlines have access to many funding and financing initiatives (grants, low-cost lending programs, tax-credits) that help shortlines to make the business case for infrastructure investments, allowing them to accommodate heavier traffic and move products more efficiently.

On the other hand, in Canada such largess is simply not there. Over the six years 2007-2012, only two Canadian short lines received any support, and that from the Building Canada Fund. Shortline projects are also eligible to tap the federal Community Improvement Fund, but for that to happen, local governments have to select railways over highways for infrastructure upgrades. And so far that hasn't happened. Jeb concludes,

> The Railway Association of Canada, which represents some 40 Canadian shortline railways, is calling for the federal government to introduce a dedicated financial assistance plan for small railway operators, so that we can maintain and improve our infrastructure, meet new safety requirements, and expand our networks.