

RAILROAD WEEK IN REVIEW

April 7, 2017

“If you are seeing what everybody else is seeing, you’re probably not seeing the right things.” -- John Mauldin, Thoughts from the Front Line, April 2

Picking up last week’s housing-starts thread, the \$55 billion homebuilding industry is showing signs of life with share prices up 17% year-to-date. Shares of the market-cap leaders — D. R. Horton, Lennar, Toll Brothers, Pulte — are sporting double-digit gains. As to why, a note from Schwab tells us housing continues to recover and growth may accelerate as Millennials begin to move out of apartments and into homes. Moreover,

The outlook for American consumer spending appears to be improving, with consumer confidence strong and wages generally showing signs of trending higher. Consumers have reduced their debt loads since the Great Recession and the job market is solid. We’re also starting to see wages increase in a growing number of areas. Average hourly earnings have risen 2.8% over the past 12 months, according to the Bureau of Labor Statistics. Continued low interest rates support consumer borrowing and spending and the March reading for The Conference Board’s Consumer Confidence Index® rose again, coming in at 125.6.

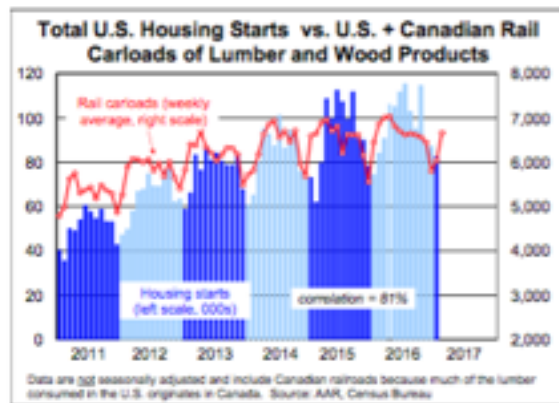
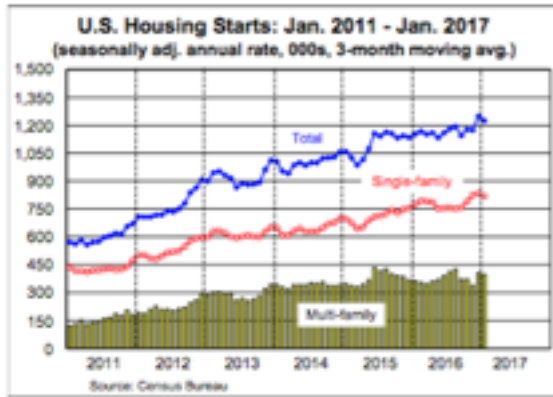
On the other hand, Americans’ willingness to take on consumer debt appears to have waned. We haven’t seen debt as a percentage of disposable income bounce back in any meaningful way, following a considerable decline after the Great Recession, although there are some indications that this may be reversing somewhat.

Within the household durables industry, homebuilding is the second best performing sector, up 17%, against first place consumer electronics, up 24%. By comparison, The whole household durables industry is up 12%. Morningstar says residential construction and housing starts are on the upswing thanks to “a combination of favorable demographics and improved household finances.”

North American lumber producers will benefit in particular as principal beneficiaries of the resurgent housing demand. Canadian producers Canfor (TSX: CFR) and West Fraser Timber (TSX:WFT) will gain as lumber capacity utilization pushes prices higher. In the US, the forest products sector of the materials industry is up 39% over the past 12 months; Louisiana Pacific (NYSE: LPX) and Boise-Cascade (NYSE: BCC) are two names to keep in mind, especially the former where OSB and siding account for 80% of revenue.

The AAR’s *Rail Time Indicators* publication shows why housing starts are important to railroads. The broad “housing starts” category includes both single-family and multi-family construction, and of course you need 2x4s and paneling for both. That’s why the chart on the right is key. (First

quarter AAR North American total revenue units increased 4.4% YTD; forest products — no paper vs lumber data given — are down 4.8%.)



“Rail Made Easy” is the OmniTRAX slogan and it’s working in Brownsville, Texas. The Brownsville & Rio Grande International Railway (BRG) has won the opportunity to serve CSC Sugar’s new packaging and distribution operations at the Port of Brownsville. Connecticut-based, privately-held CSC (annual revenues well north of \$250 million) is one of the largest importers and exporters of refined sugar to and from North America, and chose Brownsville for its simultaneous access to BNSF and UP, thanks to the BRG’s connections with both Class Is.

CSC already has dry transfer and liquid sugar plants in El Paso and Forth Worth Texas; Covington, Tennessee; Chicago; and Fairless Hills, Pennsylvania. The Brownsville location gives them 242,000 sq. ft. of leased warehouse space at the port to export beet sugar to Africa. CRC President Paul Farmer says, “Freight rates to Brownsville are about the same regardless of where you’re coming from, whether it’s from the sugar growing regions in Minnesota or Idaho.”

CSC expects to receive up 25 to 30 rail cars weekly — the first cars arrived at the Brownsville packaging plant March 22. The facility can package some 500 tons of sugar daily into 50-kilogram bags for export, which then move to the storage areas that can accommodate 25,000 tons of packaged sugar. Schaeffer Stevedoring is the selected stevedore; ocean shipping will be via Handymax-type ships with the first vessel expected to arrive in May.

The OmniTRAX relationship with the Port dates back to 2014, when they created a strategic partnership to operate BRG and develop the 1,400-acre GEOTRAC Industrial Hub. Together they are working collaboratively to bring businesses like CSC Sugar to the GEOTRAC Industrial Hub, which is located adjacent to the port. This deal potentially translates into thousands of additional rail cars on the BRG and many new vessel calls to the port.

OmniTRAX President Kevin Shuba put it this way: “The Port of Brownsville and the GEOTRAC Industrial Hub offer a unique location for companies like CSC Sugar. Plus, the

BRG's operational flexibility creates new opportunities for exporting and importing a variety of products like beet and cane sugar," Thus, for another satisfied customer, OmniTRAX has Made Rail Easy.

Two other roads doing well by doing good are Conrail and North Shore. The former has been awarded the *Railway Age* Regional Railroad of the Year; the latter wins the Short Line Railroad of the Year award. Formal presentations are scheduled for Tuesday, April 25, 2017, at the morning general session during the ASLRRRA Connections Convention.

Conrail (known officially as Conrail Shared Assets Organization or CSAO) is a switching and terminal railroad serving the Detroit, North Jersey and South Jersey/Philadelphia freight markets. CSAO began life on June 1, 1999 with the NS/CSX split of "Big" Conrail. It is the eighth-largest railroad in the U.S. measured in hours worked. Though not a regional railroad running end-to-end as, say the New England Central or the Arkansas & Missouri, it is very much a regional operator serving three major metropolitan ADIs.

The North Shore operates over the west end of the former DL&W Scranton-Northumberland branch and is unique for its handling a significant number of dimensional (high/wide) loads. The NSHR is one of the six lines the North Shore Group operates and got its start in 1984 when the SEDA-COG Joint Rail Authority acquired the line from (big) Conrail and then contracted with the North Shore Railroad Company to operate it.

There are those asking whether the disciplines of Precision Railroading can work at CSX. I think they can. Precision Railroading starts with asset turns and that includes MOW equipment productivity.

Hunter Harrison single-tracked the IC and got six turns a month for grain trains by scheduling everything, including MOW windows. He took out two humps at Taschereau, substituting flat-switching with two remote control units per cut, allowing men on the ground to pass loco control to the guy nearest the point on the move. He reduced yard dwell at CP by convincing the regulators that a run-by terminal brake test is as good as walking the train.

There are those who say you can't do any of this on CSX — short hauls between major terminals, many low-density branch lines, short crew districts, and so on. I disagree. Given the complexity of the CSX network compared to the IC, CN, and CP, doing all three on CSX ought to yield results even more quickly.

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