RAILROAD WEEK IN REVIEW

June 1, 2018

"Are the company's leaders honest? Do they have integrity? Do they have huge turnover? Do they treat their people poorly? Does the CEO believe in running the business for the long term, or is he or she focused on the next quarter's consensus earnings?" — Warren Buffett

There still appears to be a mismatch between job seekers' skills and the jobs available, leading some folks to work for less than they would like. — Brad Sorensen, CFA, Managing Director of Market & Sector Analysis, Schwab Center for Financial Research

Norfolk Southern hosted its 17th annual shortline meeting in Norfolk May 21-22. Nearly 400 souls were in attendance, representing most of NS' 250 direct-connection Class II and III properties plus a handful of other interested parties. The smart-phone app supported the entire program, from the agenda to maps of the hotel to speaker bios to a complete attendance list, thus saving a ton of paper to carry, while still providing a convenient folio for speaker notes.

Tuesday morning's presentations kicked off with a highly informative and helpful Industrial Products Overview. In this and every presentation that followed, the talk zeroed in on topics of most value to short lines, avoiding the 30,000 foot analyst speech we see and hear too often. Presenter Ed Elkins, newly tapped VP for Industrial Products, discussed Norfolk's desire to copy the shortline approach to business development: simple, direct, frequent, supportive and with a view to becoming supply chain partners.

Music to our ears: carload velocity is critical for beneficial owners of goods in motion; the present truckload tightness (from capacity to availability of equipment to double-digit price hikes) plays directly to us. YTD shortline carloads for NS are up 14 percent with a five-year CAGR of three percent to Norfolk's one. Best of all, NS is starting to do dock-to-dock carload trip plans, though the Local Operating Plan Adherence tool (LOPA) doesn't yet capture shortline interchanges thanks to some unexpected PTC-related glitches.

Chief Operating Officer Mike Wheeler confirmed that the NS Northern Region is "more resilient" than south due to the more robust physical plant and operating culture that has been in place since PRR and NYC days. In a neat segue to Wheeler, Director of Shortline Marketing Brian Vittur emphasized the reasons short lines are "the engine for IP growth at NS." That's not surprising, given the shortline commodity mix ranked by percentage of the whole: Metals/Construction; Chemicals; Coal; Ag Products; Paper/Clay/Forest; Intermodal; and Auto. (Of the lot, only Metals/Construction; and Autos were revenue-down in Q1.)

Putting it all together, VP for Strategic Planning Mike McClellan says we still have work to do. Total IP carloads for NS and CSX combined have been in steady decline for some years. If we are to reverse that trend, we must provide "predictable service at a completive price, be easy to do business with, and manage car supply to the customers' benefit." [*Recall the equipment manager some years ago who said he wouldn't allow shortline cars in the mix because his job was to cut car hire, not increase revenue. — rhb]* Listening between the lines, as it were, one could hear a wish that NS in general (and short lines in particular) start thinking in terms of logistical solutions, not just moving cars. That would make us more truck-like in a heartbeat.

Over lunch, CEO Jim Squires explained why the merch carload franchise brings better incremental margins than others: the infrastructure is there, the mindset is there, customers want to do more carload, and margins can support paying for the existing resources in place for it. [*This is in direct contrast to CSX saying it's reviewing some 8,000 route miles to see what fits their core and non-core routes, and to see who else is out there to protect what carload revenue is left elsewhere at lower avoidable cost to CSX. —* trains.com *newswire, May 23*]

Squires also picked up on the technology thread he touched on during the BankAmerica Merrill Lynch Transportation Conference (WIR May 18). Unplanned events are the bogeymen of railroad operations and customer service, and many can be traced to human mis-behavior — not being the right place or doing the right thing at the right time. PTC can help. NS is transforming the technology from a strict safety focus, morphing it into an information base that can tell NS what's where, when, and why. Short lines can broaden the scope with prompt and accurate event reporting, and NS is here to help. [*but somebody better tell the NS train crews not to report interchange complete when it isn't. — rhb*]

The afternoon's classroom and breakout sessions provided considerable detail supporting the morning's general themes. Some tidbits one can use right away: Southern yellow pine is replacing northwestern fir in residential construction — you can get 80,000 board-feet in a boxcar (90K on a center-beam), and there's a strong backhaul market for 60-foot, Plate F boxcars. The chemicals group includes asphalt, dirty-dirt, asphalt, STCC 29s. You can find competitive truck routes, volume, and prices on line at dat.com (I did a test inquiry and had a phone call is 15 minutes) and truckstop.com .

The wrap: This was a highly effective session because all presenters zeroed in on what's essential for short lines — matching transit times and prices to customer needs, being easy to do business with, and being consistent in doing what you say you will. To their credit, short lines are already pretty good at this, and the failures typically happen beyond the interchange. I think NS has a better sense of this than some others, and short lines are well positioned to take advantage.

Pan Am Rail has authorized a one-time $1,100 bonus for every employee of the railroad and its subsidiary companies, effective immediately. The payment highlights the benefits of the recent Tax Cuts and Jobs Act ("TCJA"). Pan Am says the bonus is "intended to acknowledge the importance of our employees; and to provide those employees with additional compensation to use as they elect."

As far as I know, PAR is the only non-Class I railroad operator to do so. With this bonus, Pan Am shows its commitment to future capital investment to foster growth of the company. Pan Am strongly believes that programs such as the TCJA and the 45G tax credit provide substantial incentives for investment in this railroad's future. I agree.

Canadian Pacific dodged what could have been an ugly strike. T&E and electrical personnel officially began their action at 2200 Eastern time after the union and the railroad said they couldn't reach and agreement. About 3,000 T&E (Teamsters) and 400 electrical (IBEW) jobs were at stake. Happily, the issues were suddenly resolved so operations could resume at 0600 Wednesday, thanks to a tentative four-year understanding.

With more than [100 short lines and regional]() railroads (a quarter of which are through connections, rather than direct interchange) in Canada and the US, a work stoppage of any significant duration could have wreaked significant harm. In Canada alone, grain, crude oil, forest product and mining customers would have been especially hard-hit. The strike, coming on the heels, as it were, of last winter's delays, when both CP and CN struggled to keep up with an unexpected surge in demand for oil and other commodities.

Allison Landry, lead railroad analyst at Credit Suisse, writes,

> We have no doubt that CP CEO Keith Creel dug in his heels with a fair offer, though the Teamsters probably walked away with one extra year than CP was initially willing to give. Creel undoubtedly anticipated how this would play out, and was prepared to offer an extension in exchange for some flexibility in work rules. In our view, the Teamsters were likely testing Creel, and now think it is unlikely they will strike again under his leadership.
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> Pressure on all sides may have expedited the deal. In spite of Trudeau's seemingly pro-worker commentary on Tuesday, we still think that we still think there was a great deal of pressure on both Teamster leadership and CP management to get a deal done to agree. No doubt the commodities-based customers more than played a significant role in influencing both parties to come to a quick resolution.

No WIR next week. We have a family event June 9 and have been asked to take part in the preparation for the festivities. The regular WIR rant will continue June 15.