RAILROAD WEEK IN REVIEW

June 28, 2019

"Tariffs and trade uncertainty appear to be having a negative impact on companies' ability to manage input costs as well as a chilling influence on their capital spending plans." — Robert Kaplan, President, Dallas Fed, June 24

"The Cass Freight index is at its lowest levels since 2009 in anticipation of the economy slipping into contraction... The West Coast's three mega ports are in contraction. Through the first 24 weeks of the year, U.S. railroad combined traffic is down 5.3 percent." — Danielle DiMartino Booth, "The Daily Feather," June 24

"While softer than expected volumes to start 2019 have certainly enabled the rails to cut volume-sensitive staffing, successful PSR implementation and related efficiency gains (longer trains, less interim car handling) have enabled lower terminal and train operator headcount." — Bascome Majors, Susquehanna Financial Group, June 19

"China, for example, supplies 42 percent of all apparel purchased in the US; supplies 73 percent of all household appliances, and supplies a staggering 88 percent of all of the toys bought. — Dennis Gartman, June 25

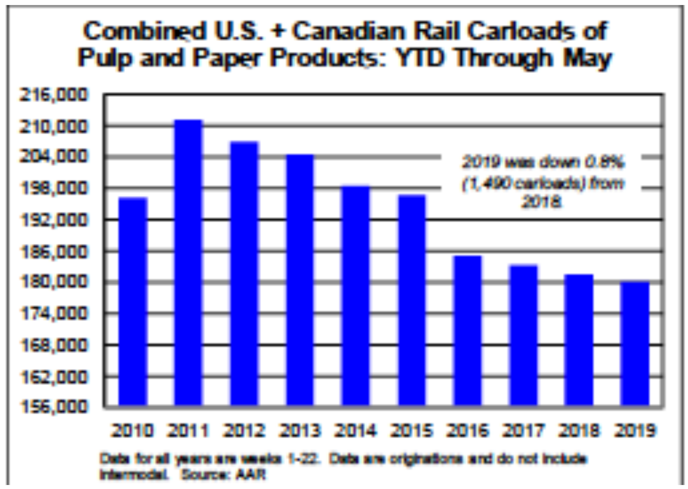
Longer trains, less interim car handling, to pick up Bascome's wording, can't be all that good for single-car shipments not moving in unit trains. For several reasons. To begin, AAR train speeds capture only symbol freights between specific OD pairs. The measure does NOT capture local freights and yard jobs actually providing the first/last mile service the customer sees.

Second, the merchandise business does not lend itself to the batch process that makes intermodal unit trains so efficient. The latter are hook-and-haul and away you go, never touching classification yards or stops longer than the 1000-mile inspection. On the other hand. merchandise service is it messy — a custom service, if you will.

You need a local job to serve the customer (or short line interchange), a receiving yard, a hump or flat switch to put the individual loads on the individual departure tracks, and you need another loco-crew set to get the mixed freight to the next receiving yard. Lather, rinse, repeat. So while the Class Is tout storing equipment and reducing head-counts, they're actually saying they're de-marketing commodities that don't fit the batch process model.

They're doing a pretty good job of it, too. As noted above, Week 24 total revenue units were down 5.3 percent year-over-year. Every commodity group but industrial chemicals and petroleum products had a negative-delta week. In the merchandise sector, forest products (paper and lumber combined) led the downdraft — 12 percent. Metals/ores and aggregates were tied at down seven percent, and “other” ripped three points. Merch as a whole including auto slipped two percent.

A recent research note from UBS confirms STCC 26 is still in a funk. "US boxmakers who typically expect to see a seasonal uptick in demand by mid-June have yet to see any signs of a pickup as demand remains sluggish. This lack of demand remains concerning as nearly 2.1 percent of new capacity is expected to come to the market in 4Q19-1H20.” The AAR agrees per this exhibit in their June *Rail Time Indicators,* page 19:



Per paperage.com, total May 2019 year-over-year negative comps by paper type were boxboard nearly five percent, container-board six percent, and packaging papers (bag & sack, multi-wall, food wrapping) seven percent.

Recall too that STCC 26 is a generally low-rated commodity with many different OD pairs, creating trip-plan havoc, hardly hitting what the Class Is in their analyst calls say are “the most profitable use of assets.”

Kansas City Southern is making good on its commitments to improve railroad performance. Train speeds are up, dwells are down, trains are longer, car-miles per-day are up, and they’re doing it all while burning less fuel per thousand GTMs. Revenue units, alas, are off a couple of points. Looking on the bright side, chems/petroleum and ag products — a quarter of the portfolio — are seeing gains, whereas intermodal, some 45 percent of units, is posting high single-digit volume growth in franchise cross-border truck- to-rail conversions.

The energy, automotive, and general merchandise sectors have been hit with declines in crude oil and frac sand, utility coal, pulp/paper, and automotive. I’m quite sure these short-falls are temporary, as there is every indication KCS is running a better railroad that will create more customers through improved service and greater reliability.

The FRA has awarded a $3.3 million Consolidated Rail Infrastructure and Safety Improvements (CRISI) Grant to the Ohio Rail Development Commission (ORDC). This grant, along with $3.3 million in matching funds from GWR’s Indiana & Ohio Railway, will be used to rehabilitate the Port Delta Yard and construct mainline siding capacity in Delta, Ohio.

Customers in the area include several steel manufacturing and processing businesses that provide products for U.S. industries including automotive, construction, agriculture, and general manufacturing applications. These facilities depend on IORY freight rail service to receive raw materials, such as scrap steel and pig iron, and to ship finished products to their destinations.

And now for something completely different. BNSF puts up an 8x32-foot layout at the Annual Berkshire Hathaway meeting. The long layout incorporates a number of landscape features found along the real railroad, including the Two Medicine Bridge in Montana's Glacier National Park and Sullivan Curve over California's Cajon Pass. Nestled along the ROW is the town of "Berkyville," featuring "store fronts" representing the more than 50 BRK sister companies.

The O-scale Lionel model railroad is featured on bnsf.com and features the myriad industries BNSF serves. There are mining operations, a coal-fired power plant, grain elevators, and an intermodal yard.

To create visual space between the BNSF terrains, the three loop tracks run over mountains and through the cityscape, tunnels and rural areas, connecting the railroad to customers – just like in real life. You can check out the video here.

Trains are powered by modern six-axle power, showcasing the diverse commodities BNSF handles (intermodal, merchandise, grain and coal) and running multiple trains at the same time. And with a nod to passenger operations, a union station and a streetcar are part of the layout.

The layout typically takes about four hours to set up and another two to get trains running. The display went up in 2012 for the first time and since then the layout designers have added more vignettes of people doing everyday tasks. The railcars are updated occasionally to coincide with new BNSF equipment. Note the intermodal crane, for example. Not many of them on your typical model railroad. Kudos to BNSF.