RAILROAD WEEK IN REVIEW

October 16, 2020

"In a year when Precision Scheduled Railroading (PSR) continued to transform the broader rail industry, non-Class I railroads found new ways to become indispensable partners in connecting their customers to the U.S. and world economies." — Chuck Baker, President, ASLRRA.

"There are signs of decline everywhere, from lines of stored power in Edgemont and Alliance to multiple sets of coal gondolas parked on one of the four main tracks north of Bill, Wyo. And on UP's Powder River sub just east of Shawnee, Wyo., I stumbled upon a track crew that was lifting the rails of the now unnecessary third main track on Myles Hill, whose summit was among the higher points on the former CNW." — Bill Stephens, Trains Newswire, October 5

"Rail service metrics (train speeds and dwell times) deteriorated on a y/y basis for the rails during 3Q as volumes have recovered. Service rankings in aggregate declined sequentially for the second straight quarter from 2Q to 3Q. Service rankings declined y/y for every railroad, with the greatest declines for Canadian National and Union Pacific." — State of the Freight, Wolfe Research, October 2020 2)

"The U.S. is caught in a debt trap, a term originated by the Bank for International Settlements. A condition where too much debt weakens growth, which elicits a policy response that creates more debt that results in even more disappointing business conditions." — Lacey Hunt, Oct Letter

The persistence and success of non-class I regional and shortline railroads in creating new customers is a fact. The ASLRRA every year recognizes their members who have been particularly adept. Those the awards are usually made in May, but it wasn't till last week's virtual ASLRRA Annual Meeting that we heard from the perpetrators themselves. The common thread throughout is doing your homework and meeting a particular transportation need.

In Michigan, Watco's Ann Arbor Railroad did its homework on auto industry trends and created a partnership with Fiat Chrysler America to turn an under-used Toledo facility into a new distribution center for finished automobiles. Breaking ground in 2018, and beginning operations in time for the Jeep Gladiator launch in July of 2019, the facility supports FCA's Toledo and Detroit assembly production with an 1,800 car per-day through-put capacity, has created 102 new jobs, and has helped stabilize the local economy.

Chicken feed is big business on the Delmarva Peninsula. Conrail exited the market some years ago, and through a succession of shortline operators, the Carload Express-owned Delmarva Central Railroad went looking for additional carload business. They did their homework with existing customers and learned that certain liquid ingredients, vital to the manufacture of chicken feed, were being trucked in from beyond. And so it was DCR repurposed a former feed mill into a transload facility. Now the feed liquids are 100 percent rail from beyond. Both ends of this food chain are happy and the citizens along US 13 see fewer heavy-haul truck traffic tie-ups.

The Indiana Rail Road Company (INRD) teamed up with a local Indianapolis trucker to build a 406,000 square-foot, state-of-the-art, rail-served distribution center in Indianapolis just three years ago. The facility sports 15 indoor freight car spots that feed 58 truck docks and is the most modern rail-served facility in central Indiana. They did 1,200 cars in Year One, more than doubling that by Year Three. All this for a modest $21 million investment.

The Reading Blue Mountain and Northern Railroad in central Pennsylvania has, in its 30+ years of existence, transformed this section of former Reading mainline from a regional coal hauler into a 30,000 car railroad with a long list of commodities. Marketing their services and creating customers has been their unique selling point, and transloading is a particular strength, Being visible and accessible is key.

RBMN in 2019 opened two new transload facilities in West Hazelton and Ransom. They brought the trucking piece of transloading in-house at all four of their transload locations. The addition of truck loading services provides a competitive advantage over other operators, allowing for control of all aspects of the operation (rail, transloading/warehousing, and trucking), providing customers with a timely and seamless flow of goods and material. Collectively, transload efforts resulted in nearly 900 carloads in 2019.

For all these success stories, there is still much work to be done. We still see new distribution centers growing up convenient to the interstate highway system but totally without the rail option. This is a shame. Not that long ago the Class I railroads all had industrial development departments that were specifically charged matching businesses with industrial sites along their rights-of-way. Happily, feeder railroads are largely filling that void. And the Class Is get the carloads anyway.

I've noticed lately that OmniTRAX, for example, is aggressively marketing sites on its railroads. Their motto is "Rail Made Easy," and they're starting with site selection. The premise is that "our team operates at the intersection of real estate, supply chain and rail transportation."

Every two weeks or so OmniTRAX puts out a state-specific press release that touts "rail-ready suited to your area" and names local sponsoring authorities. In Georgia, for example, "the Savannah Gateway Industrial Hub features direct dual Class 1 rail connectivity, proximity to a deep-water port and access to a high quality workforce." Further,

> OmniTRAX and local partners seek to market and develop more than a dozen sites in Savannah Gateway, ranging from 60 to more than 200 acres. Located near the Port of Savannah and with direct access to CSX and Norfolk Southern railroads, these sites are ideal locations for plastics, aerospace, automotive and advanced industrial manufacturing, as well as logistics and distribution centers.

State of the Freight report from Wolfe Research advises that shipper volume expectations increased to their highest level in two years. Some 43 percent of respondents said current inventories are below target levels and thus inventory re-stocking should support strong freight volumes into the first half of 2021. However, intermodal is losing share to truckload and I think it's because of service inconsistencies, which are incompatible with tight supply chains.

Carload gains continue to lag intermodal and carload service seems to be getting worse, not better. Scott reports that customers are more reliant on technology to manage goods flow, which I perceive as a negative for railroad customers who sometimes must wait weeks for a rate quote. However, if railroads can get their service acts together, they can benefit from truck driver shortages and the shifting of manufacturing away from China eastward along the ocean trade routes from Malaysia to West Africa. (Ethiopia, for example, is big in low-end garments.) for example. Could mean more boxes going to the east coast via the Suez Canal.

The third quarter earnings calls are starting. KCS leads off today, with the rest over the next ten days. However, since BNSF has no earnings calls and its results are largely ignored by the Street, let me shed some light on their third quarter year-to-date results. My sense is that given the rapid ups and downs March through June, the longer look paints a more accurate picture.

Total revenue units declined 11 percent to seven million. "Consumer products" (auto and intermodal) dropped seven percent and represented 56 percent of total units. Coal/coke not surprisingly lost 22 percent and comprised 15 percent of total units. The merchandise group (industrial and agricultural) has over the years shrunken to just 29 recent of total revenue units. Only four of the 18 commodity lines showed any gains at all, and — except for grain — each of these counts for less than three percent of the total pie.

BNSF wasn't alone in a disappointing 2020 YTD. Red ink abounds among the US railroads with, from least worse down percentage-wise, KCS 7.4; CSX 8.8; UP 10.4, BNSF 10.7, and NS 14.9. Commodity patterns are about the same across the board — intermodal and ag up, most merch groups down, and forget about coal. I'm hopeful the earnings calls will shed some light on expected volume trends for 2021. From this short lines and regionals ought to be able to start planning resource allocation by customer and investing accordingly.