RAILROAD WEEK IN REVIEW
August 6, 2021

"If you take the S&P 500 and you look back to its earliest days, the average lifespan of a company back then was 100 years. Today, we're probably at fewer than 25 years. And we think, given the kind of creative destruction and innovation that's taking place, that that is going to drop towards 10 years or less." — Cathy Wood, ARK Investments on Real Vision, July 26

"KCS believes that shareholders should focus on the opportunity to receive a value under the CN combination of $325 per share, compared to CP's now terminated offer of $275 per share. We believe that CP's recommendation to vote against our combination with CN is not in our shareholders' interest. Shareholder approval of the CN transaction best positions KCS to deliver superior value to our shareholders as soon as possible." KCS Press Release, August 2

"We just saw refinery utilization come out of the tank from the time that all the airlines were shut down and grind higher all the way back to pre-pandemic levels. Meanwhile, the cost of gas has doubled along the way. And I think that's saying that the Green Movement hasn't figured out that hydrocarbon demand is inelastic." — Tony Greer, Real Vision, August 3.

AAR Week 30 (ending July 31) revenue units increased 11 percent to 20.9 million. Not surprisingly, intermodal is the largest chunk at 53 percent of total units, up 14 percent. Coal, now down to ten percent of total units, increased five percent on steam and met coal, both for domestic and overseas use. Auto jumped 19 percent as builders started making cars again after last year's hiatus but represents just three percent of total units.

Merchandise commodities from agriculture to zinc grew at a respectable eight percent rate, to just over seven million carloads, 34 percent of the total. Four of the eight merch commodity groups in the AAR Week 30 report gained. Three were up double-digits — grain, metallic ores/ metals, and nonmetallic minerals (a grab-bag of materials from salt to aggregates to phosphate fertilizers). Chems ooched up five percent. I think we've turned the corner and the short lines that take the best care of their customers will do very well.

The STB has been busy. Late last week the Board accepted the CSX re-write of its Pan Am application and has given CP access to the KCS documentation it wants. In the former, the Board writes, "The Board's decision preliminarily determines that environmental and historic review is not necessary and requests additional environmental information from CSXT.

"Previously, the Board issued a decision on May 26, 2021, finding that the applicants' merger application was incomplete and permitting them to file a revised application. In today's decision, the Board determines that the applicants' revised application meets the informational requirements for a "significant" transaction application, including with respect to the market analysis and the operating plan."

In FD 34672 the Board provides a schedule for subsequent rebuttals and comments for the next four months. The final briefs will be due by January 3, 2022 and the Board will issue its final briefs on a date to be determined by the Board. The Board will issue its final decision by April 1, 2022, and the decision will become effective on May 1, 2022.

The STB has also given CP permission to get its hands on KCS documents and records pertinent to its application to acquire KCS. The original CP petition asks the STB “to confirm that Kansas City Southern Railway (KCS) remains obligated to provide information to CP for purposes of preparing an application to acquire control of KCS.”

Furthermore, “CP asks the Board to confirm that KCS remains obligated to provide CP with information CP needs to complete its application and that CP *may retain and continue to use* materials provided by KCS before their merger agreement was terminated for the purposes of preparing and defending CP’s application” (*emphasis added*). However, the Board “declined to opine on whether the parties’ contractual obligations require the return of information previously provided.

Jason Seidl of Cowen and Wolfe’s Scott Group have been staying on top of all the proceedings. The former maintains there’s “a 60 percent chance of approval for the voting trust” but remains “wary of the political climate.” The latter says KCS will hold its shareholder vote August 19 “even if the STB hasn’t ruled on the CNI-KSU voting trust by then.” He then lays out the repercussions of the Board saying no or not voting at all.

Put Cathie Wood’s comments about the disappearance of company names in a railroad context. Think of the hundreds of railroad names in an *Official Guide* from the 1950s. The Biden “Fact Sheet” says that number had shrunken to just 33 Class Is in 1980, and then down to today’s seven. One can’t blame it all on “creative disruption,” but “disruptive technology” — another Cathie Wood favorite — has certainly played a critical part.

Even as steam gave way to diesel, the lash-up of five SD-40s on the head end has given way to three SD70 ACE AC units running as distributed power with one unit on each end and one in the middle. Track inspection is no longer a guy in a hi-rail vehicle on a track warrant but rather is done by an electronically rigged-out boxcar running at train speed. PTC has displaced wayside signals and end-of-train devices have made the caboose obsolete.

The official Wikipedia definition of creative destruction is a process that “breaks existing patterns of behavior” so as to create a significant departure from the norm. The three examples above do just that: improve train performance, provide a better ride over more of the railroad, and computerize train operations by eliminating many “unscheduled events” that destroy capacity. All of which falls under the general heading of “disruptive technology.”

From the customer point of view, “train time is anytime” will no longer do. The move to minimize inventory leads to smaller, more frequent shipments, and placing an order with the click of a mouse has replaced phoning or faxing a movement request to a distant market manager. So one reason the number of railroad names has come down is the sheer expense of old-world operating practices in a New World of disruptive technology.

Mergers provide creative destruction by eliminating the need to coordinate moves between different carriers, providing what CN President JJ Ruest calls “a roadmap of the move.” The present KCS transaction under consideration is just the most recent example; CSX plus PanAm Rail is another.

What’s not being talked about much is going out and getting the business. You can cut costs and streamline internal processes all you want, but if nobody’s buying what you’re selling, it’s all for naught. At some point you piss off enough customers to drive operating income into negative numbers, and today’s perversion of the Principles of Precision Scheduled Railroading is squarely to blame.

I tend to credit PSR with making the railroad run better as long as all five of its Principles are invoked: service, cost control, asset utilization, safety, people. Yet it appears to me that PSR as practiced on the US Class Is is all about cost control. Cut costs to the bone and park equipment so what you have can work more, albeit without a safety net of back-up resources.

One need look no farther than the Key Performance Indicators and AAR Performance measures as reported in the railroads’ 10-Qs. Hours of yard dwell up, OT arrivals and departures down, trip plan compliance worsening, labor expense up on re-crews and other unplanned events.

Precision Scheduled Railroading means you run the railroad the same way every day so that at the end of the day assets from crews to power are in place for the next day’s work. You’ve got to block for the distant node and get trains out of town according to plan — no more holding for tonnage.

And PSR is not solely for the Class Is. Feeder lines can commit to specific arrival times at customers and run trains to the Class I connections in accordance with the Interline Service Agreement, even though the Class Is seem to honor ISAs more in the breech than in practice — which is ironic because it’s been the Class Is pushing for ISAs the hardest.

Railroading is a network business, where the end product is no better than the network’s weakest link. Running to plan is not optional.