RAILROAD WEEK IN REVIEW

April 14, 2023

"FRA has noticed a rising trend in recent incidents where train build and makeup have been identified as a potential cause or contributing factor… To address these concerns, FRA is providing recommendations for freight railroads to improve the safety of their train build processes and practices." — FRA Safety Advisory 2023-02; Train Makeup and Operational Safety Concerns, April 6, 2023

The FRA Safety Advisory analysis of the recent train accidents reveals several common characteristics and patterns. Each of the accident trains had 125 or more cars running with DPUs and more than 14,000 trailing tons — more than three times the AAR maximum weight threshold. In each accident the first car to derail was an empty.

Five out of the six accidents involved mixed freight trains, which typically require more complex train makeup considerations. Five out of the six accident trains contained hazmat cars; hazmat cars were derailed in three of them, releasing hazmats. Two of the accidents led to the evacuation of local populations due to hazmat release.

Railroad	Date	Cars	Trailing Tons	Power*	Cars derailed
NS	3/4/2023	210	17,996	3x2x0	28
NS	9/19/2022	131	11,392	3x0x2	27
UP	9/5/2022	165	18,479	2x0x1	44
KCS	5/16/2022	125	17,113	2x0x3	1
UP	2/17/2022	195	14,017	3x1x1	4
UP	5/16/2021	159	16,545	2x1x0	47

** 3x2x0 represents 3 headend locomotives, 2 mid DPU's, 0 rear DPU's.*

Three of the six accident trains were classified as Key Trains, which are trains with a higher level of potential risk due to the nature of the cargo they carry or their operational characteristics. In this regard, the FRA notes that though technologies such as DPUs, energy management systems, and dynamic braking can can improve train handling and fuel efficiency, they cannot replace the need for correct car placement and assembly.

Therefor railroads must prioritize proper train makeup to maintain safety, prevent accidents, and optimize train performance. Further, all operating employees must be properly trained in these technologies and the handling of complex trains to ensure safe operation and minimize human error.

I have to agree with the FRA that — from what I've heard about East Palestine and other service failures — there is a lack of effective field management. And so it is that the FRA is recommending these *best practices t*o improve train safety and reduce the risk of accidents.

The guidance is unambiguous, instructing railroads to review and update train makeup policies, procedures, and guidelines to ensure they are comprehensive, effective, and current. In the process they must ensure that all personnel involved in train makeup decisions and operations receive appropriate training, guidance, and supervision to execute proper train makeup policies, procedures, and guidelines to ensure safe operations.

The field leadership is to regularly monitor and assess train makeup practices, with a focus on identifying and addressing potential safety risks. To do so, senior leadership must ensure everybody from crews to dispatchers to mechanical crews speaks the same safety language. Adhering to train makeup policies, procedures, and guidelines is a must — even if it delays a train.

Those making up trains must follow specific instructions to lower the risks associated with train build factors, such as the proper use of distributed power, train length limitations, and other operational train handling practices. And finally, if there *is* an incident, the leadership absolutely must enhance incident investigation procedures to specifically address train makeup factors and their potential contribution to the cause of the incident.

We must have a no-excuses approach to train make-up before starting a trip. And we must make sure the individual at the throttle can feel the train as it compresses and stretches on grades and curves, knows how to use the DPUs to manage buff forces, and, when making local spots and pulls, keeps half a dozen loads between the power and the first empty. Then we'll have a better chance of keeping trains *on* the rails, not between them.

The estimates I'm seeing re first quarter results seem to be sending mixed messages. On the one hand, CN and CSX get high marks for expectations with mild positives for NS and UP perhaps troubling. The consensus is that on average we should expect rail volumes will decline about two percent year-over-year in 2Q, yet many writers expect to see earnings growth. Hmmm. The only growth I'm seeing is in fuel surcharge fees.

Reports are that buy-siders' views swung back in favor of the rails. I'm not convinced. If it were so, price charts should show short-term moving averages starting to head up and to the right. As of Friday, only CN and CP showed an uptick over the SMA 200. The other three still point down for the near term, say a few weeks to a few months.

I use the Schwab Equity Rating system to sanity check my observations. Their A-F ratings (outperform-sell) already have brokerage firm analysts' rating baked in. CN, CSX and NS are rated B (buy) on essentially a six month outlook; CP and UP are ranked C (hold). Fingers crossed.

Earnings calls start with CSX and UP April 20; CP, CN and NS are the following week. To me, volume changes are the best measure of customer acceptance. The YTD Week 13 AAR carload figures are not reassuring. One reason is that in the longer term it's very likely the feds will put real pressure on train composition, attention to proper classification and car placement, eschewing today's *ad hoc* operating decisions.

The end result: more need to reinstate class yards, more yard jobs and more car knockers at a likely minimum, adding points to the sacred OR. More fruitful research may be to try to divine an OR where you can comply with tighter standards and attract more traffic of a "service sensitive" nature where the growth economy resides.

Let's say that number is in the 65-70 area, not the 55 area. Let's further postulate that you run your railroad to a 68 OR ratio. First, where does that leave you in EPS without traffic growth? Now, with marketing, what does that extra expense buy you in the nature of revenues if anything? (If nothing why do you have a marketing department?) What is the incremental operating income? What is the incremental EPS assuming no change in shares? Sounds like something worthy of discussion.