RAILROAD WEEK IN REVIEW

June 16, 2023

"FRA is currently working with the [ASLRRA] to draft a Risk Reduction Plan (RRP) template that could be used by Class II and Class III freight railroads found to have inadequate safety performance. Each railroad has three years from the date of FRA's plan approval to fully implement its RRP program, meaning all Class I plans will be fully implemented before May 2025. Approved RRP plans include implementation plans with timelines and milestones. FRA plans to begin auditing RRP implementation plans in the first quarter of fiscal year 2024." — FRA Administrator Amit Bose letter to Senator Charles Schumer, June 1

"Single-B-minus rated firms have seen average debt costs jump to 7.1 percent from 5.7 percent, while, at the other end of the spectrum, investment-grade companies now borrow at 3.7 percent on average compared to 3.4 percent in 2022." — Almost Daily Grant's, June 12

"Lawmakers have approved the last major piece of public financing for a rail line the state promised about eight years ago to bring the Volvo Cars plant to South Carolina. A legislative panel on May 16 authorized the S.C. Commerce Department to draw $48.5 million from a special economic development fund for the long-delayed project, now projected to cost $185 million, or about a third more compared to a 2021 estimate." — Charleston Post & Courier, May 16

Picking up on the ADG quote above, A reader in Florida writes, "New regulations are afoot to increase reserve requirements across most classes of banks. The smaller guys hold a lot of their loans on the books. They are scared. Residential loans are the bread and butter of the mom and pop banks and things are not as robust as we jaded types see every day.

"As one banker told me two years back... there is a lot of money available now but that does not mean it will be available when you want it, or worse, need it. Everyone is more levered than they let on. Factor in student loan payments and there will probably be a large drop in unfilled jobs."

ADG continues, "Considering that corporate profitability, as measured by aggregate global Ebitda, declined on a year-over-year basis last quarter for the first time since summer 2020, those rising interest burdens will prove painful for some. The prospect of imminent economic contraction presents a further complication for those vulnerable borrowers."

What's really happening here is the commercial real estate market is in the toilet. The XLRE real estate ETF is down 16 percent from its 2023 high, mainly a casualty of the Silicon Valley Bank collapse. SVB tried to raise rates to cover the higher fed funds rates but borrowers that couldn't meet the higher payments handed in the keys instead.

By way of background, a quarter of the XLRE's holdings are in commercial real estate from office towers to shopping malls to casinos. So if regional banks are having trouble making ends meet, they're not going to be in any rush to lend money to a local lumber dealer for a center-beam carrying half a million dollars worth of lumber.

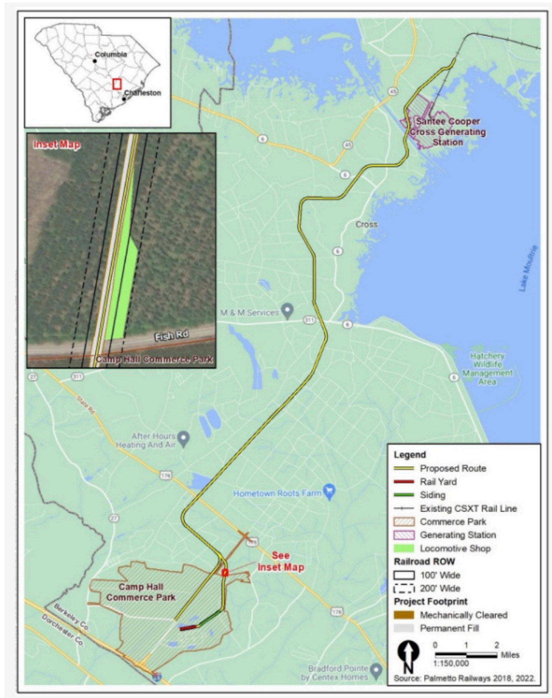
Happily for the railroads, the XHB home builder ETF is cranking right along as home builders from Pulte to Horton to Toll Brothers are being kept busy. Folks would rather feather their nests and work from home than commute to an office or shopping mall, especially with anything and everything available next day from Amazon with mere click of a mouse.

Though the traffic growth commentary for the railroads may not be breaking down any doors, we're on the cusp of the end of 2Q2023 with the street looking for a stronger second half to the year. The $IYT chart below (DJ Transport average ETF) shows institutional investors are bidding up shares and over the last month pushing them above the 200, 50 and 20 day moving averages.

Monthly revenue unit volumes are coming in a little less worse year-over-year — down 5.8 percent in May from down 6.3 percent in March. BNSF continues to drag the averages down, being the only double-digit decliner of the group.

To be sure, the negative hype re railroad safety hasn't helped. But I sense that noise is settling down to mere political posturing. The rails seem to be in pretty good shape for the shape they're in.

CSX of late has been touting its industrial development successes, and short lines are playing their part. In eastern South Carolina, the state-owned Palmetto Railways, a 90-mile short line, has begun construction on a 23-mile extension to serve the Volvo assembly plant in Ridgeville. The site is just off I-26 a few miles north of Charleston; the short line connects with NS as well as CSX. The new branch is an extension of the Class I service to Santee Cooper electric power generating station, South Carolina's largest.



The line extension will cost $185 million to build and has been in the works since 2016 — the rail line was included in the original negotiations to bring Volvo to the area. The press release says Palmetto will be running a train a day five days a week. At an average of 30 cars per train, that's 7,500 cars a year, triple what my 100 Car Rule calls for.

Palmetto Railway is a successor to the Palmetto Railroad, which had been chartered by the general assemblies of South Carolina and North Carolina in the 1880s. In 1895, the Palmetto Railroad was reorganized due to financial difficulties and renamed the Palmetto Railway.

The line stretched from Hamlet, North Carolina, to Cheraw, South Carolina, where it connected with the Cheraw and Darlington Railroad. In 1900, the Palmetto Railway become part of Seaboard Air Line Railway. Exactly when it became a ward of the state is unclear. Fast forward to October, 2013, when South Carolina Public Railways changed its name to Palmetto Railways, "a move designed to streamline operations and better reflect the state-owned agency's expanding economic development mission." And it has worked well.