RAILROAD WEEK IN REVIEW

December 1, 2023

"The Dow Jones Transportation Average has added 4.9 percent since mid-November and is up 13.0 percent for the year. The stocks driving the jump include railroad operator Union Pacific… Investors expect a soft landing to boost demand for goods, as well as transportation of the raw materials to make them… money managers often see these [railroad] shares as indicators of the commercial activity that underpins much of the economy." — Wall Street Journal, November 25

"It's rare to be offered an experience to link academic learning with real-world business acumen. I was pleased to able to shine a spotlight on CSX, talk about all we have to offer, and serve as a spark of motivation for the possibilities that lie ahead for these accomplished students." — Arthur Adams, CSX SVP Sales and Marketing, addressing Florida A&M University School of Business and Industry Forum Series

"In the poll published by the American Association of Individual Investors, we see that bullishness rose to a 45.3 percent share in the past week (up +1.5 percentage points) while the bear camp dropped 4.5 percentage points to 23.6 percent. Nearly two bulls for every bear. Now, that is extreme." — Breakfast with Dave, November 28

"Growth buckles but doesn't break – an economic slowdown in the US is already underway, and it's likely this becomes more pronounced in the months and quarters ahead as a variety of headwinds conspire to depress activity… However, despite a lot of recession talk, the US avoids formally entering one, and a rebound is underway by the end of the summer."— Vital Knowledge: 'Vital 2024 Outlook'

John Deere management expects FY 2024 farm equipment and "precision ag" net sales to be down 15 - 20 percent, according to a note from TD Cowen equipment analyst Matt Elliott. He thinks they are taking an unnecessarily gloomy view of their future and writes, "The strong growth achieved in 2022 continues throughout 2023. Crop conditions remain largely favorable" and it's quite possible "Deere's new precision ag technologies will gain traction faster than expected."

Agreed. A long-time WIR subscriber in Central California writes, "John Deere tractors and fertilizer remain the bright spot here — carloads are matching last year. Our outbound frozen vegetables are way down as area farmers here have been successful selling fresh produce into west coast markets. Consequently product is trucked directly to their regional warehouses rather than railed to a central distribution location."

His UP short line has always been a significant part of their outbound refrigerated perishable franchise with inbound farm equipment and fertilizers providing the “raw materials” referenced in the WSJ quote above. So even with area farmers’ fresh produce to California markets up and frozen to distant markets down, “raw materials” are up. What a perfect situation!

The STB’s spring 2022 “Urgent Issues” hearings resulted in, among other things, this May 6, 2022 STB press release: “Today’s decision requires all Class I carriers to submit several specific reports on rail service, performance, and employment. In addition, BNSF, CSX, NS, and UP are required to submit service recovery plans, progress reports, historical data, and participate in bi-weekly conference calls with Board staff.”

It is not clear to me whether the STB instructions regarding first-mile/last-mile (FMLM) service performance includes short line interchanges. It ought to. Recall that a few years ago the Class Is were pushing “Interline Service Agreements” (ISAs for short) outlining when and where the Class I/non-Class I interchange would take place. The ISAs never really worked as the Class I failures to show up as advertised made the ISA worthless.

Fast forward to the present and it appears the Class I railroads have gotten away from regular interchanges with short lines.That not only inconveniences the short lines, but it also interrupts short line customers’ supply chains. In most cases, the short lines have been able to absorb the Class I interchange irregularities, but not without additional cost.

There are, for example, documented cases where Class I non-performance between OD pairs for shortline customer movements has actually caused the customer to shift to truck. I recall, for example, an instance in central Pennsylvania where a STCC 26 paper customer went to truck because of Norfolk Southern failure to move that customer’s goods promptly from the short line interchange to the short line customer's customer. On the West Coast, there are instances where Union Pacific failures caused produce shippers to use truck for the same reason.

It would appear to me that the STB could expand its coverage of FMLM performance to include short line interchanges. Short lines are really Class I customers that rely on regular service from their Class I railroads. For obvious reasons, no short line is going to make a FMLM filing with the STB, which is why I’m suggesting it’s something for the Board to take a look at.

Tony Hatch writes that RailTrends 19 was “perhaps the best RailTrends ever, sold out for the first time, too. I think the event can best be summarized by perhaps five overriding themes – Collaboration, Trust, Commitment, the Great Experiment – and, as always, some measures of Drama. Of these, the overriding theme was that of collaboration – with each other (Class Ones), with partners (viz BNSF & JBHunt), with suppliers, and in a big way, with short lines."

I'll say.The six shortline presenters underscored that theme in all their remarks. RJ Corman's Ed Quinn talked about their journey "from command & control to collaboration." GWR's Mike Miller (recently tapped as CEO) called the collaboration initiatives an "ecosystem approach," noting his joint efforts with CSX and CPKC in Meridian, and the new CN deal in Nova Scotia (in general he credited CN with "re-engaging").

Henry Posner of RDC expressed concerns about Class Is buying back short lines they had created— BNSF/Montana Rail Link, CP/CMQ, e.g. OmniTRAX President Dean Piacente stressed their acquisition focus remains business development and real estate. Gulf & Atlantic's Ryan Ratledge is optimistic about deals to be had (they have, in fact, recently added four small properties to their original two).

Then there's matter of trust, especially where railroad users are concerned — where it has gone, how to get it back and — where it never existed — how to create it. Says Hatch, "Collaboration, in that color-blind map-reading way, combined with improved service and better technology (backed by strong capex) should finally, at long last, lead us to the Growth Pivot."

Norfolk Southern CEO Alan Shaw, the 2023 RailTrends Innovator of the Year, "was the first Class I CEO to lay out this new (or is it a back-to-the-future) vision." The event was last December's NS Investor Day. I listened to that session and found it remarkable that in 102 slides the term operating ratio was mentioned just once — "a recognition that the old playbook didn't apply any more to the modern game."

"At RT, Alan laid out the challenges, industry-wide and company specific (East Palestine) that have occurred this year but remained unwavering in his commitment to what I call The Experiment – investing through a cycle, focusing in ROIC, investing to support the Growth Pivot, and collaborating to achieve that growth." And that set the tone for the entire two days of RailTrends 19. Let's see if Tony can best this in 2024.