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# After Renaissance, Retreat – Now What?

Can the North American Railway network  
really “Pivot to Growth”?

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Opening Day

2024!

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# 5+ Enduring (?) Railroad Competitive Advantages

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**1 Labor Advantage**  
(ex: Double-stack LA-Chi – or Rupert-Toronto)<sup>1</sup>

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**2 Fuel Advantage (2A)**  
(4:1 ton/mile; AAR)<sup>2</sup> – So 2B is **EMISSIONS**/Environmental Advantage (see...WMRT, Unilever, etc.)

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**3**

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**4 Infrastructure Advantage**  
(after the IHS buildout; user-pay and capex to support changing logistics patterns – ex: transcon)<sup>3</sup>

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**5 Railroads' Excellent Financial Condition, Liquidity, Free Cash flow**

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**? Railroads' Historic Ability to Reduce Expenses in a Known Slowdown (2009, 2020)<sup>4</sup>**

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1. AV trucking?; 2. EV Trucking?; 3. Infrastructure Bill? (LOL); 4. Newly Added (in response to C19)

# Can Rails Change the Narrative After the 3 Big Blows?

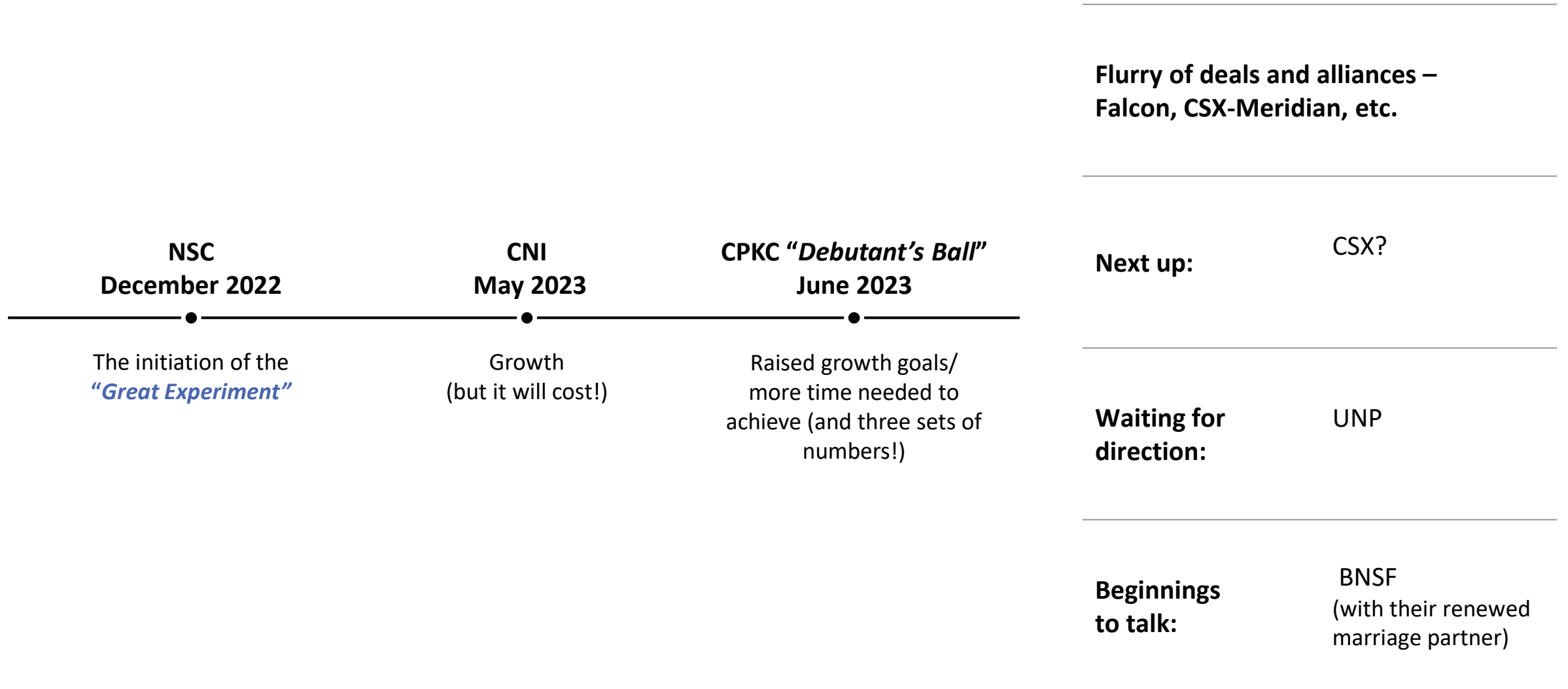
**Rails suffer # (3, at least) Big Body-blows over the last 18-24 months (some wounds self-inflicted but not all)**

- Supply Chain Crisis/STB Hearings
- Regular labor round goes the distance
- East Palestine and ramifications

## ***So - Are Rails Inept, Greedy & Dangerous?***

- *NSC Investor Conference (joined by CSX new CEO) – “The Great Experiment”, change in incentives, furlough policy, investment*
- CNI Investor Conference – Growth through Investment
- CPKC Debutant’s Ball – Growth through Competition
- Slow but *steady* progress on service consistency & *resiliency*

# 3 Railroad Investor Conferences Push Growth



# NSC, East Palestine (a year later) & the (over?) reaction – Existential Threat?

- NS accident couldn't have been worse timed - or to a more unfortunate carrier
- NS safety history, efforts at Common Carriage, originator of TGE
- Rails are not *allowed* to carry haz-mat, they are *compelled* to do so
- ASCE Grade of B; Big & Consistent Capex
- Bad press continues, reputational hit enormous
- No action (as of now) in do-nothing congress
- Everyone on the attack:
  - Train length??
  - Crew size???
  - **ECB Brakes (*car-based!*) – your thoughts??**
  - *Corp Greed/share buybacks??*
  - *Don't trust the EPA*
  - *Fix everything but the problem!*
  - *Doubling hot-box detectors price tag \$1-2B*
  - *Etc*
- *~\$900mm\* (net) spent, excluding reputational and political hits*

\*Not sure of the current number! Much bigger!

# Battle Stations! Activists Attack NSC

## 1

**An Ancora-led group (?) plans to run+ a proxy fight vs Norfolk Southern**

- Supposedly \$1B stake, up from less than \$100mm 12/31
- 8 Board nominees, 4 with varying “rail experience”
- Strategy not yet *fully* revealed
- CEO-designate Barber from UPS
- Key man is COO-designate Jamie Boychuck (CN, CSX)
- Activists are 4-0-1 vs. RRs in 21<sup>st</sup> C
- Hunter Harrison is still dead

## 2

**(Yet another) potential Existential Threat to the Great Experiment**

- Return of the Cult of the OR?
- An attack on Intermodal?
- Long term investment strategy given only a year?
- Industry-wide implications

## 3

**Defend the position! Doing otherwise bound to fail (CP, CN, CSX)**

# Union Pacific's Sunday Surprise

- Soroban forces a change of leadership (in February)
- Suggests Vena (again) – after 5 months, Board agrees
- Another “existential fight for the soul of the rails”? (from growth to margin focus?)
- Many gaffes - Capex at 15% or less; G55; STB issues
- Chronic under-performance (of *potential*)
- Still the best (“Yankees manager”) job in the business?
- New Strategy unclear, retain fighting attitude with the STB
- H2, K2 or J2?

# The CN Mothership and the Diaspora

- Vena in at UP
- Cory replaces Boychuck at CSX COO
  - “Culture change”
  - Similar pattern as at CN
- Orr at CPKC
- The return then retirement of the Old Guard at CN
- Oh, yeah....Keith
- Still out there: Boychuck, Fahmy, others....



# Brand New Baby Railroad

<p>CPKC “Last Spik” April 14, 2023</p>	<p>Never (NEVER) in doubt – just listen to the STB (and to me)</p>	<p>Congrats to the STB for filtering out the noise (DOJ, Warren)</p>	<p>New Growth Opportunities can help to turn around perception of rail</p>
<p>Rail/Rail Competition</p>	<p>Rail/Truck/Competition</p>	<p>80% Synergies – i.e., revenues</p>	<p>Can the Unicorn bring it home – yes. In 3 years? (A: No – they pushed out the really big numbers to '28)</p>

# RailTrends 2023 – Competition & Cooperation

- Increased *rail-to-rail competition* (CPKC)....
  - ...has unleashed new levels of *cooperation and alliances* (Falcon)
  - ...and new levels of (planned) entrepreneurialism (ex Quantum)
  - ...and, hopefully, more partnerships with *short lines* (despite CN/IN?)
- All examples of the *Great Experiment* – loY Alan Shaw (and others)
- But not without healthy *skepticism* (CSX, analyst panel) – requiring a level of *faith*
- And of course, there was drama: STB/UP, Mexico

# Mexico's Moment?

- For rails, since NAFTA it has *always* been momentous
- Near-Shoring is the headline grabber
- However:
  - Pemex support
  - KKR
  - Passenger traffic forced on the freights?
  - Border shutdowns
  - Election (you get my point....)
  - 25% of Latam GDP; 17% FDI
- But – CPKC; Falcon, Tesla – especially now BNSF/JBHunt
- Mexican elections at midyear; US in November
- Modelo Especial!

# Short Lines To the Rescue of Class Ones?

## ***Class One service crisis and the impact on/of regulators (STB/FRA) and Legislators***

- New focus, data on First Mile/Last Mile (and it ain't pretty!) – made more intense with Reciprocal Switching?
- Service failures are manna to STB concerned about rail market power (price)
- STB use of *common carrier obligations* as a lever (UP/Foster Farms), focused on weekly switches
- Declining Class One carload growth since the 2008-9 Financial Crisis

## **SOLUTION?**

### **Increased use/creation of Short Lines!!**

- Short lines have consistently out-grown C1 in carloads
- Short lines offer tailored, customizable switching services
- Short Lines have better work rules, less severe labor shortages
- Short Lines are looked upon quite favorably by regulators and legislators!
- Watco's Dow and especially Dutchtown Southern (Louisiana/CN) increased weekly switching from 3-5 to 7+ and grew carloads by over *one third* in the first year of operations – win (customer switches)/win (Watco new business)/win for C1 partner CN (more cars for its long-haul business)
- All SLHCs have logistics/switching arms etc

## ***So why is the momentum of C1 strategy seemingly to buy or retake SLs***

See DMQ/Pan Am/MRL??

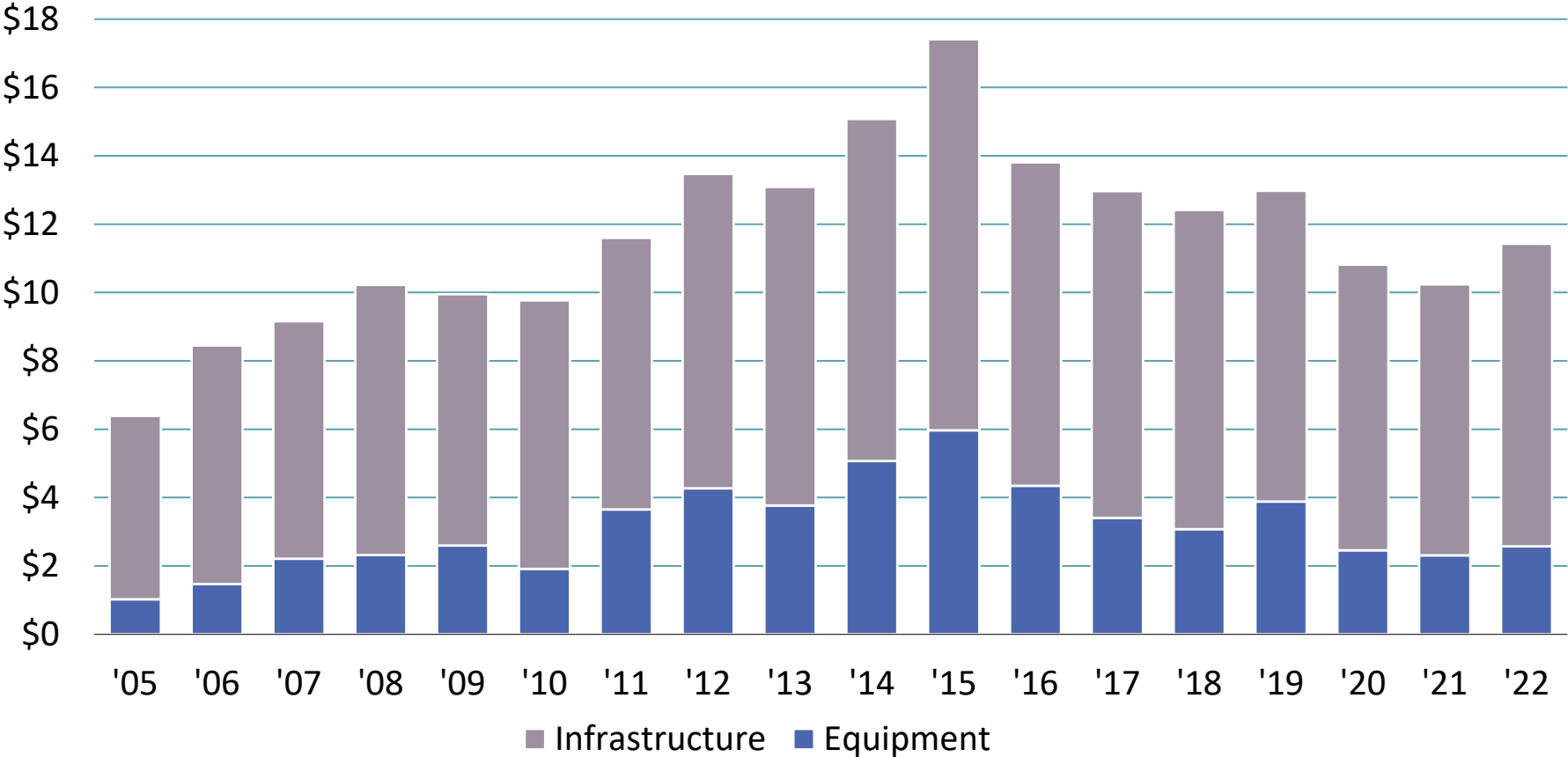
- I support a “feed the beast” strategy (looking to extend a C1 market reach – ex CN 2018-21)
- However that should not preclude thoughtful C1-SL partnerships (that solve customer problems!) – ex RailPulse
- *Nonetheless, I see no evidence of C! leadership taking these steps (yet?)*
- *There have been more C1 SL Meetings, discussions (ASLRRRA)*

# Regulators, Luddites & Data – DC in tha House

- Peak STB post merger?
- Reciprocal switching – a “nasty curveball”, but good for analysts – and?
  - Canada sticks to a larger milage-based plan
  - Standardized (and more) data will be useful in the US
  - A tailwind for service recovery?
  - But will a fastball follow the deuce?
- Will the Hatfield (UP) & McCoy (STB) feud finally end?
- The FRA takes the Trident – anti-technology in favor of jobs

# Railroad Capital Spending

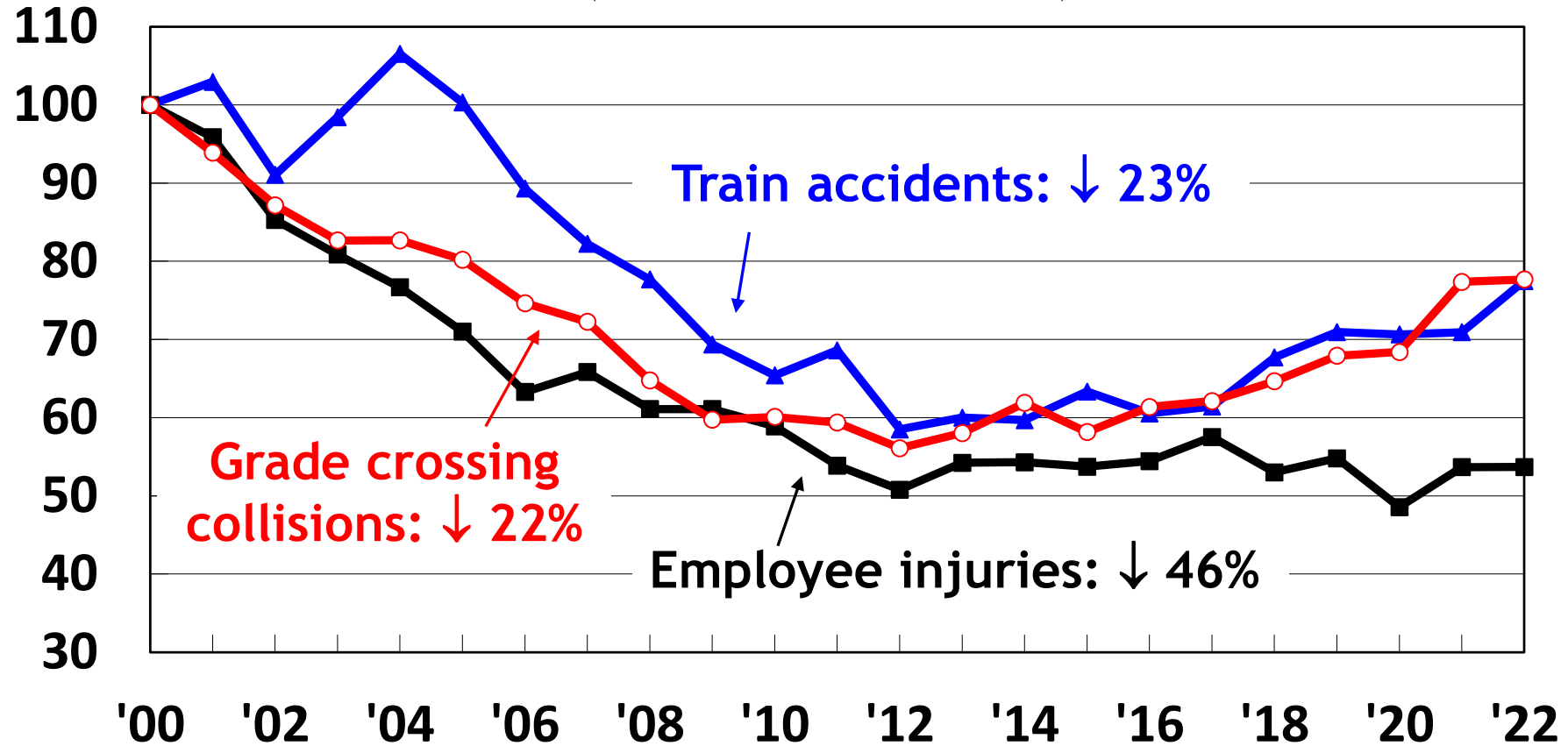
(\$ billions, current dollars)



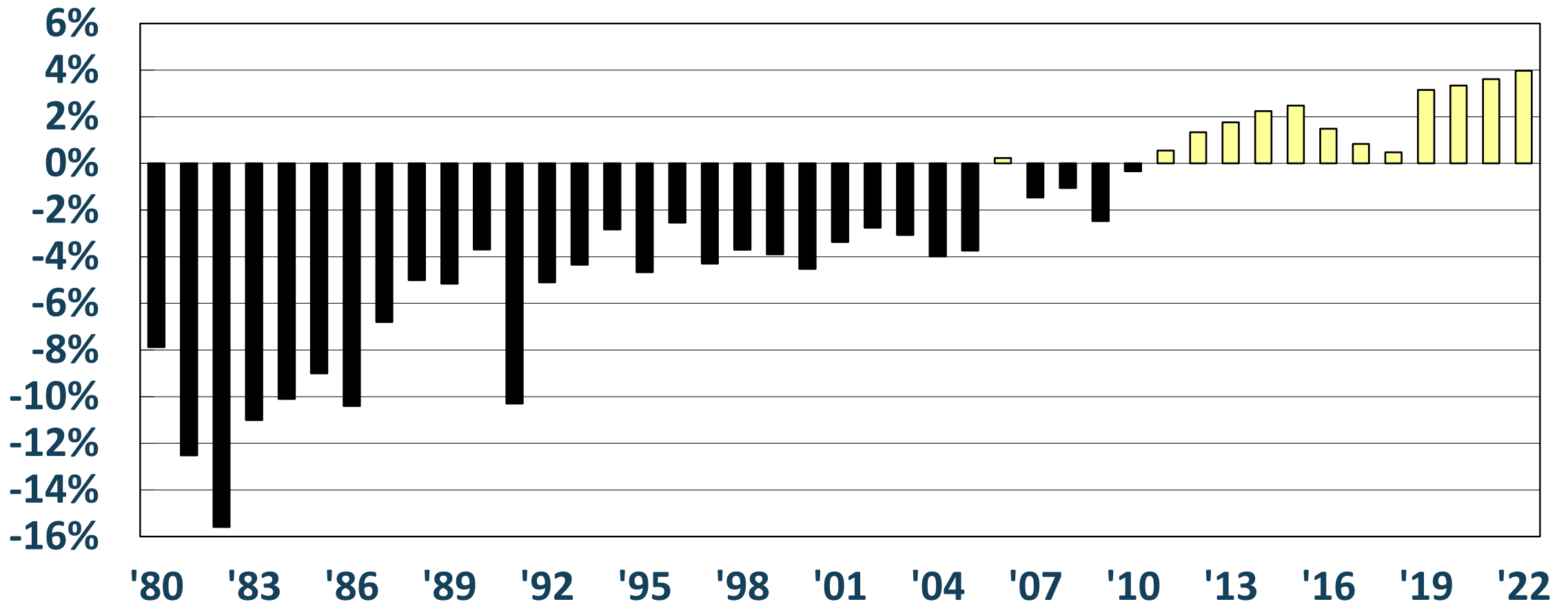
Data are for Class I railroads. Source: AAR

# Recent Decade Was Safest Ever

(Index 2000 = 100)



% = change in rate from 2000-2022. Source: FRA



\*In 2006, the Surface Transportation Board significantly changed the method by which it calculates the rail industry cost of capital. Source: STB



# Return on Investment is Crucial

If ROI > cost of capital

Capital spending expands • >

Stronger physical plant; more and better equipment. •

Faster, more reliable service •

Sustainability •



If ROI < cost of capital

• Lower capital spending

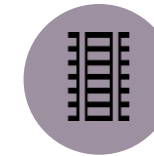
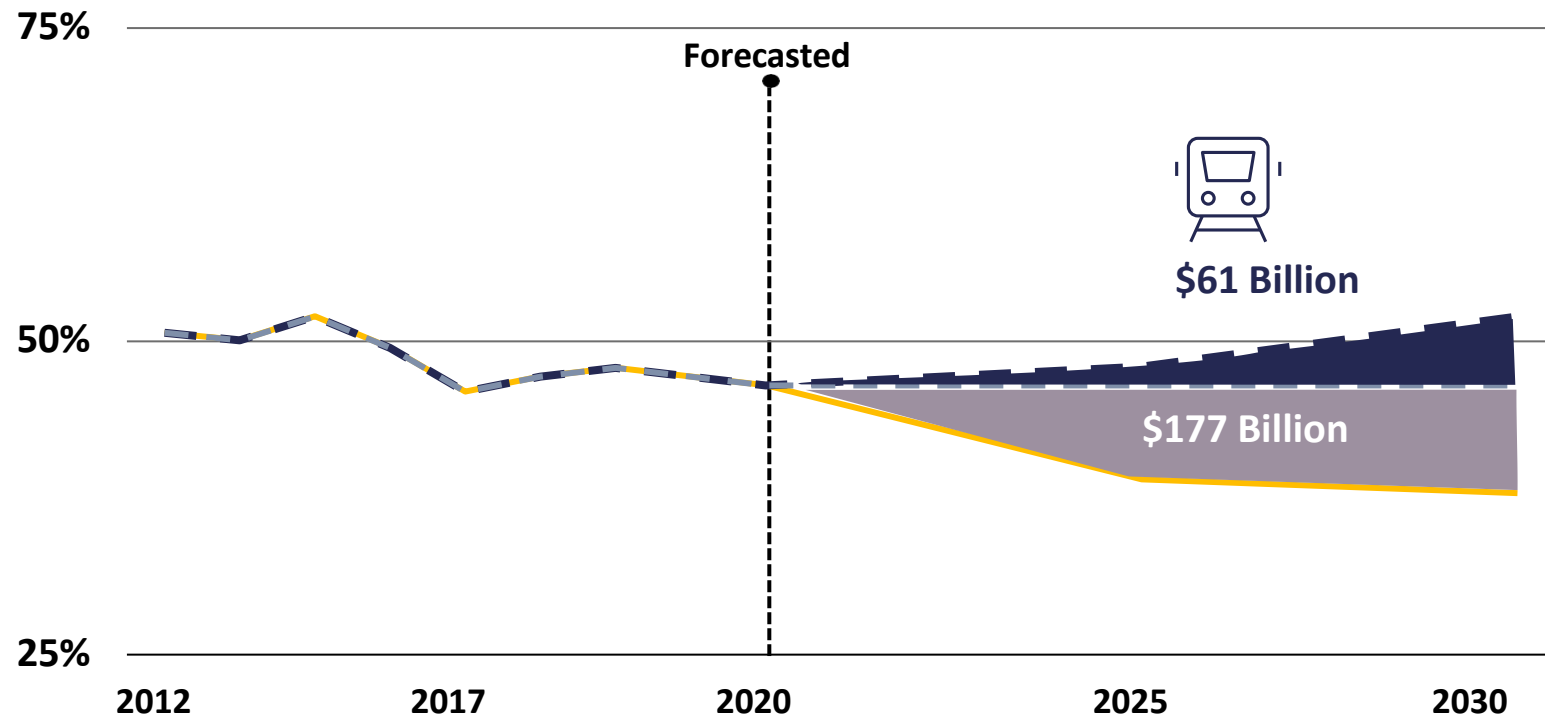
• Weaker physical plant, equipment

• Slower, less reliable service

< • Disinvestment

# By using available capacity, railroads could add \$61BN more in growth revenue – with limited capex

## Freight market share analysis and forecast by ton-mile



Gaining a half point of share per year delivers growth that by year ten fills current available capacity



Assumes no material technology advancements

■ Rail share   
 ■ Rail share with growth   
 - - - Maintained rail share

Source: © Oliver Wyman

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