Touchbase

JULY 2016

In This Issue

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Railroad & Policy Updates

Railcar demand "has weakened significantly in this year's opening quarter and backlogs have dropped to only 95,038 cars," according to the most recent report issued by Economic Planning Associates. The smaller backlog represents 5.6 quarters (roughly 17 months, through November 2017) of assemblies at current rates.

"The railroads will shoulder a heavy commodities burden this year," EPA said. "Coal and petroleum loadings have faltered considerably this year and will be slow in recovery. Intermodal traffic has also been weak. On a brighter side, we expect some improvement in grain, motor vehicles and chemical movements as we proceed through 2016 and into 2017."

Based on significant boxcar backlogs, EPA expects an acceleration in boxcar assemblies that will result in deliveries of 3,000 units this year and 3,500 cars in 2017.

Freight car demand significantly weakened

Due to the strength in current backlogs and the anticipation of continued growth in the corn-to-ethanol process that will keep DDG (distiller's dried grain) demand strong, EPA predicts deliveries of some 9,000 hi-cube covered hoppers this year; 7,500 units in 2017. From 2018 through 2021, deliveries will be in the range of 4,000-5,000 cars per year. Given the high backlogs and strong first-quarter assemblies, EPA is raising 2016 medium-cube covered hopper deliveries to 8,000 cars this year. After 6,500 cars are assembled in 2017, EPA expects deliveries of 6,000 per year from 2018 through 2021. Based on assemblies to date and industry reports of a stretching out of deliveries by customers, EPA expects deliveries of only 6,000 small-cube covered hoppers both this year and next year.

Demand for coal cars "is non-existent," EPA said. "The 400 steel-bodied hopper cars ordered in the first quarter are for ore and aggregate services, and there were no orders for the aluminum-bodied cars generally used for coal movements."

The current energy environment "is sluggish, at best, and we noted a slowing in orders and assemblies of tank cars," EPA said. "As a result, we are lowering our 2016 tank car deliveries estimate from 30,000 to 20,000," a 33% reduction.

Due to the weakness in coal cars and lower orders and backlogs for other car types, EPA has lowered its 2016 deliveries estimate to 60,300 cars and its 2017 projection to 47,300 units

Due to the weakness in coal cars and lower orders and backlogs for other car types, EPA has lowered its 2016 deliveries estimate to 60,300 cars and its 2017 projection to 47,300 units. After 44,000 thousand cars are assembled in 2018, deliveries will rise gradually to an annual level of 54,500 cars in 2021, EPA said.

Read more at:
http://www.railwayage.com/index.php/mechanical/freight-cars/freight-car-demand-significantly-weakened"-economic-planning-associates.html?channel=59

AAR releases economic impact report

Spending by the seven largest U.S. railroads created $274 billion in economic activity, generated nearly $33 billion in state and federal tax revenues and supported nearly 1.5 million jobs nationally in 2014 alone

“Railroads provide the foundation that enables the world's top economy to thrive”

AAR Releases Economic Impact Report

The Association of American Railroads (AAR) released on June 13 a "State of the Industry Report" featuring new research from Towson University's Regional Economic Studies Institute (RESI) that finds spending by the seven largest U.S. railroads created $274 billion in economic activity, generated nearly $33 billion in state and federal tax revenues and supported nearly 1.5 million jobs nationally in 2014 alone. AAR says the report is the first of its kind to quantify the impact of investments by Class I railroads with U.S. operations on the overall economy.

Several key points highlighted by AAR:

> *Spending: $28 billion in investments by freight railroads in 2014 is more than half of all federal spending on transit formula grants, federal highway construction programs and airport improvement programs combined.
>
> *Output: $274 billion in output - or goods and services produced - is nearly the GDP of Finland, according to International Monetary Fund data. This amount of money could build 24,909 miles of six-lane urban interstate highway, fund Medicare for nearly 25 million Americans or pay for the four-year college education of 2.2 million students.
>
> *Jobs: One job in the freight rail industry supports nine others touched by the industry, including retail, manufacturing and transportation and warehousing.
>
> *Taxes: The rail industry's state and local tax generation is greater than the taxes collected by 30 individual states in 2014; The nearly $21 billion in federal taxes is nearly three times the amount allocated for the National Science Foundation in 2014.

"Railroads maintain high paying jobs within its sector and create numerous jobs in related industries that collectively spur significant economic activity," said Dr. Daraius Irani, lead researcher and Chief Economist at RESI. "Significant capital investments by railroads and the steady presence of a coast-to-coast network that can reliably deliver goods at a cost effective rate generates a ripple effect seen in this study. Railroad spending means job growth, dollars to communities and global competitiveness."

"Railroads provide the foundation that enables the world's top economy to thrive," writes AAR President and CEO Edward R. Hamberger in the report. "For manufacturers and consumers, small and large businesses, energy companies and farmers, freight rail is the basic building block that allows a great sweep of economic activity to take place across the country. Without railroads our economy would be vastly different."

Read the entire article:
http://www.railwayage.com/index.php/freight/class-i/aar-releases-economic-impact-report.html?channel=50&utm_source=WhatCounts%2c+Publicaster+Edition&utm_medium=email&utm_campaign=RGN+6.14.16&utm_content=Full+Article

AAR Field Manual - Rule 1 “Disposition” Explained

Mechanical Brief with Steve Christian

Rule 1 is titled “CARE OF FREIGHT CARS.” It sounds like a pretty simple and straight forward rule. In fact, when I first cracked open the AAR Field Manual around 1968 it was. If I remember correctly, it was a little more than one page and set out the basic responsibilities of the handling line, including inspections, and the limits placed on the railroad for making repairs to empty and loaded bad order (defective) railcars. It also had a simple mechanism for sending bad order railcars to home shops for repairs.

Today, Rule 1 is 5 pages long and covers:

1. Inspection
2. Repairs to Foreign Cars
3. Disposition
4. Ownership Identification
5. Gages and Publications Required for All Repair Tracks
6. Car Classification

“Disposition” is the only section that I will attempt to cover in this article. Here is my take on the contents of this section:

a. If the handling line (railroad) inspects your car and finds defects that are the **car owner’s responsibility** (per the AAR Rules) and either the railroad is not allowed to make repairs or doesn’t want to make repairs, they will notify the Car Owner through the DDCT system. The car owner has <u>two business days</u> to advise where they want the car to be sent for repairs. Failure to do this could result in the railroad sending it to any shop they choose. Usually one that is inconvenient for you and costs you a fortune to get it back on route. The DDCT system is detailed in AAR Rule 115. Explanation of this rule is for another day.
b. Sometimes, the handling line sends you a notice through the DDCT system for disposition for a DDCT Rule 1 incident (aka MA124) but then continues to move the car in normal operation. If that car ends up making <u>3 consecutive cycles</u> (empty-load, etc.), the car will be “autoclosed” in the system. You would be amazed how often this happens.
c. If <u>48 months</u> pass since the DDCT Rule 1 incident (MA124) and the car is not at a shop it will be “autoclosed” in the system.
d. The car owner should report the last commodity loaded in the car whenever disposition is given.
e. Cars that have major structural defects (center sill, side sill, crossbearer, body bolster) must be repaired under the rules contained in Rule 107 (railroad pays for repairs because they damaged it) or Rule 108 (car owner pays because it is due to structure defects).
f. When railcars have defects that cause transfer of the lading

If the handling line (railroad) inspects your car and finds defects that are the car owner’s responsibility (per the AAR Rules) and either the railroad is not allowed to make repairs or doesn’t want to make repairs, they will notify the Car Owner through the DDCT system

Rule 107 (railroad pays for repairs because they damaged it) or Rule 108 (car owner pays because it is due to structure defects)

When railcars have defects that cause transfer of the lading (commodity) the railroad will apply one of those yellow-green decals that say "HOME SHOP FOR REPAIRS-DO NOT LOAD" on both sides of the car before it moves

When creating waybill for movement of any defective or damaged you must include code "HR"

Private marked cars must be waybilled in accordance with applicable tariffs, service rules, directives, special car orders or tariffs

(commodity) the railroad will apply one of those yellow-green decals that say "HOME SHOP FOR REPAIRS-DO NOT LOAD" on both sides of the car before it moves. As an example, you don't want to load a car when the commodity might leak or pour out due to a missing outlet.

g. When Leaky tank cars are found they must be stenciled "LEAKY TANK. DO NOT LOAD UNTIL REPAIRED" on each side adjacent to the car numbers. The railroad must stencil an "X" near where the leak is, immediately notify the car owner and ask for disposition. One of those yellow-green decals that say "HOME SHOP FOR REPAIRS-DO NOT LOAD" must be applied on both sides of the car before it moves. Owner must furnish disposition within <u>15 days</u>. Stencils and decals stay on the car until all repairs have been completed.
h. Uninsulated tank cars (112A and 114A) that have cuts or burns from coming in contact with the wheels must be sent home with the yellow-green decals that say "HOME SHOP FOR REPAIRS-DO NOT LOAD" to both sides of the car before it moves.
i. Empty pressure differential cars (207W) with exterior shell damaged similar to Rule 95, illustration A and B must be sent home for repairs with the yellow-green decals that say "HOME SHOP FOR REPAIRS-DO NOT LOAD" applied to both sides of the car before it moves.
j. When creating waybill for movement of any defective or damaged you must include code "HR".
k. The car owner must provide disposition for all cars sent to a shop under paragraph e., f., g., h., i., or n. of this section. All cars moved to a home shop, or to and from a shop located on the billing road or an intermediate road that is not further than the nearest home shop capable of making repairs, must be waybilled on a **<u>non-revenue</u>** waybill provided the handling railroads have the car service responsibility for the return of such cars to the owner. Authority for sending cars to shops and the major defects must be shown on the waybill. Waybill must show "moving per AAR Interchange Rule 1". Private marked cars must be waybilled in accordance with applicable tariffs, service rules, directives, special car orders or tariffs. If a car cannot be properly routed in accordance with the above provisions, the owner is responsible for providing routing and arranging for transportation with the out-of-route carriers.
l. This paragraphs a and k of this rule do not affect the rights and obligations of railroads may have with national pools, bi-lateral agreements or private marked cars moving under tariff
m. Handling line must begin the movement of the car in accordance with the disposition given within <u>5 days</u>.
n. When Leaky hopper cars are found they must be stenciled "LEAKY HOPPER. DO NOT LOAD UNTIL REPAIRED" on each

side adjacent to the car numbers. The railroad must stencil an "X" near where the leak is, immediately notify the car owner and ask for disposition. One of those yellow-green decals that says "HOME SHOP FOR REPAIRS-DO NOT LOAD" must be applied on both sides of the car before it moves. Owner must furnish disposition within 2 business days. Stencils and decals stay on the car until all repairs have been completed.

Sometimes it seems that you need to be a "Philadelphia Lawyer" to understand all this stuff

Sometimes it seems that you need to be a "Philadelphia Lawyer" to understand all this stuff. Eventually, I will put together a flow chart that shows how Rules 1, 95, 96, 102, 107, 108 and 115 all work so that it is less confusing for all of us. Until them, we will sift through the AAR Field and Office Manuals to glean the information.

As always, Tealinc stands ready to employ our many years of experience and varied talents in the railroad industry to work for you.

Steve Christian is the Manager Value Creation-Railcar Performance Manager for Tealinc, Ltd. You may contact Steve directly in his Colorado office at (719) 358-9212 or via email at ***steve@tealinc.com****.*

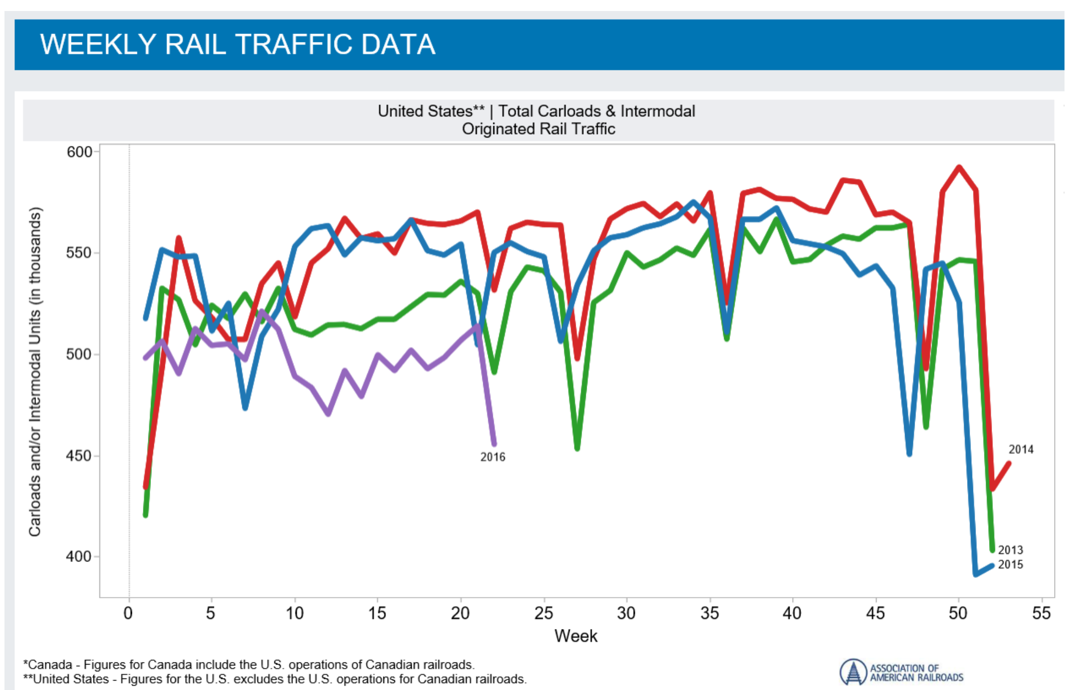
Railroad Traffic

May 2016 carloads down 10.3 percent

Association of American Railroads (AAR) reported [June 1, 2016] weekly U.S. rail traffic, as well as volumes for May 2016.

Carload traffic in May totaled 962,571 carloads, down 10.3 percent or 110,678 from May 2015. U.S. railroads also originated 1,049,631 containers and trailers in May 2016, down 3.3 percent or 36,365 units from the same month last year. For May 2016, combined U.S. carload and intermodal originations were 2,012,202, down 6.8 percent or 147,043 carloads and intermodal units from May 2015.

Ten of the 20 carload commodity categories tracked by the AAR each month saw carload gains including miscellaneous carloads, crushed stone, gravel and sand, and chemicals



Commodity declines in May 2016 included: coal, petroleum and petroleum products, and metallic ores

In May 2016, ten of the 20 carload commodity categories tracked by the AAR each month saw carload gains compared with May 2015. These included: miscellaneous carloads, up 30.8 percent or 5,854 carloads; crushed stone, gravel and sand, up 5.3 percent or 4,670 carloads; and chemicals, up 3.8 percent or 4,514 carloads. Commodities that saw declines in May 2016 from May 2015 included: coal, down 29.6 percent or 109,276 carloads; petroleum and petroleum products, down 20.3 percent or 11,988 carloads; and metallic ores, down 12.9 percent or 3,701 carloads.

Excluding coal, carloads were down 29.6 percent or 259,735 carloads from May 2015.

Total U.S. carload traffic for the first 21 weeks of 2016 was 5,050,191 carloads, down 13.6 percent or 792,892 carloads, while intermodal containers and trailers were 5,417,763 units, down 1.3 percent or 70,136 containers and trailers when compared to the same period in 2015. For the first five months of 2016, total rail traffic volume in the United States was 10,467,954 carloads and intermodal units, down 7.6 percent or 863,028 carloads and intermodal units from the same point last year.

"Most economists think the economy has picked up in the second quarter from the dismal 0.8 percent growth in the first quarter, but so far railroads aren't seeing much of it"

"Most economists think the economy has picked up in the second quarter from the dismal 0.8 percent growth in the first quarter, but so far railroads aren't seeing much of it," said AAR Senior Vice President of Policy and Economics John T. Gray. "A variety of environmental and market forces continue to punish coal, and high business inventory levels and excess truck capacity, among other things, are pressuring rail intermodal volumes. Railroads are focusing on what they can control — providing safe, reliable service — while looking forward to the forces they can't control turning their way."

Read more at:
https://www.aar.org/newsandevents/Press-Releases/Pages/2016-06-01-railtraffic.aspx

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Industrial Inside

Grain prices rebound after U.S. data on corn, wheat stocks fall short

Grain prices rebounded after the U.S. said its corn stocks would not rise nearly as much as investors had expected, while making a surprise cut to estimates for wheat inventories, citing strong feed usage.

Corn futures for December, which had stood 1.4% lower ahead of the US Department of Agriculture's flagship Wasde crop report, bounced to post a gain of 2.0% immediately after the briefing was released.

Wheat futures for September, which had been trading 0.8% in negative territory, revived to see a 1.7% gain.

November soybean futures, meanwhile, for which the Wasde was less upbeat held onto gains, standing 1.3% higher at $10.68 ¼ a bushel.

The grain price gains followed an estimate in the Wasde, the USDA's flagship world crop supply and demand report, that US corn stocks would end 2016-17, which starts in September, at 2.08bn bushels (52.9m tonnes).

While representing an upgrade of 73m bushels on last month's estimate, and rise of 380m bushels year on year, the revised figure was well below the level that the market had expected, after the USDA at the end of last month lifted expectations for domestic corn sowings this year.

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Although the USDA lifted its estimate for the US harvest to 14.5bn bushels (369.3m tonnes), and trimmed hopes for domestic feed use of the grain, the revisions were offset in part by raised hopes for exports, after drought cut supplies in rival Brazil.

"Exports [for 2016-17] are projected 100m bushels higher on reduced competition from Brazil, as reflected by new-crop export sales that are well above a year ago," the USDA said.

For wheat, price headway was supported by an unexpected downgrade of 4.1m tonnes to the estimate for world stocks at the close of 2016-17.

Although this still left the inventory forecast at a record high, of 253.7m tonnes, the figure was well below the reading of 258.8m tonnes that investors had expected.

The unexpected stocks downgrade reflected uprated ideas for the volume of wheat which will be used in livestock feed, "primarily on increased feed use, stemming from the large world supplies and heavy late-season rain in several production regions".

While rains in the growing season are generally beneficial for yields, harvest-time rains are a setback for farmers, in encouraging ripe kernels to sprout, so reducing the milling credentials of the crop and fuelling quality downgrades, potentially to feed use only.

While rains in the growing season are generally beneficial for yields, harvest-time rains are a setback for farmers, in encouraging ripe kernels to sprout, so reducing the milling credentials of the crop and fuelling quality downgrades, potentially to feed use only.

Indeed, the USDA hiked by nearly 11m tonnes to 144.4m tonnes its forecast for world feed use of wheat in 2016-17, upgrading the figure to the second highest on record, behind only that five years before.

"Feed use [estimates] in China and the EU are raised 5.5m tonnes and 1.5m tonnes, respectively," the USDA said, with the French crop in particular seen as suffering from poor weather.

However, low wheat prices, which on the Chicago futures exchange remain close to 10-year lows, also played a role in higher feed use, and in a 50% hike to 300m bushels (8.17m tonnes) in the estimate for consumption of the grain by US livestock.

The USDA - cutting by $0.20 a bushel to $3.40-4.20 a bushel its forecast for US farmgate wheat prices in 2016-17, the lowest in 11 years – flagged the "increased wheat price competitiveness with corn".

On soybeans, the USDA raised its forecast for this year's harvest by 80m bushels, to 3.88bn bushels (105.6m tonnes), a little more than investors had expected.

However, the extra output was offset in part by upgrades to estimates for both domestic use of the oilseed in 2016-17, and for exports which were now seen hitting a record 1.92bn bushels (52.3m tonnes), a figure the USDA said was based on "outstanding sales through early July".

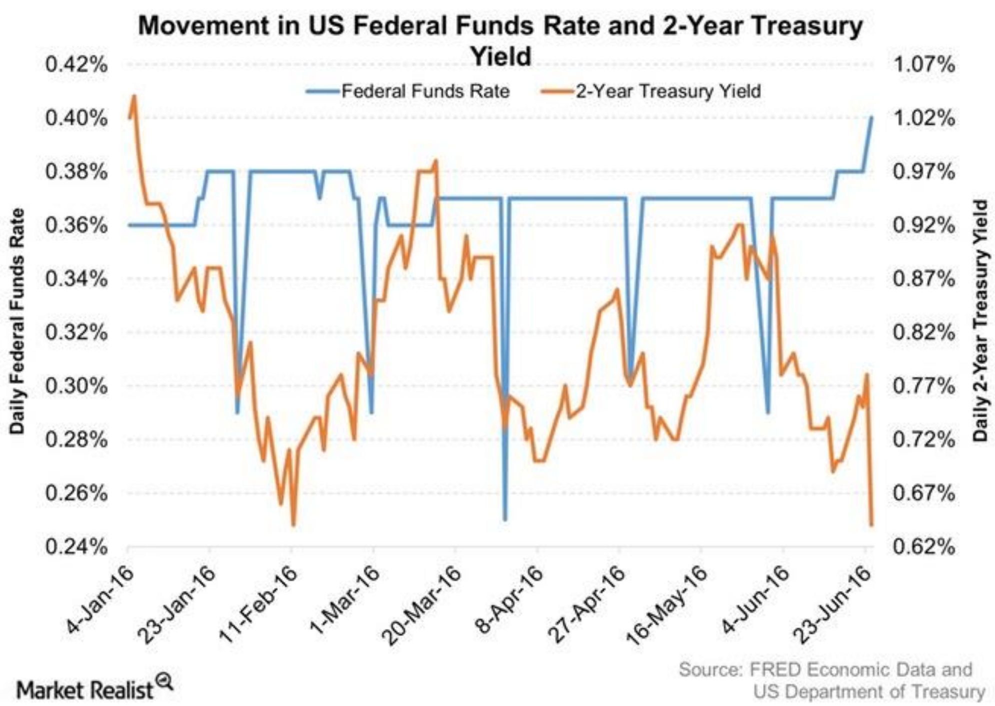
The estimate for carryout stocks of 290m bushels was, while up 30m bushels from last month's forecast, in line with market expectations.

Read the entire article at:
http://www.agrimoney.com/news/grain-prices-rebound-after-us-data-on-corn-wheat-stocks-fall-short--9742.html

Financial Focus

Brexit, the Fed, and interest rates: time to change strategies?

The United Kingdom's momentous decision to leave the EU (European Union) on June 24 rattled markets around the globe. Now, with Brexit turning into a reality, the Fed (Federal Reserve) may hold off raising interest rates in 2016 due to the slowing economy, the weak labor market, and subdued inflation.



"It is a decision that could have consequences for economic and financial conditions in global financial markets."

On June 24, the Fed said it "is carefully monitoring developments in global financial markets, in cooperation with other central banks, following the results of the UK referendum on membership in the European Union." Janet Yellen already warned in the June FOMC (Federal Open Market Committee) meeting that if the United Kingdom decided to leave the EU (EWZ), there would be disruptive tremors around the globe. She stated, "It is a decision that could have consequences for economic and financial conditions in global financial markets." She added, "If it does so, it could have consequences in turn for the US economic outlook that would be a factor in deciding on the appropriate path of policy."

The rising dollar may create financial volatility in emerging markets, particularly China, due to the large amount of dollar-denominated debt, currency outflows and devaluation

The dollar rose sharply after the United Kingdom voted to leave the EU, as money flowed into safe havens. However, the rising dollar may destabilize the already unsettled markets and add further pressure on the Fed to delay a rate hike. The strong dollar has adversely impacted US exports, inflation, and corporate earnings. According to UniCredit Research, nearly 50% of sales by S&P 500 companies in 2014 were generated through exports.

Further, the rising dollar may create financial volatility in emerging markets, particularly China, due to the large amount of dollar-denominated debt, currency outflows, and devaluation.

Low interest rates are positive for dividend strategies. Historically low interest rates are required for the developed world to lower its debt and create a strong environment for dividend strategies, especially in times of financial repression.

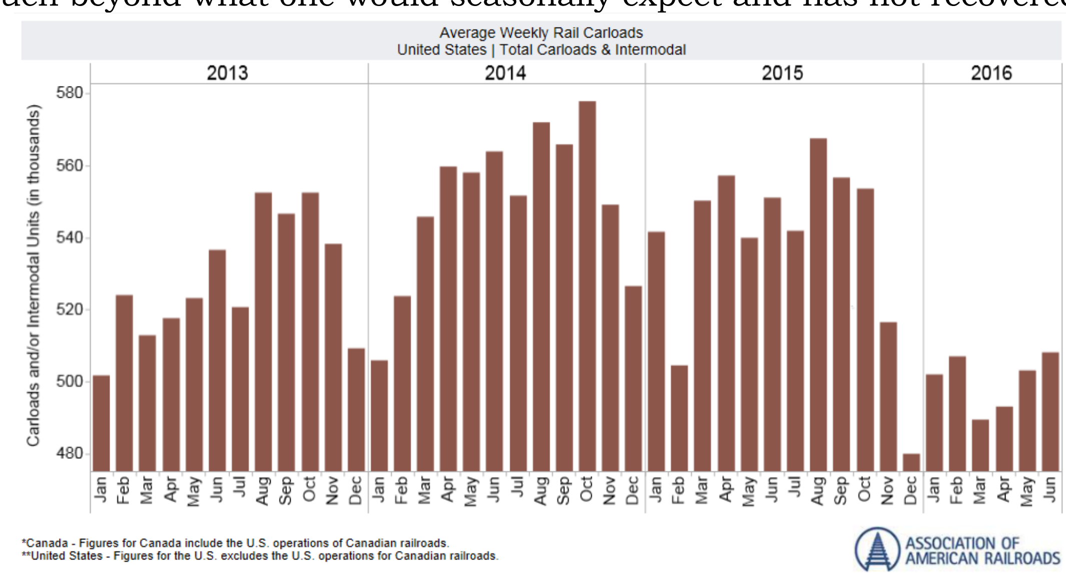
Learn more at:
http://marketrealist.com/2016/06/brexit-fed-interest-rates-will-affect-one-strongest-strategies-yea/

The Edge
… with Darell Luther

Happy belated July 4th and thank you service men and women for your efforts in keeping America free!

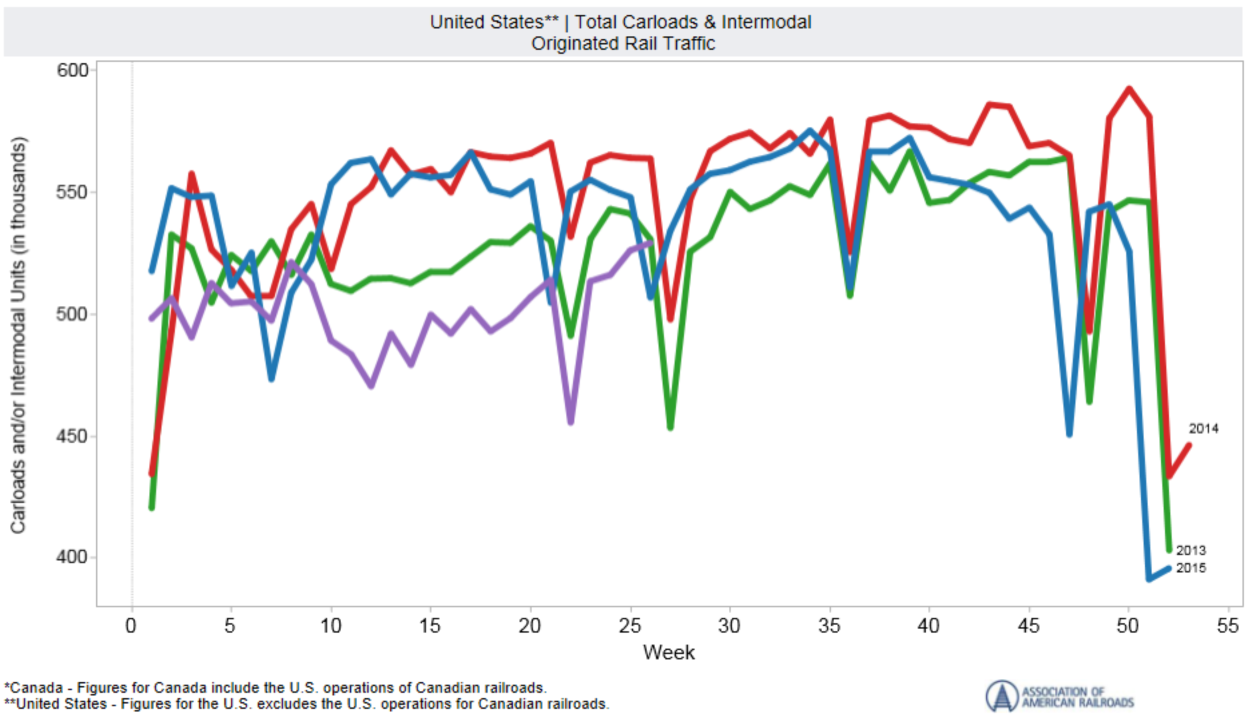
Macro-Economic Trends in the Railroad Industry

Economic signals continue to confuse economic experts on whether we are stagnate, growing slightly or decreasing in overall economic health. It's interesting to keep up with weekly numbers and the changes from week to week or month to month but it's always good to step back and look at the big picture. The chart below is for average weekly rail carloads for total carloads and intermodal. Note the changes from year to year. During 2013 there appeared to be some growth tempered by seasonality with good and steady growth into 2014 and most of 2015. This growth appeared to have fallen off in November of 2015 much beyond what one would seasonally expect and has not recovered since.



Railroads have adjusted by idling assets, rolling stock and in some cases reducing staff through layoffs and other means. There have been some 20,000 railroad employees falling under these situations during the course of the last year including, in some cases, deep cuts in management. Railcars are beginning to be a line item empty railcar movements to storage locations. The onslaught being led by the forty some thousand coal cars being stored due to the thirty plus percent drop in coal railcar loadings.

So what does 2016 originated rail traffic look like in comparison to similar time frames in different years? The chart below shows that 2016 (purple line) has generally lagged the previous three years with a slight rebound occurring more recently.



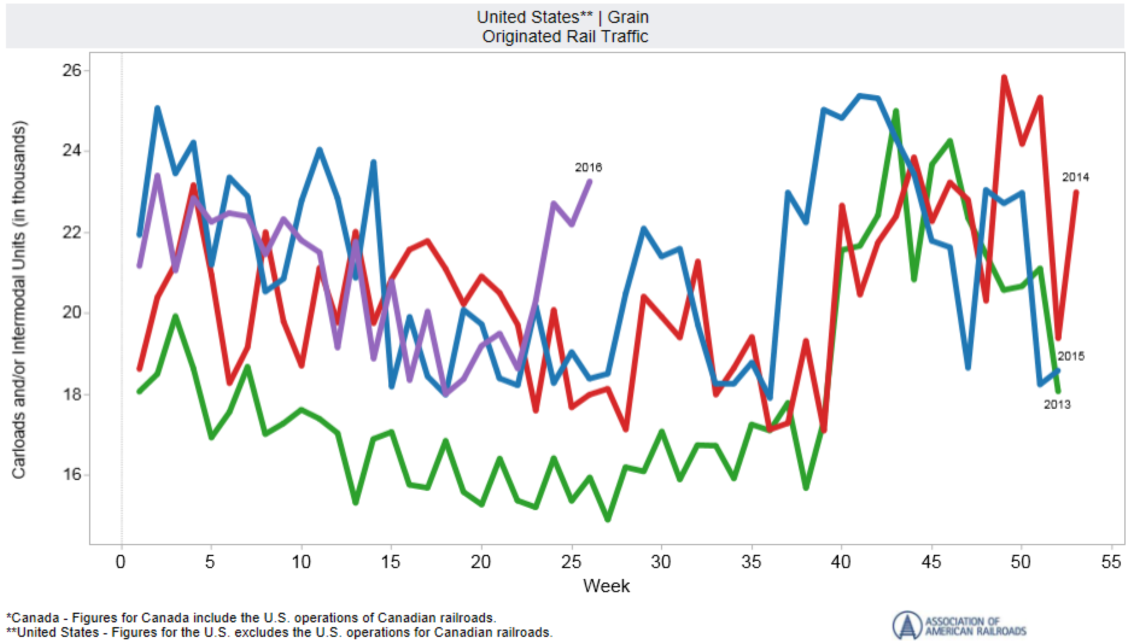
2016 - Million Carload Origination Club

There are three major railroad commodity groupings that make up the million carload origination club. These are

1. Agriculture and Food Products (964k carloads through July 2, 2016 YTD) of which grain is the largest single contributor,
2. Chemicals and Petroleum (& petroleum products) (1,105k carloads through July 2, 2016 YTD) of which chemicals is the largest single contributor and
3. Coal (1,815k carloads thru July 2, 2016 YTD).

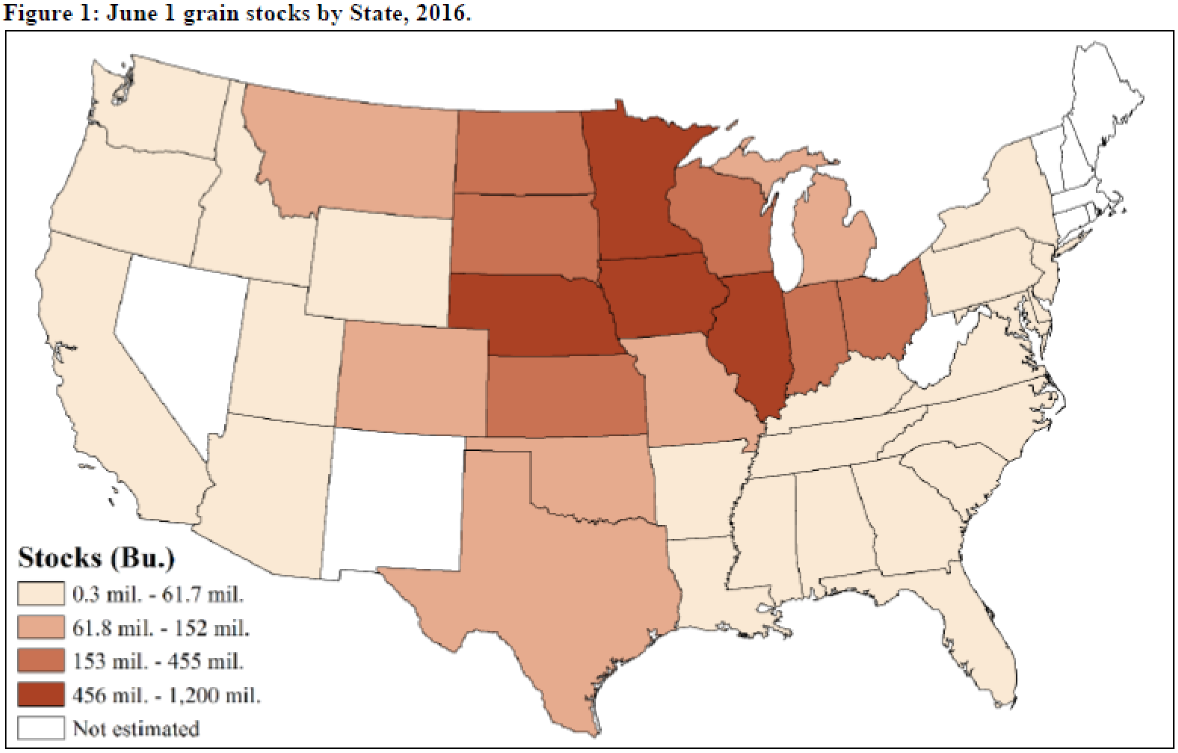
Grain Showing Some Life

One of the commodity groups that appears to be showing some strength in railcar loadings is grain (albeit recent data still shows grain down by some ~3% to 4% year over year).



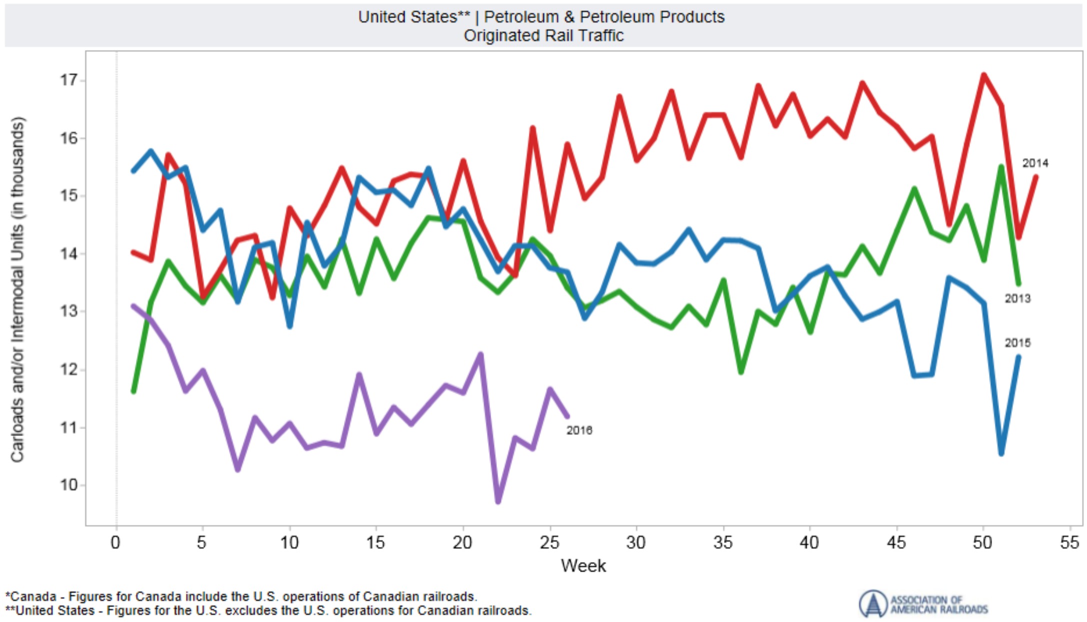
There appears to be some pent up supply that's going to need to find a home soon before wheat, corn and soybean harvests are in full swing. The map below (source USDA-NASS) shows several million bushels of grain in storage that will need to move via some transportation alternative before binning a new crop. In fact the USDA-NASS has reported that the stocks in storage are the highest they've been in the last 20 years at 6.8 billion bushels and new crop corn is estimated at 14.4 billion bushels – it's got to go somewhere!

Figure 1: June 1 grain stocks by State, 2016.

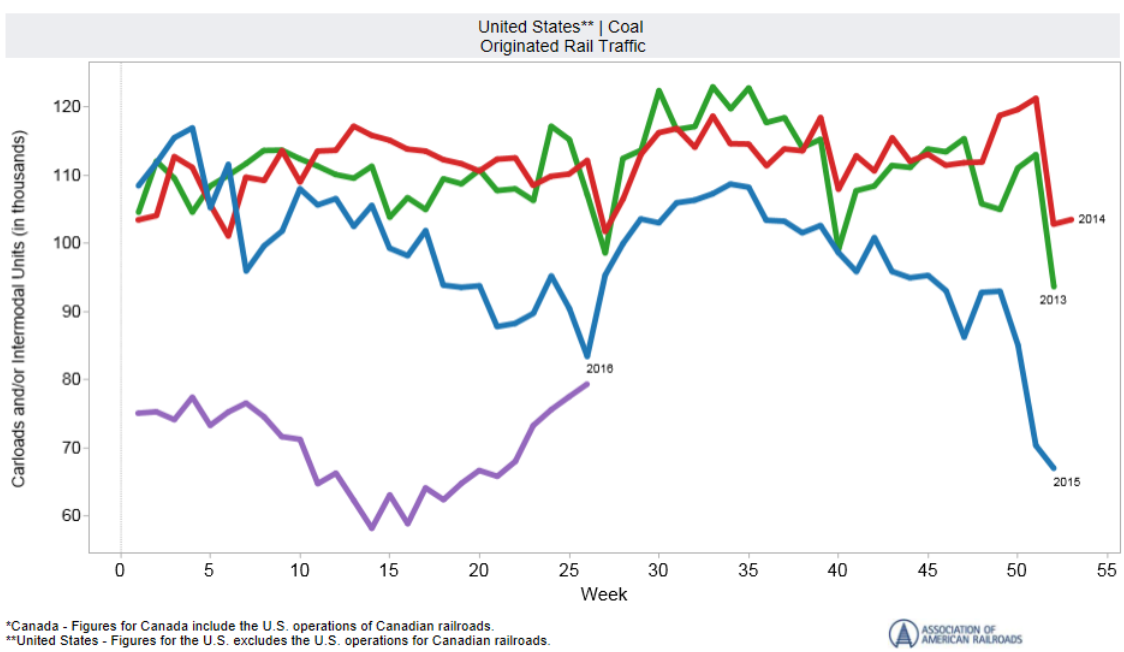


Notes: Stocks include corn, sorghum, and soybeans, and old crop wheat, barley, and oats. NASS does not collect stocks data on rye. Represents 98 percent of the total (U.S.) grain stocks disclosed by NASS.
Source: Analysis of USDA-NASS, *Grain Stocks*, June 2016. Data retrieved from Quick Stats.

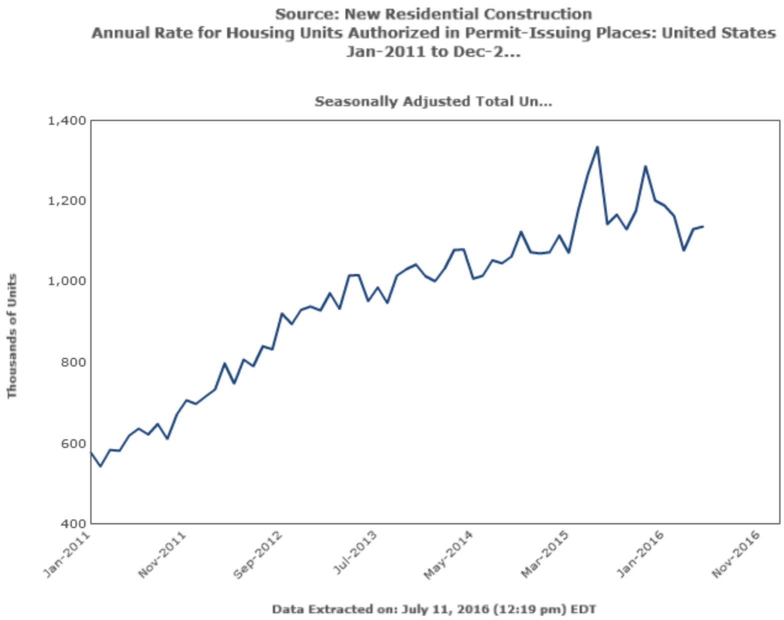
Chemicals & Petroleum
Carload originations of chemicals are doing fine clocking in some 810k carloads YTD through July 2, 2016, up some 2.4%. Petroleum though follows the price of oil and it's not so healthy logging an 81,000 carload loss or some 21% for the same time frame.



What about Coal?
Coal actually had its lowest carload year over year loss this June measured at roughly a 16% decrease when compared to the same time frame in 2015. Coal is even showing a little rebound in June 2016 on a year to date basis. Why? Henry Hub natural gas is trading up slightly from the $2.78 nearby range to the $3.04 range in December 2016 (source: Chicago Mercantile Exchange). Cost to produce electricity using gas is moving into a range where "some" utilities find it less expensive to utilize a bit more baseload coal fired generation. We'll see if gas prices continue to rise and put a floor under the coal business.



Housing Starts
If we take a slice of data on new housing starts we'll see a somewhat macro trend reflecting growth from 2011 through YTD 2016. However near term trends show some weakening or possibly a little less confidence from the new home builder and/or financiers. The chart below (source: Census.gov) shows longer term growth but near term pullback. The importance of this from a rail transportation perspective is the near term opportunity to haul building goods (lumber, plastics, poles, etc.) and the longer term growth opportunity for consumer goods (intermodal).



Railcars in Storage
The Association of American Railroads is once again publishing the freight cars in storage statistics. As of July 1, 2016 there were approximately 388,000 empty freight cars in storage or approximately 26% of the total freight car fleet. Although they aren't segregated by railcar type it's easy to believe the tens of thousands of coal cars are leading the car count number with additional contributions by tank cars and frac sand hoppers.

Lead Up / Lag Down
It's often said the railroad carload originations are an indicator of the economic health of the United States. Typically leading up or increasing in shipments prior to actual economic health recovery and lagging down or following economic downturns. When you combine this old axiom with the world stage (Breixt, WTO on trade, strength of the dollar, etc.) and closer to home a major presidential race, ones clear vision on the economic trends gets muddy pretty fast. Some indicators tell us we're starting to lead up (albeit in a microscopic way) and others indicate that we're going nowhere fast. What do you think?

The opinions shared here are those of the author only. If you'd like to share your opinions with us email me at **Darell@tealinc.com** or call at 406-347-5237.

We look forward to earning your business!