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Specializing in Rail Transportation Solutions

Tealinc Touchbase Newsletter

Inside This Issue

The Edge

Darell Luther provides insight

Wow, talk about interesting times in which to live. Right when it looked like the U.S. was positioning itself for a spurt of renewed growth by making major strides in tariff negotiations with Mexico and Canada (USMCA) and with China, we get the equivalent of a worldwide natural disaster. Corona virus/COVID-19 has made a significant impact on the growth within our country and the world.

Those of us in the transportation business and those businesses supporting transportation must ensure that the supply chain of goods continues to be functional. In particular, food and medical supplies need to be readily accessible to treat the masses that unfortunately become infected with COVID-19.

We're back at the base footprint of Maslow's hierarchy of needs. Right now, it seems most people and companies are concentrating on food, shelter, toilet paper, and health of employees—as it should be.

As of this writing, we've not seen any shutdowns or closures of railroads. But there is certainly a curtailment of service requirements and increased restrictions as the demand side of providing rail services has slowed due to the impacted businesses. I'm sure you've read or been involved in the slowdowns in scrap and steel markets, grain exports, automobile manufacturers, food and farm products, coal, containerized traffic, supplier delays (such as railcar repair shops temporarily closing due to lack of respirator supplies, safety gear,

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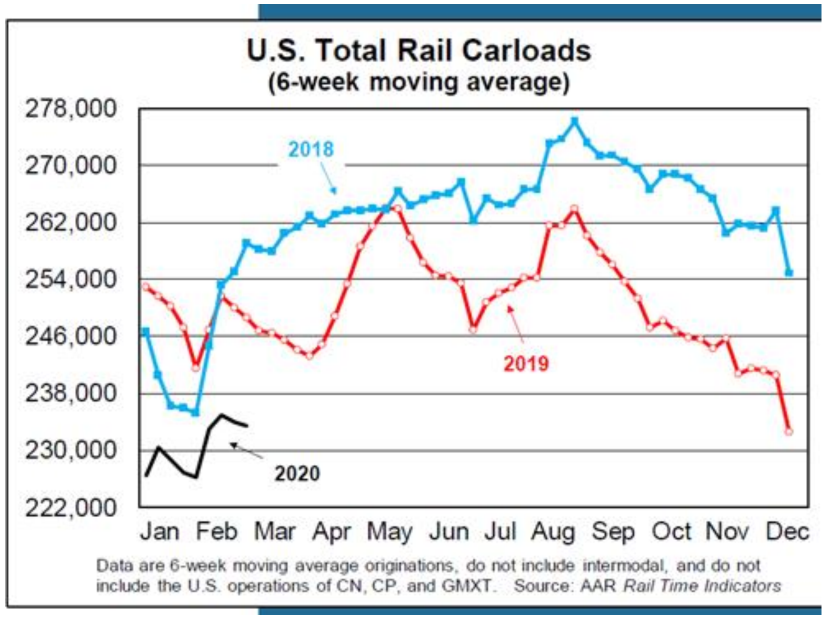
The Edge (continued)

and supplies), etc. Outside inspections of railcars at certain railroads are being limited to on-site employees, significantly hindering the ability of buyers, lease returns, and sellers to inspect railcars. The Association of American Railroads (AAR) has even postponed audits, including M-1003, Tank Car M-1002, Mechanical Inspections, DPLS Quality Review, and other Technical audits and inspections.

Railroads certainly don't need another hit to add to the current freight recession. Railcar loads are trending at a pace far below the previous two years and have been far in advance of the COVID-19 announcement.



Adding to the market slam is the recent announcement of the collapse of the production cut agreement by OPEC. Saudi Arabia has taken it upon itself to ramp up production by some 3.0mm/bd — approximately 30% — creating an all-out price war. Although ultimately good for the users of large quantities of gas and diesel, it is certainly not good for the oil companies and E&P companies. On March 16, 2020, West Texas Intermediate crude was $28.70 per barrel — significantly below break-even for U.S. oil producers. The financial health of energy and oil companies strongly correlates to the overall health of the economy (to a point), and if U.S. oil companies (as a general category) aren't healthy, the economy will eventually stagnate.

As transportation professionals, we have four distinct challenges to address: a freight recession, a north American and international trade reckoning, an oil oversupply, and a pandemic virus. Turbulent times require a deep look at your operations and overall production and distribution plan. Focusing on the fundamentals is paramount. Performing daily tasks, such as managing empty and loaded railcars to be sure your supply chain is not interrupted, is even more important. Correlating those loaded railcars to inventory in route is the next step, and tracking empty railcars coming at you falls right in line with planning for the next load. In order to survive this calamity, review production, processing, and distribution, and create contingency plans for all three.

As transportation professionals, we have four distinct challenges to address: a freight recession, a north American and international trade reckoning, an oil oversupply, and a pandemic.

If we can be of service, please don't hesitate to call upon us.

We look forward to earning your business!

Rail Fleet Management Brief with Shannon Rodgers

Hello! I'm Shannon Rodgers and I've most recently taken on the Manager of Value Creation – Operations for Tealinc, Ltd. I'm responsible for all things operations, including maintenance auditing, lining up and conducting railcar inspections, development of railcar shop programs, UMLER registration and changes, OT57 registration, assisting in rail rate negotiations, and managing the tracking, tracing, and reporting of loaded and empty railcars. Another important task is the occasional push on the railroads to be sure our customer's railcars don't get misrouted and arrive in a timely manner. All of this is to provide exemplary customer service.

Having previously worked for a shortline, I was exposed to many different areas of the rail industry. I was directly involved in doing car repair billing from the railroad's perspective. This knowledge gave me better insight when auditing and reviewing car repair bills and estimates from shops. While working at the shortline, I had direct contact with many industries, so I understand the importance of having railcars move quickly and as scheduled. Whether they are new cars coming into service, or a car that needs repairs or proper tracing, reporting and monitoring is an essential factor for industries using the railcars.

I also helped process car repair bills from a car owner and railroad's perspective for over 100 different marks. I am familiar with the AAR Field and Office Manuals. I have managed several different fleets for my customers, which allowed me to create different customized report types.

Tealinc tracks, traces, and reports on *a lot* of railcars in motion across the United States, Canada, and Mexico. We are continuously calling or emailing the operating railroad for updates on why railcars are delayed, determine if there's something we can do to help the railroad get a railcar moving, and obtain commitments to move our customers' railcars from their origin to their destination in a timely fashion. Here are a few examples of where our customers have found value in this service.

Customer A has 424 railcars in their fleet. It's a combination of railcars leased from other Lessors, railcars owned by the customer, and Tealinc-leased railcars. They had not had an in-depth look at their fleet for many years. We ran cycles on the fleet for several months, accumulating enough data to eventually call it information. For instance, we learned they had six cars that were scrapped several years ago over various time frames that they were still paying lease on through an internal accrual method. They also had railcars disproportionality assigned to lanes, because it takes someone looking at the data to manage a

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Rail Fleet Management Brief with Shannon Rodgers (continued)

change. This someone is now Tealinc, and it looks as if we're squeezing more loads out of less railcars in service than ever before. Turning data into information and using that information proactively really has an impact.

Customer B has 319 railcars in their fleet. They have a pretty closed loop cycle and a seasonal business. This is really a challenging environment in which to fine tune railcar demand with product needs and still meet required preventative maintenance. A combination of "watching and managing" the railcar fleet yielded information that was helpful in determining seasonal peak and lull times. This information was then plugged into a maintenance model so we could identify the holes in the maintenance program. We dispersed railcars between two fixed shops and employed two mobile operations to fast-track the preventative maintenance program. This increased availability and reduction in repairs during the peak season freed up assets. Those assets were then sublet (we handled the transaction and manage the lease) to a third party during the low cycle of the business, generating extra cash for our customer, keeping assets fully utilized, and increasing the availability of the railcar fleet.

I have over 20 years of experience in the railroad industry, and have helped customers in many different areas of rail. After working with Tealinc for a year, I am beyond impressed with their current processes and loyalty to their customers. Every customer, from the largest to the smallest, gets treated with the same dedication. Every deal, from start to finish, is documented and shared with all team members to make sure nothing gets lost or overlooked. This process makes sure deals are handled as quickly and smoothly as possible.

If I can be of assistance, please don't hesitate to reach out to me.

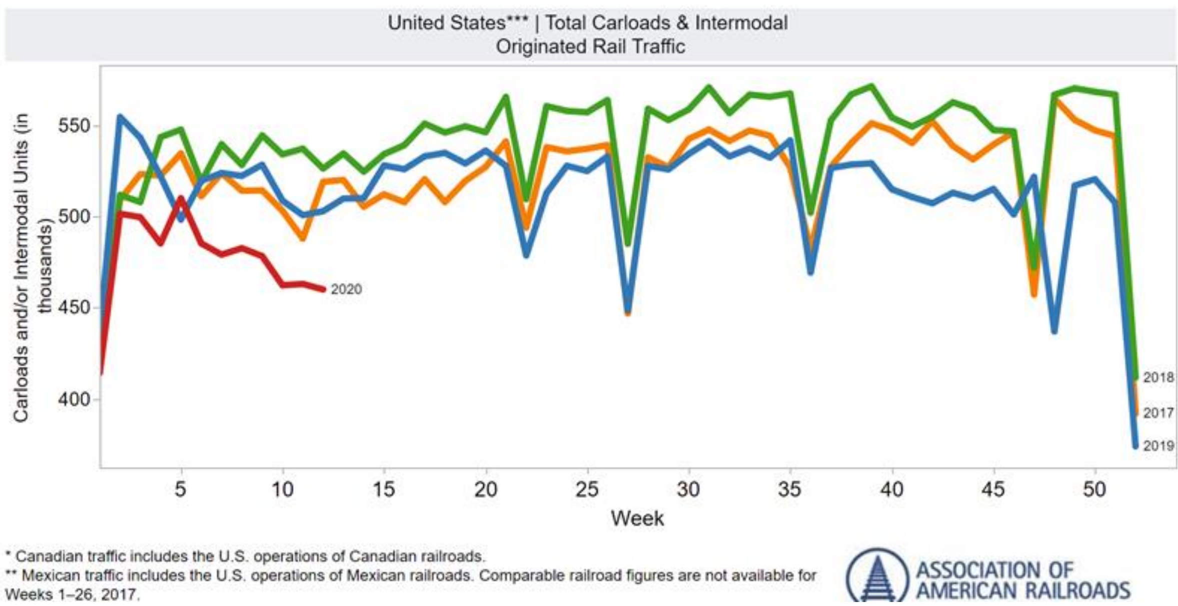
Tealinc Equipment

Explore our inventory online at www.tealinc.com.

- Mill gondolas available in upstate New York. Cars are 100 ton capacity, 52'6" length and will be available within 30 days. Available for long term lease.
- Flat cars available in Montana and midwest and central states. Various sizes and configurations. Available for sale or lease.
- Box cars available in Canada. Various dimensions, door openings, 70 and 100 ton cars. Available for sale or lease.
- Covered hopper railcars available from 3000 cubic feet to 5800 cubic feet, 100 ton to 110 ton. Available for sale or lease.

Railroad Traffic

2020 railroad freight traffic, measured by total carloads and intermodal originated rail traffic, is dismal, per the [Association of American Railroads](#) (AAR) chart below. That trend has been developing long before the Corona virus outbreak, and has been somewhat affected by the lack of U.S./Canada/ Mexico and U.S./China trade negotiations. Both trade negotiations now mostly, or maybe temporarily, behind us allow the freer flow of goods. The Corona virus has been more detrimental to carload originations than all the trade negotiations. Shutting down an economy makes it difficult to post positive numbers. Another set of AAR measures are the number of railcars in storage. As of February 1, 2020, there were 400,215 railcars in storage — 23.9% of the U.S. railcar fleet. The AAR considers a railcar in storage if it hasn't moved in the last 60 days, or has moved empty since its last loaded move—e.g. assumed to be moving to storage.



North American Freight Cars in Storage by Major Car Type
(as of February 1, 2020)

Car Type	Primary Commodities	Total Cars In Service	In Storage	Percent In Storage	Percent of Stored Cars
Box	Paper products, wood products, food prod.	105,443	21,686	21%	5%
Covered Hoppers	Grain, chemicals, nonmetallic minerals	572,388	142,129	25%	36%
Flats	Containers, trailers, lumber, steel, autos	75,265	21,597	29%	5%
Gondolas	Coal, nonmetallic minerals, metals, scrap	206,935	48,089	23%	12%
Hoppers	Coal, metalic ores, nonmetallic minerals	128,705	37,522	29%	9%
Intermodal	Containers, trailers	73,511	12,314	17%	3%
Refrigerator	Food products, farm products, chemicals	10,811	3,059	28%	1%
Tanks	Chemicals, petroleum, food products	433,450	107,109	25%	27%
Vehicle Flat	Autos	66,406	6,710	10%	2%
Grand Total		1,672,914	400,215	24%	100%

Source: Association of American Railroads

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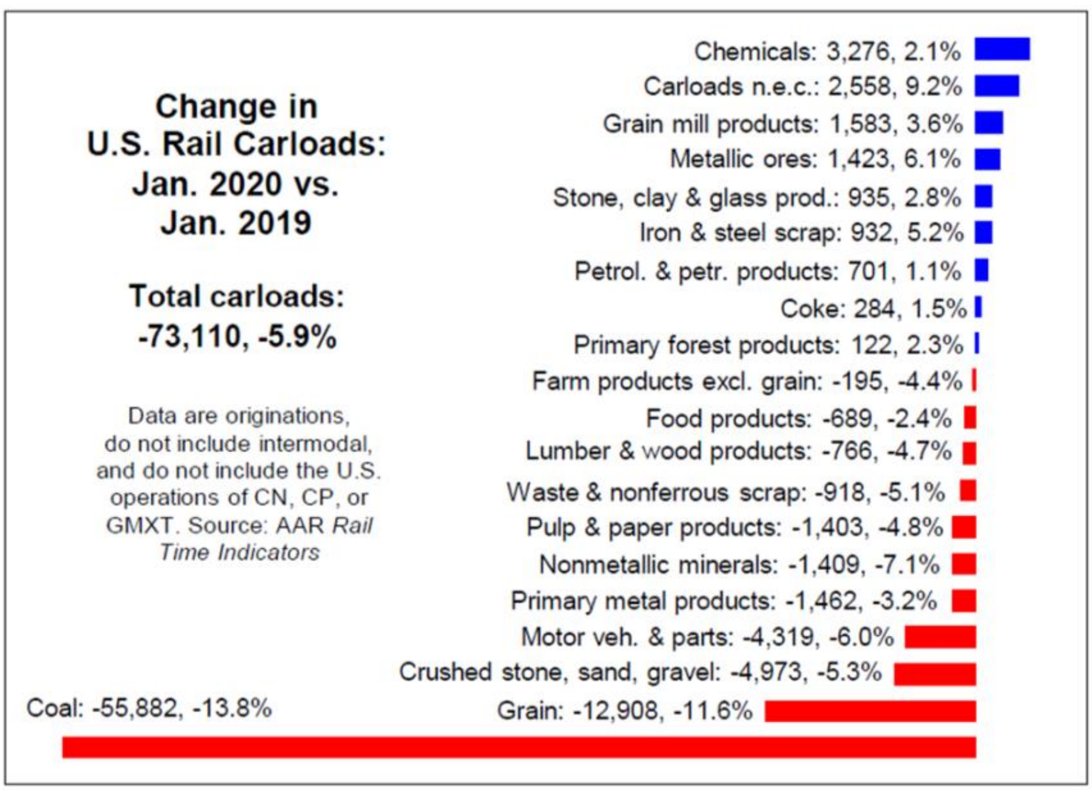
Railroad Traffic (continued)

The AAR chart below makes it clear that the coal rail traffic numbers continue to dwindle lower, with some 55,882 railcar loads fewer when comparing January 2019 numbers to 2020. Coal has been out of favor for a several years now, and environmental legislation implemented years ago is now showing its full impact. The railcars in storage here are generally 4000-plus cube coal gondolas or open top rapid discharge hoppers.

Following coal is grain, which is sensitive to trade tariffs, crop health, growth in foreign countries, and the strength of the dollar. There has been some movement on tariffs, and world crop health (wheat, corn, soybeans, rice, barley, oats) is generally good. The strength of the dollar is currently high when compared to foreign currency. The value of the dollar in foreign markets has been one of the most influential impacts on the movement of U.S. grain. If a country can't afford our grain, they will buy cheaper imports elsewhere. Otherwise, it usually takes a drought or a surplus in a world powerhouse (China, Europe, Russia, Venezuela, etc.) to make grain move internationally.

Next in line is the frac sand market. Oil (see article in this newsletter) is in the tank, literally and financially. Without a high demand for oil, there is less need for frac sand, and hence frac sand railcars. To save operating dollars, a lot of producers have switched away from white sand to brown sand. Most of the brown sand, particularly in the Permian Basin, is a short truck haul away, negating the need for a lot of railcars. Compounding the surplus is the fact that the frac sand railcar market was significantly overbuilt, or maybe more accurately, built for peak usage for all oil and gas basins being served by the white sand market, which was a decent rail haul away.



The rest of the commodities have single-digit changes in U.S. rail carloads. (See chart at left.)

Industry Insider

The energy industry has certainly taken second seat in the news after COVID-19. Crude oil prices have dropped through the floor, setting historical lows. Exploration companies and big oil alike are taking unprecedented financial hits. The impact of this drop along with the Corona virus has likely set the stage for a U.S. recession.

Let me tell you a story.

Once upon a time, there were several countries competing for oil reserves and the right to sell oil on the world market. Being intelligent, disciplined marketers, they decided to form various alliances. The Middle East and South America began the Integrated Oil Companies (IOCs). This arrangement didn't prove satisfactory. Leaders of producing countries began asserting their authority, and in the 1960s, to be sure the world understood their newfound strength, the governments of Saudi Arabia, Kuwait, Iraq, Iran, and Venezuela founded the Organization of the Petroleum Exporting Countries (OPEC). Their purpose was to negotiate with the IOCs on matters of oil production, oil prices, and future concession rights. The 1970s brought a significantly rising energy demand, re-negotiation of terms of business in Libya, and the fourth Arab-Israeli war. OPEC estimates they represent 81% of the world oil reserves.

Fast forward to the 2000s. Over the preceding decade, oil prices veered from over $100 a barrel to $20 a barrel or lower. Macro-economic trends point to more recent weakening growth in the United States, Europe, and China, the major economic powerhouses in the world. Political impacts are also seen in Brexit in Europe, tensions in the Middle East, and, for us, the U.S. election (to our own tension and often amusement).

Since the 2014 price crash, global fuel consumption has grown at a rapid pace, but trade disputes and a slowdown in economic growth could weigh on 2020 oil market fundamentals. Demand is not the only concern, as U.S. shale has continued to be the biggest single source of production growth year after year. This remains true even as investment dries up in many regions, and OPEC has pushed to balance the markets.

In mid-2019, an OPEC/non-OPEC country (e.g., Russia) agreement was established that cut target production by 1.2 million barrels per day. Lower shale output from the U.S., along with OPEC's quotas, should have brought the market into balance in 2020. Oil production is always a concern, but with the worldwide supply network, it's looking like the concern is managing supply in a prudent economic fashion.

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Industry Insider (continued)

Recently, the three-year OPEC/non-OPEC agreement (which expires in April) fell apart, with Russian and OPEC increasing oil production to the determent of all oil producing nations. The result $20 per barrel oil.

The impact? A major setback to the economic health of worldwide petroleum-producing countries, including the U.S. The word on the street reported by many of the major news agencies is that influencers will meet soon to discuss a more reasonable approach. Regardless of what a person thinks about gas prices, for the economy to be healthy, oil needs to stay north of $50/barrel. Healthy oil companies pay billions in taxes and are major contributors to the economic health of large regions of the U.S.

For more information, see History of Oil and Deloitte 2020 Oil and Gas Outlook.

Financial Focus

It's tax time! I don't know about you, but I have a begrudging resignation that I'm going to pay for another piece of asphalt I don't want, or support a foreign country's politics that I don't even know exists. A friend of mine met with his tax professional in early March and found he had earnings in Canada and had a credit for Canadian taxes already paid. I got curious about what the exchange rate was doing, and on looking it up, I noticed the Canadian dollar had fallen out of favor when compared to the U.S. dollar.

The U.S. dollar is the strongest, most stable financial instrument in the entire world. There are many reasons for this financial stability, but one of the most prevalent is our Federal Reserve Banking system. That system operates the Federal Open Market Committee (FOMC). The FOMC has had a busy March announcing a series of adjustments to monetary policy.

March 03, 2020
Federal Reserve issues FOMC statement

> The fundamentals of the U.S. economy remain strong. However, the coronavirus poses evolving risks to economic activity. In light of these risks and in support of achieving maximum employment and price stability goals, the Federal Open Market Committee decided today to lower the target range for the Federal funds rate by 1/2 a percentage point, to 1 to 1-1/4 percent. The Committee is closely monitoring developments and their implications for the economic outlook, and will use its tools and act as appropriate to support the economy.

Financial Focus (continued)

March 15, 2020

Coordinated Central Bank Action to Enhance the Provision of U.S. Dollar Liquidity

The Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve, and the Swiss National Bank are today announcing a coordinated action to enhance the provision of liquidity via the standing U.S. dollar liquidity swap line arrangements.

These central banks have agreed to lower the pricing on the standing U.S. dollar liquidity swap arrangements by 25 basis points, so that the new rate will be the U.S. dollar overnight index swap (OIS) rate plus 25 basis points. To increase the swap lines' effectiveness in providing term liquidity, the foreign central banks with regular U.S. dollar liquidity operations have also agreed to begin offering U.S. dollars weekly in each jurisdiction with an 84-day maturity, in addition to the 1-week maturity operations currently offered. These changes will take effect with the next scheduled operations during the week of March 16.[1]

The new pricing and maturity offerings will remain in place as long as appropriate to support the smooth functioning of U.S. dollar funding markets.

The swap lines are available standing facilities and serve as an important liquidity backstop to ease strains in global funding markets, thereby helping to mitigate the effects of such strains on the supply of credit to households and businesses, both domestically and abroad.

March 17, 2020

Federal banking agencies provide banks additional flexibility to support households and businesses

The federal bank regulatory agencies today announced two actions to support the U.S. economy and allow banks to continue lending to households and businesses. They are:

- A statement encouraging banks to use their resources to support households and businesses; *and*
- A technical change to phase in, as intended, the automatic distribution restrictions gradually if a firm's capital levels decline.

The statement notes that banks have more than doubled their capital and liquidity levels over the past decade and are now substantially safer and stronger than they were previously. As a result, the agencies are encouraging banks to use that strength to support households and businesses. The statement is substantially similar to one issued by the Federal Reserve Board earlier this week.

Financial Focus (continued)

The technical change is an interim final rule that, if a bank's capital declines by a certain amount, phases in the agencies' automatic distribution restrictions gradually, as intended. Like the statement, the interim final rule facilitates the use of firms' capital buffers to promote lending activity to households and businesses.

March 19, 2020
[Federal Reserve announces the establishment of temporary U.S. dollar liquidity arrangements with other central banks]

The Federal Reserve on Thursday announced the establishment of temporary U.S. dollar liquidity arrangements (swap lines) with the Reserve Bank of Australia, the Banco Central do Brasil, the Danmarks Nationalbank (Denmark), the Bank of Korea, the Banco de Mexico, the Norges Bank (Norway), the Reserve Bank of New Zealand, the Monetary Authority of Singapore, and the Sveriges Riksbank (Sweden). These facilities, like those already established between the Federal Reserve and other central banks, are designed to help lessen strains in global U.S. dollar funding markets, thereby mitigating the effects of these strains on the supply of credit to households and businesses, both domestically and abroad.

These new facilities will support the provision of U.S. dollar liquidity in amounts up to $60 billion each for the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Korea, the Banco de Mexico, the Monetary Authority of Singapore, and the Sveriges Riksbank and $30 billion each for the Danmarks Nationalbank, the Norges Bank, and the Reserve Bank of New Zealand. These U.S. dollar liquidity arrangements will be in place for at least six months.

The Federal Reserve also has standing U.S. dollar liquidity swap lines with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank.

Other countries have their own versions of the Federal Reserve. I can't comment on their structure, strength, or tenacity, but there is a reason the U.S. dollar is the strongest currency in the world. For more Federal Reserve press releases and other Fed news, see https://www.federalreserve.gov/newsevents/pressreleases.htm.

Railroad and Policy Updates

The Association of American Railroads has several updates around the Corona virus outbreak. Despite this disease, the movement of freight must go on. It takes fuel to run trucks, trains, airplanes, automobiles, etc. These modes of transportation are all integral to delivering medical supplies, health and sanitary products, and food and shelter items. Freight railroad employees—those on the ground doing the work—are to be commended for showing up every day to provide essential services for the rest of us. *Thank you!*

Now on to the rest of the story….

Over time, the duopolistic pricing model of railroads have raised the ire of many a trade group, political faction, and/or industry that depends heavily on railroads to transport their goods to market or to further processing. Claims of monopolistic pricing abound when a revenue-to-variable-cost model is used to "check" rates, or when measures of revenue adequacy absolve the railroads of rate challenges.

These claims are often defended by comparing current pricing to historical pricing. Looking back to deregulation in the 1980s, the Staggers Rail Act of 1980 largely deregulated railroad pricing. Prior to that time, rail rates were regulated; it really depended on where you were geographically located and how good your railroad salesperson was on convincing you that their railroad was the best option to haul your freight. Fact of the matter is, rail rates measured on a real price basis were 45% lower in 2018 then in 1980. In fact, when railroads are measured against other industries, they come up woefully short on the return on invested capital.

Let me back up here for a minute. In the late 1970s and early 1980s, the railroads were on the verge of bankruptcy. During that time frame, Congress had bailed out the airline industry, and despite a few early railroad bankruptcies, wasn't interested in bailing out the rail industry. They figured it was less expensive to allow the railroads to compete at a reasonable level than it was to regulate their every move. And they were right.

A lot has changed over the past decade. Several railroads have merged, some have divided, some have become shortlines or regional railroads, and some have become bike paths! Railroads have fine-tuned pricing to extract the highest rents as possible on the traffic that will support it, which is frustrating to shippers but admirable to investors.

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Railroad and Policy Updates (continued)

I admire the market position in which railroads have managed to position themselves through mergers, acquisitions, duopolistic pricing, and the focused management of accessorial items (e.g. no waybills, demurrage, order in, switching, empty car pricing, storage, and fuel surcharges—all accessorial items that can sneak up on you if you're not paying attention). But reregulation isn't the answer.

In the last five years, the pricing power of railroads has really become evident in comparing railroad earnings to rail traffic. Rail traffic originations are down 3-10% or so (depending on the commodity), and earnings continue to climb year over year (and it's not all about PSR). Yet railroads are often revenue-inadequate, and return on investment measures prove they have a lot of room to grow the top line, so re-regulation really isn't an option.

__Tealinc, Ltd.__ is dedicated to creating value for our customers.

We specialize in Rail Transportation Solutions

by buying, selling, leasing, consulting and managing rolling stock fleets

with our customers' long- and short-term requirements in mind.

Tealinc, Ltd.

Specializing in Rail Transportation Solutions

Railcar Leasing & Sales

Rail Fleet Management Services

Rail Transportation Consulting