RAILROAD WEEK IN REVIEW

May 17, 2019

"Farmer bankruptcies in six midwest states rose 30 percent in 2018, according to the Federal Reserve Bank of Minneapolis. A report by First Midwest Bank in Chicago showed past-due agricultural loans up 287 percent in 2018 over the previous year... Brazil is now poised to overtake the U.S. as the world's biggest soybean grower in the 2019-20 growing season, only the second time it has done so, according to a new USDA forecast." — Bloomberg

"What is retailing after all? It is an industry that largely sells goods. What is the warehousing, distribution and transportation sector? It is the handing, storage and relocation of goods. If the flow of goods into the US [from China] is disrupted or made more expensive it is going to affect all of these so-called service workers too." — Robert Brusca, Fact and Opinion Economics

"We estimate Union Pacific has the most China exposure at around 12 percent of total revenue, driven mostly by intermodal imports and grain exports. On the other hand, we estimate Kansas City Southern has the least China exposure." Scott Group, Wolfe Research

China and the tariff wars have been very much in the news this week and, naturally, those of us in the transportation business are concerned about the fallout on us. To put things in perspective, Robert Brusca (above) estimates that total non-petroleum imports to the US are less than 10 percent of our GDP. US imports from China are 15 percent of ten percent or 1.5 percent of total US imports. A simple 1.5 percent of a 25 percent tariff hits retail prices less than a 0.4 percent.

Drilling down still further, items the Core Producer Price Index (CPI), essentially everything but food and energy — neither of which we import from China — is roughly 80 percent of the total. Services represent 60 percent of the CPI, are largely not subject to international competition, and are in no way subject to tariffs. So we're really talking about goods — 20 percent of the total Core CPI. And that's where transportation comes in.

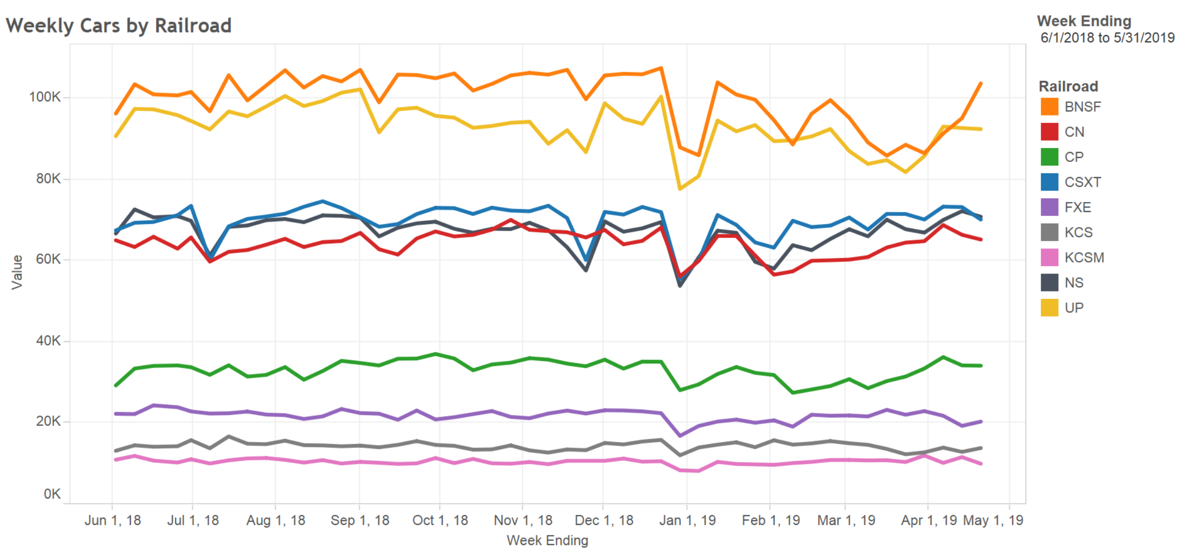
The *Consumer* Price Index is released monthly by the Bureau of Labor Statistics and represents the cost to purchase a fixed basket of *goods*, as a way of determining how much inflation is occurring in the broad economy. And, since *consumers* buy *goods* at retail outlets — recall the dry goods store of yore — transportation is needed to get the goods to the outlet. If the flow of goods is interrupted, so will be the warehousing, distribution and transportation sectors that see to the handing, storage and relocation of goods.

So much for the consumer and the impact of tariffs on the consumer economy. Tariffs on US exports are a different story. Scott Group tells us, "China has historically accounted for 60 percent of U.S. soybean exports, but less than 20 percent so far in 2019." And if China can't get the beans it needs from us, they will look elsewhere. Brazil, for example.

Reuters reports, "Brazil's share of soybean exports to China, the world's top buyer of the commodity, grew to the largest on record in 2017 and looks set to expand again this year." Moreover, as the US loses share to Brazil — the latter last year supplied half China's bean needs to the US one-third — Chinese buyers will start looking elsewhere to feed bigger and bigger livestock herds. Reuters concludes, "Chinese importers have been very savvy, the way they have been buying, getting the best quality at the right price."

Scott Group shows that, of the four publicly-traded US railroads, UP has the largest China exposure at 12 percent, two-thirds of which is intermodal (*goods* for the *consumer*) and one-sixth is ag products — 20 percent of total revenue. Of that, 60 percent is corn and 10 percent is beans. Beans are cyclical, though, with shipments peaking in Q4, according to usrailimpact.com (log in required). One would hope to see US and China resolve the beans issue before the peak season, but, since hope is not a strategy, those with exposure to the China grain trade had best not make commitments to be long bean cars until there's a clear signal as to which way the wind blows.

Here's why I don't pay much attention to the changes in weekly AAR carloads.



By definition, the weekly volume of carloads (intermodal boxes are "carloads") carried by the major railroads in North America as reported by the AAR is the sum of carloads originated and carloads received from connecting railroads. As you can see, the rate of change over the past year is essentially zero, and yet per-share earnings keep going up as operating ratios go down.

There are two reasons for this asymmetry. One, share buy-backs reduce the number of shares outstanding, so a modest upward percentage change in net income becomes an even bigger upward percentage change in earnings per share. Two, the commodity mix is trending toward higher-rated commodities that command higher unit rates and thus have higher margins. So, even if operating expense is unchanged, operating income goes up. The question is how long this trend can continue.

Genesee & Wyoming Revenue units for North America in April increased 2.9 percent vs. 2018. Of the seven commodities comprising 80 percent of total rev units, three were up with double-digit gains — aggregates, agricultural products, and chemicals, together comprising more than a third (35%) if total revenue units. Yellow is that 80 percent-plus; red is their downs.

GWR NA units							
April				2019	2018	YOY	2019
	2019	2018	% Chg	% Total	% Total	Change	Cume
Mins & Stone	21,163	19,051	11.1%	16.0%	14.8%	1.2%	16.0%
Ag Products	19,359	17,054	13.5%	14.7%	13.3%	1.4%	30.7%
Coal & coke	16,688	19,029	-12.3%	12.6%	14.8%	-2.1%	43.4%
Chemicals	15,763	14,289	10.3%	11.9%	11.1%	0.8%	55.3%
Pulp & Paper	12,776	13,079	-2.3%	9.7%	10.2%	-0.5%	65.0%
Lumber, FP	12,003	12,274	-2.2%	9.1%	9.5%	-0.4%	74.1%
Metals	11,970	12,517	-4.4%	9.1%	9.7%	-0.7%	83.1%
Petroleum	8,109	7,563	7.2%	6.1%	5.9%	0.3%	89.3%
Waste	5,108	4,445	14.9%	3.9%	3.5%	0.4%	93.2%
Food or Kindred	5,079	4,881	4.1%	3.8%	3.8%	0.1%	97.0%
Auto	2,723	3,082	-11.6%	2.1%	2.4%	-0.3%	99.1%
Metallic Ores	1,228	1,418	-13.4%	0.9%	1.1%	-0.2%	100.0%
Carloads	131,969	128,682	2.6%	100.0%	100.0%	0.0%	
Intermodal units	1,872	1,366	37.0%	1.4%	1.1%	0.4%	
Other	6,062	5,890	2.9%	4.6%	4.6%	0.0%	
Total rev units	139,903	135,938	2.9%	106.0%	105.6%	0.4%	

Same-railroad traffic in April 2019 increased 4.8 percent compared with April 2018, excluding shortline lease expirations in Canada, primarily due to increased agricultural products in the midwest and west, minerals & stone in the northeast, and chemicals in the midwest and west.

GWR President Jack Hellman opens the Wolfe Transportation Conference in NYC next week. What he has to say about 2019 volume expectations by region and commodity, especially as regards China and grain/metals, will be instructive.