RAILROAD WEEK IN REVIEW

September 25, 2020

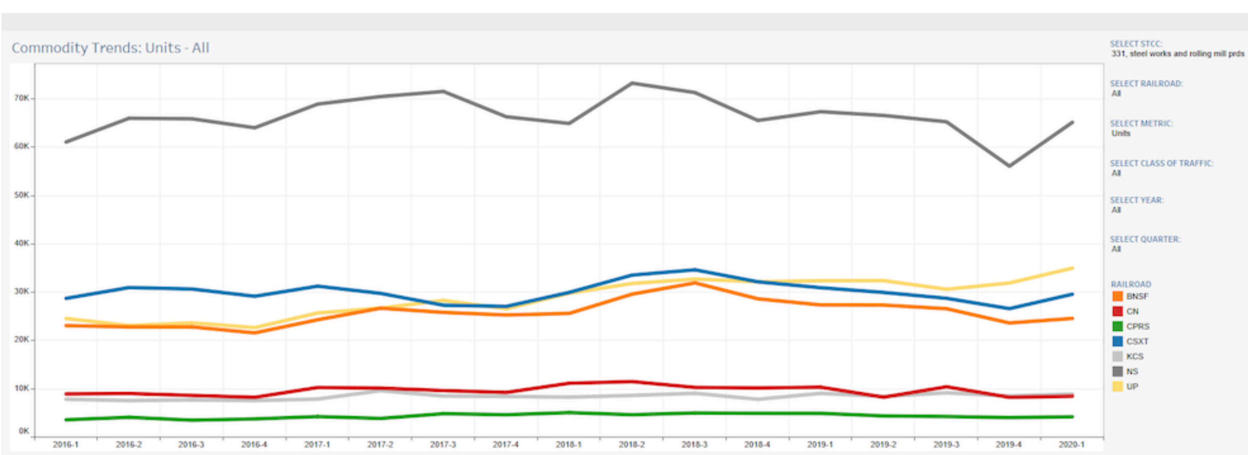
"Commercial loans dropped again last week and have declined in nine of ten weeks so far in 3Q20. Total loans were off by $16.2 billion last week. Commercial loans were down $18.1 billion -- minus $11.9 billion of core-Commercial & Industrial loans and minus $6.2 billion of wholesale loans." — Keefe, Bruyett & Woods, September 20

"U.S. railroads originated an average of 224,557 total carloads per week in August 2020. That's the lowest weekly average for total carloads for August since some time before 1988, when our data begin. It's also down 14.9% from August 2019." — AAR Rail Time Indicators, September 4

"A time of negative GDP means small to medium sized enterprises who are most at risk start closing, and they will start laying off more staff. That goes up the food chain as the larger providers that service those small businesses start laying off staff." — Raoul Pal, Real Vision Finance, September 21

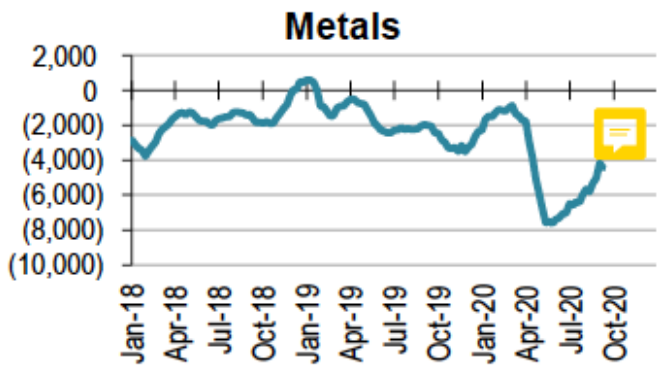
The tea leaves are pointing to a slowing economy and it's a cascading event. People lose jobs or have to settle for lower paying gigs. Fewer meals out, less travel, less "discretionary" spending. Restaurants go out of business, retailers close. Restaurant suppliers and clothing manufacturers lose customers and cut work forces. More people out of work, more cuts in discretionary spending, more second-tier job cuts. And so on up the food chain.

I fear this trend will hurt the non-Class I railroads disproportionately. Their customer base is composed of companies that are relatively close to the end user: lumber yards, propane distributors, steel fabricators, supplier of aggregates, and so on. Moreover, as the economy slows, they will have fewer vendors as they cut back. And that works its way up into the Class I food chain and explains why commercial and industrial loan demand is slowing. Take steel:



This is STCC 331, "steel works and rolling mail products," from the 2016 first quarter through the 2020 first quarter, before the pandemic hit (2Q2020 QCS is due out shortly). Demand has been relatively flat, and the whole AAR "metals and ores" category was down 37 percent just in Q2. Using a broader brush, the whole "merchandise category" — including automotive — was down 22 percent in the 2020 second quarter. (Chart courtesy usrailimpact.com)

Or take Scott Group's Metals chart from his latest "Weekly Recap." Whereas the economic pundits speak of a "V" recovery, the financial types fear the recovery may be closer to a reverse square root symbol — high to low, retrace some portion of the route back to the previous high, then flat going forward.



That is to say, imagine the chart turning flat where it is now, and continuing flat for some quarters. The reasoning is that as current businesses close, others will step in, albeit at a slower pace. The bottom of the food chain — the shortline customers — inevitably will follow the pattern, suggesting a more muted shortline recovery. Thus attention must be paid.

The North Eastern Association of Rail Shippers (NEARS) held its annual fall conference this week as a virtual event. I thought it was done quite effectively and seamlessly, kicking off with a Railroading 101 session to orient customers who may not be conversant with railroad terminology or operations, showing how a car moves between OD pairs and what to watch for. Norfolk's Paddy O'Neill did his annual update of the boxcar story.

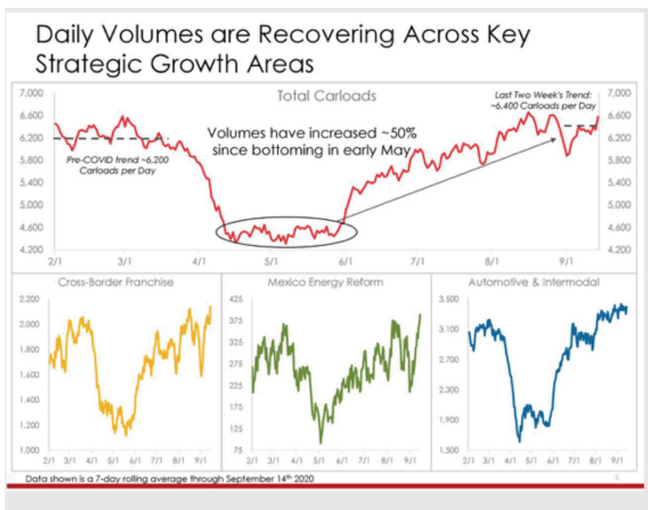
CSX shortline maven Tom Tisa laid out their program, its opportunities, how connecting short lines and regionals can capitalize on them (short-haul intermodal?), and how shippers can benefit from their hands-on relationships with short lines. KCS President and CEO Pat Ottensmeyer spoke on the railroad implications of the new US-Mexico-Canada Trade agreement, and why service begets growth. Scattered throughout the program were panel discussions of the shipper view, equipment trends, and transloading.

The customer panel on car leasing revealed the continuing disconnect between carriers and shippers in such things as transit times, car-servicing, billing, and ancillary support. PSR gets luke-warm reviews. Unplanned events that add to customer cost are very real disincentives to use the railroad where there is a choice; better tracking of trip plan compliance could help, especially since carriers are really pushing privates over railroad-owned freight cars.

David Fink of Pan Am Rail, the longest continual operating name in New England, provided significant insights into their new business successes and capital upgrade initiatives. CP's Coby Bullard talked about their thought process leading to the re-acquisition of the "customer rich" original CP Saint John route across Maine, most recently operated by the Central Maine & Quebec. The remarks of ASLRRA President Chuck Baker framed perfectly the OmniTRAX business development story with Robert Russell, their SVP for Marketing & Corporate Strategy.

I was particularly pleased to see the presenters' emphasis on on the relationship between the COVID slow-down and transportation demand. FTR's Todd Tranusky, for example, showed how the original Feb prediction for full-year intermodal demand took a deep hit in March, has recovered partly through August, but flat-lines forward. The reverse square root symbol, exactly, supporting the above argument that economic activity will recover but at lower levels. And the same pattern repeats across all carload commodities.

You can download the entire program at www.nears.org and learn about the spring 2021 program slated for Saratoga Springs in late April. I've been a member of and contributor to NEARS for nearly a quarter of a century and have found the relationship challenging and invigorating. And although the virtual format was well done, one misses the camaraderie and one-on-ones of the more usual meeting format. Fingers crossed.



Pat Ottensmeyer's NEARS talk touched on recent trends. This slide from the KCS September 11 JPM conference adds some color.

The top half captures KCS's rapid recovery from the COVID depths earlier this year. The bottom three graphs show changes in the cross-border volumes, the middle looks at carloads related to Mexico energy reform, the rightmost drills down to auto and intermodal revenue units.