RAILROAD WEEK IN REVIEW

October 30, 2020

"As the service continues to get better we are finding more of those conversion opportunities. We have seen a lot of good wins in forest products and metals and even in bulk markets like ag. And thanks to the service product that Jamie and his team are delivering to us, that's making those conversion opportunities easier." — Mark Wallace, EVP sales & marketing, CSX

"The Union Pacific team has done a great job of inserting the UP product into customer supply chains. So whether it's hatchbacks in Dallas, whether it's reloads out of the Midwest, we're doing everything we can to make it sticky for our customers." — Kenny Rocker, EVP marketing & sales, Union Pacific

"We are taking a bottoms-up approach to reviewing each part of the operation, and I am confident we will find opportunities to apply principles that have been successful during prior experiences. In my 58 days here, I've already found opportunities that will help us improve and achieve higher levels of productivity." — Cindy Sanborn, Chief Operating Officer, NS

"Instead of travel and experiences, consumers are spending on cars and other manufactured goods. The global manufacturing purchasing manager index (PMI) is on track to rise for the sixth straight month in October. Demand for goods has led China's exports to rise 9.9 percent year-over-year in September, the most since March 2019." — Jeffrey Kleintop, Schwab

CSX Q3 revenue units were down three percent to 1.5 million and revenues fell 11 percent to $2.6 billion. Merch carloads including auto dropped five percent and RPU was off eight percent. They cut ops expense 11 percent; ops income was $1.1 billion and the OR was up 13 bips to 56.9. Net income was $736 million, down 14 percent.

Every merch commodity lost ground. Agricultural and Food Products slipped due to lower shipments of grain and feed, partially offset by increases in ethanol shipments. Minerals were down on lower shipments of aggregates and other minerals. Fewer shipments of printing paper, wood pulp, and building products brought down the forest products group; reduced sheet steel and pipe shipments hurt the metals group; and ferts were down due to lower shipments of phosphate and sulfur.

Originations were 85 percent OT and arrivals were 71 percent OT. Carload trip plan compliance (TPC) was 73 percent; intermodal 87 percent. (I suspect it may have been worse, if 15 percent of trains were late leaving and 27 percent were late arriving.) Moreover, the TPC data covers locals so trains that miss shortline ISAs will go against the TPC score. It's uneven, though — not bad in the northeast, terrible in the mid-south.

Says Foote, “Carload trip plan performance slightly trailed previous quarters due primarily to the timing lag at the beginning of the quarter when we began to step up to handle the surge in volumes. Trip plan performance improved throughout the quarter and we exited the third quarter near an 80 percent trip plan performance level for carload and 90 percent level for intermodal.”

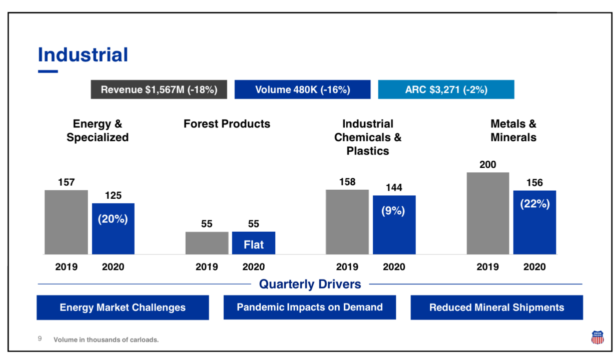
Finally, there was a question on “chipping away” at the opportunities to convert merchandise carload volume from the highway. Operations EVP Jamie Boychuk took that one. “In some areas, some of the execution wasn’t perfect, maybe what we were used to at the time. Yet where we missed on our trip plans, it was only within a few hours. For us, service is all about reliability.” Agreed.

Union Pacific Q3 revenue units slipped four percent to 2.0 million but revs were off 11 percent to $4.6 billion due to a seven percent drop in RPU. Merch carload vols fell ten percent and revs were off 12 percent to $2.6 billion. Operating expense fell 12 percent; operating income was $2.3 billion, down nine percent, for an OR of 58.7, down 79 basis points. Net income was $1.4 billion, down 12 percent.

There were no particularly strong commodities on the upside, though within the industrial commodities group petroleum sank 32 percent due to low oil prices coupled with weak demand. Metals and minerals volumes decreased by 22 percent due to reduced sand shipments associated with the decline in oil prices and a surplus in local sand. Rock shipments were also reduced due to the pandemic-related impact on demand and project delays.

Forest products volume was flat. Growth in lumber shipments from improved housing starts and repair and remodels offset declines in paper shipments. Industrial chemicals and plastic shipments declined by nine percent due to the pandemic-related impacts on both global and domestic demand. Industrial chemicals volume had the largest reduction as these carloads are closely tied to industrial production.

On the call, Kenny Rocker said, “As we enter the fourth quarter, our overall volume is up four percent year-over-year. Based on these run rates we’d expect year-over-year fourth quarter volumes to be up low single-digits. We expect premium volumes (auto, intermodal) to remain strong similar to current run rates for the remainder of the year.” Putting that in context, intermodal and merchandise are both 40 percent of the total UP revenue unit volume.



Norfolk Southern brought up the markers on Wednesday. Total revenue units were down seven percent to 1.8 million, merchandise including auto saw units fall 11 percent to 551,200, and merchandise per-carload revenue averaged $2,823, up a point. Metals/construction and chems carload vols were off double digits.

Freight revenues including fuel surcharges dropped 12 percent to $2.5 billion (NS publishes revenue numbers ex-FSC because that number varies YOY. I include it because that's what customers are paying.); merchandise carload revenue including auto was off ten percent to $1.6 billion.

Operating expense is a bit tricky. On Oct 7 NS took a $99 million "non-cash impairment charge" (not a peep of what it was on the call or in the Q&A). They called it non-GAAP and put it against purchased services. That increased operating income and lowered the OR. I don't do non-GAAP. I agree with Warren Buffett that non-GAAP numbers tell investors "to ignore certain expense items that are all too real."

The way I see it, whatever they did to incur the charge is a cost of doing business and should be accounted for as such. And by always using GAAP I get better annual comps because they include everything, even expenses that may not recur. And so, under GAAP, third quarter operating income dropped 16 percent to $840 million, and the OR gained 154 basis points to 66.5. Net income was down 13 percent to $569 million.

Chief Commercial Officer Alan Shaw had encouraging words about both the "consumer" (auto, intermodal) and the merchandise carload sides of the house. With respect to the latter, Shaw says, "We check the pulse of economic trends and market shifts, innovating supply chain solutions for existing and potential customers." He adds that strong customer relationships and market knowledge allow railroads to respond to trends and quickly secure new business. To me, that sounds like an invitation for non-Class Is to keep bringing on their marketing success stories.

Cindy Sanborn says her top priority is building on the PSR momentum already under way. There will be more attention to car velocity, fuel efficiency (NS lags its peers at more than a gallon per KGTM), train size, and asset utilization. For example, as freight volumes recovered over the past two months, they kept crew-starts flat and started blending train types "to leverage the existing available capacity."

To date they've closed five hump operations as well as a number of smaller yards to reduce car "touches" in order to increase car-miles per day. Macon is next, along with several support yards in the Atlanta area. Improved service in the south, lower fixed and variable cost levels, and additional room for growth will result. Color me impressed.

Rail Pulse is a new a venture to create an innovative technology platform that will help transform rail shipping in the 21st century. This joint effort by Norfolk Southern, GWR, Watco, GATX and Trinity will facilitate and accelerate the adoption of GPS and other telematics technology across the North American railcar fleet. The Rail Pulse partners collectively own nearly 20 percent of the North American railcar fleet.

Chief among the Rail Pulse goals is to increase the railroads' competitive position relative to other modes by improving visibility into the status, location, and condition of individual railcars. Rail Pulse intends to provide a neutral, open-architecture, industry-wide railcar telematics platform to make it easier to ship by rail and to track rail shipments across the North American rail network. The full-service platform targeted for availability to the North American railcar industry by the end of 2022.

It may introduce customer visibility of goods on the road, but it does nothing to get more sales boots on the ground to create customers or to make sure the service offering fills supply chain support requirements. Like PTC, Rail Pulse has great commercial value. The question is whether today's middle-management generation of old-school railroaders will use it.