RAILROAD WEEK IN REVIEW
January 22, 2021

“Over the course of the year, we reexamined every process from the ground up to identify and eliminate unnecessary steps across the railroad. And, as a result, we uncovered significant opportunities to build upon the progress made during our transformation. These changes will provide benefits for years to come.” — Jim Foote, CEO, CSX

"While our goal is to outpace the market, there are still some pieces of our business that will continue to be adversely impacted by external factors. The piece we’re watching most closely is the industrial economy, which is still expected to be weak year-over-year in the first quarter.” — Kenny Rocker - EVP Marketing and Sales, Union Pacific

“We’ve gone through an exciting rebranding process to make sure our customers and our team members understand exactly what we do, where we do it, and who we serve. Were are one Watco, one company, offering services across an amazing landscape.” — Dan Smith, Watco CEO

I wrote last week that the Reading & Northern “is unique in that it has eschewed the handling line settlement process, opting to be an ISS road…” Actually, R&N is one of a number of short lines going the ISS route. Many of them have roots going back pre-Staggers, so they’ve always been ISS roads.

The Handling Line process was an invention of the Class Is to offset the fact that newly-created shortline spin-offs were spending their settlement funds on car hire and payroll. To prevent this, the Handling Line settlement process was created, in which the Class Is invoice the customers, collect the funds, and settle. The short line gets a portion of the settlement, very often a flat fee per car regardless of commodity or car hire exposure. It also gets them off the waybill routing.

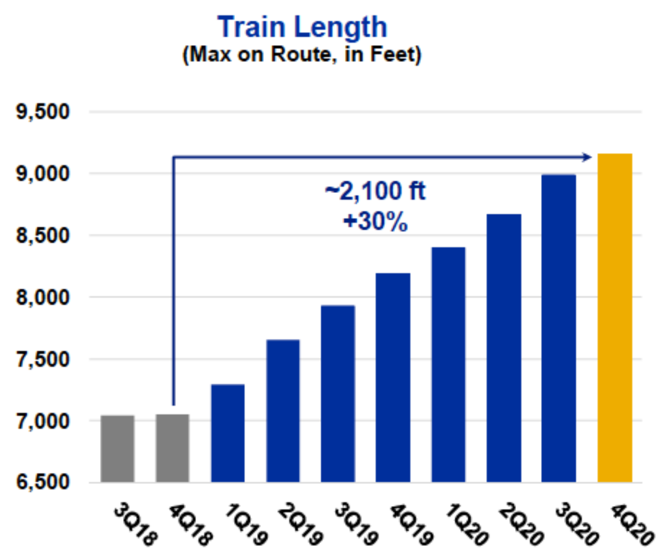
Short lines like the R&N were initially created as handling lines but as their business grew, they needed a more reliable supply of cars than the Class is were providing. Thus as equipment suppliers, they needed more control over rates, and so made arrangements to exit the Handling Line agreement and take responsibility for proper settlement. Gong ISS also puts them back in the waybill routing, making them once again visible to customers. Much to be preferred.

Union Pacific launched the 4Q2020 earnings season Thursday morning. The railroad reported total revenue of $5.1 billion, down one percent, on 2.1 million revenue units, up three percent. Operating income came in at $3.1 billion, up a point, and the OR was 61.0, up 127 basis points. Net income before taxes fell five percent to $1.8 billion. (UP took a $278 million “impairment charge” relating to Brazos Yard, generating non-GAAP results that increased ops income to $2.3 billion, net income to $1.6 billion, and cut the OR to 55.6)

The grain and grain products group was the big winner, volume-wise — up 20 percent. Grain alone leapt 44 percent with grain mill products up six percent. Revenue for the group increased 15 percent on 216,000 units though RPU slipped four percent to $3,708. Ferts were down two percent in carloads, though I expect that will turn upwards shortly given the 2021 crop outlook. Food and refrigerated carloads increased seven percent.

"Energy and Specialized Markets" saw volumes drop 16 percent and revenue drop 18 percent. There wasn't much detail on the call; however, AAR petroleum products were down 28 percent and the aggregates category where frac sand lives came down 11 percent. Forest products carloads increased 11 percent with particular strength on the STCC 24 side, up 13 percent.

Operating results were impressive. They're getting 224 miles per car day and hit new records in GTMs per horsepower day and in daily miles per full-time employee. Fuel expense came down 35 percent as price per gallon plummeted to $1.45. GTMs increased one percent and RTMs increased two percent, yet fuel burn decreased three percent. Trains are getting longer and UP has completed 36 sidings of 15,000 feet to accommodate them.



To sum up, I think Susquehanna's Bascome Majors puts it best: "We view Union Pacific's initial 2021 outlook as conservative on both the top line and margin when viewed against a recovering industrial economy, and see both moving higher this year.

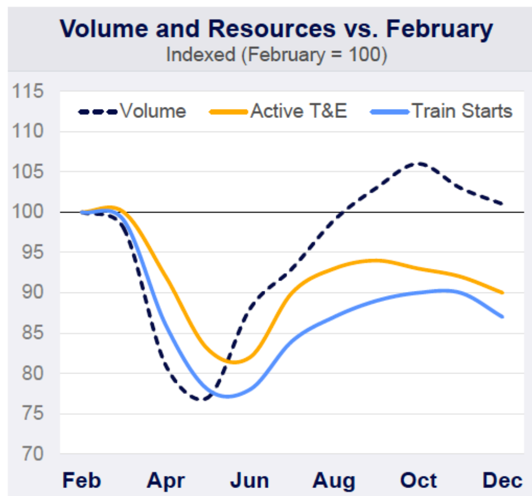
CSX was next up, reporting Thursday after the close. Total revenue decreased 2.1 percent to $2.8 billion while revenue units increased 3.9 percent to 1.6 million and system RPU fell 5.6 percent to $1,698. Merch revenues and carloads were essentially unchanged. Operating income increased 5.3 percent to $1.2 billion as ops expenses decreased 7.0 percent. Below the line, net income before taxes (I use before taxes because I get better comps as tax hits vary among railroads) increased 1.3 percent to $994 million.

Chemicals ex-fertilizer, agriculture, and metals were the only merch carload gainers, metals being the only double-digit winner thanks to increased scrap and raw steel. Fertilizer, while down 2.0 percent in carloads, saw revenue gain 4.6 percent on a 6.4 percent RPU increase. Merch carloads now represent 66.0 percent of total revenue while coal has fallen to 13.3 percent of the total, making good on the CSX commitment to replace lost coal with new merch traffic.

Unfortunately, the railroad did not run as well as one would have liked. Train velocity, fuel efficiency, terminal dwells, all went the wrong way, except that GTMs per available horsepower increased slightly. Still, GTMs increased a point and RTMs got two points, and GTMs per gallon of diesel improved 5.0 percent. Carload trip plan compliance decreased to 75 percent from 85 percent a year ago.

Peering ahead into 2021, CEO Jim Foote sees merch carloads increasing faster than industrial production as better TPC offers a more competitive supply chain service. Intermodal volume growth will continue to exceed the growth rate for carload (in Q4 up 11 percent to carload ex-coal essentially unchanged).

The trends are pointing in the right direction as running a faster, smarter railroad adds more revenue units per train- and crew-start. Even with the slight Q4 volume decrease, crew-starts and T&E staffing have continued to lag the rate of change in volume.



As Jim Foote said on the call, "We are investing to improve our customer experience and create easier and more streamlined processes for our customers to do business with CSX. Every action we take is designed to make CSX smarter, faster and more reliable." Increasing revenue faster than expense will work every time.

Kansas City Southern wrapped up the week on Friday. In the interest of getting WIR out on time, I will hold off on KCS until next week. Norfolk and the Canadians (sounds like a singing group, eh?) report Tuesday and Wednesday so I can easily run all four and still have an on-time departure on Friday.