RAILROAD WEEK IN REVIEW

May 21, 2021

"The gap between reported price inflation and the experiences of businesses and consumers is a signal to investors that inflation is hotter than it looks. Implications of the disconnect are vast, affecting Social Security payments, tax-bracket adjustments, and economic growth calculations, in addition to investment returns, inflation expectations, and interest rates." — Barron's May 17

You will start seeing many more EV trucks in the next few years. This is all solid-state batteries, suggesting a 130% range increase in comparison to today's most advanced lithium-ion batteries. There will be a significant increase in terms of lifetime stability and fast charging, for instance. And of course the volume of trucks will significantly rise within this decade as well." — Volkswagen Group Innovation Executive Director Nikolai Ardey, Real Vision, May 14

"In a May 14 filing with the Surface Transportation Board, the United States Department of Justice has said CN's application for a voting trust to acquire Kansas City Southern should be denied, because the proposed merger 'raises sufficient competition concerns.'" — Railway Age Newswire, May 15

KCS is going with CN's offer of $325 per share total consideration. In addition, CN will reimburse KCS up front for the $700 million break-up fee it must pay to CP, which effectively adds another $8/share to the total consideration. CP has responded, saying that they're not surprised "and it only highlights CN's recognition of the risks of its anti-competitive bid."

The question of timing is important. KCS shareholders don't get their cash until the STB approves CN's Voting Trust, complicating matters with the time value of money. It's not clear to me exactly how long the approval process will take; however, we can bet that CN this summer will provide a detailed operating plan which will in turn trigger a discovery process in which all concerned parties get to file their pros and cons. That could take a couple of *years*. Here's how Reuters puts it:

> U.S. railway operator Kansas City Southern said Thursday it had accepted Canadian National Railway's $33.6 billion acquisition offer, upending a $29 billion deal with its competitor Canadian Pacific Railway. This gives CP five business days to make a new offer for Kansas City Southern. Were CP to table a new offer, a bidding war could ensue.
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> CP had previously announced a deal to buy KCS on March 21, before CN said it had submitted a higher bid on April 20. The headline price in CN's cash-and-stock bid remains $325 per share as originally announced, though the company offered more of its shares to compensate for a decline in its stock price (all figures US$).

CN has offered to cover the $700 million break-up fee KCS will owe CP. It will also pay KCS $1 billion if the U.S. Surface Transportation Board (STB) rejects a voting trust structure it has put forward to complete the deal.

So here KCS sits with a $325 per share offer, but can't cash the check until Act IV. It's not over till the fat lady sings, or so they say, and, as a Met fan, I can safely say she isn't even in the wings.

Comparing the relative importance of various commodities to Class Is and their feeder railroads can be instructive. Though these are February numbers, the mix is fairly constant over time. It is immediately evident that nearly a quarter of feeder line carloads are "other," mainly empties going back to their home roads or customers/lessees, whereas only three Class I carloads in a hundred fall here. (I've left out intermodal to keep it simple.)

Carloads, by commodity	Feb 21	Feb 20	% Change	% Total	AAR YTD % Total	Spread
All Other Carloads	61,131	67,856	-9.9%	23.8%	2.6%	21.2%
Chemicals	46,389	49,762	-6.8%	18.1%	14.1%	4.0%
Grain	30,152	24,504	23.0%	11.7%	11.3%	0.4%
Coal	18,164	12,769	42.3%	7.1%	26.7%	-19.6%
Pulp, Paper, and Allied Products	15,472	16,891	-8.4%	6.0%	2.5%	3.5%
Metals and Products	14,782	16,313	-9.4%	5.8%	6.3%	-0.5%
Crushed Stone, Sand and Gravel	12,680	22,048	-42.5%	4.9%	7.0%	-2.1%
Stone, Clay and Glass Products	10,795	10,927	-1.2%	4.2%	3.1%	1.1%
Food and Kindred Products	9,250	10,313	-10.3%	3.6%	2.6%	1.0%
Waste and Scrap Materials	9,110	9,408	-3.2%	3.5%	3.3%	0.2%
Lumber and Wood Products	8,648	8,815	-1.9%	3.4%	1.5%	1.9%
Motor Vehicles and Equipment	7,481	10,094	-25.9%	2.9%	6.4%	-3.5%
Grain Mill Products	6,920	7,711	-10.3%	2.7%	4.1%	-1.4%
Nonmetallic Minerals	2,374	2,525	-6.0%	0.9%	1.5%	-0.6%
Petroleum Products	1,796	1,839	-2.3%	0.7%	4.9%	-4.2%
Metallic Ores	1,510	2,477	-39.0%	0.6%	2.1%	-1.5%
Total Carload	256,654	274,252	-6.4%	100%	100%	
Source: Railinc, AAR						

In mix, feeder roads do a little better than the Class Is in STCC 28 industrial chemicals and fertilizers, haul a lot less coal, and grain is much more important to the feeder lines than to the Class Is. Ditto paper. On the other hand, the Class Is have the edge in automotive, aggregates, and STCC 29 petroleum products (asphalt, LPG, etc.) and crude oil.

You can conclude from this spreadsheet that empties aren't very important to the Class Is and that explains in part why we see so few trips per year for boxcars, for one. For another, lease fleets have to be bigger than they would be with better turn times. And the slower the leased car turnover, the higher the customer lease cost per ton moved. Like the man says, turn the cars and fear nothing. And the feeder lines ought to be pretty pesky about this.

As for intermodal, I've had a sneaking suspicion for some time that the carload side of the house is subsidizing intermodal. Roughly a third of Class I revenues are from intermodal and carload ex-coal is about half. I also expect the revenue-variable cost margins for intermodal are about half what they are for carload.

For example, consider a 53' box Elizabethport to Bedford Park Terminal in Chi. CSX quarterlies say their intermodal revenue averages $645 a box. QCS tables for "shipper assn or similar traffic" is STCC 45111. The railroad cost model at usrailimpact.com says the variable cost for the move in a 53' box is $600 ex-fuel surcharge.

Of course, you shoot for two boxes per platform, so we are talking a putative $1,290 per carload equivalent. To do apples-to-apples, let's put this on a tonnage basis. Figuring the usual 40,000 pound (20 tons) tariff basis for a box versus an average of 93 tons for a carload, a 4.65 -to-one ratio would be generally correct. That gives you a putative conservative ratio of two and a half wells per carload.

Let's compare that to a load of plastics. My waybill samples suggest $6,300 for one 100-ton covered hopper car of plastic resins for the same OD pair, with an RVC of 2.6. Even if the two-container platform weighs about the same as that plastics carload and incurs the same weight-based cost — $2,400 — you get an intermodal RVC of about 0.53. Who is subsidizing whom?

End note. Week in Review is taking a break for the Memorial Day weekend. Be safe out there.