RAILROAD WEEK IN REVIEW

May 15, 2020

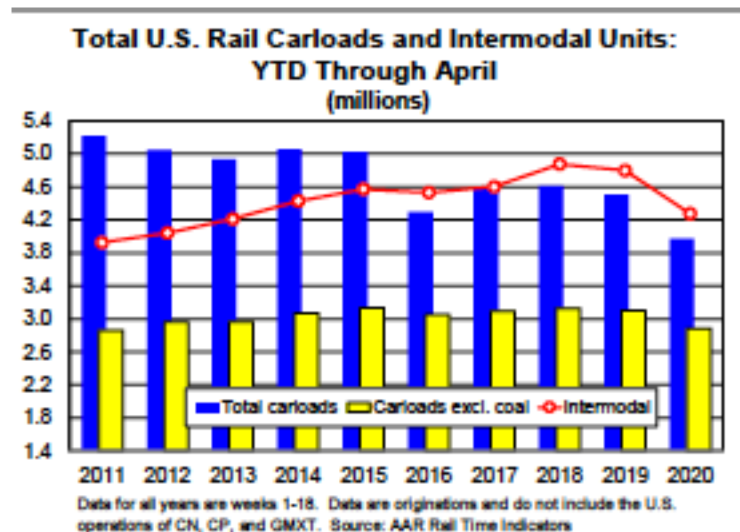
"Carload declines in April were paced by big declines for coal (thanks to cheap natural gas and lower electricity demand overall) and autos (because there essentially was no auto industry in April), but carloads fell across the industrial spectrum — steel, lumber, chemicals, scrap, petroleum products, sand, food products, and more. Of the 20 carload categories we track each month, just two saw gains in April, and one of those [Other] may have grown only because of railcars moving into storage." — AAR Rail Time Indicators, May 8.

"Union Pacific has just shut down its Cold Connect service for perishables traffic from the West Coast to the East Coast. Cold Connect began in January 2017 with the acquisition from Railex of three cold storage and distribution facilities in Delano, Calif.; Wallula, Wash.; and Rotterdam, N.Y." — Railway Age, May 10

"We are entering a new evolutionary stage of retail, in which big companies will get bigger, many mom-and-pop dreams will burst, chains will proliferate and flatten the idiosyncrasies of many neighborhoods, more economic activity will flow into e-commerce, and restaurants will undergo a transformation unlike anything the industry has experienced since Prohibition." — The Atlantic, April 27

You can see where the AAR Rail Time Indicators editor Dan Keen is going in this exhibit from his most recent effort. The blue bars are total conventional carloads including coal; the yellow bars are carloads ex-coal. Intermodal floats above the fray on the red line. The decline in coal over the past five years is dramatic and intermodal boxes are now back to their 2013 levels. The good news I see in this graph its that merch carloads including auto have been in a consistent narrow range of three million units, plus or minus some crumbs.

But I worry these relatively good times may be drawing to a close. According to RTI, chems ex-petrol could drift down a third this year and the 16 percent drop in frac sand is killing the aggregates group. Over the past few weeks, carloads in primary metals, forest products, and export grain have fallen sharply.



We can get an inkling of what's going on from the Bureau of Economic Analysis (BEA). They announced two weeks ago that 1Q2020 GDP fell an annualized 4.8 percent from where it was a year ago, the worst decline since 4Q2008. But because most of the layoffs and shut-downs due to the Coronavirus didn't happen till mid-March, the Q1 numbers don't begin to capture the full economic impact.

The RTI note concludes we could be faced with a U-shaped recovery, with the bottom of the U of undetermined length. Or, it could mean a W-shaped recovery, perhaps caused by the demise of lots of firms that tried to hang on but finally succumbed, or by consumers who stop spending after a brief catch-up period to face an uncertain future. Clearly, it's time to do a full risk-reward analysis of your railroad's entire book of business.

Is the railroad business a growth business? You tell me. I say not really. Total revenue units for the Big Seven Class I railroads decreased 1.4 percent over the five years 2015-2019. The strongest increases were in Canada, with CN up 7.8 percent and CP up 5.3 percent. Norfolk Southern was the only US railroad with an increase, a paltry one percent. UP and CSX duke it out for last place, down 7.9 and 8.0 percent respectively.

Revenue Units (000)

Railroad	2015	2016	2017	2018	2019	% Change
BNSF	10,269	9,758	10,277	10,698	10,221	-0.5%
CN	5,485	5,205	5,737	5,976	5,912	7.8%
CP	2,628	2,525	2,634	2,740	2,766	5.3%
CSX	6,761	6,352	6,400	6,482	6,220	-8.0%
KCS	2,227	2,167	2,270	2,306	2,291	2.9%
NS	7,479	7,260	7,612	7,928	7,554	1.0%
UP	9,062	8,442	8,588	8,908	8,346	-7.9%
Totals	43,911	41,709	43,518	45,038	43,310	-1.4%

Coal had a lot to do with it. It's not that big a commodity in Canada, accounting for 5.0 and 10.0 percent of total 2015 revenue for CN and CP respectively. Compare that with something around 20 percent for each of the Big Four US roads. By 2019, coal had declined to less than 20 percent of revenue for the Big Four US roads while remaining about the same in Canada.

Now take a look at revenue. Over the five years Class I revenues increased 6.2 percent, with CSX and NS taking top honors thanks mainly to their drastic slimming down under the new (to them) PSR discipline. CN and CP saw moderate gains while BNSF lagged at 3.5 percent. The common thread here is more revenue for fewer revenue units — more money for less work.

The reason there is less work is that truck volumes keep growing while railroad volumes keep shrinking. Yes, I know coal can't move in trucks, but the railroads did not do well replacing lost coal revenue with new revenue streams.

Five years operating earnings ($mm)

Railroad	2015	2016	2017	2018	2019	
BNSF	$7,767	$6,637	$7,293	$7,800	$8,071	3.9%
CN	$5,266	$5,312	$5,243	$5,493	$5,593	6.2%
CP	$2,688	$2,578	$2,519	$2,831	$3,124	16.2%
CSX	$3,584	$3,389	$3,720	$4,869	$4,965	38.5%
KCS	$ 804	$ 819	$ 922	$ 986	$ 886	10.2%
NS	$2,884	$3,074	$3,371	$3,959	$3,989	38.3%
UP	$8,052	$7,272	$8,106	$8,517	$8,554	6.2%

Part of the problem is, I think, that Class I field sales forces have been shrinking while truckers and brokers are doing better at creating new customers and adding value for old customers. Short lines and regionals, on the other hand, largely continue to see volume increases because they stay in front of customers and honor service commitments. And where a customer needs a new service — a lumber transload or a distribution center, e.g. — the serving railroad can help make it happen, proving once again that if you don't go see the people, you can't ask for the order.

The present economic downturn is forcing changes in supply chains, more for consumer staples (grocery store items) and energy than for consumer discretionary goods from refrigerators to cars. Local sourcing is preferred, and we're seeing a change in consumer priorities, from spending money on entertainment and travel to what Apple's Tim Cook calls "new ways to stay connected, informed, creative, and productive."

That bodes ill for railroad services from intermodal to long-haul carloads in sectors other than heat-and-eat. Grains, grain products, packaged foods, both forest product STCCs, fertilizers, and construction products from aggregates to steel framing will do OK. Says AAR's Dan Keen in the May 8 *Rail Time Indicators*, "Wary consumers have turned extremely cautious as they brace for incredibly challenging times." Railroads take heed.

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