RAILROAD WEEK IN REVIEW
May 22, 2020

"Forces have been set in motion that will slowly but inexorably change the status quo in myriad ways. One of the more significant changes will be a great dispersal insofar as where freight is coming from and where it is going. This will cause changes across the economic spectrum, and intermodal will not be immune. The current intermodal focus on running the simplest possible network of the largest trains will also need to change in the years to come in order to adapt to this new reality." — Larry Gross, Gross Transportation Consulting

"Capital spending (capex) was already under pressure in the past year due to the trade war and impact of tariffs that U.S. companies have been paying on imported goods from China. The impact of COVID-19 on planned capex has been particularly swift, and points to even more weakness to come in longer-term corporate investment." — Liz Ann Sonders, Charles Schwab

"Excessive borrowing by businesses and households leaves them vulnerable to distress if their incomes decline or the assets they own fall in value. In the event of such shocks, businesses and households with high debt burdens may need to cut back spending sharply, affecting the overall level of economic activity." — May 20 Financial Stability Report, Federal Reserve Board

Last week I tossed out the question of whether railroads are still a growth business. The tone of the answers has not been very favorable. One writer points out that the Class Is have been touting tighter operations leading to winning business back from the highways. As far as he can tell, it has not happened and shows no sign of happening, yet the railroads seem to be moving in the opposite direction. The UP retreat from the Cold Connect franchise is Exhibit I.

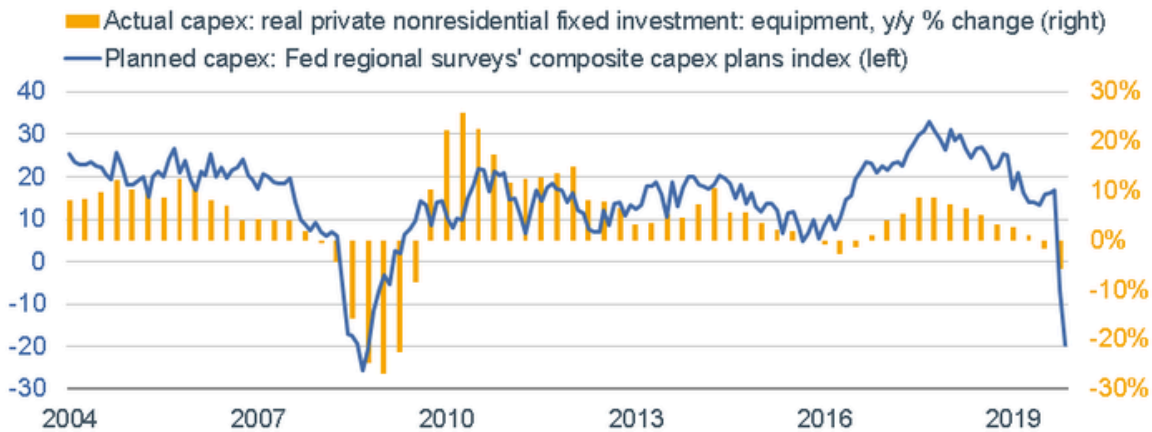
I also raised the question of customer involvement, citing the apparent reduction of Class I direct sales forces. Here again reader response supports this idea. One chap who is a former Class I market manager tells me that not only have marketing forces been reduced, but also there's been a lot of internal turnover. He notes that each of those still in the marketing seats is now doing the work once spread among several people.

Seems to me that, from a market manager's perspective, keeping up with one's calendar of renewals could take priority over building a deeper understanding of customer supply chains. From that, one might well conclude that Class Is don't see much value given to market managers or sales managers who have worked a commodity or roster of customers for a long time. Worse, the reduction of marketing and sales forces leads ultimately to a concentration on large accounts, with personnel being spread too thin to cover lower volume accounts.

Here's where short lines come in. They invariably build deeper relationships with the smaller customers that don't even register as a rounding error for the Class Is. Several short lines are seeing record April and May-to-date carload volumes, and they trace this success directly to customer coverage.

To which another reader adds, "The Class Is should treat the single car franchise like intermodal [everything FAK] and give up the marketing to the short lines who know how to do it and are not afraid to invest in the tools to accomplish the job." (He notes this applies more to the US than Canada because CN and CP seem to have a better focus on growing the business.)

The Liz Ann Sonders quote above is important for railroad commodity carload traffic trends. According to the AAR's *Rail Time Indicators*, raw materials from forest products to chemicals represent the largest portion of carloads. Manufactured goods in the STCC 30s are almost non-existent. So when capital investment falls, so do commodity carloads. Here's Liz Ann's chart:



Source: Charles Schwab, Bloomberg, Bureau of Economic Analysis, Federal Reserve Banks of Dallas, Kansas City, New York, Philadelphia and Richmond, Strategas Securities, LLC. Actual capex as of 3/31/2020. Planned capex as of 4/30/2020.

Right behind capex in importance to railroads come consumer goods from cars to Cokes. Liz Ann again:

> The shutdown of the economy has compressed both the demand and supply sides of the economy, which has also had an impact on inflation. The latest consumer inflation statistics were quite weak — although not across-the-board (more on inflation — or the lack thereof — below). Core (excluding food and energy) CPI inflation sank in April. About the only category within overall headline inflation that was up was, not surprisingly, "food at home."

Not long ago the Class Is employed a cadre of economists who would watch this stuff and advise marketing, finance, and ops accordingly. Not any more. As a result, it is up to the regional and local shortline operators to stay ahead of the trends, such as small cap companies suffering a greater COVID impact than their large cap brethren. All of which means that paying attention to the Liz Anns of the world can be invaluable.

The 13th Annual Wolfe Transportation Conference went virtual this year and we got five 30-minute railroad conversations Wednesday morning. In order of appearance, NS led off with Chief Commercial Officer Alan Shaw and new CFO Mark George. They pretty much stuck to financial and operating trends, with just the odd nod to the customer. Shaw is "not chasing volumes," preferring to look for "quality revenue." Board member Claude Mongeau is taking an active part in Board activities and acting lately as a consultant.

CSX EVP Marketing Mark Wallace was more customer-focused, saying the Pandemic has actually strengthened customer relations -- Zoom meetings, etc. Merch trip plan compliance is at 80 percent and growing while right-sizing the network. RPU is not a good proxy for price; see mix examples in ferts and mins. QTD vols are down 20 percent; crew starts are down 30 percent. As auto plants reopen, CSX is putting auto racks in merch trains, not holding them to make unit trains. New business targets are current customers, ex-customers, and new customers.

Union Pacific CFO Jennifer Hamann summarized Q2 to date citing volume growth in grain and construction materials offset by declines in STCC 20 foods, frac sand, and finished vehicles. The 2020 growth strategy is led by reduced complexity, consistent service, and lower operating expense. Six of seven Key Performance Indicators improved, most by double-digits. UP is not cutting train starts where doing so would hurt trip plan compliance.

Canadian Pacific President Keith Creel was the only CEO speaking. Train starts are down, key performance measures have improved. Like Wallace at CSX, CP is using Work From Home (WFH) as an opportunity to strengthen customers ties through greater contact frequency. Re CMQ, Creel would like to bring ocean freight to Saint John, and sees new CMQ revenue opportunities to be brought in with CP margins. Some CMQ personnel will go to CP.

Canadian National CFO Ghislain Hoele was less conversational and more scripted than Creel. Crew starts are down and dwell is up. I got the same WFH read as Wallace, Creel; CN is shrinking office real estate footprint as a result. Halifax could displace NY/NJ Port Auth containers. 2020 are vols at or near bottom. Reefer produce is up two percent. Automated inspections are faster and find more defects.

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