RAILROAD WEEK IN REVIEW
October 9, 2020

“Wall Street economists are sharply lowering their growth forecasts for the year’s final quarter. Goldman Sachs cut its fourth-quarter real gross domestic product growth number in half, to three percent from six percent. JPMorgan trimmed its estimate to 2.5 percent from 3.5 percent.” — Randall Forsyth in Barron’s, Sep 28

“We are seeing a classic inventory rebuild based on the actual inventory data and the backlogs in the orders. I don’t think business is seeing a sustained acceleration in demand, but right now there’s an inventory replenishment. I fully agree that without significant stimulus —the economy is still operating with a tremendous amount of stimulus from the government — that’s going to dissipate no matter what in the fourth quarter.” — David Rosenberg on Real Vision, Oct. 5

“Rail volumes declined six percent year-over-year in 3Q, materially improved from the 20 percent decline in 2Q, though comps get easier in 4Q. However, mix was negative again in 3Q with intermodal volumes up slightly year-over-year; merchandise carloads were down sharply at 11 percent.” — Scott Group, Wolfe Research, October 5

Third quarter revenue units are now at hand. Week 40 (October 3) total year-to-date revenue units for North America are down 9.8 percent with intermodal down 6.0 percent. Every merch carload commodity but chemicals, farm ex-food and grain, and grain is down more than intermodal. Coal and auto each dropped 26.1 percent.

That said, at least the trend is improving. The AAR’s John Gray says September 2020 was the fourth best intermodal month in history for U.S. railroads; overall U.S. freight rail traffic volume for the month of September dipped a mere one percent, based partly on that healthy increase in intermodal. Merchandise carloads remained down in September compared with last year, but showed marked improvement compared to a few months ago.

NS has filed an 8-K advising that it “expects to have a non-cash impairment charge of approximately $99 million in the third quarter of 2020 related to the value of one of its equity method investments.” NS will show this as a non-GAAP event in its 3Q financials.

We get Q3 results and the presentation before the bell October 28. Lifting the skirts a bit early, Norfolk Southern says in the filing it expects to report “railway operating revenues of approximately $2.5 billion, railway operating expenses of approximately $1.7 billion, and an unadjusted operating ratio of 66.5 percent. Excluding the non-cash impairment charge, for the third quarter, Norfolk Southern’s adjusted railway operating expenses are expected to be approximately $1.6 billion and its adjusted operating ratio is expected to be 62.5 percent.”

The term “equity method investments” is a mystery to me. The 2019 10-K notes on page K42 that “the equity method is used for accounting for investments in entities over which we have the ability to exercise significant influence but to not control the entity.”

Further, investopedia.com says simply “the equity method is an accounting technique used by a company to record the profits earned through its investment in another company… Investment amounting to 0-20%, 20%-50% and more than 50% of the outstanding capital must be accounted for using fair value method, equity method and consolidation respectively.” Curious.

The most up-to-date shortline numbers I have are from Railinc for July, but what we’re looking for is mix, and that doesn’t change much over time. Merchandise carloads — everything but coal, intermodal, and auto — represent 80 percent of shortline revenue units and were down 11 percent for the month.

The biggest single merchandise commodity group is chemicals at 16 percent of the total; everything else is single digits. Grain, aggregates, the STCC 26 paper group, and the STCC 32 “stone, clay, glass” combo that includes bricks and gypsum are here. Everything else is less than five percent of total units.

The elephant in the merch carload room is “Other” — 22 percent of loads. That’s worrisome because the AAR commodity groups cover just about everything on a Class I and the percentage of “Other” carloads in the mix can be counted in basis points on the Class Is. At the end of the day, most shortline commodities are relatively low-rated and so don’t get much of a priority at the Class Is. So for short lines to have 22 percent of carloads so far off the Class I’s radar screen is not encouraging. I’m hopeful the readership can shed some light on this conundrum.

The Western Group, a shortline holding company out of Ogden, Utah, has filed (FD 36440) to sell five short lines, totaling more than 450 route-miles, to a joint venture between the Ontario Public Service Employees Union (OPSEU) Pension Plan Trust Fund, and Jaguar Transport/Rail Holdings, LLC. The principals of Jaguar are two Watco alums, J. Stuart Towner, and Terry Towner, both of whom enjoyed C-Suite positions. The OPSEU fund indirectly controls Jaguar Transport of Joplin, Missouri. Financial terms of the acquisition are not disclosed.

The transaction is expected to be finalized next month. Moving east to west, first is the Texas & Eastern Railroad that runs 30 miles east from a UP connection in Palestine, Texas. It isn’t really a freight railroad as such but rather is the designated operator of the Texas State Railroad tourist train between Palestine and Rusk, having assumed that role from Iowa Pacific Holdings in May, 2017.

Further north is the Cimarron Valley, a classic granger railroad, running southwest out of Dodge City, Kansas over 254 miles of former Santa Fe routes to Boise City, Oklahoma, and Pritchett, Colorado. Principal commodities are agricultural commodities (such as wheat, corn, and milo), along with sand, cement, poles, pipe, and fertilizers.

In the Pacific Northwest we have the 27-mile Oregon Eastern, running west from its UP connection at Ontario, right on the Idaho state line. Officially, it is the Wyoming & Colorado Railroad Company D/B/A the Oregon Eastern. The original 1989 sale was to the Wyoming Colorado short line. Most of the west end was abandoned in 1992 and the remaining trackage is still operated by the Wyoming Colorado Railroad as the Oregon Eastern Railroad.

The Washington Eastern runs 108 miles of state-owned former NP rails heading due west from its Cheney (Spokane) connection with both UP and BNSF to Coulee City. BNSF first sold the line to Watco in the late 1980s, but in 1998 it was deemed unprofitable and Watco sold the property to the state. Eastern Washington Gateway Railroad operated the line starting in 2007 and went out of business in late 2018, with operations assumed by Washington Eastern Railroad.

The final property for sale is the Southwestern Railroad — Whitewater Division, a vee-shaped railroad with a UP connection at Deming, New Mexico, a BNSF connection top right at Rincon, and copper mines at the top left. Thus the primary commodities are copper-related: ore from the mines to adjacent concentrators, and outbound loads of copper anodes, cathodes, and sulfuric acid (a by-product of the refining process).

This is a tough railroad. It was on the copper mine branch that three people were killed in a 2013 run-away train accident. The FRA report found that a locomotive and six open-top hopper loads derailed at 45 mph on a ten mph curve, with the power tumbling down a 40-foot embankment into the creek below. Unfortunately, there evidently had been a number of safety lapses before the event.

The 2020 annual RailTrends bash goes virtual this year and is just six weeks away, running November 19 and 20. The speakers list contains all the usual suspects: Rod Case, Oliver Wyman; Chuck Baker, ASLRRA; Pat Fuchs, STB; Larry Gross, intermodal expert. Class I railroad speakers include Beth Whited, Union Pacific; Jim Foote, CSX; JJ Ruest, Canadian National; Keith Creel, Canadian Pacific; Alan Shaw, Norfolk Southern. There will be the usual shortline panel and the heads of both the AAR and the Railway Association of Canada. Watch this space for more as the date approaches.

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