RAILROAD WEEK IN REVIEW

January 7, 2022

“Merchandise volumes have tracked in line with seasonality over 4Q as strength in chemicals and metallic ores & metals is offset by weakness in petroleum products and recent declines in forest products. Lastly, bulk traffic (grain + coal) continues to sit in line to slightly below historic seasonality as strength in coal offsets continued weakness in grain shipments.” — Bascome Majors, Susquehanna Financial Group, January 3

U.S.steel producers are buying up scrap businesses, seeking a steady supply of raw material from junked cars, old pipes, and manufacturing waste for new mills… Companies are going to need the ability to have a meaningful percentage of their scrap requirement covered by their own supply sources.” — WSJ, January 3

“CSX will report train speed as a measurement of the line-haul movement between terminals; terminal time is excluded. ***Local****, passenger, maintenance of way trains and* ***yard jobs*** *are* ***excluded*** *from train speed measurements.” — STB Individual Carrier Performance Data Methodologies (emphasis added — rhb)*

Supply chains and inflation continue to dominate the headlines. I think there is ample opportunity for the railroads to capitalize on both. The analyst community seems to agree that while 4Q2021 was essentially a place-holder, there will be modest volume improvements near term with the volume and pricing rates of change improving as we go out in time, a major catalyst being the shift in consumer spending from services to goods.

Trucking spot rates are coming off their highs; rates of change might even go negative year-over-year. I see the change being a function of supply chain management shifting to “just in case” as opposed to “just in time.” With supply chains still being somewhat irregular, it’s better to have too much inventory than not enough. Moreover, the continuing congestion at west coast ports could push incoming goods shipments to the Gulf and Atlantic ports. The effect on merchandise carload service would be indirect, with a faster, fuller railroad benefiting all customers.

And, speaking of service, Susquehanna’s railroad analyst Bascome Majors notes that “Railroad service metrics have become more of a focal point over the past few quarters as widespread supply chain bottlenecks impede network fluidity coupled with the STB's more vocal stance on service performance,” and that could be a good thing. After all, “service sees an inverse relationship with volume growth,” something I’ve been harping on for lo these many.

In that regard, I’ve quoted the CSX methodology for train speed as reported to the STB. Note that local trains are excluded. So even though your customer’s car may be whisked between the

end points of a core train, it may still languish in a yard waiting for the next local scheduled to make your interchange.

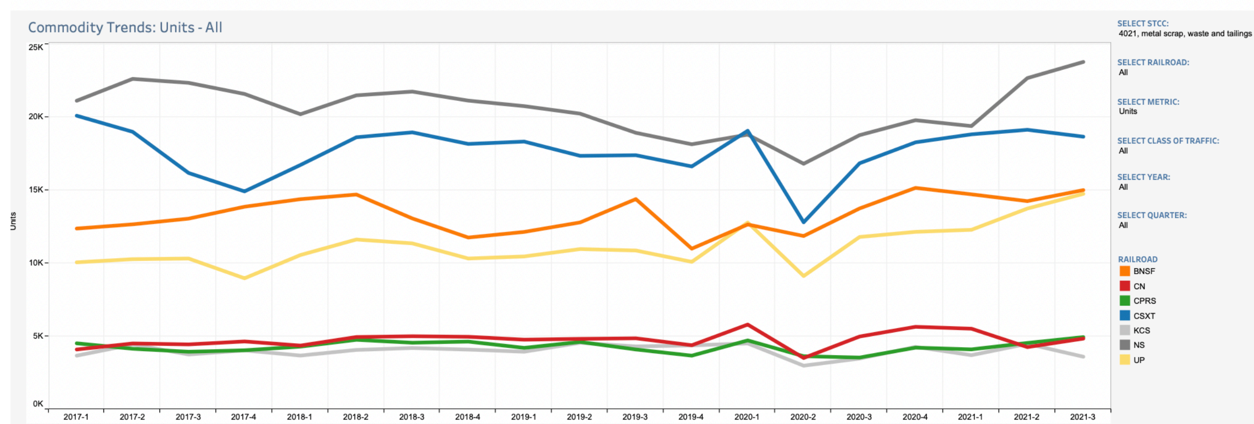
FWIW, the UP says pretty much the same thing on its website: “Train Velocity measures the time from origin departure until final arrival, including time at intermediate terminals. Calculated by dividing train miles by train hours (mph) for **through** freight trains.” That is to say, they don’t try to calculate train speeds for trains that work customers’ locations. And it’s pretty standard across the industry.

The steel business is looking up. The *Wall Street Journal* on Monday reported that three of the country’s largest steel producers in 2021 spent more than a $billion for steel scrap processors “as millions of tons of added capacity are being added to the domestic steel market in response to rising demand.” About ten million annual tons of new flat-rolled capacity will come on line this year and next — this in addition to the eight million tons of capacity added in the last two years.

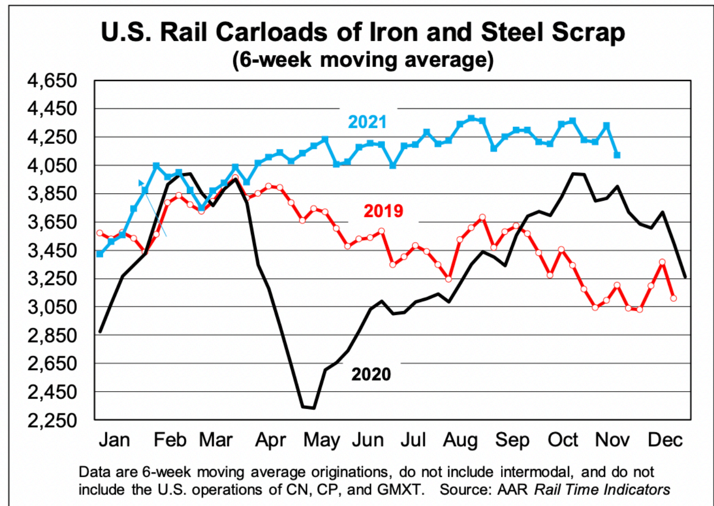
Ferrous scrap is the new iron ore, as an increasingly large share (now approaching 70 percent) of new steel comes from scrap melted in electric-arc furnaces. Through October, 2021, scrap purchases were up 17 percent year-over-year, according to the *Journal*. Scrap prices hit $540 a ton last year, up 34 percent, as demand starts to exceed supply.

Steel makers mentioned in the article include Nucor, Cleveland-Cliffs, Steel Dynamics, and North Star BlueScope. The railroads serve a number of their facilities, and I’ve visited several. Incoming open-top gons of scrap steel are unloaded with huge magnets and transferred literally to mill gons that move the scrap to the furnace itself. There the scrap is melted and molded into ingots that are further processed into shapes and sizes according to customer orders.

As you can see from this USRailImpact chart, STCC 4021 carloads started to pick up in the 2020 second quarter, running through 3Q2021.



As for the quarter just closed, the AAR has the broad metals category up 23 percent year-to-date. Scrap alone was up 12 percent in November, its ninth consecutive moth of increases.



Just to give you a flavor of what's going on, take Ferrous Processing, Inc., a major collector of prime scrap from automotive-related manufacturers. It runs 22 collection points in the U.S. and Canada, with most of them located in southeast Michigan and northern Ohio.

The higher price of nat gas is pushing up food costs as it's a main ingredient in nitrogen-based fertilizers. Over the last 12 months shares of companies in the fertilizers and ag chemicals sector have increased by nearly 30%. Leaders in the space are CF Industries, Intrepid Potash, CVR Partners (mainly UAN), and Mosaic. All are up mid-double digits. Schwab research expects fertilizer markets "to remain tight on limited foreign exports and strong demand trends."

If so, higher prices could limit farmers' patterns of putting down nutrients. Ask your ferts customers what they see now and for the 2022 crop year. We know that fertilizer demand is largely correlated to crop prices and it can run to extremes depending on the planting region. At one extreme is central California where farmers get three plantings of fresh vegetables per season, and much of this moves east in refrigerated box cars. At the other extreme are northeastern states where field crops and the shorter growing season limits nutrient use.

Over the past year QCS carloads in STCC 271, ag chems, have been relatively unchanged on all six Class Is. Yet a quick check of QCS waybill samples show RPU increasing slightly for 3Q2021 vs 4Q2020. Ergo carload numbers are essentially unchanged yet units sport higher RPUs. And as for the manufacturers, the trends seem to suggest share prices are up mainly on higher fert prices driving higher margins and better earnings.

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