

RAILROAD WEEK IN REVIEW

March 11, 2022

“Not every recession has been caused by an oil price spike but every oil spike has caused a recession. This is likely to be a drawn-out affair and will have a sustained impact on commodity prices.” —Brian O’Reilly, head of market strategy at Mediolanum International Funds.

“One of our greatest investment regrets was selling CP a number of years ago. Keith and the team have done a superb job since. We are delighted to again be an owner of this remarkable and growing franchise at a time when transcontinental rail infrastructure could not be more important for our economy and our continent.” — Bill Ackman, Pershing Square Capital Mgt.

“Export coal demand is outstripping supply. You see it in the export benchmark prices, and they look incredibly strong right now. We’re almost at all-the highs when you look at the met and thermal markets, so we have some opportunity here.” — CSX 4Q2021 earnings call

“Of the total amount of U.S. hard red spring wheat exported each year, approximately 75 percent leaves the country via Pacific Northwest ports, 14 percent from Gulf ports, 7 percent from the ports in the Great Lakes/St. Lawrence Seaway region and 2 percent is directly railed to Mexico.... North Dakota wheat is heavily reliant on exports, as these statistics demonstrate.” — North Dakota Wheat Commission STB Filing re CPKC, February 28

Canadian Pacific once again counts hedge fund operator Bill Ackman among its significant owners. Pershing Square Holdings’ recently amended 13-F filed in December shows 2.8 million shares worth roughly \$202 million. This comes a decade after Ackman had won a high-profile proxy battle, installing Hunter Harrison as CEO. He has recently added to this position which Bloomberg estimates to be some 14.8 million shares, total value \$1.2 billion.

Ackman ultimately left CP’s Board in 2016 after selling the last of his shares. Bloomberg estimates CP share values nearly doubled from the time of Ackman’s first stake in 2011 to its exit in 2016, earning a profit of about \$2.6 billion. Evidently Creel’s leadership has won Ackman back, and I wouldn’t be surprised if it turns out the CPKC prospect is a further Ackman enticement.

Can CSX coal be making a comeback? Writing for seekingalpha.com March 6, rail specialist Leo Nelissen notes that the strong 2021 coal numbers (CSX coal was up 13 percent, twice the rate of increase for the company as a whole) could become even stronger this year as the war in Ukraine creates increased demand for imported coal far beyond the borders of that country.

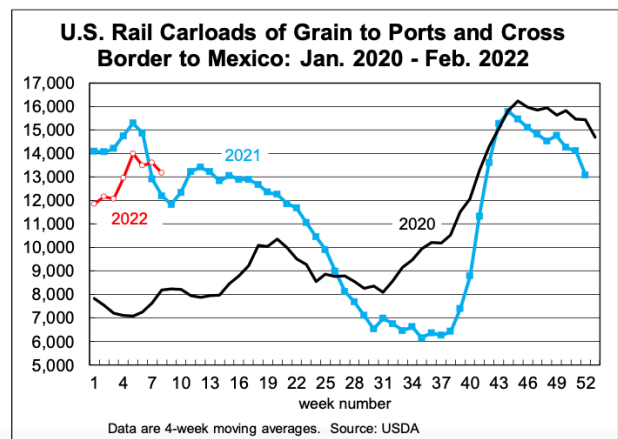
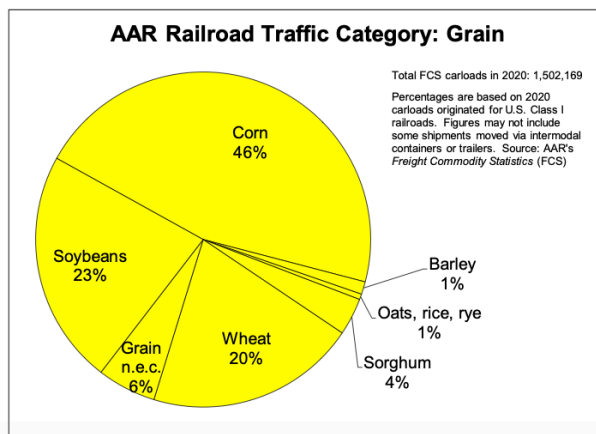
Nelissen writes that the US is one of the few countries that can ramp up exports of coal, fertilizers, LNG, nat gas, grains, and more. And, since Russia is a major coal exporter, sanctions can only diminish the tonnage that traditionally goes to major markets like China, South Korea, and European countries such as the Netherlands. As a result coking coal futures are now north of \$400 a ton vs. the \$80 pre-pandemic median.

Whereas coal has been in a long-term secular decline for some years, the current crisis has quadrupled the price of nat gas and made coal not only more accessible but less costly. So global coal consumption, says Nelissen, is expected to continue its upward trend as emerging markets more than offset slower demand elsewhere.

In 2021 CSX garnered 14.3 percent of total revenue from coal, highest of any Class I, and in 2021 CSX export coal increased ten percent year-over-year. Its Appalachian coal network is made up as such fallen flag coal stalwarts as C&O, B&O, L&N, and the Clinchfield. All of it funnels through Richmond and on to the Newport News piers.

CSX puts it thus way in the 10-K: “The CSX coal network remains well-positioned to transport coal for export. Approximately one-quarter of export coal is used for generating electricity or industrial purposes.” CSX sent 32 million tons of coal abroad last year. If that number was a ten percent increase for “normal” times, one would have to say the 2022 number ought be well north of that.

Export grain, particularly wheat, was a topic in WIR for 3/4. I ought to enlarge on that. Though one can’t really get a state-by-state grain origins, the AAR provides some useful detail. Corn is the dominant crop with beans and wheat¹ next. Export grains this year are



running in the tens of thousand cars per week; the AAR tells me exports dominate. There is an extremely close positive correlation between overall rail grain carloads and rail

¹ 46% of wheat is exported

carloads of grain to ports. Total reported grain carloads are much more volatile from month to month than you'd expect if domestic consumption was all there was. As for wheat alone, there are three recent STB filings on CPKC that provide some detail on where the wheat comes from and where it goes, stressing the need for competitive rail service for all of it. The North Dakota Wheat Commission says its market "is home to the primary US hard red wheat and durum wheat production area" and "at times is the leading wheat producer" in the country.

CP handles 20-25 percent of it with BNSF a close second. Export wheat goes via water through Duluth, the Gulf Coast, the Pacific Northwest, and by rail directly to Mexico. The NWDC says most of its wheat is for export and thus reliable and competitive railroads are key. And as the number of Class I railroads has shrunken, rates have increased and so "the current market power of the Class Is and the lack of serious competition" hasn't helped.

The National Grain and Feed Association "consists of more than 1,000 grain, feed, processing, exporting companies that operate more than 8,000 facilities in the US." There are also 27 affiliated state and regional grain and feed associations "and the association has a strategic alliance with the North American Export Grain Association." The filing asks that in this transaction the railroads "generally preserve and encourage additional rail competition."

The National Association of Wheat Growers, which "is the primary representative in Washington, D.C. for wheat growers, representing 20 state wheat grower organizations," opposes the merger without provision for giving CPKC captive shippers "open access to reciprocal switching." The importance of the export trade is alluded to in its statement:

Wheat is already heavily reliant on rail transportation... due to the amount of the commodity that is exported and where major growing regions are located. Distances from the central and northern plains, the largest growing areas, are too great a distance from ports, waterways, and end users to be trucked, making railroads a crucial link in the wheat transportation logistics chain.

So, although we can't say exactly which states export how much of what, we can say the northern plains states are major wheat players. From that one must conclude that BNSF, CPKC, UP and their connecting non-Class I railroads will see increased wheat loadings as the Ukraine situation evolves. The battles are destroying extant crops and put the whole 2022 growing season in doubt.

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