RAILROAD WEEK IN REVIEW
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“We’ve leaned into our scheduled operations, improving train performance and service to our customers… We’ve begun the work on our book of business to ensure that we're selling into our operating model in a manner that we can deliver to our customers.” — Tracy Robinson, CEO and President, Canadian National

“In the second quarter we stabilized service levels, expanded our pipeline of conductor trainees, and launched the next evolution of our operating plan, TOP/SPG, with our signature no-surprises approach. Service is not yet where we want it to be, but I am encouraged by our progress” — Alan Shaw, CEO and President, Norfolk Southern

“Looking at the back half of the year from a demand standpoint, we continue to build momentum on the CP network, the upcoming grain harvest is looking better every day, and the demand environment continues to be strong.” — Keith Creel, CEO & President, Canadian Pacific

Let me revisit the subject of de-globalization and intermodal volumes in North America. In WIR July 8 I wrote, “YTD 2022 intermodal volumes through June are down six percent from what they were a year ago. Yet carload business including coal and auto was off a mere ten basis points year-over-year. This suggests we’re seeing less of what’s sourced overseas and more of what’s produced chiefly in the lower 48.”

Larry Gross, widely regarded as the best intermodal analyst in the business, has picked up on this thread and writes, “I think there is a big difference between a decline in globalization and re-shoring. What I do see is that off-shoring is tapering down.

“For many years there was a constant shift of products that were being sourced here to being sourced overseas. This meant that import TEUs were consistently growing faster than the goods portion of GDP. I think that trend is abating. What that means is that import TEU growth will start to look a lot like the goods portion of GDP.

“But that is not at all the same as saying that the flow is reversing. This implies production coming back to the U.S., or more likely, North America (including Mexico) That trend is in its infancy. Not to say it won’t eventually happen but not moving the needle yet. But that’s what it will take for import TEU growth to trail that of GDP.

“The problem with the railroads isn’t that intermodal is sucking up too many assets. It’s that they are shedding too many assets in general and not operating the carload network satisfactorily. What they should do is give up the single car franchise and outsource it to one of your subscribers like Watco or a consortium of shortline operators. Let the Class I operate the line-haul the unit trains and give the classification yards and the locals to the short lines.” Like I said, the carload side may benefit in the longer term. Thanks, Larry.

Canadian National’s second quarter results show how operating to plan relates to customer satisfaction. Tracy Robinson set the tone first thing in her conference call opening comments, quoted above — using the word “customer” twice in the same paragraph. June on-time departures hit 90 percent; connection performance was 80 percent to plan, though longer car cycle times on interline moves are cutting into car supply. (This is something JJ Ruest mentioned eons ago — cars sent to the US don’t come back quickly.)

Total freight revenue increased 22 percent to C$4.2 billion even though revenue units hardly budged. Merchandise carload revenue including automotive was C$2.6 billion, gaining 16 percent on volume up four-tenths of a point. Chief Commercial Officer Doug MacDonald said, “U.S. grain and coal continues to remain strong due to the unfortunate war in Ukraine and the sanctions on Russia. Forest Products and metals orders remain strong and well above empty car supply.”

There is also a focus on adding volumes to those portions of the network that have capacity —such as the Halifax-Chicago corridor — where MacDonald sees opportunities for new volumes in metals/minerals, automotive, and intermodal. The Chicago-Gulf Coast lane has room for more grain, metals/minerals, chemicals, and petroleum.

Operating expense was held to a 16 percent gain, leveraging a 20 percent operating income gain and a 2.3 point drop in the OR to 59.3. Fuel efficiency (gallons/KGTM) improved 351 bips to 0.838, an industry low. COO Rob Reilly says this reduction “drove the reduction of about 43,000 tons of carbon emissions.” Headcount is up 850 since Jan, mostly conductors.

Wrapping things up, the outlook is most promising. MacDonald: “We are expecting a Canadian grain crop over 70 million metric tons versus less than 50 million last year. We are working with our supply chain partners and customers on solutions to alleviate the challenges with import containers destined to Montreal and Toronto. We will continue to benefit from strong coal prices and higher production in both Canada and the US. We remain focused on driving strong yields with contract renewals coming in above rail inflation.” And that’s how a precision scheduled railroad is supposed to work.

Norfolk Southern Q2 revenue increased to $3.3 billion, up 16 percent — all of it on price increases — as revenue units came down three percent to 1.6 million. RPU gained ten percent in merchandise, 32 percent in coal, and 27 percent in intermodal. Fuel surcharge gains were the principal contributors — merchandise seven percent, intermodal 17 percent, coal five percent. All in, RPU less fuel surcharge increased ten percent.

Operating expense was $2 billion, up 22 percent, mainly on the doubled fuel expense. Operating income was $1.3 billion, up nine percent, for an OR of 60.9, up 259 basis points, though 200 points of that came from last year's non-recurring property sale that was taken as a reduction to operating expense. Net income was flat at $819 million.

The Service, Productivity, Growth pillars of the updated TOP are paying dividends. COO Cindy Sanborn cites balancing crews and locomotives on core routes, using distributed power as needed on longer trains, and simplifying the role of intermodal terminals, especially where several serve one market. Unit trains of bulk commodities are being broken up and run in merch trains, and all trains are hitting their slots more and more.

Merch carloads took hits in steel and construction materials, partially offset by gains in frac sand and export grain. Intermodal's higher fuel surcharges combined with increased storage fees for containers and related equipment more than offset volume declines. Coal tonnage dropped four percent with domestic met coal taking a 16 percent haircut, though total coal revenue increased 34 percent.

Chief Commercial Officer Ed Elkins anticipates "overall year-over-year improvements in most merch markets as service levels recover." He's most upbeat on automotive and lukewarm on manufactured products. Intermodal is poised for upticks in domestic and international markets, and coal will benefit from growth in utility and export demand.

In sum, I see NS as an operating story, where there is a commitment to creating customers through a higher quality product that can demand higher unit prices. Top priority, though, has to be trip plan compliance, especially where origins and destinations are on connecting railroads, whether Class Is or feeder lines.

Canadian Pacific rounded out the week with total revenue of C$2.2 billion, up seven percent, on a one percent decrease in revenue units to 712,700. System RPU was up nine percent. Grain was the big hit — volume down 29 percent, revenue down 17 percent — due largely to the 40 percent smaller grain crop, though this year's larger harvest should rectify matters. The US grain crop helps, posting the third consecutive record quarter.

Carloads in the energy-chemicals-plastics (ECP) group dipped three percent, though excluding crude oil the core ECP commodities delivered record Q2 results. Potash carloads increased six percent on strong global demand for nutrients. Forest products carloads gained three percent and the metals/minerals/construction group units were up nine percent with more frac sand to support increased drilling activity. Automotive carloads were unchanged and intermodal boxes were up nine percent.[1]

CP operating expense was up eight percent, which against the seven percent revenue gain yielded just a six percent operating income gain; the OR gained half a point to a still enviable 60. Comp & benefits came in eight percent lower even though headcount was up some six percent sequentially. Fuel expense was up 70 percent on fuel price (adding 220 bias to the OR) though fuel burn was down two points on the four percent GTM slip. Material expense gained 17 percent on inflation.

As for the KCS merger, Creel had this to say during the Q&A:

> Once the STB gives us a green light, we'll continue to invest in the infrastructure, but the investments we've already made, the traffic that rides it today, the operating plan that we have ready to engage and execute — this is not driven by cost synergies, but just railroading better, being more efficient with assets, turning cars faster, putting these two networks together and benefiting on the backbone of those capital investments.

Talk about a strong close to a strong call!

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[1] I'm talking carloads here. Brooks' volume figures in his earnings call remarks are in RTMs.