RAILROAD WEEK IN REVIEW

October 14, 2022

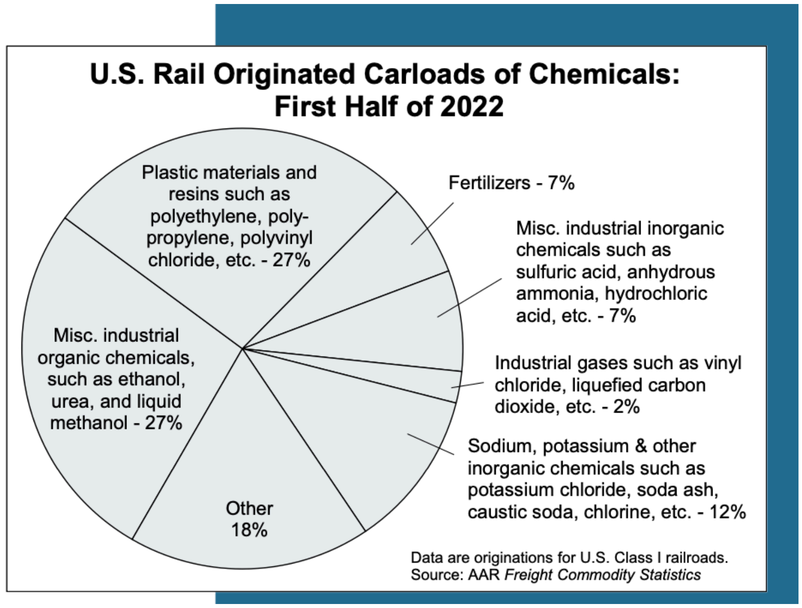
"The chemical industry is one of the largest U.S. industries. Its revenue of $517 billion in 2021 (excluding pharmaceuticals) was approximately seven times the revenue of the U.S. freight railroad industry. Although the U.S. chemical industry consists of thousands of firms located throughout the country, many plants are concentrated in the Gulf States, where petroleum and natural gas raw materials are readily available." — AAR Rail Time Indicators, September 6

"The outlook for earnings is dimming on the cusp of the reporting season. Historically, there is a tight relationship between the global manufacturing purchasing managers' index (PMI) and earnings growth for global companies, as you can see in the chart below. The PMI tends to lead the trend in earnings growth by three months, with the dividing line at 50 between expansion and contraction in global manufacturing aligning with the analysts' consensus outlook for earnings growth and contraction over the coming year. The PMI turned negative in September as the quarter came to an end, likely pointing to flat earnings on a year-over-year basis for global companies as we look out to the fourth quarter." — Jeffrey Kleintop, Charles Schwab & Co.

The third quarter of 2022 is now officially over. Earnings calls start October 20 with Union Pacific and run through October 26 — dates and times are on the respective railroads' websites. BNSF will report with Berkshire November 6. In the meantime, you can get commodity carload activity from the railroad websites.

Total North American year-to-date revenue units through October 1 (week 39) decreased 2.1 percent vs. the 2021 Week 39 units. Intermodal was the drain, down 4.2 percent, whereas carload freight including coal and automotive was essentially flat — down 0.2 percent.

Putting carloads into perspective, industrial chemicals is the largest individual commodity group at 15 percent of manifest carloads; grain is second at ten percent, and aggregates account for nine percent, so these three account for third of all manifest carloads.



According the AAR *Rail Time Indicators* for September 9, the broad STCC 28 chemicals group is comprised of industrial, chemicals, plastics, and fertilizers. See pie chart.

For the first half of 2022, about half the chemicals carload volume consisted of various industrial chemicals, including soda ash, caustic soda, urea, sulfuric acid and anhydrous ammonia. Plastic materials and synthetic resins account for more than a quarter of rail chemical carloads. Most of the rest is agricultural chemicals.[1]

As one reviews the quarterly earnings materials, this Warren Buffett quote should be kept very much in mind. “When Charlie and I read reports, we have no interest in pictures of personnel, plants, or products. References to EBITDA make us shudder: does management think the Tooth Fairy pays for capital expenditures?

“We’re very suspicious of accounting methodology that is vague or unclear, since too often that means management wishes to hide something. And we don’t want to read messages that a public relations department or consultant has turned out. Instead, we expect a company’s CEO to explain in his or her own words what’s happening.”

Too often the slides and commentary tend toward the comfortable words, not accurate picture where there railroad is, how it got there, and what management sees for the future in terms of revenue unit growth based on accounting methodology that is neither vague nor unclear.

There is no better way to size up any industry than to do a little stock screening. I use the Schwab *StreetSmart **edge** ® Screener+* to find the best-performing industry sectors and the leading companies within those industries. Chemicals is a sub-sector in the Materials Sector and the subindustries include all the AAR chemicals commodities.

[1] In 2021, trucks accounted for 58% of chemical tonnage shipped and 72% of chemical transportation costs, says the AAR. So you can see the chemical industry is hardly “captive” to the railroads, never mind what their representatives are telling the STB

I look for companies with market caps north of $500 million that have earned a Schwab Equity Rating of A or B. This screen gives me 13 chemicals companies including name-brand railroad customers such as Lyondellbasell, Olin, CF Industries, Mosaic, and Celanese. Armed with this list you can call on your customers, see who their vendors are, and compare the customer outlook with the Schwab (or other analyst) company report.

You should also be aware of the share price trends of your customers' vendors. For example, here is the three-month chart for A-rated fertilizer maker CF Industries:

There has been a sharp uptrend since the beginning of July, with the 200-day average (yellow) providing support; and prices are now north of both the 50 and 200-day lines (blue and red). Tells me the Street (more than 80 percent of trades are institutional as opposed to retail) is looking favorably on ferts. How about your fertilizer customers?