

# RAILROAD WEEK IN REVIEW

May 19, 2023

*“First and foremost, corporate culture determines the success or failure of an enterprise. The single, most important reason any company can survive for a long time is the existence of a corporate culture that motivates employees to give their all for the success of the firm and its customers. Once you have that culture, you must nurture, protect, and improve it as the central tool kit containing the guiding principles of management and employee behavior.” – James Cortada, IBM: The Rise and Fall and Re-invention of a Global Icon, MIT press, 2019*

*“We understand infrastructure needs around the world and that means the need for various minerals in steel production, or iron-ore mining. These latter things we understand. These latter things we can count. The latter things if dropped on your foot will hurt and we can understand that.” — Dennis Gartman Letter, February 9, 2011*

*“[My March 15 trip between Chicago and Detroit](#) aboard CSX’s beautifully refurbished Executive Train was most memorable, mainly because it was an opportunity to spend time with Joe Hinrichs, CSX’s recently appointed President and CEO, and a group of industry veterans who, in more ways than one, helped shape the industry into what it is today.” — Bill Vantuono, Editor-in-Chief, Railway Age, May 15*

**The US Department of Agriculture** expects total corn, wheat, and soybean production to increase by nine percent after a seven percent decline a year ago, the largest year-over-year increase in several years. Much of that will be for export for a five percent increase after two straight years of declines.

My interest is in where it goes and what railroads can be involved. As to the former, my new research assistant, ChatGPT, says:

**\*\* Processing:** Depending on the type of grain and its intended use, it may undergo further processing. Processing can include activities like milling, grinding, crushing, or cracking to produce various products such as flour, meal, oil, or feed.

**\*\* Distribution:** Once the grain is processed or if it's sold directly in its raw form, it is distributed to various destinations. Grain may be transported to food processing plants, bakeries, breweries, feed mills, or other end-users. Distribution can be done by truck, rail, or ship, depending on the location and the scale of transportation required.

\*\* Export or local markets: Grains may be exported to international markets if the country is a significant grain exporter. Otherwise, they may be distributed within the country to meet local demand for food, livestock feed, or industrial purposes.[end]

Two of the biggest corn processors are Cargill and ADM, both of whom are major railroad customers. The former Corn Products is now part of Ingredion, the result of a merger with Dutch-owned National Starch. General Mills, Kellogg, and Cargill are Listed processed food makers. All are part of the Consumer Staples sector which has been trading above its SMA 20 since March.

Then there are the poultry, pig and cattle feed markets, where short lines and regional railroads make a significant contribution. There are several short lines in the Carolinas and Georgia alone where brand names such as Perdue, Tyson, and Mountaire provide a significant customer base, and in Pennsylvania the Union County Railroad has won a new locally-owned and operated feed mill facility that will take a unit train a week of feed ingredients.

As to the Class Is, Scott Group at Wolfe Research notes that “overall agricultural products account for seven percent of total rail volumes but 15 percent of total rail revenues. CPKC and UP have the most overall grain exposure at around 19 per of total revenue. Looking ahead, the expected increase in U.S. grain production and exports should benefit the U.S. rails and UP in particular starting later in 3Q. We believe this will help drive an overall convergence for U.S. vs. Canadian rail volume trends.”

Grain may not necessarily hurt if you drop it on your foot, but it is a dense, heavy bulk commodity like coal, aggregates, and steel that *will* hurt if you drop them on your foot, per Gartman. And, again per Gartman, they all belong on the railroads. In short, the grain trade looks like a good place to be if you’re on the receiving end, the distribution end, or both. Time for my whole-wheat BLT sandwich.

(As an aside, a minor wobble in the supply of nitrogen fertilizers may push your local farmers’ applications into the third quarter. It appears nitrogen prices have formed what is likely a brief floor on a belated spring demand season, assuming farmers make up delayed spring applications of ammonia and UAN (urea ammonium nitrate) later.

**It’s time the railroads** got back to the core business where they have a natural competitive advantage. I’m thinking in terms of large volumes of heavy, dense materials where reasonable, consistent transit times will do. Thus is where Gartman’s drop-it-on-your-foot commodities fit best — raw materials and semi-finished goods from coal to corn to potatoes to plate steel to plastics to dimensional lumber by the thousands of board-feet.

Time-sensitivity is a function of the receiver's supply chain needs and what your customers need to keep their customers happy. I think the Canadian railroads do this particularly well. Just look at their first quarter commodity mix: these commodity groups make up most of their carload business and, combined with auto, make up some sixty percent of the total revenue units.

The demand is there. Although Trinity, GATX, Greenbrier, and Wabtec all report slowing deliveries due in part to the general slowdown in carload freight volumes, the second half looks better so customers better start lining up freight car space now. The RSI says the largest gainer in orders has been open top hoppers as absolute volumes for metallic and nonmetallic minerals plus coal remain strong.

The backlogs are there with tank cars and covered hoppers accounting for three-quarters of the backlog. GATX is capitalizing on the demand for leased equipment, citing its 11th consecutive quarter-to-quarter lease rate increase. Greenbrier at its April Investors Day introduced long-term targets, including more than doubling leasing and fleet-management recurring revenue in the next five years.

Wabtec's first quarter earnings call arrived with a note of optimism: "The underlying business fundamentals strengthened in the first quarter despite a challenging environment; we're expecting better margins in the back half of the year." And on the Q1 earnings call Trinity President Jean Savage said, "We expect to see segment operating margins up significantly as we take advantage of the manufacturing backlog and strong railcar lease environment."

For its part, the AAR shows that even though intermodal accounted for about half of the total revenue units, bulk commodities and raw materials account for nearly 90 percent of manifest carload moves. Yet the rate of change in carload commodities ex-auto was barely up and to the right — mostly under five percent.

Surely we can do better than that, given the competitive advantage the railroads provide for customers in these lanes. Happily, there are glimmers of hope. Surveys reveal that shippers expect to start shifting some of these volumes back to the rails this year after their significant share shifts from rails to trucks over the past several years.

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