RAILROAD WEEK IN REVIEW

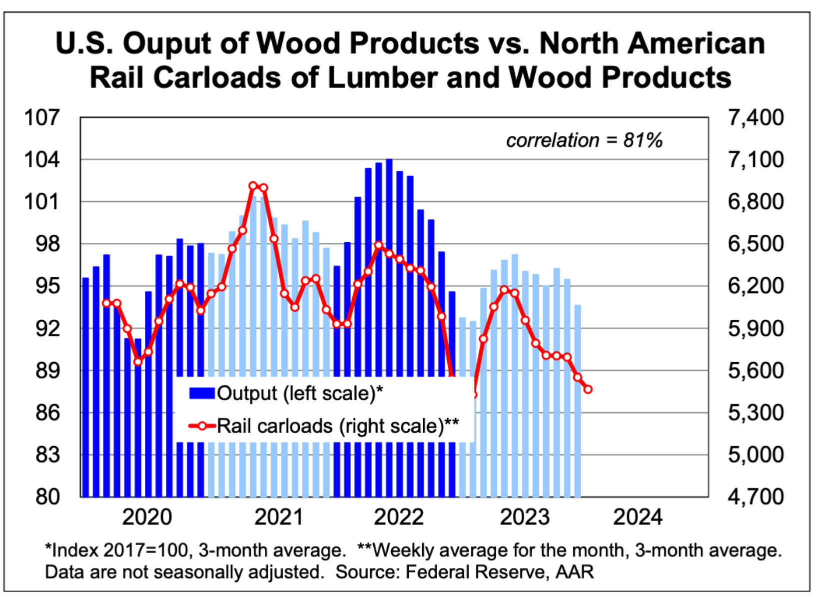
March 8, 2024

"The ongoing concern around railroad industry growth obscures the simple fact that railroad volume growth is the problem. Finding growth that supports the same margins and increased income levels seems to have put a ceiling on loading." — David Nahass, President, Railroad Financial Group, in Railway Age, Feb 2024

"Today, so many public companies feel compelled to focus on pleasing their investors with big dividends and share buybacks, and then they think about their customers. With me, it's the other way around. If you take good care of customers, you get more customers — and investors will be rewarded because revenue and profits grow." — Rob Krebs, CEO (Ret.), BNSF, Riding the Rails, © 2018

"The board continues to oversee management's successful execution of our strategy to balance safe and reliable service, continuous productivity improvement, and the pursuit of smart, sustainable growth. We are making disciplined investments in resiliency while driving efficiency, all to position our business to secure growth and strong incremental margins as the market recovers." — NS Presser, Feb 20

It appears railroads may be losing share in the percentage of US lumber and panel production. In addition to declining domestic production (see chart), STCC 24 carload declines could be from the increased use of offshore lumber, combined with continued reductions in lumber from British Columbia. Says the AAR, "US softwood lumber demand will increasingly be met by expanded supply from the US South, Eastern Canada, and overseas."



The trend for offshore lumber sourcing is mostly from Europe. Germany, Sweden, and Austria are the major players, in that order. The ocean container seems to be the preferred mode, limiting US railroad participation.

But regardless of where it's coming from, as long as there's construction there's going to be lumber, panel, OSB, and all that other good STCC 24 stuff. And don't forget the non-wood commodities going into construction.

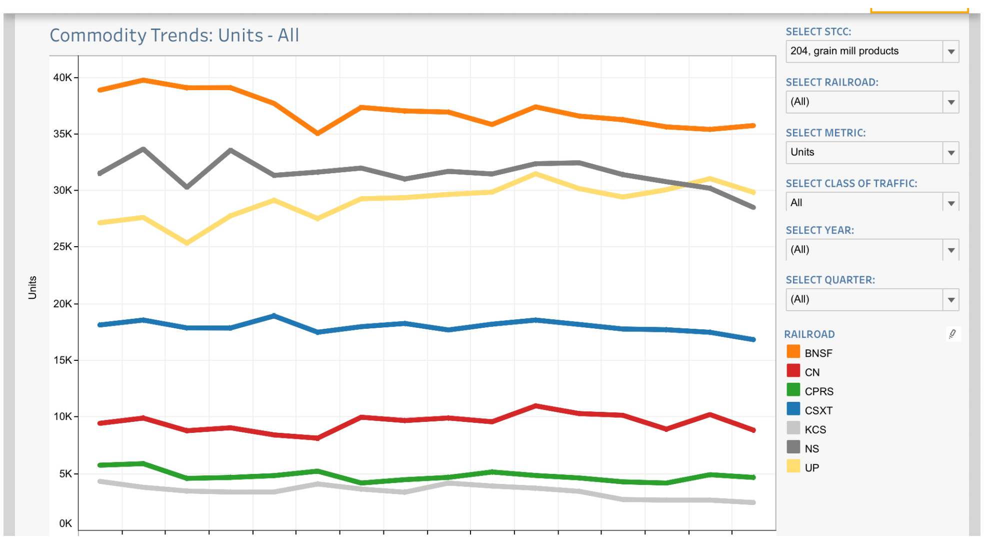
If your railroad is in the warmer climes of the US, you could be in good shape. Even though aggregates, for example, rarely move more than 50 miles, there are places (Austin/Watco) running 50-car unit trains of rock relatively short-haul. I can see asphalt and cement on longer hauls. BNSF specifically mentioned aggregates and cement opportunities at the 2018 short line meeting, still relevant today:

We know the south and west are gaining households because migration patterns (measured by one-way equipment rentals) continue to fuel growth in Florida ("snowbirds" moving from the NE to FL), the Southeastern U.S. ("halfbacks" leaving NE for FL then coming "halfway back" to the Carolinas) and Texas ("Winter Texans" moving from California to Texas).

Reasons for migration likely change from situation to situation, but common explanations for making the move include flight to lower cost of living/tax jurisdictions, favorable year-round weather, and post-pandemic remote work flexibility. Opportunity abounds if you know where to look for it. And the growth outlook in the South remains strong when also considering the migration of jobs and offices into the region due to its "business friendly" reputation.

Everybody knows how important the broad ag products are to the rails. The group includes STCC 01 grains — essentially unprocessed field grains, 50 percent corn and 40 percent split between wheat and beans — and STCC 20 "food or kindred products" — processed edibles from meat to potatoes to wine to ingredients like corn sweeteners and flour. It is this latter group I wish to address here.

They are all lumped together in what market watchers call "consumer staples," are tracked via the XLP exchange traded fund and are part of the consumer price index. Ergo STCC 20 carloads can provide a view on consumer food demand. So following the XLP can provide a view on likely STCC 20 carloads going forward.



BNSF is clearly the dominant player, with UP and NS in hot pursuit. The chart covers the years 2020-2023 so you can see there's not a lot of variation over time. And this is good for freight railroads in consumer staples. A nice, steady reliable carload stream without the variables found in building materials or industrial chemicals.

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