RAILROAD WEEK IN REVIEW

April 12, 2024

"Shortlines at our recent railroad happy hour acknowledged that improved service on the rail network has supported volumes in 1Q and average train speed for the Class Is indicates that harsh weather had a relatively muted impact on service… We see sustained service levels as a positive for the Class Is' long-term ability to price ahead of inflation." — Jason Seidl, Lead Rail Analyst, TD Securities, April 10 note

"There are significant risks in Ancora's reckless plan and its demands for a wholesale overhaul of management and the Board. These draconian changes would decelerate the momentum of Norfolk Southern's strategic transformation, force substantial furloughs, and destroy long-term value for shareholders." — NS press release, April 2

"Arkansas-based investment bank Stephens, Inc., found that 91 percent of shippers surveyed believe that Ancora Holdings' strategy – which includes focusing on the most profitable traffic and reducing the railroad's operating ratio to 60 percent within 14 months and to 57 percent within three years – would hurt Norfolk Southern's service." — Bill Stephens, Trains News Wire, April 4

Though Norfolk doesn't report until the last week of the month, the street is starting its prognostications early. From my collection:

** Remain Neutral on NSC shares as the proxy fight comes to a head in late April… Other management-related costs (proxy fight included) will increase operating expense. In spite of lower fuel surcharge revenue, adverse mix, and lower seaborne coal prices, management sees improvement in adjusted margins.

** Preliminary Q1 adjusted results were light of expectations as both revenue (reflective of RPU pressure) and the 69.9 percent OR (more inline vs. guidance but objectively weak). Recent operating changes reflect needed urgency to improve profitability…With a meaningful activist premium already embedded, we remain disciplined in adding exposure.

** Ancora and NSC have exchanged a steady flow of public messaging ahead of their shareholder meeting scheduled for May 9… Recently, NSC updated 2H OR guidance that is better than consensus forecasts, and long-term guidance that is 140bps better than previous LT outlook. Ancora stated they could see an OR of 57 percent within three years. We take long-term targets with a grain of salt." Like Yogi Berra is purported to have said, "It ain't over till it's over."

Warren Buffett and Benjamin Graham are great proponents of “intrinsic value,” essentially the present value of the sum of the cash flows five years out. Since that’s way above my pay grade, I look at “owner earnings” — cash from operations less capex. Back in 2016 NS had owner earnings of a $billion. They finished 2022 at $2.9 billion for a 7-year CAGR of 16.4 percent (I’m using 2022 because 2023 was an aberration due to East Palestine.)

Meanwhile, the NS share price has risen 13.4 percent, pushing toward $250 from the $118 six years prior. I avoid using the earnings per share because it’s operating income polluted by all the below-the-line noise plus share buy-backs. So, on an owner-earnings basis NS appears to be fairly valued. The OR is never part of the discussion.

As you can see from this 5-year chart, Norfolk share prices have done better than the Dow — red line below. (I avoid S&P comps because it’s so heavily skewed toward the tech side) and have recovered nicely from the occasional dips.

A friend writes, “There is still work to be done to get Class Is and short lines on the same customer advocacy page. I can think of no better way to start than with a Zoom call or text thread among a handful of shortline owners and leaders to once again address the topic of railroad relevance in the 21st century.

“Specifically we need to lead off with a discussion of how the railroads, large and small, must work to be successful going forward. To start, we could show our Class I contacts the successful moves we have made and how the Class Is contributed.”

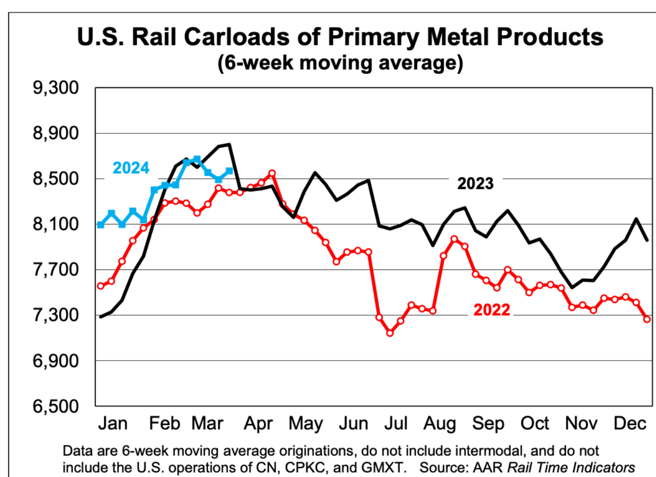
In my experience, the most successful moves have trip plans from release at the origin to placement at destination; UP had at one time been particularly helpful. To keep transit

times down, for example, we could tell the origin customer which days of the week to release cars by destination so as not to hit any yard on a weekend when it was closed. That was when operations and marketing ran the railroad, before the money changers got into the temple. Vena to the rescue?

I'm afraid that, until the Class Is move away from paying the C suite on share prices rather than building a customer base, it will be tough for short lines to get any more traction. I mean, if Chuck Baker can't do it, I see little chance of a number of independent short lines getting anything done.

Perhaps the best thing any of us can do is to keep the pressure on our connecting Class Is to behave and keep service levels where they need to be for us to keep our customers happy. Alan Shaw has the right ideas for NS, I think. Now he has to get his VPs in line. The alternative is Arcona.

The AAR's Rail Time Indicators for April reminds us, "When the overall economy is doing well, there's a good chance railroads are too. However, when the parts of the economy associated with goods (i.e., goods production, trade in goods, consumer spending on goods) are doing well, railroads are more likely to be doing well."



I've written recently about the Industrials Sector overtaking the Technicals Sector in share price increases. And within industrials, I think the metals group is an excellent leading indicator for more carloads. This is 90 percent primary metals — ingots, bars, coils, slabs — and in recent years the metals group category has accounted for between three and four percent of total U.S. rail carloads.

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