RAILROAD WEEK IN REVIEW

July 19, 2024

“Overall, sentiment on transport stocks has modestly improved compared with 3 months ago with 61% of investors now expecting transport stocks to outperform the S&P 500 this year, up from 54% last quarter. We think this reflects a catch-up trade after transports have badly underperformed this year, along with improving sentiment on the group as it seems like we’re finally getting closer to a Fed easing cycle again.” — Scott Group, Wolfe Research, July 14

“UP will experience service variability in the Houston-Galveston area until commercial power is fully restored and all roadways are accessible for transporting crews. Customers with rail shipments moving through the impacted area should anticipate some delays.” Rick Paterson, State of the Rails, July 14

“Our predictive freight survey suggests truckload contract rates will decline sequentially off the baseline. We view the index as a modest negative for the truckload group and neutral for the LTL group. Our survey work suggests a continuation of broad market uncertainty and a lack of confidence in the current spot market bounce.” — Jason Seidl, TD Cowen Research, July 14

Anacostia’s Pacific Harbor Lines (PHL) and the BLET have successfully ratified a three-year extension to their current collective bargaining agreement well ahead of any deadline. The extension—effective May 1, 2024 through September 20, 2027—covers 145 of PHL’s 180 employees and was ratified on July 12 by a record number of eligible BLET members with more than 90 percent voting in favor of the agreement.

Key highlights include wages and benefit provisions. The extension sets competitive wage structures, while maintaining the same lower-than-rail-industry employee contributions for health benefits.The ratification of this agreement emphasizes the power of dialogue and cooperation in achieving mutually beneficial outcomes.

By way of background, PHL provides transportation, maintenance, and dispatching services to the Ports of Long Beach and Los Angeles, which together form the largest container port in the United States. PHL dispatches all BNSF and Union Pacific trains within the ports. PHL parent Anacostia Rail Holdings operates six non-Class I freight railroads in seven states.

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Further indications that earnings announcements may affect share prices: this chart shows CPKC share prices around the time of the 1Q2024 earnings call April 24. Reported EPS was down three percent. The call itself was after the close so the share price drop was April 25 — see the big red price and volume bars about an inch in from the left side. You get the same pattern for NS where EPS was down 89 percent.

It works the other way, too. UP reported on 4/25 before the bell 1Q2024 EPS, up just a point on vols -1%. That day shares closed at $241, up 2%.

It's clear that institutional investors are indeed watching railroad performance numbers. Changes in revenue-unit counts drive revenue and that's the denominator of the OR. And if institutional traders are watching, then share price direction could provide a clue as to volume changes.

It's also important to note that what's down stays down to a point. Ditto upward trends. CP has dropped from its $91 YTD high and has yet to recover; UP rose to $247 in a week but has since pulled back a tad on the soft economy. Railroad earnings calls start July 23 with CN. I expect modest earnings results across the board.

Labor continues to strengthen its grip on railroad regulation at the Federal level. *Railway Age* Capitol Hill Contributing Editor Frank Wilner writes that President Biden has tapped Robert Primus to succeed Marty Oberman as head of the STB. In short order Primus just last week scheduled a public hearing in Washington September 16-17 "to gather information about recent trends and strategies for growth in the freight rail industry."

Invited to testify are "executive-level officials" from all Class I railroads plus representatives from smaller railroads, labor unions, shippers, rail suppliers and industry analysts. Primus called the hearing without seeking a concurring vote of fellow STB members.

Wilner writes, "The subject of this hearing displays unreserved moxie on Primus' part. He has a perceived cozy relationship with rail labor plus owns a history of a prickly exchange with the late and former CSX CEO Jim Foote from an April 2022 hearing called by Oberman looking into rail service disruptions. Foote, the only CEO to attend, termed his attendance a ‘courtesy, to the Board and soon found himself in a contentious exchange with Primus.

I remember that exchange vividly. As I wrote in WIR at the time, “Foote went into great detail explaining, among other factors, the challenges of projecting market changes, especially when customers over- or under-state their own outlooks.” Primus grilled Foote mercilessly, obviously making Foote most uncomfortable, and was seen by many watching the Zoom call — myself included — as unnecessarily harsh and even rude.

Wilner continues, “If Primus intends to impersonate a railroad board of directors and cross-examine rail officials as to marketing and investment strategy decisions, his reach may exceed his statutory grasp. The STB statute provides for regulating service disruptions, anticompetitive activity, rate reasonableness, revenue adequacy and financial health. The statute does not give the STB authority to regulate crew size, employee head-counts, train length or capital investment.”

Moreover, “Questioning Primus’ motive for this arguably problematic September hearing is proper given a perception he has a thumb on the regulatory scale in favor of rail labor. Just days before announcing the hearing, Primus was hosted by the Transportation Division of the International Association of Sheet Metal, Air, Rail and Transportation Workers (SMART-TD), telling its leadership, ‘Thank you for letting me represent you.’”

Wilner properly concludes, “Railroads are not without opportunity at this hearing to explain the devastating impact of declining coal revenue and an urgency that the STB not reverse a 44-year course of limited economic regulation.” I thought Oberman brought a refreshing understanding of how railroads work to the STB and provided an unrelenting focus on the railroad-customer dynamic. Let’s not see that undone.