RAILROAD WEEK IN REVIEW

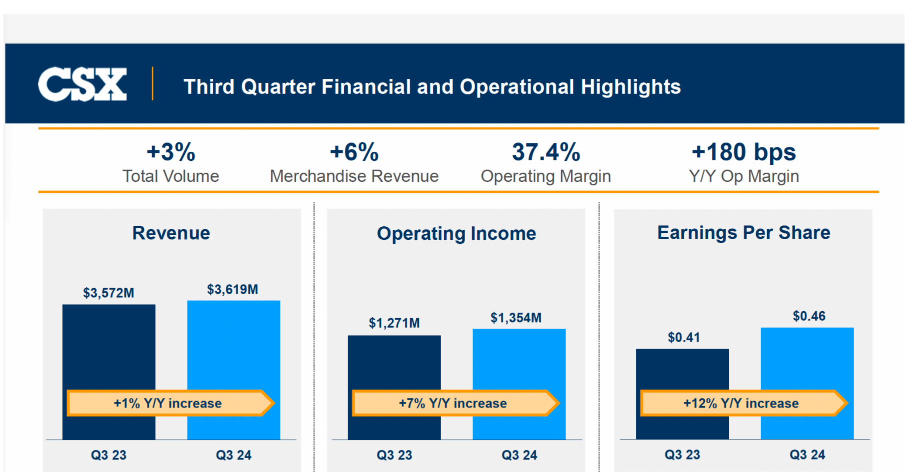
October 25, 2024

“We’re only hiring for attrition and we’ve got line of road capacity. So, you take all that together, it’s a good setup for strong incremental margins. There are always things we can’t control that could make it easier for us to achieve margin improvement and operating income growth, which, frankly, is the first goal. Operating margin is really sort of the outcome of all of it as we grow into the existing capacity.” —Sean Pelkey, CFO, CSX, during earnings call Q&A, October 17

“Let me say a few words on operations. We implemented our scheduled operating plan 30 months ago now. It’s proving over and over again to be the right plan for our network and the velocity it creates, the levels of customer service it supports, and in its resilience and ability to recover.” —Tracy Robinson, CEO, CN, October 23 earnings call

“The merchandise segment produced year-over-year volume growth led by our grain markets and segments of our chemicals business. NS was able to deliver this growth backed by a service product that our customers can count on every day. This marks the 37th out of the prior 38 quarters where merchandise RPU less fuel grew year-over-year. — Ed Elkins, NS Chief Marketing Officer, October 23 call

CSX has resumed its position as lead-off batter in the quarterly earnings game. Revenue for the quarter increased 2% on 1.6 million revenue units, up 3%. Merchandise carload including automotive increased 6% with particular strength in chemicals and ag/food, both up more than 10%. Revenue units for both groups were up more than 9%. Average revenue per carload decreased 40 basis points on the 14% drop in fuel surcharge collections, which in turn cut reported RPU by 16%.



It should be noted right up front that “during second quarter 2024, CSX completed a review of the accounting treatment for engineering scrap and certain engineering support labor and identified misstatements between the balance sheet and operating expense.” Even though these accounting errors “were determined to be immaterial to previously issued reports” and will not effect forward financial statements, it remains that there were errors in the reported results that were not caught at the time. Makes one wonder about the veracity of this set of reports in spite of their disclaimer.

Operating income rose 7% to $1.4 billion; the operating ratio dropped 280 basis points to a respectable 62.6. Net income increased 8% to $895 million; earnings per share gained 11% on the 3% reduction in shares outstanding. Net income year-to-date was $2.7 billion, down two points, and cash from ops was $3.9 billion, off four points. Owner earnings (cash from ops less capex) dropped 12% to $2.2 billion.

The view from here is that CSX is still very much a work in progress. Yes, there’s been some management reshuffling — the shortline group comes first to mind. But the respectable Q3 results in the manifest carload sector were much better than the YTD numbers showing this is indeed a company on the mend.

Norfolk Southern was next up and I have to say that while listening to the call I sensed an air of renewed confidence and positivity starting with CEO Mark George. First quarter revenues were $3 billion, up 3% on 1.8 million revenue units, up 7%. System RPU slipped 4%. Merchandise carloads crept up a point and half led by the ag/forest/consumer group and chemicals. The weakness in the metals cohort showed up in the 10% drop in met coal and little change in metallic scrap.

GAAP results are a little misleading thanks to the manner in which the East Palestine expenses and income from line sales have to be treated. As a result, operating expenses declined 34% and ops income more than doubled to $1.6 billion. Though I am not generally a fan of non-GAAP numbers, I am grateful that NS provides a separate table to strip out the exceptions to get what looks like a more “normal” set of operating figures. As a result, ops income increases to $1.1 billion, up 22% — still a respectable number.

The operating metrics improved markedly. Terminal dwell was down, car-miles per day and train speed improved; merchandise trip plan compliance was unchanged at 80%. I’ve said before NS had too many assets chasing too little freight and COO John Orr its clearly addressing this. Even as revenue units increased, they have year-to-date parked 500+ locomotives, improved fuel efficiency 5%, and increased GTMs per available horsepower by an additional 8%.

Finally, the financials are improving — as one might expect with an ex-CFO running the show. Current ratios of the railroad industry as a whole have always seemed stuck north of one; NS closed the Q at zero point 78. Owner earnings — operating cash flow less capex — increased by a third. Retained earnings increased 5% to $11.7 billion. I'd say they're off to a good start.

CN presented their 3Q2024 results Tuesday afternoon. Freight revenue increased 3% against a 2% drop in revenue units, even as RTMs grew 2%, partly on CN's move to higher-cube covered hoppers for grain. Long-haul opportunities in refinery products also contributed.

As we've seen elsewhere, "heat and eat" commodities are the sooner winners. Grain and fertilizer revenue increased 9% on 7% more carloads. The petroleum/chemicals franchise saw revenue increase 11% on a mere one point volume gain. Regarding this last, Chief Commercial Officer Remi Lalonde said on the call, "We saw RTMs and revenue gains in petroleum and chemicals due mainly to refined fuels and NGLs, including projects like the Greater Toronto Area fuel terminal and propane exports through Prince Rupert."

Operating expense increased 5% against the 3% revenue gain, pushing the OR up a mere 119 basis points to a still respectable 63.1. There were no extraordinary changes in the expense lines, though the railroad burned 5% more fuel to handle 2% more GTMs. By the end of September car velocity stood at 219 miles per day, dwell had dropped by seven hours, and meeting local service commitments hit 95%.

To sum it all up, CEO Robinson put it this way at the end of the formal remarks: "Without a doubt, our margin is going to improve in Q4. Now Q3, as you know, is normally the quarter that we have our best margins, and this year, it's going to be Q4. We're pushing hard to rightsize the railroad to the volume that we now expect. And I think what's really going to determine exactly where it lands is international volumes. Remi is watching that very closely and working hard to get that up again. And that will drive exactly where it's going to end up." *Pas mal.*