

RAILROAD WEEK IN REVIEW

Friday the 13th, December, 2024

*“For CSX, our rating is **Hold** as we believe shares are close to fair value. CSX holds strong positions in commodity freight markets and other markets in the Merchandise segment (auto and minerals used for infrastructure-related activities), which we view as well-positioned businesses in the medium term.” — CFRA Stock Report, December 7*

“Share repurchases may be made through a variety of methods including, but not limited to, open market purchases, accelerated share repurchases and negotiated block purchases. The timing of share repurchases depends upon management's assessment of marketplace conditions and other factors, and the program remains subject to the discretion of the Board of Directors. Future share repurchases are expected to be funded by cash on hand, cash generated from operations, and debt.” — CSX Form 10-Q, September 30, 2024

“The chemical sector has been an area of CSX strength really across the board — plastics, LPGs, petroleum. So a lot of strength playing out within that market. And we do see that continuing. I don't think we'll see the same level of growth on a year-over-year percentage basis in '25 as we did in '24, but expect that to continue to be a positive market for us.” — Sean Pelkey, CFO, UBS Global Industrials and Transportation Conference, December 4

Whenever I'm running or advising a short line, I pay very close attention to my connecting Class Is' SEC filings, quarterly earnings calls, and comments at investors conferences such as the UBS event cited above. I find that what I call “listening between the lines” and the manner of oral presentation can provide important clues to the presenter's operational, financial, and commercial health.

Then I look at my connecting Class Is' performance at my interchanges as well as their over-the-road performance in the commodity O-D pairs my customers use. Where there are delays, I can go to the weekly STB performance reports, eyeball Rick Paterson's weekly *State of the Rails* report (which forward on to present clients), or even look at Trip Plan Compliance, if the Class I will oblige me.

Armed with this intelligence I can better schedule crew-starts, track maintenance, and 92-day inspections. I can also adjust switching schedules to minimize the impact of Class I missteps on the customer's supply chain. But it all starts with Following the Financials. Begin with the Notes section in the 10-Q and you'll be amply rewarded.

I've mentioned before the importance of staying ahead of the business curve. This is what the picture looked like two weeks ago. The white is the large company Institute for Supply Management (ISM) outlook; the blue is the same for the National Federation of Independent Businesses (NFIB), which represents mainly smaller companies.

My sense is the NFIB number is a better fit for the smaller railroads. They may not have a US steel or ADM facility but a local steel fabricator or grain mill is a distinct possibility.

These charts are prepared by GMI head of macro research Julien Bittel at least monthly and I find them helpful in staying ahead of the railroad volume outlooks and trends.

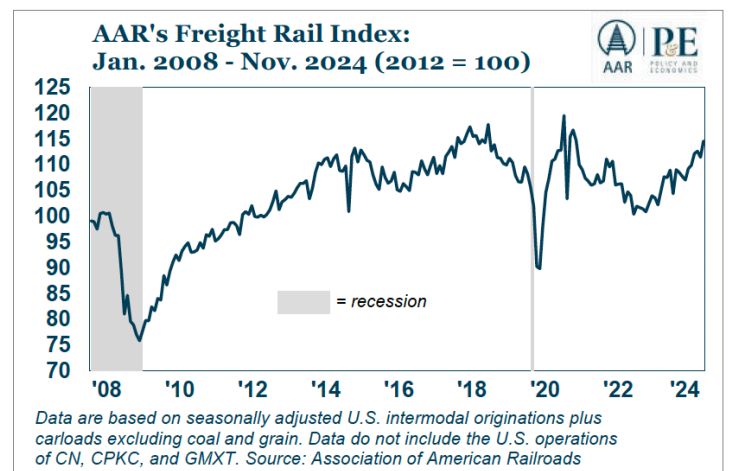
What Julien is suggesting here is that the small business expansion in the next quarter will lead any large company expansion by at least a quarter. He adds that purchasing and hiring trends lead the expansion by some months, so it's entirely possible that we could begin to see carload volume increases starting in a few weeks.



The AAR's monthly *Rail Industry Overview* can be very helpful in putting general economic trends into actionable railroad management tasks. From the December issue:

“The AAR’s Freight Rail Index (FRI) is defined as intermodal plus carloads excluding coal and grain. We exclude coal and grain because their carloads tend to rise or fall for reasons that have little to do with what’s going on in the broader economy.

“For most rail traffic categories, what’s going on in the broader economy absolutely matters.” Note how the blue NFIB line in the AAR chart mirrors the blue NFIB curve above.



The AAR continues: “In November 2024, the FRI was the highest it’s been since May 2021 and is up 2.8% over October 2024. This suggests that, while the economy has its challenges, it remains generally on solid ground.” To be sure, carload volumes have not set any records in the past couple of years, but the railroads have used this low to good advantage, getting their arms around costs and operating disciplines.

The AAR sums up the situation nicely in three bullet points:

- *The Job Market Remains Robust.* Strong November job gains boosted consumer confidence, supporting continued spending growth.
- *Factory Activity Remains Weak,* impinging on rail carload volume. Flat rail carloads of industrial products in November reflect weak factory activity, with volumes down 1.0% year-to-date.
- *The Carload Big Three — Coal, Grain, and Chemicals — Are on Different Trajectories.* Coal carloads are down sharply this year, continuing a multi-year slide; chemical carloads are at record highs and grain has recovered from a dismal 2023. Together, these categories account for half of total U.S. rail carloads.

The first two are the main drivers. Without any new orders, manufacturers are not going to be bringing in raw material or producing outbound carloads. Decreases in carloads and customer demand naturally inveigh against hiring additional workers. Which is precisely why hiring levels and manufacturing activities are leading indicators of industrial activity.

The AAR concludes, “Adjusted for inflation, year-over-year consumer spending on goods rose 3.1% in October 2024 over October 2023. This robust growth in spending on goods has been a key driver of the sustained surge in rail intermodal volume throughout the year. And While not all labor market indicators are flashing green today, the overall picture remains healthy, which bodes well for railroads that rely on strong consumer demand and economic activity to drive freight volumes.”

The improved traffic potentials point straight to the railroads’ ability to handle the growing traffic base. And that takes capacity: locomotives, crews, and track space. You’ve read here and elsewhere about how Canadian National is growing capacity on its transcon from Winnipeg to Prince Rupert. You’ve read about BNSF incorporating a more robust signaling system on its ex-Santa Fe transcon. And I could go on for several pages.

I’d say it all bodes well. Bring it on.

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