RAILROAD WEEK IN REVIEW

July 18, 2025

"Deere has increasingly invested in connecting its machines to GPS and other technology architecture to boost their performance in the field. In 2020, management launched its 'Smart Industrial' operating model, which included a reorganization of its reporting segments to focus on customer production processes and where Deere can enhance efficiency via technological innovation" — Morningstar, May 15

"We note the recent 5% reduction in CSX middle management was announced less than two weeks ahead of the 2Q25 print. While ultimately supportive of long-term margin improvement, the timing of the announcement struck us as somewhat odd and arguably reactionary… In that context, we have some concern that the headcount reduction action may have been informed by early visibility into 2Q25 financial results." — Baird Equity Research note, "Adjusting Our 2Q25 EPS Estimate," July 14

"Tariff uncertainty continues to pressure the new railcar order book. End users are unwilling to make capital decisions due to volatile policy, and the inquiry-to-order conversion rate remains weak. Panelists noted that railcar users need 6-7 months of forecast clarity to justify the capex. While panelists are seeing speculative purchases up slightly, the bulk of ordering activity is replacement or linked to new plants." — Cowen Research note, July 15

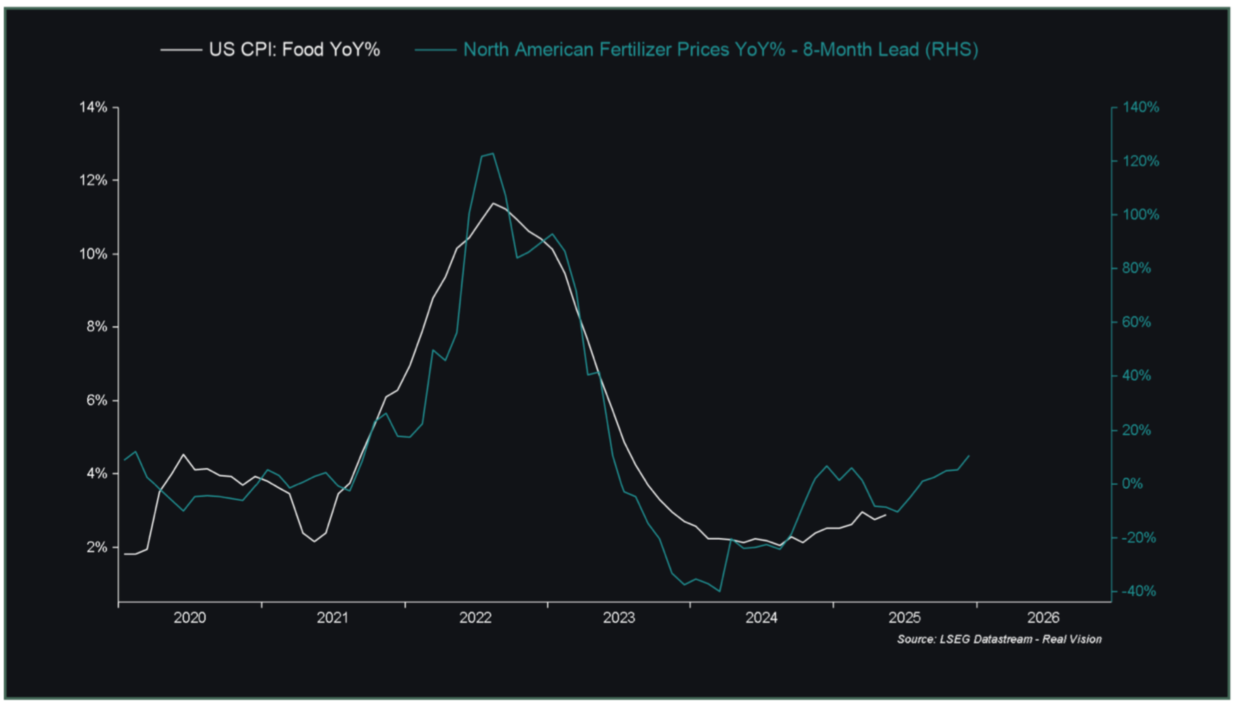
The June NFIB report showed a sharp increase in the percentage of small businesses reporting year-on-year sales growth. This tick higher was notably strong and supports the view that the business cycle is gaining momentum rather than slowing down. It also reinforces the idea that the ISM is in the process of bottoming – a view echoed by several of our leading indicators. All signs are pointing to a cyclical turn taking shape right now." — Real Vision Macro Investing Tool, July 15

Now that we're seeing the second quarter results — carload gains, improved margins, more revenue, increased earnings — it's time to start drilling down into the 10-Qs and find out what's really going on. For instance, it continues to bother me that revenue increases a mere percentage pittance while net income growth percentage is a positive multiple of that. The commodity trends are key.

The AAR grains category continues to be in the top three growth sectors for the railroads and I think watching what's happening in fertilizer can provide a good idea as to what present and future crop trends are going to be. This chart from the Real Vision Macro Investing Tool dated June 19 is an example of what I'm talking about.

Says Real Vision, "Fertilizer prices are on the rise (blue line on this chart) and typically lead the Food CPI by around eight months.This is another segment we expect to keep climbing, based on that historical relationship and our broader business cycle outlook. Food is 14% of total Headline CPI. So, when we factor in Core Goods at 19% and now this additional 14%, that's 33% of the CPI basket we think will continue rising."

It's important to note the chart is in terms of *cyclical* inflation here – inflation driven by the business cycle – not structural inflation, which is driven by demographics and productivity trends. I've written here in WIR about how structural forces like demographics and AI-led automation are deeply deflationary, with the latter eventually making everything so cheap that cyclical inflation will cease to show up on the charts.



Some time in the next ten years cyclical inflation will simply get rolled into a sustained, persistent trend. The tea leaves seem to be saying that AI and robotics reduce labor costs across multiple sectors including food production, fuel, and freight. Productivity will undoubtably increase, leading to lower marginal costs of production.

In agriculture, “precision agriculture” from Deere and others could conceivably expand supply capacity in terms-of food products per acre, allowing prices to increase faster than pressure on prices. Higher prices are an incentive for more planting more acreage, which in turn will increase fertilizer demand and more tonnage on the rails.

“One third of our carload freight originates or terminates on a short line,“ says Mark Ganaway, BNSF general director of marketing, leader of the Shortline management group at the railroad. That would be more than a million carloads a year including coal and coke, based on the 2024 numbers in the 10-K.

Excluding coal/coke, ag products is the biggest commodity group, followed by, in descending order, chemicals/petroleum related, and the broad industrials group from chemicals to metals, forest products, and aggregates, worth about $12 billion in total revenue — call it $4 billion from the short lines.

BNSF shows more than 200 individual short lines spread throughout its entire system. They range in size from Watco’s 4-mile Yellowstone Valley to the independent Red River Valley & Western at 517 miles. A growing number of these names — RRVW among them — participate in the BNSF *Shortline Select* program, a strategic initiative that brings BNSF and a group of performing short line railroads into closer alignment.

From the description of the program at bnsf.com, I can only conclude that they have taken the “go see the customers“ rule to heart. Says Ganaway, “We want to make sure that the service we’re collectively providing exceeds our customers expectations.” The program, says BNSF, “is built around shared goals: improving service, increasing transparency, and driving growth for customers.”

An up-front benefit of this collective effort is improving trip plan compliance. An outbound carload originating on a short line can be released by the customer to the short line, triggering a trip plan on the connecting Class I from origin to destination, regardless of carrier. That’s the way it should be.