December 4, 2019 | 4:15 PM EST

Intermodal Markets

Overview

Over the past two days, North American Class I railroads have conducted investor presentations at the Credit Suisse Annual Industrials Conference in Palm Beach. Yesterday, CSX CEO Jim Foote spoke; this morning Norfolk Southern CEO Jim Squires delivered remarks and answered analyst questions.

Both the CSX and NSC presentations held clues to the Eastern rails' intermodal strategies going into 2020. A week ago, we wrote that our intermodal rate data, when read in conjunction with falling volumes, indicated that the railroads were not willing to lower prices to compete with trucking, and management comments at Credit Suisse have confirmed that hypothesis.

Foote said that CSX has largely completed the demarketing of about 15% of its intermodal capacity and would look to grow volumes beginning next year. Foote also said that CSX believes it does not have to lower prices in order to achieve volume growth; he claimed that CSX's intermodal business has an on-time rate of 98% and service "better than a truck."

Norfolk Southern is in an earlier stage of its operational turnaround. NSC has been discussing "clean sheeting" (i.e., redesigning local operations from a clean sheet of paper) for more than a year now, and its intermodal business is still in the process of clean sheeting. In other words, NSC is still working to optimize its network and is not yet ready to grow intermodal volumes — that will come with Stage 3 of its TOP21 strategic plan.

Spot rates per mile

Chicago to Linden, NJ	$1.84
Los Angeles to Dallas	$1.53
Linden, NJ to Chicago	$1.16
Los Angeles to Chicago	$1.16
Chicago to Los Angeles	$0.92

53-foot container volume seven-day MA (weekly change)

Los Angeles to Chicago	922.20 (-24.3%)
Chicago to Los Angeles	579.40(-31.30%)
Chicago to Elizabeth, NJ	302.60 (-56.8%)
Los Angeles to Dallas	343.20 (-23.04%)
Chicago to Harrisburg, PA	312.40 (-26.49%)

Outbound intermodal tender rejections

Savannah, GA	1.03%
Joliet, IL	1.92%
Chicago	1.64%
Memphis, TN	0.39%
Los Angeles	1.86%

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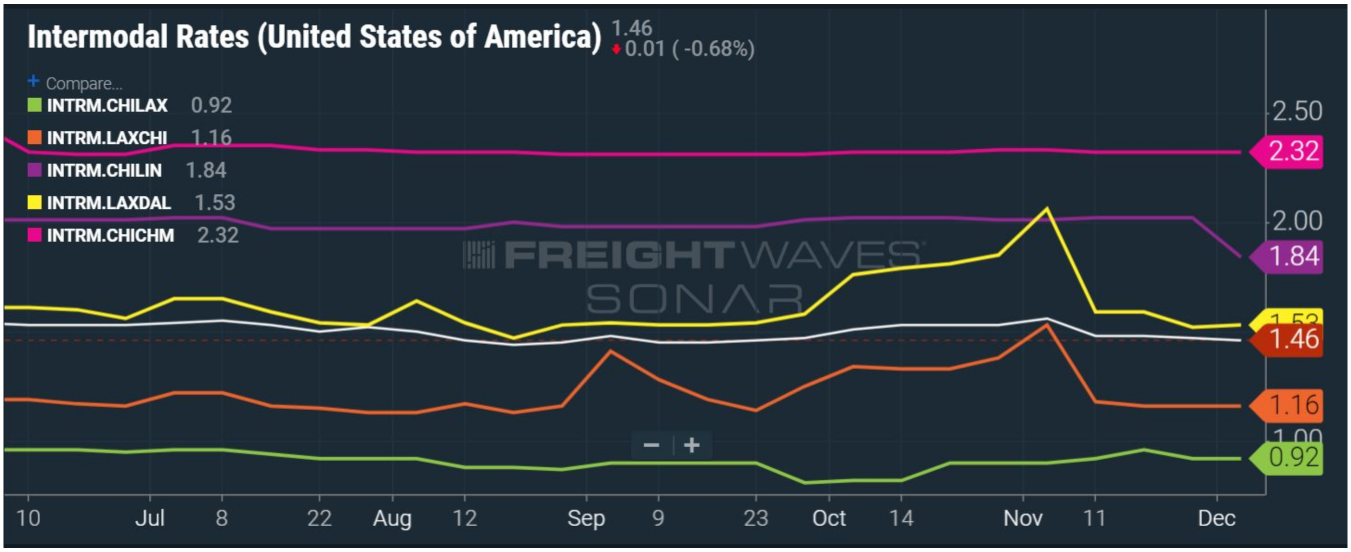
Intermodal spot rates



(Chart: FreightWaves SONAR)

Intermodal rates continue to remain steady, which we expected. Chicago to Linden, New Jersey, (i.e., New York City) did see a modest drop in rates to $1.84. We believe that moderation in truckload tender rejections will help keep intermodal rates contained.

Per management comments from CSX, it is increasingly likely that the spread between intermodal rates and trucking rates will narrow further. This comes as service improvements continue to take hold. We take today's TOP21 guidance from Norfolk Southern to mean that the railroad will not soon be in a position to go after intermodal volumes; this is bullish for intermodal spot rates on the East Coast, particularly out of NSC's Atlanta hub.

"Our expectations for a stairstep recovery in intermodal volumes and pricing are muted given abundant excess truckload capacity and still-falling rates," wrote Susquehanna equities analyst Bascome Majors this morning in an investor note. We would add that for us, the Eastern railroads' own operating plans underscore those muted expectations.

Railroads are not budging on price and instead seem content to tolerate lower volumes while they wait for trucking capacity to appreciably tighten. Trucking spot rates from Los Angeles to Dallas surged 5.7% over the past week to $1.65/mile, widening the spread against the intermodal rate, which did not move. At this time, we believe the movement in truck rates on that volatile lane is related to temporary peak demand and should not result in a concomitant move in intermodal pricing.

Freight demand

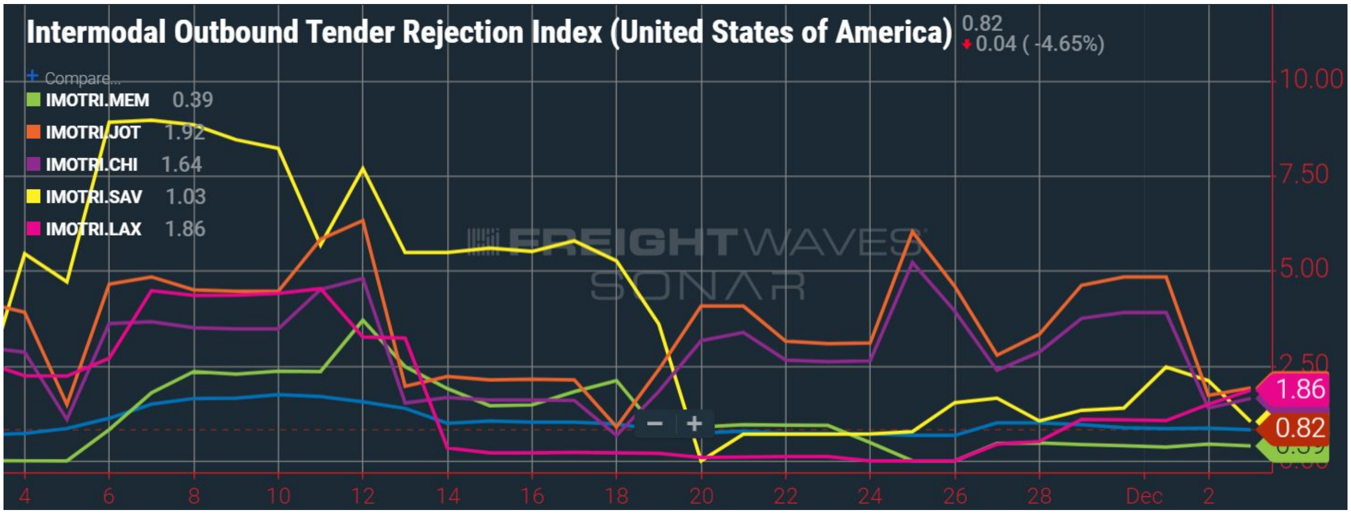
This past week saw some pretty dismal Y/Y comparisons, with total intermodal units down 24.5% compared to the same week in 2018. This is due to Thanksgiving coming one week later this year than last. It is likely that we will see more normal Y/Y comparisons next week as it is back to business as usual before the Christmas season comes around. Note that last week had a favorable comparison against the 2018 holiday week, but volumes were only up 13.5% year-over-year; in other words, while this week was not as bad as it looked, it was still bad.

The railroad that has seen the biggest decline in intermodal volumes over the past four weeks has been Union Pacific. Union Pacific has seen a decrease in intermodal volume of 14.0% over the past month. This coincides with a drop-off in maritime import shipments into Los Angeles, a major terminal for Union Pacific. LAX maritime import volumes are down 23.8% Y/Y. With companies potentially trying to front-run increasing tariffs on Dec. 15, Union Pacific could see a pickup in volumes albeit short-lived.

Weak Union Pacific intermodal volumes and customs imports into Los Angeles should be understood in the context of relatively weak freight demand on the trans-Pacific maritime trade lane. After each of the container lines' attempts at general rate increases, 40-foot container spot rates from China to West Coast ports (FBXD.CNAW) have converged downward to market prices. The rate is currently $1,332.59 per box.

Soft demand out of Southern California is truly multimodal. Outbound contracted truckload volumes (OTVI.LAX) peaked on Oct. 9 and have fallen since, even leading into the Thanksgiving holiday last week.

Intermodal capacity



(Chart: FreightWaves SONAR)

Intermodal capacity continues to remain loose this week coming off the Thanksgiving holiday. Intermodal outbound tender rejections (IMOTRI.x) were higher on Thanksgiving and the weekend following. Over the past few days, rejections returned to a similar position to where they were the week prior, with the exception of Los Angeles, which continues to tighten. This time last year, we saw capacity get extremely tight in Chicago and Joliet, Illinois, with a huge spike in rejections — nearly 20% of intermodal loads were rejected. This year we have not seen that spike and rejections remain on the floor. We expect this trend to continue as we exit peak rail season and enter Q1 2020.

(Chart: FreightWaves SONAR)

Intermodal rail speeds have increased since the beginning of November. All of the U.S. Class I railroads are averaging speeds above 30 mph with the exception of Norfolk Southern, which is just shy of the 30 mph mark at 28.6 mph. Higher velocities are good news for shippers with time-sensitive freight. Depending on the lane, intermodal shipping takes a day or two longer to reach the destination than trucking because of the number of times the load has to change hands.