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Intermodal markets

Overview

Railroads are set up to have a much better year for intermodal in 2020 than they had in 2019. Last year, volumes were under pressure from slowing economic growth, trade tensions, competition from the highway and the operational changes implemented by railroad executives.

Going into 2020, most railroads have rationalized their intermodal networks, have maintained pricing at levels that will yield significant operating leverage once volumes return, and are waiting for trucking capacity to correct itself.

In two important lanes — Chicago to Linden, New Jersey, and Chicago to Los Angeles — intermodal spot rates actually went up.

The bigger question hanging over the railroad industry at the moment is whether the secular growth trend for intermodal is over and if further positive volume moves will be on the margins. Much of that depends on the complex landscape of the trucking industry; even new regulations like the Drug & Alcohol Clearinghouse are still question marks as to their ultimate impact on capacity.

On Jan. 16, CSX kicks off the transportation industry's earnings season with its fourth-quarter report. J.B. Hunt reports the next day. Those two companies' guidance will shed more light on 2020's intermodal outlook.

Spot rates per mile

Chicago to Linden, NJ	$2.02
Los Angeles to Dallas	$1.56
Linden, NJ, to Chicago	$1.16
Los Angeles to Chicago	$1.19
Chicago to Los Angeles	$0.94

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

Los Angeles to Chicago	718.86 (+14.39%)
Chicago to Los Angeles	588.57 (+24.09%)
Chicago to Elizabeth, NJ	480.57 (+6.25%)
Los Angeles to Dallas	284.43 (+13.00%)
Elizabeth, NJ, to Chicago	290.86 (+24.91%)

Outbound intermodal tender rejections

Savannah, GA	20.74%
Joliet, IL	0.00%
Chicago	0.00%
Memphis, TN	5.60%
Los Angeles	3.53%

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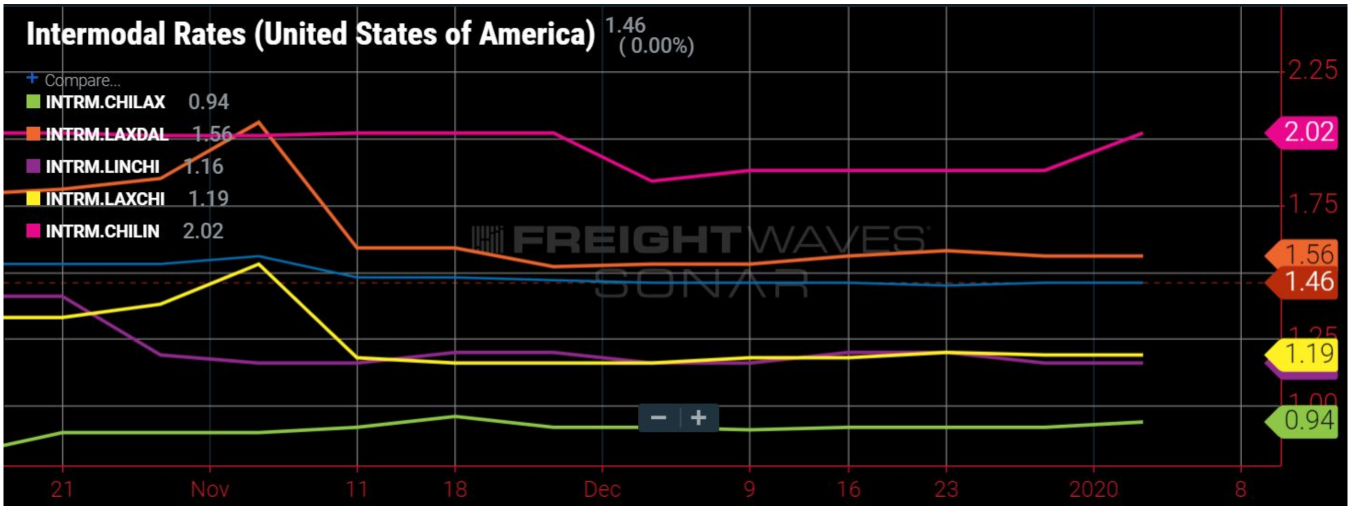
Intermodal spot rates



(Chart: FreightWaves SONAR)

Intermodal rates are still sideways, continuing the theme of this weekly report since we initiated intermodal coverage. Rates bumped upward slightly going into the new year on two lanes. Chicago-Los Angeles (+2.2%) and Chicago-Linden (+7.4%) have both rallied since the end of 2019.

We have three reasons to believe that rates will hold steady in the near-term before rising in the second quarter of 2020. First, trucking rates should find support after the first quarter, which will widen trucking-intermodal spreads. Second, commentary from railroad management has fairly consistently rejected the idea of competing with trucks on price. In terms of potential upside risk to intermodal rates in the near-term, we believe they hold at current levels in the first few months of the year due to volumes typically being weakest in the beginning of the year.

“The first week of 2020 intermodal data suggests that transcontinental intermodal volume will be weak to start the year, but with CSX posting slightly positive year-over-year volume for the first time in recent memory, that is perhaps an early indication that the rails truly are finished de-marketing intermodal lanes, as they claim,” wrote FreightWaves intermodal expert Mike Baudendistel in a client email earlier this week.

We will get more clarity over the next few weeks as Class I railroads start reporting earnings. It is likely that analysts will focus their questions on how competitive rails plan to be with trucking along with railroads switching their focus to growing volumes.

Freight demand

U.S. Class I intermodal volumes were down 7.4% Y/Y in week 1. This is an improvement over the four-week average of -9.6% Y/Y. We are still in a tough comps environment with the tariff pull-forward extending strong intermodal volumes into the beginning of 2019 but will start to see easier comps going forward.

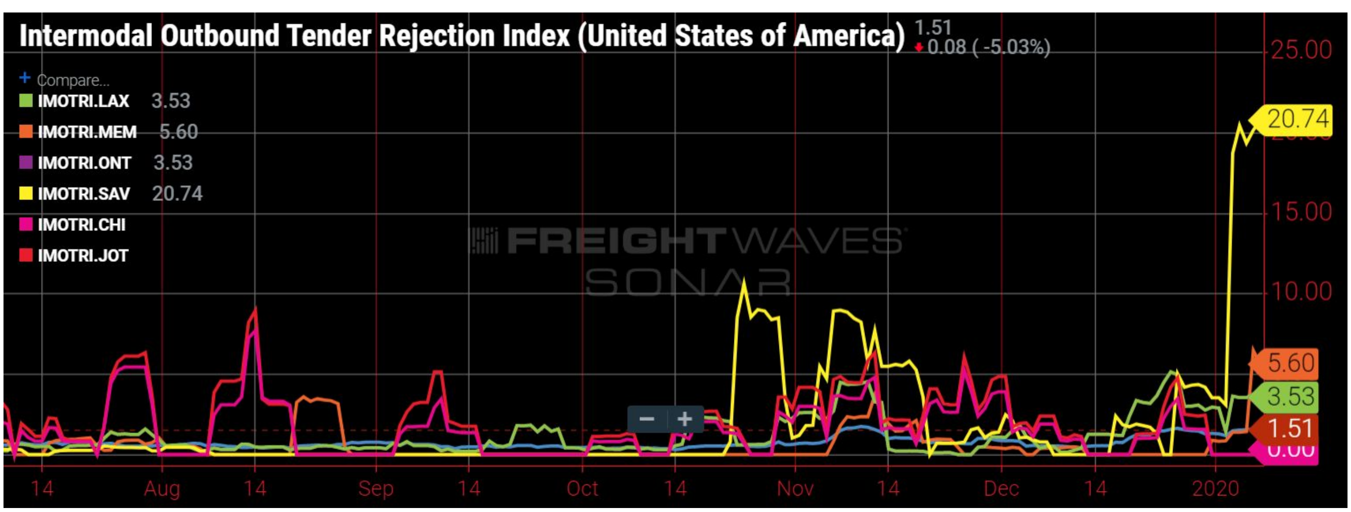
The railroad taking the hardest hit is Union Pacific. Unfortunately for Union Pacific, this has been the case for an extended amount of time, due to generally weak activity in UNP’s key origins in the

Southern California region. UNP's intermodal volumes were down 14.7% in week 1 Y/Y. This is slightly better than their four-week average of -16.7%. There were two bright spots in week 1, with Kansas City Southern growing intermodal volumes by 0.9% Y/Y and CSX Transportation growing intermodal 1.1% Y/Y.

(Chart: FreightWaves SONAR)

CSX has performed relatively well compared to most of its competitors in recent history, and the stock performance reflects this. Over the past five years, CSX has returned more than its U.S. Class I competitors. But in 2018, CSX underperformed. We believe this has to do with a very strong 2018 stock performance along with fewer real estate sales, lower coal exports and, being further along in PSR implementation than its peers, less relative margin in 2019. Company management guided that they were only expecting single-digit revenue growth for 2019.

Intermodal capacity

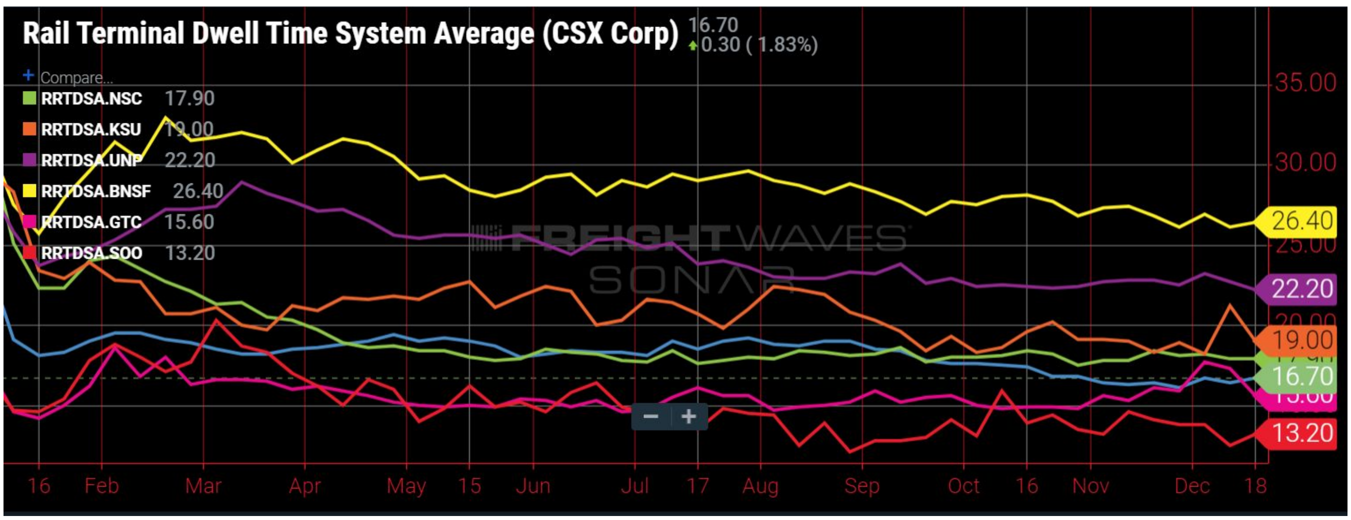


(Chart: FreightWaves SONAR)

Intermodal capacity was loose through the first week of 2020. Intermodal tender rejections (IMOTRI.x) have remained flat in the first full week of 2020 but still remain below year-ago levels. Capacity will remain loose through the first half of 2020 as the overall freight market remains soft and trucking rates are depressed.

A capacity crunch occurred in Savannah, Georgia, last week as intermodal tender rejections spiked above 20%, the highest level in years. Intermodal rejections are currently outpacing trucking rejections, which are sitting just above 7%. Intermodal spot rates from Savannah to Chicago are at a 24% discount as compared to the traditional 10-15% discount that intermodal traffic receives.

We expect capacity in Savannah to correct itself and rejection rates to fall back to levels closer to the 2019 average. As capacity returns to the trucking market, volume will shift from intermodal to trucking, driving rails to reduce their intermodal capacity.



(Chart: FreightWaves SONAR)

Railroad dwell times are a measure of the service that railroads provide to their customers. Railroad Terminal Dwell Time System Average (RRTDSA.x) is the average number of hours a train is sitting in a terminal across the Class I railroad networks. The implementation of PSR across the Class I railroads is designed to have longer trains that move at higher speeds across their network and spend less time sitting in their terminal.

As Hunter Harrison said, “an empty yard is a good yard.”

All of the rails have cut their terminal dwell times over the past year. The only Class I railroad that hasn’t publicly announced that they are implementing PSR is BNSF, and they currently have the highest rail terminal dwell time, as on average their trains sit in the terminal for over a day.

Last year, Norfolk Southern slashed its dwell times, from 31 hours at the beginning of 2019 to just 17 hours now. The 14-hour improvement can be attributed to the implementation of the first two phases of TOP21, Norfolk Southern’s version of PSR. As the calendar turns, NSC will start phase three of TOP21, which will focus on intermodal traffic.