Canadian National and Canadian Pacific Face Big Challenges in 2014

Description

Challenges continue to mount for Canada's two main rail companies **Canadian National Rail** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Rail** (TSX:CP)(NYSE:CP). Among the concerns are rising fuel costs, a falling loonie, a mandate to lower operating costs, and the newest curve ball to hit the industry — quotas.

Back in November we discussed how a record crop of wheat and canola was left sitting in silos as rail companies dedicated more and more of its quotas to crude oil and chemical loads. This left farmers, elevators and shippers struggling to move record harvests.

As a result, the rail companies now fall under the so-called "Fair Rail Service Act" in order to ensure the 76 million tonne 2013 crop finally gets delivered. This law allows shippers and companies to negotiate firm delivery dates with CP or CN. If a rail company fails to meet the agreed-upon deadline, fines could be issued by the government of up to $100,000.

For the next 90 days, CP and CN are faced with mandatory quotas of a combined minimum of one million tonnes of grain every week, or 11,000 cars combined. This would double the current quota being carried by the rail companies, which was 9,300 cars combined during the fall. Even if the mandatory quotas are met, 25 million tonnes of grain are expected to still be in silos when the 2014 harvest is collected.

Adding further fuel to the fire (bad steam engine pun intended), Agriculture Minister Gerry Ritz hinted that "there could be legislation coming to ensure the efficient movement of crops", adding, "the railways have dropped the ball".

Record crops and cold weather

The railways maintain that this year's cold temperatures have been a major factor in the backlog. CN claims that the cold and difficult weather conditions caused a shortfall of around 10,000 carloads thus far. CN has cited safety concerns, saying that trains are shorter in winter to ensure they can stop safely, and switches and equipment are more prone to break down.

Neither company was prepared for what farmers say was the best harvest in Canadian history. CN Rail's initial estimates placed the crop totals at 60 million tonnes, 16 million tonnes below what was harvested.

Foolish bottom line

Both companies have been trying to lower operating expenses in the past couple of years — especially CP Rail, which since 2012 has gone through an aggressive cost-cutting program that may have hindered it this year. It shut down 400 locomotives and cut 4,200 jobs. Gaps in the line have become apparent with this record harvest and CP may be forced to pay a financial cost if the new quotas are not met.

Both companies must act fast to beat the deadline and avoid any unnecessary fines, but this is only one issue working against the rail companies in 2014. In my next article, I will look at the rising cost of fuel, the falling dollar and the public outcry for safer tracks.

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