Canadian National and Canadian Pacific Face Big Challenges in 2014, Part 2

Description

Yesterday we talked about the forced quotas placed on **Canadian National Rail** (TSX: CNR)(NYSE:CNI) and **Canadian Pacific Rail** (TSX:CP)(NYSE:CP) by the Federal government to ensure the delivery of the 2013 grain harvest. But this is only one of several issues piling up against rail companies in 2014.

Safety and efficiency upgrades

Back in February, CN Rail announced that it will undergo $2.1 billion worth of safety and efficiency upgrades in 2014. This comes after a rough year for the industry that has put rail safety at the forefront of Canadian minds. These upgrades include:

- $1.2 billion in track infrastructure (replacement of rail, ties and other track materials, bridge improvements, as well as various branch-line upgrades)
- $300 in capital expenditures such as 45 new high-horsepower locomotives (CN has acquired 763 high-horsepower locomotives since 2004)
- $600 million in facility upgrades, the completion of the Calgary Logistics Park project and capital for information technology to improve service and operating efficiency

Bye-bye DOT-111 tanker cars

Another big safety change being embraced by both companies comes in the form of pushing older model (primarily DOT-111) tanker cars off the tracks. This will be done through either retrofitting older cars to meet newer/higher standards, or encouraging shippers to purchase newer tanker cars which already meet standards. There are an estimated 92,000 rail cars in North America that carry flammable liquids, of which only 14,000 meet current standards.

One way both companies have moved to encourage shippers and producer is the introduction of surcharges on older tanker cars. CN Rail announced that effective March 14 it would be adding a 5% surcharge on each car of crude that is shipped in any container other than the CPC 1232 model (which meets higher safety standards). And CP Rail is preparing to impose a $325 “general service tank car safety surcharge" on each pre-2011 DOT-111 tanker car moved by its locomotives. It has not been released by either company of what would be done with the surcharge revenues.

This call for retrofits may actually turn into an opportunity for both companies to keep maintenance yards busy. CP Rail President Hunter Harrison has offered his companies services to perform the upgrades saying, "Look, we'll retrofit our fair share of cars. We'll open the shop. I'll create more jobs. We'll fix the damn tank cars – and make a safer Canada."

Foolish bottom line

Rail companies are scrambling to keep up with better safety standards and are motivated to never again see another Lac-Mégantic disaster. These infrastructure upgrades may cost a pretty penny in the near term but could save both companies thousands if not millions in the coming decade.

Rail companies are faced with a quandary of liability and regulations that could/have put them in unnecessarily risky positions. Or as Hunter Harrison puts it, "CP has no choice but to move commodities like explosive propane and crude if customers want it to. As long as regulations allow those goods to be shipped by rail, the railway is bound by law to move the products on any government-approved rail car, on any route that shippers request."

Knowing this, any opportunity CP Rail or CN Rail can take to limit liability and improve safety is a good investment.

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2. NYSE:CP (Canadian Pacific Railway)
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