Desjardins

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Canada's Logistics Conference 2024 recap—freight recovery looking like a 2025 story

The Desjardins Takeaway

Well-attended conference. We recently returned from Canada's Logistics Conference, which was held in Halifax on June 5–7. Overall, the conference was very well-attended, with ~250 participants from a variety of sub-segments of the logistics industry (railroads, trucking, retailers, e-commerce players, logistics, port authorities, 3PL, various associations). We had the opportunity to speak with several industry participants and highlight some key themes that were discussed during the event.

Highlights

Freight recovery taking longer than expected. Most agreed that we are still in an overcapacity situation and that the anticipated freight recovery is looking like more of a 2025 story (or later in 2024 at the earliest). Conditions remain favourable for retailers/shippers and some are taking the opportunity to extend contract lengths at favourable prices (transportation executives are seeing more RFPs come to market this year, including from some customers who have never taken this step in the past). While some trucking and brokerage bankruptcies have made headlines year-to-date, pricing remains very aggressive (undercutting bids still present in the marketplace).

Significant labour uncertainty in Canada currently—represents a threat for cargo diversion and the country's reputation globally. This topic took centre stage at the conference as there are several ongoing labour negotiations, creating significant uncertainty for shippers as multiple segments of the Canadian supply chain could potentially grind to a halt over the coming days or months. According to certain industry participants, they have already begun seeing cargo diversions and blank sailings, and the Port of Prince Rupert is expecting a drop in volumes in the coming months as a result. Although the TCRC rail labour negotiations in particular are currently at a standstill until the end of July, we continue to believe that a prolonged strike is unlikely given the significant impact it would have on the Canadian economy. Below is a list of ongoing labour negotiations in the Canadian transportation sector:

- Teamsters Canada Rail Conference union (~9,000 conductors/engineers at CN and CP)—awaiting a Canadian Industrial Relations Board review.
- Canada Border Services Agency union (9,000 workers)—tentative agreement reached on Tuesday morning (June 11) (but vote still needed to ratify the deal).
- Port of Montreal longshoremen union (1,200 dockworkers)—parties are in a mediation phase in an attempt to reach an agreement.
- BC ports International Longshore and Warehouse union (730 union foremen)—awaiting a Canadian Industrial Relations Board review.
- Air Line Pilots Association union (5,000+ Air Canada pilots)—requested help from a federal conciliator to assist in negotiations.

Key themes

Freight recovery taking longer-than-expected—more of a 2025 story. The industry participants we spoke with recognized that the market environment for transportation has been challenging over the last few years, with many disruptors (unfavourable weather events such as wildfires and floods, labour issues and geopolitical tensions that changed routing patterns). Most agreed that we are still in an overcapacity situation and that the anticipated freight recovery is looking like more of a 2025 story (or later in 2024 at the earliest). Conditions remain favourable for retailers/shippers at the moment, and some are taking the opportunity to extend contract lengths at favourable prices although they are closely monitoring signals that could once again lead to supply chain issues (transportation executives are seeing more RFPs come to market this year, including from some customers who have never taken this step in the past). While some trucking and brokerage bankruptcies have made headlines year-to-date, pricing remains very aggressive (undercutting bids still present in the marketplace), although certain retailers continue to value a premium service and partners that had supported them when times were tough.

Significant labour uncertainty in Canada currently—represents a threat for cargo diversion and the country's reputation globally. This topic took centre stage at the conference as there several ongoing labour negotiations, creating significant uncertainty for shippers as multiple segments of the Canadian supply chain could potentially grind to a halt over the coming days or months. The Canadian government has been vocal that where possible it is looking to stay out of negotiations and let the discussions progress between parties, which has caused real concern among industry participants and led them to look at contingency plans. According to certain industry participants, they have already begun seeing cargo diversions and blank sailings, and the Port of Prince Rupert is expecting a drop in volumes in the coming months as a result (with the US ports of Los Angeles–Long Beach, Tacoma and Seattle being the biggest beneficiaries despite dealing with their own congestion issues). Moreover, shippers and retailers are preparing for the upcoming peak season with contracts that were typically signed in early July, so there is further risk ahead for Canadian transporters if these labour issues are not resolved (it would appear that Canada's reputation is at risk following last summer's two-week work stoppage at the west coast ports). We continue to strongly believe that Canadian ports have competitive advantages given the investments in capacity expansion over the years and with some ports benefiting from shorter sailing times. Nevertheless, given the importance of the economy and the negative impact felt last year at Vancouver and Prince Rupert, we believe that the Canadian government will be forced to intervene in any work stoppage of significance in order to protect its competitive positioning in the world economy. Although the TCRC rail labour negotiations in particular are currently at a standstill until the end of July, we continue to believe that a prolonged strike is unlikely given the significant impact it would have on the Canadian economy. Recall that this is a unique situation, as it is the first time in more than a decade that both CN's and CP's conductor union contracts are up for renewal at the same time. Another important factor to consider is that a strike would also affect Canadian passenger rail dispatchers (Metrolinx in Toronto, Via Rail in Montréal and West Coast Express in Vancouver).

Below is a list of the ongoing labour negotiations in the Canadian transportation sector and the latest updates:

- Teamsters Canada Rail Conference union (6,000 conductors/engineers at CN and 3,200 at CP)—currently awaiting a Canadian Industrial Relations Board review (CN and CP both commented that a decision will likely not be made until the end of July at the earliest).
- Canada Border Services Agency union (9,000 workers)—tentative agreement reached on Tuesday morning (June 11) (but vote still needed to ratify the deal).
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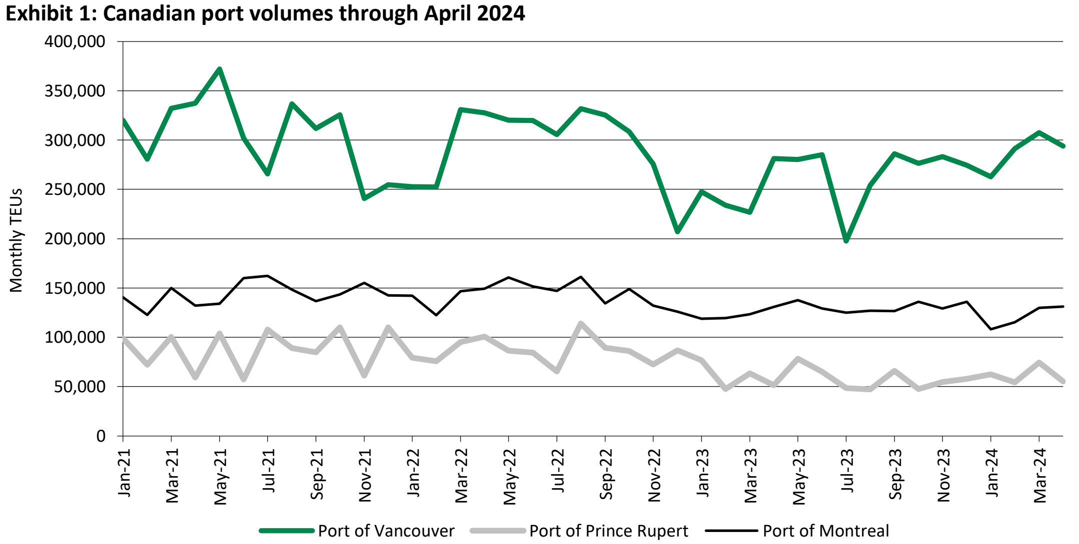
Big jump in international intermodal—what's the cause and is it sustainable? Two years ago, we wrote about the JIT (just-in-time) model, which evolved toward the JIC (just-in-case) model in light of the pandemic's supply chain issues, forcing retailers to stock higher inventory in order to offset any unexpected disruptions. As supply chain issues continued to abate, a period of massive destocking ensued, with retailers' inventories now at more normalized levels. Looking specifically at the railroads, intermodal has remained a bright spot this year, with international significantly outperforming domestic. When speaking with port participants, it appears that the cause of this spike is not specific to one factor but, rather, to a combination of multiple factors—US tariffs on China bringing more traffic to Canada, volumes returning post last year's strike, the impact of geopolitical issues shifting some traffic to western Canada from eastern Canada, retailer restocking, an inflection point in customer demand, etc. Despite the strong start thus far in 2Q for both CN and CP (RTMs up 7.1% in 2Q to date at CN and 5.5% at CP) and the fact that they will be lapping easy comps in 2H, it is possible that the ongoing labour uncertainty noted above could potentially put a dent in the overall volume recovery—especially if negotiations are still not settled when it comes time to sign contracts for the upcoming peak season. While we will be monitoring these situations closely, looking at port volumes in April (see Exhibit 1) and CN and CP's weekly intermodal carload trends, we have not seen a material negative impact yet. If intermodal continues to outperform expectations, we believe investors are better positioned for exposure to the cyclical upswing in volumes with CN than with CP given CN's greater exposure to international (63% of total intermodal volumes in 2023 vs only 42% at CP), not to mention its higher exposure to the west coast, with plenty of untapped exclusive capacity at Prince Rupert.

Exhibit 1: Canadian port volumes through April 2024

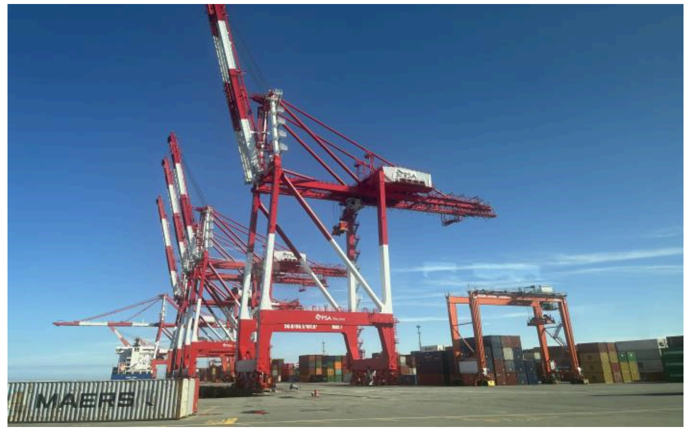


Source: Desjardins Capital Markets, port websites

Exhibit 2: Port of Halifax's new electric rubber tyre gantry cranes (E-RTG)

Source: Desjardins Capital Markets

Exhibit 3: Port of Halifax's mega ship-to-shore (STS) vessel cranes



Source: Desjardins Capital Markets

CN and CP rail update—topics discussed include Mexico, Milton and more. Corrine Kostyshyn, CN's assistant vice-president, international intermodal sales & marketing, and Jordan Kajfasz, CP's assistant vice-president, international intermodal & autos, provided commentary on the rails' current operations and growth prospects during a rail panel at the CITT conference. Beginning with Mexico, CP indicated that it is in the midst of a major IT project which will integrate legacy CP technology systems with legacy KCS and legacy KCSM systems. The new unified system should enable CP to offer better solutions to customers as the company believes the Mexico opportunity will not become a replacement for China but, rather, a competitive supplement. Management continued with bullish commentary surrounding customer interest for its MMX four-day truck-like service from Mexico to Chicago as well as how its new network time efficiency now allows for domestic refrigerated containers of Mexican produce into Toronto and Canada as a whole (refrigerated market from Mexico to the Midwest is currently served by trucks). CP partner Americold is in the process of building its first warehouse facility co-located on CP's network in Kansas City (335,000sf), and CP recently announced the addition of 1,000 new 53ft refrigerated containers, more than doubling its existing fleet (CP's new network has ~6,000 acres of land available for development). CP management also highlighted that it is seeing more truck-to-rail conversion in Mexico, which will be incremental to its organic growth. With regard to CN, management gave an update on the Milton Logistics Hub project, which had been put on pause back in March when a Canadian court blocked construction—construction has resumed, with management confident about the long-term potential of the project and its positive impact on the Canadian economy. CN also stated that based on the current timeline, the project should be completed in late 2026 or early 2027, which opens the door to the possibility of a slight delay vs the initial target of 2026 (not material for CN's investor day targets). The Milton Logistics Hub, which costs C$250m, is expected to provide 730,000 TEUs of domestic and international capacity. The final word will rest on a later ruling from the Federal Court of Appeal (now under review). Finally, CN provided an update on current operations, stating that with the pick-up of grain and international intermodal, the network is beginning to see limited capacity on the west coast (capex projects underway to add capacity) but capacity continues to be available in its eastern network if a new customer approaches it.

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