Rail Stocks Dip on Bakken Oil Report

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The recent report issued by federal regulators on oil transport from the Bakken region has sparked serious concerns for the railroads. Reports issued by Materials Safety Administration on Thursday suggest the hazardous impact of transporting Bakken crude oil, which can be more inflammable compared to crude oil found in other areas. Since railroads contribute the majority of the transportation requirement for crude in that region, the news has led railroad stocks to tumble down.

U.S. carriers like **Union Pacific Corporation** (UNP - Analyst Report), **CSX Corp.** (CSX- Analyst Report), **Kansas City Southern** (KSU - Analyst Report) and **Norfolk Southern Corporation** (NSC - Analyst Report) registered declines in their share prices on Thursday trading. In addition, Canadian counterparts **Canadian Pacific Railway Limited** (CP - Analyst Report) and **Canadian National Railway Company** (CNI - Analyst Report) also registered declines in their last trading day.

Following a slowdown in coal shipments that constitute maximum shipments for the railroads companies, the industry has been shifting its focus to petroleum product shipments. According to industry sources, the role of crude oil as a revenue contributor has grown by leaps and bounds in a four-year span from a mere 3% to 30% of the oil and petroleum products shipment by railroads.

Despite the fact that rail-based crude transportation costs five times more ($10–$15 per barrel), crude shippers are compelled to rely on rail-based transport. This is due to the lack of pipeline infrastructural support in key oil and gas fields like Bakken Shale Formation in North Dakota and Montana, Eagle Ford Shale, Barnett Shale and Permian basin in Texas, the Gulf of Mexico and Alberta oil sand fields in Canada.

As a result, inadequate pipeline development has given rise to higher penetration of railroads transportation for crude oil shipping in these areas. According to reports, rail-loading capacity is expected to grow to 200,000 b/d by 2013 for crude oil shipments from Western Canada.

Major railroad companies like Norfolk are seeking expansion strategies fueled mostly by the development of the energy sector, including the gas exploration projects in Marcellus and Utica shale plays as well as ventures associated with coal and power generation. Over the coming years, the company plans to introduce 32 energy-related projects in 14 states under its service areas.

Canadian Pacific projects crude shipment to reach up to 70,000 oil-tank cars by the year end and 140,000 by the end of 2015. In the coming months, we expect railroads to accelerate their investments in order to create adequate service capacity for the oil and gas markets resulting in exponential growth in crude oil shipments across the rail industry. Consequently, we expect petroleum shipments to remain favorable and emerge as a significant revenue contributor in the long term.

However, given the recent report on safety issues we remain skeptical about railroads’ ability to benefit from the current surge in oil shipments. Further, infrastructural developments undertaken to carry out more oil shipment also remain uncertain in respect of their viability in the current scenario.

Stocks with Zacks Rank #2 (Buy) include CSX Corp. and Kansas City Southern. Other carriers -- Union Pacific Corporation, Canadian Pacific Railway Limited, Canadian National Railway and Norfolk Southern Corporation -- currently have a Zacks Rank #3 (Hold).