Union Pacific Corporation's (UNP) CEO Lance Fritz on Q3 2019 Results - Earnings Call Transcript

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Union Pacific Corporation (NYSE:UNP) Q3 2019 Results Earnings Conference Call
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Company Participants

Lance Fritz - Chairman, President and CEO

Kenny Rocker - Executive Vice President, Marketing and Sales

Jim Vena - Chief Operating Officer

Rob Knight - Chief Financial Officer

Jennifer Hamann - Chief Financial Officer

Conference Call Participants

Justin Long - Stephens

Chris Wetherbee - Citi

Tom Wadewitz - UBS

Scott Group - Wolfe Research

Ravi Shanker - Morgan Stanley

Brian Ossenbeck - JPMorgan

Amit Mehrotra - Deutsche Bank

Jordan Alliger - Goldman Sachs

Ken Hoexter - Bank of America Merrill Lynch

Allison Landry - Credit Suisse

David Vernon - Bernstein

Brandon Oglenski - Barclays

Walter Spracklin - RBC Capital Markets

Jason Seidl - Cowen & Company

Fadi Chamoun - BMO Capital Markets

Operator

Greetings. Welcome to the Union Pacific Third Quarter Earnings Conference Call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions]

As a reminder, this conference is being recorded and the slides for today's presentation are available on Union Pacific's website. It is now my pleasure to introduce your host, Mr. Lance Fritz, Chairman, President and CEO for Union Pacific. Mr. Fritz, you may begin.

Lance Fritz

Thank you, Rob, and good morning, everybody. And welcome to Union Pacific's third quarter earnings conference call. With me today in Omaha are Kenny Rocker, Executive Vice President of Marketing and Sales; Jim Vena, Chief Operating Officer; and Rob Knight, our Chief Financial Officer. I have also asked Jennifer Hamann, our newly-appointed Chief Financial Officer effective January 1st, to join us for the Q&A portion of the call.

So before we get started today, I want to take a moment and thank Rob for his service and contributions to Union Pacific over his 40-year career, particularly the last 16 years as CFO. Rob's been a critical member of our senior team and was instrumental in driving Union Pacific's financial success. We wish him all of the best in his upcoming well-deserved retirement and thank you very much, Rob.

I also would like to welcome Jennifer to the CFO role. She and Rob are doing a great job working through the transition and I am confident that Jennifer is the right choice to lead our financial initiatives into the future.

This morning, Union Pacific is reporting 2019 third quarter net income of $1.6 billion or $2.22 a share. This represents a 3% increase in earnings per share and a 2% decrease in net income compared to 2018. Our quarterly operating ratio came in at a 59.5%, a 2.2 percentage point improvement compared to the third quarter of 2018.

Once again, this represents an all-time record quarterly operating ratio, beating our previous low established last quarter. That's quite an achievement when you consider the fall-off in volume during the quarter.

We are continuing to drive productivity through our G55 + 0 and Unified Plan 2020 efforts, which are also producing a safe, reliable and consistent service product for our customers. The work our employees are doing as part of Unified Plan 2020 is foundational to the company's success and there are additional improvement opportunities going forward for both our customers and our shareholders.

With that, I will turn it over to Kenny to provide more details on our results.

Kenny Rocker

Thank you, Lance, and good morning. For the third quarter, our volume was down 8% as gains in our Industrial business group were more than offset by declines in Ag Products, Premium and Energy. At the same time, we generated a positive net core pricing of 2.5% in the quarter as we continue to price our service product to the value it represents in the marketplace while ensuring it generates an appropriate return.

Freight revenue was down 7%, driven by the decrease in volume partially offset by a 1% improvement in average revenue per car. Let’s take a closer look at the performance of each business group.

Starting off with Ag Products, revenue for the quarter was down 1% on a 2% decrease in volume and a 2% improvement in average revenue per car. Grain carloads were down 3%, primarily driven by continued reductions in export grain shipments, partially offsetting feed grain declines with strength in wheat. Volume for grain products was flat as sustained demand for biofuels and supporting products was offset by reduced exports. Fertilizer and sulfur carloads were down 5% primarily due to soft global demand for potash.

Moving on to Energy, revenue was down 20% as volume declined 15%, coupled with a 5% decrease in average revenue per car related to negative mix with the loss of long-haul sand volume.

Sand carloads were down 45%, largely due to the impact of local sand. Coal and coke volume was down 17%, due to the softer market conditions resulting from lower natural gas prices and weak export demand. In addition, contract changes and retirements also impacted volumes in the quarter.

However, on a positive note, favorable crude oil price spreads drove an increase in crude oil shipments, which was the primary driver for the 18% increase in petroleum, LPG, and renewable carloads for the quarter.

Industrial revenue was down 1% on a 2% increase in volume and a 3% decrease in average revenue per car due to negative mix with increased short-haul business. Construction carloads increased 16%, primarily driven by a strong market demand in the south for rock shipments. Plastics volume increased 7% due to higher production. Forest product volume decreased 11% driven by softness in the lumber and paper markets.

Turning to Premium, revenue for the quarter was down 9% on an 11% decrease in volume, while average revenue per car improved by 2%. Domestic intermodal volume declined 11%, primarily driven by an abundant truck supply coupled with softer demand during the quarter.

International intermodal volume was down 12% during the quarter, reflecting weak market conditions related to trade uncertainty, escalating tariffs, and challenging year-over-year comparisons, driven by accelerated shipments seeking to avoid tariff in September 2018.

And finally, finished vehicle shipments were down 4% for the quarter. Third quarter U.S. auto sales were down approximately 2% from 2018. Strong light vehicle and SUV sales did not fully offset declining car demand.

Looking ahead for the rest of 2019, for Ag Products, we anticipate continued strength in advanced biofuel shipments and associated feedstock due to an increase in demand, which will help offset challenges in the ethanol marketplace.

We also expect stronger beer shipments along with long-term penetration growth across multiple segments of our food and refrigerated business. And furthermore, with the recent outlook with China to take more Ag Products, we hope to see some relief as those exports resume. However, we will continue to keep a watchful eye on foreign tariffs within our Ag market.

For Energy, we expect favorable crude oil price spreads to drive positive results for petroleum products. Local sand supply will continue to impact volume, although the comps should improve over the long term. We also expect coal to experience continued challenges with volume throughout the balance of the year and weather conditions will always be a key factor for coal demand.

Looking at Industrial, we anticipate an increase in plastic shipments driven largely by plant expansions coming online later this year coupled with continued strength in the construction market in the South, but we continue to watch housing starts and the projected softness in the overall market.

And lastly, for Premium, the light U.S. vehicle sales forecast for 2019 of 16.8 million units, down about 2% from 2018. Although, we remain encouraged by the tentative agreement between General Motors and their autoworkers, we are still keeping a close watch on it and the associated volume impact. Domestic Intermodal volume is sequentially strengthening, but when compared to 2018, it is expected to be impacted by truck competition in the fourth quarter.

In addition, we expect international intermodal to return to its normal seasonal flow but face tough year-over-year comparisons due to accelerated shipments seeking to avoid tariff increases in 2018.

And now, I will turn it over to Jim.

Jim Vena

Thank you, Kenny. Well, we finally had a clean quarter from a weather perspective, and I think our results speak volumes for what is possible. Our operating metrics continue to improve and as a result, we are seeing a better service product for our customers.

Furthermore, I couldn’t be more proud of how the team has responded to the challenge of rightsizing our cost structure in the face of declining volumes while driving significant productivity.

For example, crew starts were down 15% in the quarter and outpaced the 8% decline in carloads we experienced. This, along with our Unified Plan 2020 actions drove an all-time best quarterly operating ratio of 59.5%, which truly was a remarkable achievement.

While we are continuing to drive productivity, these gains are overshadowed if we aren’t simultaneously improving safety. Our incident experience has not improved, but we are committed to getting better, as always safety remains job one at Union Pacific.

I’d like to turn over to slide 11. I’d now like to update you on our six key performance indicators. We continue to see substantial year-over-year improvement in our metrics. In fact, earlier this year, I said, we would blow by some of our goals and we are doing just that. It is a direct result of our relentless focus on improving network efficiency and service reliability as part of Unified Plan 2020.

Continued improvement in asset utilization and fewer car classifications led to a 20% improvement in freight car terminal dwell and a 10% improvement in freight car velocity compared to the third quarter of 2018. Our train speed for the third quarter as a whole decreased 1% to 23.7 miles per hour compared to 2018. We turned the corner in September and saw year-over-year improvement and the trend has continued into October.

As I have mentioned in the past, our train speeds continue to be affected by additional daily work events being performed as part of Unified Plan 2020. While these work events are helping us increase train size and drive asset utilization, there is an opportunity to execute these work events even more efficiently and drive faster train speeds.

Turning to slide 12, continuing our trend from the second quarter, locomotive productivity improved 18% versus last year as efforts to use the fleet more efficiently enabled us to park units. As of September 30th, we had around 2,600 locomotives stored. Driven by a 13% decrease in our workforce levels, workforce productivity increased 4% year-over-year.

In addition to improving productivity, delivering a great service product is of equal importance to the team, car trip compliance improved 10 points year-over-year driven by increased freight car velocity and lower terminal dwell. While we are pleased with our progress, we do expect our service product to improve going forward. In fact, we are already seeing sequential improvement in October.

Slide 13 highlights some of the recent network changes we have made as part of Unified Plan 2020. By shifting classification work to surrounding terminals we are able to reduce operations at our Roseville hump yard resulting in increased car velocity for associated manifest business.

In addition, we reduced switching operations at our yard in Alexandria, Louisiana, moved the work to a more efficient terminal in Livonia. We also stopped humping cars at Neff yard in Kansas City.

As a result, we will now build overhead blocks to drive cars deeper into the network and leverage existing flat switching terminals in the Kansas City Complex. Going forward, we will continue to look for ways to reduce car touches, which undoubtedly will lead to additional terminal rationalization opportunities on our network.

Currently, one of our main areas of focus is to utilize our existing network capacity, and we are making excellent progress on this front as illustrated by the train length graph on the right. By putting more product on fewer trains, we have increased train length across our system by over a thousand feet or 15% since January of this year.

In fact, we have specific initiatives up against the Sunset, Central, and North-South corridors on our network and they are paying big dividends. Earlier this year, we discussed investing capital in our Sunset Corridor for siding extensions to support productivity initiatives. Through a collaborative team effort, that work was completed in record time. As a result, I am pleased to report the train length in the Sunset Corridor has increased 18% since January 2019.

Furthermore, operational changes in our North-South Corridor between Chicago and South Texas have driven train length up over 21% since the start of the year. Looking forward, I expect to see continued improvement in train length through a combination of transportation plan changes and targeted capital investments.

To wrap up, on slide 14, we have made a number of changes to our operations in the last year and the results have been outstanding. However, there are still a lot of opportunities ahead of us to further improve safety, asset utilization and network efficiency.

As we move forward, look for us to continue pushing the envelope and taking bold steps as we transform our operation, running a safe, reliable and efficient railroad for both our customers and our shareholders is nonnegotiable, and our team is committed to making that happen.

And with that, I will turn it over to Rob for the last time.

Rob Knight

Thanks, Jim, and good morning. Today we are reporting third quarter earnings per share of $2.22 and a 2.2 points of year-over-year improvement in our operating ratio to 59.5%. This represents an all-time best quarterly operating ratio for Union Pacific and the second consecutive quarter with a sub-60% operating ratio. This is once again a testament to the great work that we are doing with G55 + 0 and the Unified Plan 2020. Our quarterly results were affected by some one-timers, so before I jump into the details, let me set the stage.

An increased frequency of rail equipment incidence resulted in approximately $25 million of added operating expenses in the quarter. These excess costs for cleanup, destroyed equipment and damaged freight resulted in a 0.5 point negative impact to our operating ratio and subtracted $0.02 of EPS compared to the third quarter of 2018.

The combined impact of lower fuel price and our fuel surcharge lag had a favorable impact for the quarter of 0.9 points on the operating ratio adding $0.04 of EPS compared to 2018. The good news is that despite lower volumes, we drove core margin improvement of almost 2 points compared to the third quarter of last year.

Now let's recap our third quarter results. Operating revenue was $5.5 billion in the quarter, down 7% versus last year. The primary driver was an 8% decrease in volume. Operating expense totaled $3.3 billion, down 10% from 2018. Operating income totaled $2.2 billion, a 2% decrease compared to last year. Below the line, other income was $53 million, up 10% from 2018 driven by lower benefit plan costs and increased rental income, partially offset by higher environmental costs.

Interest expense of $266 million was up 10% compared to the previous year. This reflects the impact of a higher total debt balance.

Income tax expense decreased 4% to $466 million. Our effective tax rate for the third quarter was 23.1% and for the full year we expect our annual effective tax rate to be around 23.5%.

Net income totaled $1.6 billion, down 2% versus last year, while the outstanding share balance decreased 5% as a result of our continued share repurchases. As I noted earlier, these results combined to produce third quarter earnings per share of $2.22 and an operating ratio of 59.5%.

Freight revenue of $5.1 billion was down 7% versus last year. Fuel surcharge revenue totaled $393 million, down $89 million compared to 2018. Business mix had almost a 1 point negative impact on freight revenue in the third quarter, driven by increased shorter-haul rock business and decreased agricultural product volumes, along with reduced sand carloadings, somewhat offset by fewer intermodal shipments.

Core price was 2.5% in the third quarter, similar to the pricing that we achieved in the first half of 2019. Although, the reported yields are slightly lower, this is not indicative of any quarterly pricing actions.

As you have heard me say many times before, in order to get credit for price under our methodology, which we believe is the right way to calculate price, you have to move the volumes. In the third quarter, the fall-off in volumes negatively impacted our price yield.

Having said that, beginning with our fourth quarter results, we will no longer report detailed pricing numbers. We are making this change solely for commercial reasons as Union Pacific is the only Class 1 railroad to publically report detailed pricing results, which we now believe disadvantages us in the marketplace.

This should not be read in any way as Union Pacific becoming less disciplined or less focused on pricing. Of course, price will continue to play a key role in achieving our financial goals and our guidance is unchanged, and rest assured, we will continue to yield pricing dollars above our rail inflation costs.

Slide 19 provides a summary of our core -- of our operating expenses for the quarter. Compensation and benefits expense decreased 10% to $1.1 billion versus 2018. The decrease was primarily driven by a reduction in total force levels, which were down 13% or about 5,700 FTEs in the third quarter versus last year. Productivity initiatives along with lower volumes resulted in a 13% decrease in our TE&Y workforce, while our management, engineering and mechanical workforces together declined 15%.

Fuel expense totaled $504 million, down 24% compared to 2018 due to lower diesel fuel prices and fewer gallons consumed. Average diesel fuel prices decreased 12% versus last year to $2.09 per gallon and our consumption rate improved 3% through more efficient operations.

Purchase services and materials expense was down 9%, compared to the third quarter of 2018 at $574 million. The primary drivers of the decrease in the quarter were reduced mechanical repair costs and less contract services and materials, partially offset by reduced foreign car repairs.

Turning to slide 20, depreciation expense was $557 million, up 2% compared to 2018. For the full year 2019, we still expect that depreciation expense will be up 1% to 2%.

Moving to equipment and other rents. This expense totaled $236 million in the quarter, which is down 13% when compared to 2018. The decrease was primarily driven by lower equipment lease expense and less volume related costs.

Other expense was down 3%, compared to the third quarter of 2018 at $277 million, driven by lower environmental expenses partially offset by an increase in costs associated with damaged freight and destroyed equipment. For the full year 2019, we expect other expense to be up low-single digits compared to 2018.

Productivity savings yielded from our G55 + 0 initiatives and Unified Plan 2020 totaled approximately $170 million in the quarter, which was partially offset by the additional costs that I mentioned in my opening remarks.

As a result, net productivity for the third quarter was $145 million, with year-to-date net productivity now sitting at $375 million. This is a remarkable outcome when you think about the challenges that we have overcome such as unprecedented flooding and a weak volume environment. In fact, we continue to gain traction with our productivity initiatives and are confident that we will still deliver at least $500 million of net productivity in 2019.

Looking at our cash flow, cash from operations for the first three quarters totaled $6.3 billion, down slightly compared to last year. Free cash flow before dividends totaled $3.8 billion resulting in free cash flow conversion rate equal to 83% of net income for the first three quarters of 2019.

Taking a look at adjusted debt levels, the all-in adjusted debt balance totaled $28 billion at the end of the third quarter, up $2.9 billion since year end 2018. We finished the third quarter with an adjusted debt-to-EBITDA ratio of 2.6 times. As we have previously guided, our target for debt-to-EBITDA is up to 2.7 times.

Dividend payments for the first three quarters totaled more than $1.9 billion, up $209 million from 2018. This includes the effect of 10% dividend increases in both the first quarter and third quarter of this year.

During the third quarter, we repurchased 6.4 million shares at a cost of $1.1 billion. We also received 3.2 million shares in the third quarter associated with the closeout of the $2.5 billion accelerated share repurchase program that we initiated in February. But between dividend payments and share repurchases, we returned $7.1 billion to our shareholders in the first three quarters of this year.

Looking out to the remainder of 2019, with the current softness in rail volumes and the underlying economic uncertainty in the marketplace, we expect fourth quarter volumes to decline year-over-year at a similar level to what we experienced in the third quarter.

Clearly, we would love to have additional volume, with a more consistent and reliable service product we are poised to grow our business. Going forward, we will continue to price our service to the value that it represents in the marketplace, while ensuring that it generates an appropriate return. We remain confident that the dollars we yield from our pricing initiatives will again well exceed our rail inflation costs in 2019.

With respect to capital investments, we now expect full year 2019 spending to be around $3.1 billion or about $100 million less than our previously announced $3.2 billion plan. Although, we are continuing to invest in projects that support the Unified Plan 2020 productivity initiatives, we have scaled back some of our growth capital spend in light of current business volumes.

As it relates to our workforce, strong productivity initiatives and to a lesser degree lower volumes have resulted in a 9% year-to-date reduction. For the balance of the year, we expect continued combination of operating efficiency gains and lower business levels should result in fourth quarter force levels to be down at least 15% versus 2018.

As a result, full-year force levels should be down slightly more than 10%, which positions us nicely going into 2020. Importantly, with improving margins in the second half of the year, our guidance of a sub-61% operating ratio in 2019 on a full year basis remains intact, despite the fall-off in volumes. Furthermore, an early look at next year’s productivity lineup gives us confidence, with our ability to achieve an operating ratio below 60% for 2020.

As you have heard me say many times before, we have to play the hand that we are dealt when it comes to volumes. But let me assure you, our commitment to achieving our financial targets is unwavering and we are moving aggressively to improve regardless of the economic environment.

Before I turn it back to Lance, if you can indulge me for just one minute. As was said, this is my final earnings call and I want to thank all the men and women of Union Pacific for the dramatic improvements in safety, service and financial results over the last 16 years.

I am very proud that we have improved our operating ratio 28 points, increasing our market cap by over $100 billion over that time and I am confident that the team will continue to drive great results as we drive to a 55 operating ratio.

I have never felt better about the path that we are on operationally and I also know that Jennifer will be an outstanding CFO. And finally, I would like to thank everyone listening today for all the professionalism and support that you have given me and Union Pacific and I wish you all the best.

With that, I will turn it back to Lance.

Lance Fritz

Thank you, Rob. As discussed today, we delivered solid third quarter financial results and we made tremendous strides to improve our productivity and service product as part of Unified Plan 2020.

For the remainder of 2019, we look forward to building on our successes and we provide a highly consistent and reliable service product for our customers. Although, there are some unknowns looking ahead at the economy, confidence in our operational capabilities, as Rob just mentioned, has never been greater.

As always, we are committed to operating a safe railroad for our employees and the communities that we serve and we have some work to do there. We remain squarely focused on driving long-term shareholder value by appropriately investing in the railroad and returning excess cash to our shareholders through dividends and share repurchases.

With that, let's open up the line for your questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Thank you. And our first question comes from Justin Long with Stephens. Please proceed with your question.

Justin Long

Thanks. Good morning. And I will start with a congrats to Rob and Jennifer on the announcement. Maybe to start on headcount, if we just look at the guidance for the fourth quarter and take the exit rate this year and hold that steady, it seems to imply another 6% reduction or so in the headcount in 2020, if you just hold things flat sequentially throughout next year. I know it's somewhat volume dependent, but should we be thinking about a 6% reduction in the headcount at a minimum for next year, and can you just speak to the opportunity beyond that level as you continue to implement PSR?

Rob Knight

Yeah. Justin, this is Rob. We haven't finalized our 2020 plan, and so volume will obviously have a role in what the headcount actually ends up being, but we are confident in that and we are hopeful that volume is positive, and we will grow that very efficiently from a productivity standpoint.

Having said that, you are right, we are exiting at a very efficient level. We are gaining momentum with the Precision Rail Unified Plan 2020 initiatives that Jim talked about. So, directionally, I think you are thinking about it right, we are not guiding to that number, but that directionally is exactly what we are thinking.

Justin Long

Okay. And then maybe secondly more of a near-term question. Last couple of years, we have seen the OR stay fairly flat sequentially third quarter to fourth quarter. Should we be thinking about the OR staying flattish sequentially in 4Q of this year as well or is there something that could cause a divergence from that trend we have seen in the past couple of years?

Rob Knight

Yeah. We are not giving quarterly guidance on that, but I think directionally also there you are thinking about it right and I gave you sort of an early look at what we expect to see on the volume front, which I think would be a similar decline in the fourth quarter that we saw in the third quarter.

So there's nothing unusual outside of that. We are obviously going to continue to implement the Unified Plan 2020 initiatives and do as good as we can, but you are thinking about it directionally right.

Justin Long

Okay. Great. That's helpful. Thanks for the time.

Lance Fritz

Thank you, Justin.

Operator

The next question is from the line of Chris Wetherbee with Citi. Please proceed with your question.

Chris Wetherbee

Hey. Thanks. Good morning and congrats to Rob and Jennifer. Rob, it's been great working with you. Wish you all the best in your retirement. I guess I wanted to come back to the headcount dynamic, certainly a 15% reduction in the fourth quarter is dramatic and a big, big number. I guess when you think about sort of when you set the target for 10% decline earlier this year relative to what we have seen from a volume perspective, you can make an argument that obviously volume has sort of disappointed I guess. So, how do you feel about sort of the balance between your resources and what we are seeing from a volume perspective? Is there opportunity, I am coming at this question, I guess, slightly similarly to Justin, but kind of a little bit different. Is there an opportunity to kind of get a little bit more aggressive on the headcount as we kind of go through this 4Q, 1Q kind of hopefully bottoming in volume?

Lance Fritz

Yeah. Chris, this is Lance. Without putting a really fine point on it, the short answer is largely yes, right? We have been a little disappointed in the topline versus what we were hoping to see when we came into the year. As a result, we have adjusted headcount more aggressively to match that drop in volume. You see that happening in the third quarter as we had headcount lower than volume, and I expect we will continue that. Jim, do you want to add a little technicolor in terms of some of the opportunities that you see in the operations?

Jim Vena

I think the numbers speak for themselves. Lance, I think, the team did a great job of taking into account where the volume ended up this quarter and what we were able to react, and we are going to do the same thing. We are going to react to -- on any volume. Hopefully, the volume goes up. But at the end of it, we will react in the right way and we see a sequential drop in the number of people that we have as we move forward against the flat line business model.

Chris Wetherbee

Okay. Okay. That’s helpful and I appreciate that. Can we talk a little bit about the topline and yield specifically. I guess from a yield standpoint, some sequential deterioration here. Can you talk a little bit about sort of the competitive pricing environment that you are dealing with in your markets, and then maybe some of the mix dynamics that are kind of working their way through? Is there any predictability to the mix as we look out to 4Q or maybe 1Q, can you sort of highlight that, but those kind of dynamics around yield would be very helpful.

Lance Fritz

Before I turn it over to, Kenny, I just want to remind everybody, Rob said this, that we calculate yield in the most conservative way, and so when you get a 10% or an 8% drop in volume in the quarter, it has a real significant impact on our ability to generate yield. And Rob, again, had said very specifically that there was nothing specific in the quarter that drove yield sequentially to decline just a little bit. But with that, Kenny, do you want to talk about the pricing environment that you are in right now?

Kenny Rocker

So, first of all, I just want to give a shout out to Jim, wishing the operating team for creating an environment where we can price to a really strong service product out there. So our commercial team is doing a really good job of keeping pricing discipline and aligning our price consistent with that service offering that’s improving.

Having said all those things, there is a very competitive truck environment that is out there. I think all of you are aware of what’s taking place in the marketplace and we complete -- compete daily with a number of rail carriers in North America.

But I think the important thing for you to hear is that we are going to maintain pricing discipline especially as our service products is improving and as that service product improves, we also expect that to help us grow.

Lance Fritz

Rob, do you want to touch on mix?

Rob Knight

Yeah. Chris, as you know, we don’t give guidance on mix and the reason for that is we have such a diverse product mix that we have mix within mix. You have heard me say that many times. Having said that, the challenges, and perhaps, to some, the surprise in the third quarter mix was I think largely explained by the increase in the shorter-haul rock shipments that we called out. I mean, intermodal, I think, everybody gets that. Most of the other moves like Ag everybody kind of gets that. The shorter-haul rock shipments that increased I think were perhaps a little bit of a surprise to some on the mix.

Having said that, I see no reason why the fourth quarter wouldn't -- would be materially different from what we saw in the third quarter. Again, I am going to stay away from specific mix guidance, but directionally I would envision it looking similar.

Chris Wetherbee

Okay. Okay. That's helpful. I appreciate it. Thanks very much.

Lance Fritz

Thank you.

Operator

The next question comes from the line of Tom Wadewitz with UBS. Please proceed with your question.

Tom Wadewitz

Yeah. Good morning, and Rob, yeah, also congratulations, wish you the best, pleasure working with you over the years and congratulations to you as well, Jennifer. The -- let's see, the volume trend, I mean, obviously there are a lot of moving parts and the weakness in volume. But I think it's notable that there's a pretty big delta in volume performance for Union Pacific versus Burlington Northern. And just wanted to see if you could shed some light on what might be driving that, in particular, I am referring to the intermodal where it looks like kind of four-week moving average you are down about 13%, BN is down about 2% and there is a pretty wide gap in the coal side as well. So just wondering if you could offer some thoughts on what's driving that and whether you think that might change over the next couple quarters?

Lance Fritz

Kenny?

Kenny Rocker

Yeah. I will tell you that we would have appreciated a stronger economy to help us compete for more opportunities. But the fact that the service product on the intermodal side is actually strengthening is something that we appreciate. And yes, we have seen a lot of competition out there from both the trucking side, and as always, we compete with the western rail carriers and the North American rail carriers. So that has going to be around for us and we will continue to compete there.

Lance Fritz

Yeah. One thing that I would add, Tom, is we are very happy with our service product and the trend that it's on. So it's currently a very good service product and it's showing itself to be reliable and consistent, and I think it's going to continue to improve. So from that basis, we are in a great place to compete for business.

Having said that, we are also continuing to be a very, very disciplined on our price. So we are not trying to chase market share, we are not trying to chase the market down against loose truck, and we will just compete based on the service that we provide, we will price for that. And as the economy strengthens, which it will at some point and as truck capacity tightens up, which it will at some point, we are in a great place to take advantage of that.

Tom Wadewitz

Okay. Just, I guess to follow-up on that a little bit further, are there contract shifts in the intermodal and coal side that might account for part of that and I guess in terms of the PSR impact, sometimes you make big changes to, as an example, in Chicago, the terminals you are using and you can cause some initial disruption to the customer but then obviously you hope to run better in the future. But is there an impact from contracts or kind of initial disruption from PSR?

Jim Vena

Yeah. Chris, I will take that, a mix of questions. The short answer is in terms of design of our network in the intermodal space. There has been small single-digit impact on intermodal volume from rationalizing low volume lanes, low density lanes. That made sense in the book of business. It still makes sense. And when you aggregate that back up to the entire railroad, it's really largely an asterisk.

When you get into the other parts of your question about contracts, we don't talk specifically about customers, but I -- but we did call out both in the first quarter, and I think, Kenny mentioned it again this quarter that, we did have a coal contract change hands that is impacting this year to a degree and we haven't talked about any other contracts precisely.

Tom Wadewitz

Okay. Great. Thanks for the time.

Lance Fritz

All right.

Operator

The next question is from the line of Scott Group with Wolfe Research. Please proceed with your questions.

Scott Group

Hey. Thanks. Good morning, guys. So want to ask a couple on the cost side, comp per employee a little higher than we thought, any thoughts on how to model that going forward and rail inflation next year? And then purchase services were flat sequentially given the weak volumes and PSR. I would have thought there would be some opportunity there, maybe can you just talk about the opportunity that is left on purchase services cost?

Rob Knight

Yeah. Scott, this is Rob. Let me take the cost per employee. The -- kind of delta, if you rose, as to why it was up above what we would expect in terms of the inflation was really some of the overtime which a lot of changes going on in operations but the overtime is something that did inflate that cost per employee up a little bit.

As we look to 2020, again we haven't finalized our planning assumptions yet, but I would say, it's probably overall inflation for 2020 is going to be in the neighborhood of 2%, with labor probably in the 2.5-ish range again.

And on the purchase services, I guess I wouldn't call out anything unique there, obviously, as we pursue the Unified Plan 2020 initiatives there will be opportunities we think for us to continue to rationalize and be as efficient as we can on that line as well.

Scott Group

Okay. And then we got the sub-60 OR guidance for next year. Rob or Jennifer or maybe Jim, if you want to comment, the street is already well ahead of that. Given the macro, does that seem reasonable or -- and then maybe asking it a little bit differently. So when we have looked at past instances of rails doing PSR, you have seen better margin improvement in the second year than the first year. Does that seem like a reasonable way to think about it or not?

Lance Fritz

Yeah. Let me start, Scott, and then I will hand it over to Rob and Jim. So the bottomline for next year is we have got guidance out there sub-60, but we have constantly said we are going to be as sub-sub-60 as we possibly can be.

As we enter next year, we have got good momentum, right? If we can get a little cooperation from the economy, that would be very helpful. We have had some puts and takes this year. We have discussed those through the quarter, so we know what those are. But we are going to get as sub of 60 as we possibly can. And with that, I will turn it over to Rob and Jim to fill in.

Rob Knight

Yeah. Scott, I would just add to that that, as you know, every step on the ladder of efficiency that we have had over the years we have always tried to get there as safely and efficiently and quickly as we can, and frankly we have. So I would say that's similar to the numbers that we have out there.

I feel, as I said in my comments, I feel as good as I have ever felt in my career about where we are operationally. So the things that I feel like we can control to get to that sub-60, I feel extremely good about.

So the variable right now as I look to 2020 is really the economy, and as we sit right here today, we are certainly hopeful and thinking that the volume will be on the maybe slightly on the positive side of the ledger, but that's still an unknown at this point. So I think that's really the big variable as to how sub, sub can be on that sub-60 guidance for next year.

Jim Vena

Listen, the only thing I can add, I think, Lance and Rob have done a great job of giving the macro view of it. Operationally, we are just starting. I think, there's lots to do. I think, I have been here for nine months, a couple of days ago. I think what the team has been able to deliver and you see it in the metrics that are real key.

I think -- I don't think, I know, next year is going to be a great year operationally. We will take whatever business. Hopefully it's an increase in business, and Kenny, a substantial increase. And we will show what this team can do, and if not, we react to it properly. I see lots of headway and I am excited by what I see coming forward for the end of this year and next year.

Scott Group

Jim, can I just clarify one thing with you? So, you -- at the beginning of the year you laid out a 10% labor productivity target. We are getting a lot of headcount out, but because volumes are down so much, like, we are getting maybe half of that on the labor productivity. So does that imply that there's a big opportunity left next year, are we thinking about that right?

Jim Vena

I think, we are headed in the right direction. You are thinking right. We are -- the more we can put, the less train starts, put more product on the trains, make it more efficient, adjust our yards just like we did in Kansas City, we drive productivity better, we will see that improve as we move ahead, Scott. So nothing wrong with the way you are thinking.

Scott Group

Okay. Thank you, guys.

Operator

Our next question comes from the line of Ravi Shanker with Morgan Stanley. Please proceed with your question.

Ravi Shanker

Thanks to everyone. And Rob, good luck on your retirement and congratulations, Jen, from me as well. So it was pretty that you are no longer going to announce core price. I think that now makes every Class 1 rail that doesn't disclose price. That's a pretty dramatic change from five years or six years ago, where that was kind of key to the rail kind of bouquet as investment pieces. Why do you think that's changed, I mean, is that because it's just gotten more competitive to get price, is it because of a tougher regulatory environment? Why have you seen that shift do you think?

Lance Fritz

So I can't speak for other railroads. I can speak for us. And that is by publishing a yield number every quarter. We work against ourselves commercially. I mean, in the simplest way, when Kenny is talking to a customer and trying to maximize that price discussion, our conservative yield calculation frequently works against us in that conversation. It's as simple as that for us. Rob?

Rob Knight

Yeah. Ravi, I would just add, Lance nailed it, but I would add, as I said in my comments, you are right, it is a shift. But I think, as I exit the company, I also have never felt better about the understanding and value of understanding the impact that the pricing has on our financials.

And you combine that with the continually improving service product, there's no doubt in my mind that Kenny and the marketing team completely understand that it's our objective to drive as positive a price and earn the adequate returns that we can in the marketplace.

So rest assured, I guess, the point is, rest assured that, because we think commercially it's not to our advantage to be talking as precisely as we have about price, don't interpret that to mean that we are not aggressively going after pricing opportunities, which we think are still there and we are going to aggressively pursue that.

Ravi Shanker

Got it. Just a follow-up. Lance, I think, you said earlier that, you guys are very clearly not chasing share and going after volume over price. Just given some of the volume delta this quarter between you and your chief regional competitor, do you feel like there is some of that going on in the marketplace?

Lance Fritz

Our marketplace, as we relay to you every quarter, it remains very competitive and it remains competitive specifically in the intermodal space not just against rail competition, but specifically against truck competition.

Trucks are pretty darn loose right now, which means the capacity is readily available and widely reported that truck pricing has been dropping. So we are looking forward to seeing a bottom of that and then an upturn.

And I anticipate that will occur. I don't know when. But you see truck orders substantially down, you see production starting to turn negative and that all bodes well for competition as we look forward.

Rob Knight

And the best way to combat that is an improved service product and that's what we are getting right now.

Ravi Shanker

Very good. Thank you.

Operator

Our next question comes from the line of Brian Ossenbeck with JPMorgan. Please proceed with your questions.

Brian Ossenbeck

Hey. Good morning. Thanks for taking the question, and again, congrats, Rob and Jennifer. Just going back to the volume side for a minute, we have easier comps here in 2020. What do you feel, Kenny, about the absolute activity levels and maybe some of the key areas to talk about? You just mentioned truck, but honestly, I am a little surprised that that's been such a factor, so maybe you can help expand on that? And then while we have talk about sand for a long time, it continues to go down. I just wanted to see when you mentioned the long-term comps get easier, is there still a big shift in local sand that's coming up that you think is going to be a mix headwind as well?

Kenny Rocker

Yeah. So, first of all, it's a little premature for us to talk about the plan for the following year. But, yeah, I would expect that we would be on the slightly positive side of the ledger. As we look towards the future and the fact that we have got a good service product really helps us out.

When you look at the sand business, yeah, that local sand penetration has been with us now for a good 18 months. I will tell you that I would expect that those comparisons to slow over time. So maybe not the immediate near-term, but over the longer term, it certainly should, those comparisons should get easier for us.

Brian Ossenbeck

And then to follow-up on the trucking side, because I feel like you didn't get as much benefit when the cycle was tight, so a little surprised to hear that it's a bit of an overhang here in some of the markets?

Kenny Rocker

Yeah. We are keeping an eye on the trucking market. Over the last couple months and even over the last couple weeks, we are seeing it firm up a little bit. We are also keeping an eye on what will happen in terms of a peak season out there because there is some interplay between our domestic business and our international business. But right now, we would really appreciate more help from the overall economy.

Brian Ossenbeck

Got it. Then just one quick one for Lance. Can you just give us your view on regulatory environment and do you see, it still feels like it's a little more active, not necessarily active from that perspective. But are we certainly seeing a lot of movement in a few different areas than we have with labor negotiation that's starting up, which I appreciate you probably can't say too much on that. But just want since there's a lot coming between now and the end of the year just kicking off here, I just wanted to get your thoughts on topics more generally? Thanks.

Lance Fritz

Sure. So let's take them in two pieces. I will start with the regulatory environment. So the STB is poised to be fully staffed with five Board members in the not too distant future. And they have already started getting more active on a host of items that they are pursuing, either old items on the docket that just weren't handled over the course of the last five years and in some cases new items.

Our posture is we are continually engaged with the STB to help them understand what some of the negative impacts could be of some of the regulations that are being considered and also help them understand that each regulation can't really be taken on its own. It forms a mosaic of regulatory impact.

And the end game for the railroads for the STB is to make sure that the railroads are healthy and can continue to invest capital in the railroads so that we have a robust infrastructure to support the United States.

So we constantly are having dialogue and communication about current state of the railroad. How good the service product is? What we are working on? And what the risks are of some of the regulations that are being considered.

In terms of our negotiation with labor, you did see that there was a lawsuit filed against the Smart TD. That was to compel that specific union to negotiate on crew consist or at least consider that through arbitration as a negotiating item. That it was -- it’s a technical matter and I look forward to that being addressed through the courts. The end of the current moratorium is November 1.

So sometime around that time frame, unions are free to put demands on the railroad management teams and railroad management is free to put demands for negotiating on unions. I anticipate that’s going to happen. I anticipate it’s going to be a robust negotiating season and I look forward to that, and I look forward to be able to work with our unions to continue to position Union Pacific as a competitive strong supporter of the U.S. economy.

Brian Ossenbeck

Okay. Thank you, Lance. Appreciate that.

Lance Fritz

Yeah.

Operator

The next question is from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your questions.

Amit Mehrotra

Thanks. Good morning. I just wanted to ask firstly about the profit potential, as volumes and revenue get better, some of the huge progress you have made on the cost side is, obviously, being masked a little bit by the revenue environment. So just in that context, when we do get back to revenue growth, hopefully, as soon as possible, probably, next year, can all of that incremental revenue drop to the bottom line, just help us think about the cost in the business whether structural or variable and how those -- which of those would have to increase once revenue growth kind of moves from negative to positive?

Rob Knight

Amit, this is Rob. I think you are spot on. We would love nothing more than to see volume be as positive as possible and there obviously are some direct volume variable costs that would come on Board with that, but at a very productive level.

But I think you hit the nail on the head, and that is we are well-positioned now as volume does return for the incremental margins to be impressive, because there is no, I mean, we won't have to add back the costs that we have been able to right-size and achieve through the Unified Plan 2020, so the efficiencies and the incremental margins, to your point, from the incremental volume that comes on Board should be extremely efficient.

Amit Mehrotra

Okay.

Jim Vena

That's where that work that the operating team has been doing on train size really pays off and when we talk about train size opportunity into the future, volume growth is just going to be our friend.

Amit Mehrotra

Right. And that's a good segue into my next question or follow-up question on the operating stats. The train length progress has been really impressive. I think it's like 8,000 feet or maybe a little bit more now. What -- I don't know if it's a question for Lance or Jim, but what's the upper limit there, I mean, can you get to 10,000? How quickly can you increase that and have you made enough -- I know you made a bunch of investments reallocated some capital towards extending sidings earlier this year. Is that all done where now you can continue to grow that, just talk about how quickly you can continue to grow that because the progress there has obviously been impressive?

Lance Fritz

Well, thanks for the feedback, Amit. Listen, the team has done a great job. You don't change from a 7,000 foot railroad to an 8,000 foot railroad in nine months without touching a lot of places. We have a great network.

So that's what's nice about as business comes, which it's going to come, we drive more of it to the bottomline because the costs are not going to go up 1 to 1. In fact, I'd be very interested to see what happens when the business goes up next year.

Second is we will invest -- we found some places in this network that we need to invest and we will invest and make sure the same as we have done on the Sunset to increase train size and be more fluid and have less trains running with more product on it.

The upper limit, I don't guess. It's a traffic mix depending on what kind of traffic you have. We have some traffic that is very tough to build big trains with just because of origin and destination and others we have the possibility to be able to increase them.

So I continue to see improvement. I know what other railroads have had the capability of doing, one that I worked at. So I think we will buy that number that they have had without an issue next year as we build this infrastructure even better and harden it.

Rob Knight

There is one last thing to note here, and it's lost on a lot of people. It's a benefit of the train design that we have got Unified Plan 2020 and that is much more of our volume is running in mixed manifest traffic now.

Kenny talks about it from the perspective of that's enabling us to win business that we used to pass on because it wasn't conducive to a unique boutique train. Well, in the old days, if 40% or 45% of our network was in the manifest world, that number is looking more like two-thirds and three-quarters, which means volume can grow across different segments and we can leverage it into train size, whereas that opportunity to do that historically was probably a little more limited. So that's a big benefit of the Unified Plan 2020.

Amit Mehrotra

Yeah. That's helpful. Okay. That's it for me. Rob, congrats. I hope you don't miss these calls and our questions too much. Thanks so much.

Rob Knight

Actually, I will miss it.

Operator

Our next question is from the line of Jordan Alliger with Goldman Sachs. Please proceed with your question.

Jordan Alliger

Yeah. Hi. Good morning. A question for you, I know the network is in good shape for the incremental margin next year, volumes snapped back. Question, though, on the headcount front, can you gear up quickly or would you need to gear up quickly given how much reduction you have had so that you can ensure the operations from that perspective will run smoothly?

Lance Fritz

Yeah. I am going to at the highest level say, yes. We have changed a number of things that make our ability to be more agile on both the upside and the downside. But on the upside, our time to hire and train and bring out a crew, a conductor, has been cut dramatically. We are actually looking forward to the next time we have to add conductors to exercise that new muscle. Jim, there are some other things we have been doing. What are your thoughts?

Jim Vena

Lance, I think, you hit it right on the nail. The bottomline is, is I don't think we have to increase. We have an increase in business. We are not going to increase on a same percentage as we go up or going to become more efficient. It helps us become even more efficient.

I think we have shown what we could do this quarter. When you have this kind of an adjustment in volume and for us to drop 5,700 FTEs in the third quarter shows that we have got the capability to make the right adjustments when the business level is and a lot of that cut was because of the efficiencies that we built into the system. So I am looking forward to what happens the next few months and into the next year and I am very excited about it. I think the numbers will dictate a great result for this company moving forward.

Jordan Alliger

Thanks. And then just a quick follow-up on intermodal, we keep hearing that service is much better from various folks out there on the rails. You guys as well intermodally. So when you talk to your customers, I mean, is it truly a price spread between what you offer versus trucks that's going to get the needle to move back to positive volumes, and if so, what sort of -- pick a length of haul, what sort of spread versus trucks percentage wise, let's say, induces a shipper to move the volume to rail, especially given the service and what have the discounts narrowed to now, if you have any input on that? Thanks.

Jim Vena

Yeah. You are right on that service has improved and our customers are realizing that and it will take a while. I mean, we are talking about a few months now where our service has really turned a corner from the weather event. The spot rates have now lowered. They are less than 20% from the highs where they were over 25% last year in terms of being depressed.

In terms of where we need to be in that delta, we have always said that we would like to be from the contracting rates anywhere from 10% to 15% lower than the contracted rates and so we will continue to see what happens in the marketplace going forward.

Lance Fritz

Hey, Jordan. This is Lance. Two points, one that the truck capacity, overcapacity of truck supply really needs to get adjusted for those spot rates and contract rates to start going back up. And then the second thing to note is, our service product consistent, reliable, over a period of time will start convincing customers who have historically split their book of business but would have benefited by putting more on rail to put more on rail. So over time, theoretically, I think, we should see more opportunity as opposed to less even in the status quo environment.

Jim Vena

I think the important thing is that we are already seeing wins. The commercial team is already putting together some wins out there that are specific to UP 2020 and so the expectation is that that will continue as we move forward in the next year.

Jordan Alliger

Great. Thank you.

Operator

The next question is from the line of Ken Hoexter with Bank of America Merrill Lynch. Please proceed with your questions.

Ken Hoexter

Great. Good morning. And Rob, obviously, congrats and really enjoyed working with you through all the years, and to Jen on your new role of finding a way to talk to analysts again. Just a great call so far on the big picture, but maybe, Kenny, if I can just drill down maybe a little nearer term here, looks like we have started off the quarter even worse than the run rate that you are highlighting that the fourth quarter should look like third quarter, particularly at Energy and Premium, which are down 18%, 13% with the quarter now down 11%, so a bit worse than third quarter. Is there anything you would put that on flood, snow, anything you look to turn around on easier comps as we move forward?

Lance Fritz

Yeah. If you look at it, clearly we have some tough comps. I think we all remember some of the pull aheads that we were faced on the intermodal side especially with our international intermodal, and clearly, natural gas is in a different place than it was around the same time last year. So structurally those are two fundamental issues that are there.

We will continue to also keep an eye on what's going on in the automotive industry. Our Detroit team is working with GM, and although, we didn't see a significant impact in the third quarter, we are going to be working with them and all the auto players to see the impacts that it's having early on in the fourth quarter.

Ken Hoexter

Okay. But just to, I guess, understand that, the pull ahead would make it even tougher comps. So you are saying that was maybe an earlier quarter event so it gets easier as the quarter rolls on?

Lance Fritz

No. What I am saying is that those comps are impacting what you are seeing in terms of the delta that we are down.

Ken Hoexter

Okay.

L

For this quarter. Yeah.

Jim Vena

Since start…

Lance Fritz

Since start…

Jim Vena

Since start of the quarter.

Ken Hoexter

Yeah. All right. And then, Jim, great slide on kind of the newer moves on kind of continued rationalization. Are there maybe your thoughts on additional yards or is it incremental from this point forward as you have cleaned out the humps, just trying to see if there are any more step function improvements that you see as you move into 2020?

Jim Vena

I think, if you look at what we are trying to do, it’s a great question, because I look at it holistically for the whole company, not just looking at numbers of what we are doing. All we are trying to do is move cars as fast as possible, remove the touch points and give better service product and that’s what we are doing. And this is a winning game, so we drop our operating, we have become the most efficient railroad in North America, we are able to then compete against everybody.

So what I see out there is we just started. We are truly baseball season, great time of the year, maybe not if you are a Yankee fan right now, a little tough, but at the end of it, I think, that we are early innings and we still have a lot to do productivity-wise in this company, and stay tuned, and we will move ahead and I will announce them as we are ready to go.

Ken Hoexter

All right. Great. I think the Yankees would say it’s still early. So thanks a lot, guys.

Jim Vena

I was waiting for that. I was waiting for that comeback. Appreciate it.

Ken Hoexter

Appreciate the time, guys. Thank you.

Operator

Our next question is from the line of Allison Landry with Credit Suisse. Please proceed with your questions.

Allison Landry

Thanks. Good morning. And congrats to Rob and Jennifer. Maybe, Jim, just following up on your recent comments about productivity. Could you maybe give us your initial thoughts on what this could look like in 2020 given that the improvement in the key metrics have really accelerated here recently? And maybe without asking you to put a specific number on it, because there a reason to think at least directionally that it should be bigger than the $500 million or plus this year?

Jim Vena

I am not going to put a number on next year. Let’s wait and see what we -- where we end up with and where we want to put the place mark for next year. But operationally and what I see in this company and what I have seen from my history is that we will continue to improve our efficiency.

We will be able to draw more business on because we win in the marketplace with a better product. We look at it end-to-end. I am going to try to make Kenny’s job easier moving forward. So I think it’s a win-win for us moving ahead and that’s about as close as I will get to giving you any numbers.

Allison Landry

Okay. Fair enough. And as you go through the network rationalization process, have you seen any meaningful opportunities for line sales?

Jim Vena

Stay tuned. We will just work through it as the business mix and what we look at. I think we have already got a pretty good plan of what we look at our network. But at this point nothing to announce.

Allison Landry

Okay. Thank you.

Jim Vena

You are welcome. Thank you.

Operator

The next question is coming from the line of David Vernon with Bernstein. Please proceed with your questions.

David Vernon

Hey. Good morning. Thanks for taking the time. Kenny, I wanted to ask you a long-term question about the Energy franchise, obviously, you have got coal and sand challenges right now. You have got a plus signup of petroleum products. I'd like to understand kind of what kind of flows near-term are driving you positive and what do you think is the risk that that positive could shift negative as we get into 2020 and the pipeline complex gets closer to being built out up in the Bakken?

Kenny Rocker

Yeah. So longer term, again, we think the comps for the sand will improve. We will see what happens there. On the crude oil side, we feel very optimistic about that market and we -- I look at that as a couple to a few years type of opportunity and we are gearing up, and we have got the resources out there, and I think you have read where the government has increased the curtailment, so we are expecting more volume to come along.

David Vernon

Is that predominantly Canadian origin stuff, or is that also some stuff coming out of the Bakken?

Kenny Rocker

That is the Canadian origin that we are looking at into the Gulf.

David Vernon

Okay. So that's really what's driving the growth near-term?

Kenny Rocker

Correct.

David Vernon

Okay. And then, maybe just as a quick follow-up in the Industrial Products sort of segment, the average RPU [ph] came in a little bit softer. Can you talk a little bit about what the mix dynamic is going on inside of that segment and what the outlook is there sort of over the next couple quarters?

Kenny Rocker

Yeah. So Rob talked about this a little bit earlier, and we really have got some strong double-digit growth on the construction products. Our rock shipments have a shorter length of haul. That's there. You could possibly make the -- as you look at a lot of the Petrochem business, it's also a lot that moves inside and interchange into the Gulf. So you have got a strong mix there of growth that is not as longer haul as say some of the other pieces of business like our lumber that's down.

David Vernon

And will that -- will those sort of mix trends sort of continue for the foreseeable future or do you see any sort of major shifts ahead or it's just kind of this shift continuing?

Kenny Rocker

We would expect both the Petrochem and the Construction Product business to continue to grow. I think the economy will help us out with the housing market right now, it's been pretty flat, and again, that's also truck susceptible. So a stronger economy will help us compete better in that housing market and we would hope for a little bit more help with the overall side there.

David Vernon

All right. Thanks, guys.

Operator

Thank you. The next question is from the line of Brandon Oglenski with Barclays. Please proceed with your questions.

Brandon Oglenski

Hey. Good morning, everyone, and thanks for getting my question in, and Rob, congrats as well. I am just going to ask one, but this may be a longer term question. When you guys look at the Intermodal business, if we comp you relative to industry growth, I think, Union Pacific has probably fallen behind there over the last decade, but obviously you guys have improved returns and margins in that time period. So I guess looking forward with the new operating plan, I mean, is Intermodal a now more attractive business than maybe it was in the past or you guys have been calling out for a couple of years here competitive pressures. I mean, is that more competition from north of the border that Jim might know very well or how do you think about it looking forward?

Lance Fritz

Yeah. So let's talk about the Intermodal business broken into two pieces, international and domestic. They are both attractive. Our work on cost structure has made growth in both attractive to us presuming it's in the right price.

And from a domestic Intermodal perspective, we have got a track record of growing domestic intermodal up until about the last call it 18 months and I think that has more to do with the flip on truck capacity than almost anything else. Once overcapacity happens in trucks, there's just a lot of behavior that breaks out the marketplace that makes it difficult to grow in an attractive return.

Our current cost structure has changed the playing field for us in terms of what's an attractive piece of business and our current service product has changed the playing field so that customers look at us and think, boy, they are a viable alternative to my truck network. So both of those I think should be positives for us to get back on the path of growing domestic Intermodal. That still needs to also occur in the context of truck capacity getting right-sized.

Internationally, there is no doubt that Southern California ports have lost some market share both to Canada and to a smaller degree the East Coast ports and that is troubling. And that I think has less to do, I know it has less to do with our service product from

California ports to, let's say, places like Chicago and more to do with the overall cost and infrastructure of landing a box and paying fees at ports.

So we are really trying to help the port of -- ports in California along the West Coast of the United States understand those dynamics and understand that it's a very competitive environment and the whole supply chain has to be involved in winning that business back to the West Coast ports.

Net-net, our service product is being designed on an end-to-end game. So it's not just the transit over the road we are worried about, what dray looks like around our facilities in Chicago, what grounding looks like, how quickly we can turn our equipment with stripping and reloading, all that is moving in the right direction, and I think, all that is going to create opportunity in the future. We need to do that in partnership with our ports as well and we are.

Brandon Oglenski

And well, I said, I was only going to ask one, but I guess, Lance, in that regard, I mean, have you guys changed your marketing efforts on the Intermodal side to address some of these challenges?

Lance Fritz

For sure we are having those conversations. You have seen our product design change. We de-market it and got out of low density lanes. We have changed the layout of our Intermodal ramps in Chicago so that they are much more focused and dedicated. For instance, G4 in Joliet on international, G2 in Proviso on domestic, G-- the yard center on North-South on automotive parts and that's helping.

So, yeah, I would say, we are addressing the marketplace in a different way to have a service product that wins. And it's a good looking service product right now. And right now it's basically up to the marketplace, and Kenny's team to make those matches happen and to get essentially the truck overcapacity back into the right box.

Kenny Rocker

Yeah. We have turned on things like the Intermodal reservation terminal reservation so that our customers have really good visibility on which containers or which boxes they are going to move on what date. So it takes out any confusion or ambiguity there, which the customers love.

Brandon Oglenski

Thank you.

Operator

Next question comes from the line of Walter Spracklin with RBC Capital Markets. Please proceed with your questions.

Walter Spracklin

Yeah. Thanks very much. Good morning, everyone, and yeah, congrats, Rob, Jennifer, on the new roles and the new retirement. Best of luck. I want to come back on your answer to the intermodal difference between you and BN. When I see a company that is implementing PSR the way Jim is doing it at Union Pacific, ripping out that level of workforce and locomotives and so on. I would expect some service disruption, and I would argue that these declines relative to your closest peer would be par for the course here. Is there any of that going on. I mean, that would suggest that the disruption and the decline is temporary and that when you are completed your PSR, you can use it as a weapon rather than a cost reduction tool. You can use it as a share gain weapon and just stay tuned for more rather than your commentary about a real competitive environment. I mean, that doesn't leave -- that's a much more negative, I think, if you are pointing at a more competitive or a competitor, I guess, is a little less encouraging than if it was just due to temporary disruption on service, any comments on that?

Lance Fritz

Yeah. Walter, so let me put a little finer point on the answer that we gave a little while back. Specific to Intermodal, specific to rationalizing our lanes, that impact might be a couple of 3 percentage points. So you are right, there's a bit of that and I would expect us to grow back through that.

But there is still a piece in that particular marketplace that is both truck overcapacity that has to get back in the box and it will. Those always ebb and flow over time in business cycles and I think those are the two big moving parts.

Walter Spracklin

Okay. And then just following up on the pace, Jim, of PSR adoption, in the past we have always noted it to be very fast, very significant early on. This quarter compared to Q2 was effectively flattish, obviously, we were expecting a little bit better given you had a lot of flood impacts in the second quarter, hoping for a bit more of a improved third quarter relative to the second quarter. I don’t want to answer it for you, but obviously prior PSR implementation generally has been done in a nice strong economy and growth environment. Is that the reason why we are seeing a bit more of a muted pace in the early execution or is there another reason?

Jim Vena

Son of a gun, I am telling you, Walter. So 5,700 FTEs, 13% drop versus volume 8%, train length up 16%, dwell time dropped, freight velocity up, workforce productivity on a dropping business model better, so if that’s average, son of a gun, I want average again next quarter, okay? That’s the way I look at it.

I think we have got to be smart about it. We don’t want to blow up the place. I could have park a thousand locomotives the first day I showed up. I am not going to do that. I think it’s a long game and I don’t mean long by years, but it’s a long game, do it right. Get the right product and this whole intermodal discussion, it’s a great question, and this is where we want to be.

We want to be where we have a very efficient railroad. We are able to open up new markets. We are able to beat the competition which is other railroads and truck and bring more product in without dropping our price. So that’s the game we are playing. I am excited about it, Walter, and you are a tough, your kids must hate coming home with their score cards, you are a tough marker.

Walter Spracklin

Appreciate the color. Thanks.

Lance Fritz

You are welcome.

Operator

Our next question is from the line of Jason Seidl with Cowen & Company. Please proceed with your question.

Jason Seidl

Thank you, Operator. Rob, I have to offer, one, my congratulations on your retirement. I think sitting in my chair for as long as I have I am definitely jealous of seeing somebody retire. Also, it’s been a pleasure to work with you over the years. You have been extremely generous with your time and always gracious with your responses. Jennifer, welcome back. All I can say if you are going to work with us analysts again you must be a glutton for punishment. Two quick questions here, one, Jim, clearly there’s been a lot of success here in PSR. But train speeds are the one thing that I would call out that I am a little bit surprised at. I knew there were some puts and takes, but relatively flat in a declining environment. Can you talk a little bit about that and what we should expect going forward and then I have one more follow-up.

Jim Vena

Okay. So let’s talk about train speed. People want to worry about train speed. I look at car velocity which is the end-to-end measure that the customer looks at. It’s not just a subsection. So what we have done is we have taken some of our trains that used to run through and been able to not stop and get end-to-end, and we have added work events for them. We get them at 3,000 or 4,000 cars instead of running extra trains.

So at this point, we are looking through that. What I see moving forward is, we will have the fastest train velocity of anybody in the railroad network that we compare ourselves to. So we are working towards that and I expect some noise some more.

If I have a choice of increasing the train speed by a tenth of 1% and running the car velocity quicker and being able to drop the number of cars I need by 5,000, I will take the car drop and car velocity over the train speed. So that's where my mind is with it.

Jason Seidl

Okay. Fair enough. And my last question, Rob, I am going to go for you for old time's sake. You talked a bit about rent expense dropping. You mentioned volume is one of the reasons it was off over 13% in the quarter. Given that volumes are going to be down on a similar fashion in 4Q, would you expect rent expense to be about down the same in 4Q as it was in 3Q?

Rob Knight

Yeah. Without a fine point on it, I can't see any reason why directionally it wouldn't look similar to the third quarter.

Jason Seidl

Okay. I appreciate the time as always.

Lance Fritz

All right. Thanks, Jason.

Operator

Our next question is from the line of Fadi Chamoun with BMO Capital Markets. Please proceed with your questions.

Fadi Chamoun

Yes. Good morning and thanks for squeezing me in here. Congratulations, Rob and Jennifer, on the announcements. One question for Jim, I mean, the operating ratio will have a pace that is also influenced by some of the topline dynamic we are seeing. But if I think in terms of actual progress on redesigning the operating plan and rationalizing the classification assets and all the kind of Unified Plan 2020 you are doing. Does less volume help you get more things done, and hopefully, as we come out of this volume downturn we can see a stronger payback than we would have otherwise?

Jim Vena

No. Fadi, in fact, it's the other way the way I see it. I would love to have increase in volume come on. Volume helps us in that we are able to really run the place more efficiently and more -- as cars come on on the same trains that we are operating on. So I see volume as a helper. It helps us both topline and bottomline. But on top of that efficiency wise it helps us even better. So that's exactly what we want, Fadi.

Fadi Chamoun

Okay. And maybe one quick follow-up. Thanks for that, Jim. If we do see next year another challenging volume environment down mid-single digits, is there any constraint or any roadblock that would prevent you from taking another 10% plus out of the headcount?

Jim Vena

I hate to be negative but the answer is no. We will react on what the market gives us. What the competition gives us and what is available for the economy. So we will react in the right way up or down and I am hoping that it's up and everything that we see is with the floods and everything we have we see a good year starting next year. So that's where we are, Fadi.

Lance Fritz

We are looking forward to volume presuming the economy stays healthy. I would love to see a little bit of growth. That would be welcome. But whatever the economy is, Rob says this, it's probably a fitting ending to the call. Rob says that every time we get together and that is the economy is what the economy is. We deal with the hand that we are dealt and we don't use that as an excuse and we won't.

Fadi Chamoun

Okay. Great. Thank you, guys.

Lance Fritz

Thanks, Fadi.

Operator

Thank you. This concludes the question-and-answer session. I will now turn the call back over to Lance Fritz for closing comments.

Lance Fritz

Thank you, Rob, and thank you all for your questions. In closing, we have made really good progress in the third quarter delivering a more consistent reliable service product with a fundamentally smaller cost structure. And although, I'd much prefer a growth environment, our operating performance gives us a lot of confidence that as volume returns to the network, we are going to leverage it very efficiently and return even stronger results. With that, I look forward to talking with you again in January to discuss our fourth quarter and full year 2019 results. Thank you.

Operator

Ladies and gentlemen, thank you for your participation. This does conclude today's teleconference. You may now disconnect your lines and have a wonderful day.