RAILROAD WEEK IN REVIEW
January 31, 2020

“Canadian National consumes approximately 15% less fuel per gross ton-mile than the North American industry average. And over the past 25 years, we have reduced our locomotive emission intensity by 39% thus avoiding over 45 million tons of CO2 emissions.” — Rob Reilly, Chief Operating Officer, CN

“Canadian Pacific set a number of operating metrics through the quarter: terminal dwell down 9%, car miles per car day up 11%, locomotive productivity up 5%, and trip plan compliance was 90% improved for the quarter, all again a testament to the power of executing with our proven operating model.” — Keith Creel, President & CEO, CP

“Improved price differentials are predicted to sustain fourth quarter 2019 crude volume levels through 2020. Overall, we expect total merchandise revenue improvement enabled by our strategy with continued support from our consistent, reliable and quality service product.” — Alan Shaw, Chief Commercial Officer, NS

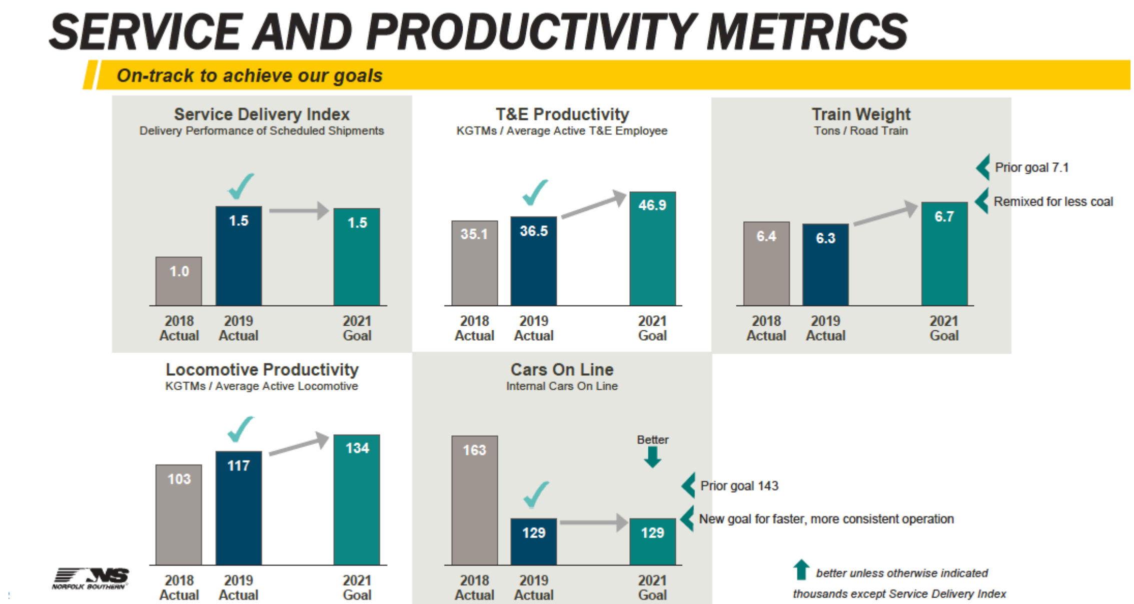
Norfolk Southern did not have a good quarter commercially. Revenue dropped seven percent to $2.7 billion on nine percent fewer revenue units and a two percent RPU gain. Merchandise carloads fell six percent as four of the five carload commodities posted declines; chemicals was the only escapee, with carloads unchanged thanks mainly to a 12 percent petroleum products/ crude oil gain.

On the other hand, NS hit full-year records for operating income ($4 billion) and operating ratio (64.7), telling us that even though Q4 was among the worst on record, the core business strength was enough to overcome that shortfall and demonstrates sufficient resiliency to resume the upward trajectory we have come to expect of NS going back to Wick’s days.

The Slide 6 revenue waterfall is good news for short lines as the merch sector offered better returns than either IM or coal. That RPU less fuel increased four percent says service was good enough to earn the increases, the key being an improved service product that allowed more aggressive pricing.

It won’t be easy, though. Says Alan Shaw, “Continued weakness in manufacturing and low commodity prices will impact our coal franchise and other segments of our merchandise markets. Overall, we have not seen an inflection point in volume trends and a high degree of uncertainty exists.” But I think as service levels continue to improve and volumes drift back, NS will emerge from 2020 in an enviable position.

On the operating side, COO Mike Wheeler gets good marks for gains in service and productivity. After all, a leading tenet for the Precision Scheduled railroad is asset management. "Service Delivery" is essentially trip plan compliance. T&E Productivity is having the right people in the right place at the right time. Same for loco productivity. Bigger trains mean more cars moving as one. And the fewer cars on line the more space you have to move what you have to move. It's that simple.



In all, a decent report given the Q4 operating environment. The bottom line is whether NS can leverage the new-found ops efficiency into new-found customers and revenue streams more from volumes than rate hikes.

The Canadian National call was heavy on customer benefits and light on the usual ops and financial gleanings. Recall that CN has organized its marketing efforts across two supply chain teams. The "Customer Centric Supply Chain" covers intermodal and automotive and is led by SVP Keith Reardon. The "Rail Centric Supply Chain" covers coal and everything else, and is led by SVP James Cairns. We will dwell on the latter.

Says Cairns, "We're focused on delivering growth in 2020, while preparing to capitalize on specific growth opportunities, starting in 2021." For example, CN has introduced new frac sand services designed to smooth out demand and protect rail share versus truck. There will be continued growth in propane exports thanks in part to the opening of a second Canadian West Coast propane export facility. There are five new CN-served high throughput loop track grain-loading facilities that came online. And there are similar projects that will increase carloads of sulfur, diesel and plastic products.

Doing all this well requires — you guessed it — a Precision Scheduled Railroad. COO Rob Reilly highlights The Story Thus Far. In 2019 car velocity increased five percent; network train speed was up three percent; yard dwell dropped three percent. This operating model has CN burning some 15 percent less fuel per GTM than the average North American Class I. Cars-on-line are down five percent as a result of greater car velocity; the owned/leased freight car fleet is 5,000 cars smaller and the loco fleet is 165 units smaller.

Operating income was down 16 percent to C$1.2 billion; the operating ratio added 415 basis points to a still-respectable 66 even. Below the line, net income was off 24 percent to C$873 million. But, as I noted above, Q4 was an evil time, and full-year results are a much better measure of what CN is all about: revenue up four percent, opening income up two percent, net income down three percent and the OR was 62.5 — up less than a point.

Canadian Pacific closed out the week with revenue of C$2 billion, up three percent, on 702,000 revenue units, down one percent, and RPU up four percent to C$2,883. Operating income was C$890 million, up two percent as operating expense was held to a four percent gain. The OR slipped a mere 55 basis points to 57.0 from 56.4 -- I'd call it no change. Net income increased 22 percent to C$664 million.

CP operating metrics are once again impressive. Each of the six measures is heading in the right direction: terminal dwell, velocity in miles per hour, FRA accident frequency, loco GTMs per available horsepower, car miles per day, and reportable injuries per 200,000 hours. And among the nine measures I use to compare North American Class I results, CP is tied with KCS with three wins each.

The FX-adjusted revenue gains need to be put in context. Though grain revenue is up only four percent, it is still the largest volume group in the merch sector, followed closely by ECP -- these two were 29 percent of total revenue units for 2019. Potash, though down six percent, is just five percent of total units and mets/mins are eight percent.

On the financial side, please ignore the "adjusted" non-GAAP numbers. I'm a firm believer that Generally Accepted Accounting Principles exist for a reason, principally to allow comps between companies on a common basis. Also ignore ebitda, slide 17. Depreciation is a necessary cost of staying in business and taxes stop only when you die.