RAILROAD WEEK IN REVIEW

June 5, 2020

"This new structure positions Norfolk Southern for continued success as a faster, smarter, and more resilient company. We are achieving further cost savings, enhancing collaboration, and increasing operational efficiency, all while maintaining superior customer service." — Jim Squires, President and CEO, NS

"Both the Energy and the Materials sectors do well when the world's economies are growing. Both are weakened by worldwide recession or depression. Both require longer-term capital investment, and neither can turn production on or off in a split second… Recovery means that demand will increase in the Energy and Materials sectors, though we do not yet know how fast demand will increase and in what components. " — David Kotok, Chairman, Cumberland Advisors, June 2

Norfolk Southern is reorganizing the C-Suite. John Scheib has stepped down as executive vice president and chief strategy officer, effective last Monday. His areas of responsibility — Strategic Planning, Network Planning and Optimization, and Customer Operations —- will be integrated into the Finance, Operations, and Marketing divisions, respectively, creating closer alignments among teams, according to the NS press release.

Strategic Planning will move to finance under the leadership of Mark George, executive vice president and chief financial officer. This move aligns strategic planning with the newly created Financial Planning and Analysis group, further strengthening the company's capabilities for rigorous analysis, robust metrics, and systematic competitive benchmarking.

Network Planning and Optimization, which played an integral role in successfully rolling out the TOP21 operating plan, will become part of operations. The team will continue to identify and drive operating efficiencies under the leadership of Michael Wheeler, executive vice president and chief operating officer.

Customer Operations will become part of marketing under Alan Shaw, executive vice president and chief marketing officer. NS claims the move "more closely aligns the groups that proactively engage with customers, enhancing the company's ability to deliver a best-in-class experience and exceptional customer service."

It's not been a good couple of years for NS. According to their own financials, 2019 full-year revenue units were off five percent from the 2018 number. The 2020 first quarter revenue units dropped 11 percent year over year, and, per NS, 2020 Week 21 (ending May 30) total units were down 19 percent year-over year, from 3.3 million units to 2.7 million.

Shaw has said repeatedly — most recently during the Wolfe Conference on May 20 — that they are “not chasing volumes,” looking instead for “quality revenue.” A year ago, the NS commodity mix was 59 percent carload, 15 percent coal, and 25 percent intermodal. By the end of the first quarter, the mix had shifted to 64 percent carload and 11 percent coal, with intermodal holding at 25 percent.

Clearly, NS is beginning to replace coal with merchandise carloads. Though total revenue units were down 11 percent in Q1, merchandise was down half that, even with the eight percent automotive haircut. System and merchandise RPUs both increased four percent, posting mid single digit gains in ag/forest/consumer, metals/construction, and chemicals. These are all single-carload commodities (with the possible exception of grain unit trains), so the shift of focus from long trains of coal running down hill to single carloads navigating a network of branch lines and feeder lines requires a different leadership structure. Now let’s see how it works.

Wednesday marked completion of Canadian Pacific’s acquisition of the Central Maine & Quebec Railway (CMQ). The transaction returns the line to the CP fold, it having once been CP’s primary route between Montreal, Quebec and Saint John, New Brunswick. From 1889-1974 part of the through route consisted of trackage rights over the Maine Central Railroad between Mattawamkeag, Maine and Vanceboro, Maine, on the Canadian border. CP bought the line from MEC in 1974. East of there to Saint John CP was back on its own rails.

In 1988, citing declining traffic, the CP set up the Canadian Atlantic Railway subsidiary to control its lines east of Montreal. That line was sold in 1994 to a group of US investors who ran it as the Canadian Atlantic Railway (CDAC). The property east of Vanceboro went to J.D. Irving Limited, which continues to operate the line segment as the New Brunswick Southern Railway (NBSR), now extending west to Brownville Jct and its connection with the CMQ.

CDAC entered bankruptcy in 2002 and the railroad went to Rail World, Inc. which reorganized the lines under its newly formed subsidiary, the Montreal, Maine and Atlantic Railway (MMA). The 2013 Lac-Mégantic rail disaster put the MMA into bankruptcy and in January 2013 the railroad was sold to a subsidiary of New York’s Fortress Investment Group. They operated the line from Montreal to Brownville Jct as the CMQ from then to the present.

Together with CP’s earlier acquisition of the CMQ-Canada, this completes CP’s purchase of the entire CMQ network, which was first announced in November 2019. CMQ US and CMQ Canada will continue to operate in the U.S. and in Canada respectively as subsidiaries of CP. The transaction also includes 57.3 route-miles leased from the Maine Department of Transportation.[1]

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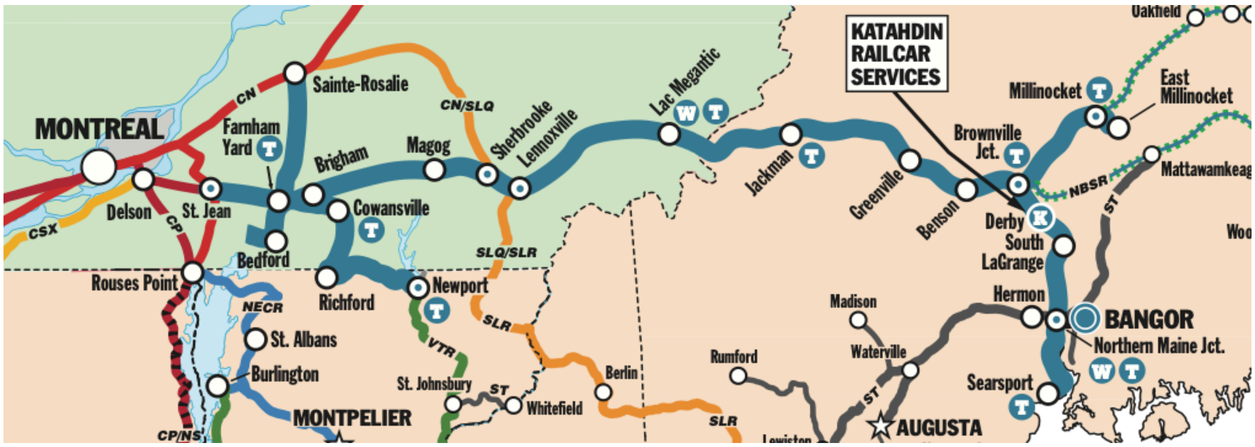
[1] The Brownsville Jct. to Lac Mégantic line figures prominently in *Requiem for Steam* by David Plowden, © 2010

With the CMQ acquisition, CP is now a 13,000-mile rail network connecting the Atlantic coast to the Pacific coast across six Canadian provinces and 11 U.S. states. The transaction returns CP to a true-transcon for the first time in more than 20 years. CP has regained access to Saint John via rights over the NBSR and gained fresh access to the port at Searsport, Maine, originally a Bangor & Aroostook station. As a result, CP now has access to a route that is approximately 200 miles shorter than the competition.



CP plans to invest as much as $90 million over the next three years to bring CMQ's rail infrastructure up to FRA Class 3 (40 mph) standards. Says CP Chief Marketing Officer John Brooks, "This expansion of the CP network creates opportunities to move products in literally every line of business in our portfolio. Through the precision scheduled railroading model and the commitment of our people, we will unlock new potential for business and industry across this region and beyond."

I see three chief regional railroad beneficiaries of the transaction. Pan Am Railways operates the former Maine Central and Boston & Maine with a 400+ mile main line between Mattawamkeag and its CP connection near Schenectady, New York. Vermont Rail reaches CP via its Washington County Railroad interchange at Newport, Vermont. And GWRR's St Lawrence & Atlantic hooks up with CP at Lennoxville in Quebec.

Severing the CP transcon west of Montreal from New Brunswick was an unnatural act. It's good to see the world made right again. Kudos to CMQ for re-establishing a viable railroad across northern Maine and to CP for recognizing its value in re-creating the original CP transcon.