RAILROAD WEEK IN REVIEW

April 29, 2022

"The current demand environment is strong, and with improved network fluidity, our focus is to improve our service to our customers and drive this growth to the bottom line. Our yield management strategy is broad-based and is backed by a solid pricing environment." — Doug MacDonald, Chief Commercial Officer, CN

"Several key elements of PSR are having a simple and executable operation as well as having a balance. You heard us talk about some of these PSR fundamentals when TOP21 was rolled out, and we now need to revisit a few of them with a renewed focus while ensuring they are embedded in all of our segments." — Cindy Sanborn, COO, NS

"We successfully launched our first interline service from Lazaro Cardenas to Chicago in early March with a 7-day transit time from the time the ship hit the port docks to the time the first container was deramped in Chicago, a pretty compelling product to test the market." — Keith Creel, CEO, Canadian Pacific

Canadian National opened Week Two of the 1Q2022 earnings season with total revenue up five percent to C$3.7 billion on a six percent decrease in revenue units to 1.3 million. Merchandise carloads decreased seven percent to 639,000 with particular weakness in grains/ferts, down 18 percent. In fact, every merch commodity group but petroleum/chemicals was down. On the call, Chief Commercial Officer Doug Macdonald said volume declines were a function of severe winter weather, not a softening of demand.

On the increase were US grain exports out of New Orleans, the Teck win for Canadian coal, and petroleum products and frac sand for western Canada. The balance of the year will see low single-digit volume gains with better volumes pretty much across the board. Petroleum products and STCC 28 chems look good, but ferts may slip a bit. Domestic intermodal looks particularly strong.

Operating expense increased 12 percent on a 50 percent increase in diesel fuel prices and seven percent more in equipment rents (car hire) due mainly to the severe winter conditions in western Canada. Operating income as a result slipped eight percent to C$1.2 billion and the OR jumped nearly five points to an uncharacteristic 66.9.

Things are looking up, though. Fluidity is on the mend with positive trends in car-miles per day, daily average GTMs, and system train speed. The focus, says CEO Tracy

Robinson, is on “long-term sustainable growth to the bottom line.” Knowing both Rob Reilly and Doug MacDonald as well as I do, I think that goal is achievable.

Norfolk Southern was next up. First quarter revenue units were off five percent, though freight revenue increased 11 percent. thanks to the 16 percent RPU increase. Merchandise carloads won a seven percent RPU hike to $3,118; coal rates jumped 25 percent snd intermodal won the gold star with a 26 percent jump in average price per box.

Traffic mix by revenue units was essentially unchanged: merchandise 32 percent, coal ten percent, intermodal 58 percent. Merchandise was 61 percent of RTMs and only 57 percent of revenue and coal generated 15 percent of RTMs and 13 percent of revenue. On the other hand, intermodal accounted for 24 percent of RTMs and 29 percent of revenue. Looks to me like intermodal is being heavily subsidized by the carload side of the house.

Ten of 17 merch carload commodities saw gains in car-counts, however meager, though STCC 20 foods posted again of just under ten percent; STCC 24 lumber and wood as well as STCC 33 metals took double-digit hits. Looking ahead, Chief Commercial Officer Ed Elkins gives green lights to US light vehicle production, ag products and fertilizer, construction materials going forward.

Total revenue increased 11 percent to a first-quarter record $2.9 billion while operating expense increased 13 percent to $1.8 billion, adding 124 basis points to the OR since last year, now 62.8. Operating income was up seven percent to $1.1 billion. Fuel expense increased 70 percent, due largely to the 77 percent increase in average price per gallon. Offsetting some of that, GTMs per gallon increased 70 basis points even though total GTMs slipped 130 bips. Fuel efficiency still lags the industry trend at 1.15 gallons per thousand GTMs.

Net income was $703 million, up five percent, though cash from operations declined two percent. Free cash flow after capex dropped 19 percent to $605 million, of which $600 million went to buy back shares. Net debt has increased $300 million since Jan 1.

Canadian Pacific wrapped up the week with quarterly revenue units down ten percent. Grain and auto were the main drags, both down 28 percent; the merchandise carload sector as a whole was off 17 percent with negatives posted on every line. Coal dipped three percent and intermodal slipped just a point. Total revenue fell six percent to C$1.8 billion, operating expense was up 11 percent, reducing operating income 31 percent to C$535,000; the OR added 10.7 points to 70.9. Net income slid two points to C$590,000.

On the call, Chief Commercial Officer John Brooks noted that, even though total grain was down, carloads of US grain to Canada hit 14,000 vs. a mere 600 loads a year ago. The diminished potash volumes from Belarus and Russia have driven prices to record highs. CP and Canpotex anticipate double-digit full-year growth here.

ECP loads decreased 17 percent mainly on crude oil though the second half is looking up. MMC's aggressive pricing turned a two percent carload drop into a 14 percent revenue gain. The CMQ acquisition continues to pay off as Hapag-Lloyd adds another weekly call at Saint John.

CP expects to see the second half posting volume increases in US and Canadian grain, potash, frac sand, ECP, automotive, and intermodal — both international and domestic. Brooks expects the second half will see "revenue and volume reflecting the demand environment."

For additional excitement this week, Tuesday and Wednesday were consumed by the STB hearings on "Urgent Issues in Freight Rail Service," STB Docket EP770. Senior management teams from all the US Class Is were summoned; CP and CN voluntarily sent senior staffers. Both days were Zoomed live and the conversation was at times — shall we say — lively.

The days were organized into panels of speakers followed by a Q&A session for Board Members to get clarification and further detail on various points. We heard from several shipper group representatives, some individual shippers, rail labor, two Wall Street analysts, and of course the Class Is themselves.

There were several dominant themes: First-mile/last-mile ("FMLM") consistency, lack of customer contacts that know the business at hand, T&E staffing, the evils of PSR, captive shippers moving to trucks, and more. The Class Is talked about steps they are taking to improve service, but it'll take time to get everything in place. However, the Board wants to know what the Class Is can do NOW to alleviates these matters.

There's enough material here to fill a couple of WIRs. Let me take the next week to consolidate my notes and related material and provide more details in the next WIR.