RAILROAD WEEK IN REVIEW

October 28, 2022

"When I joined this team earlier this year, we were coming out of a very difficult fall and winter. We declared at that time that we're going to lean into a scheduled operation and focus on moving our assets more quickly. Our intent was to demonstrate that this discipline will drive the growth in our top line to the bottom line, and we're doing just that. This team has done a great job of driving this program forward. We're not finished yet, but we have a great start and some positive momentum." — Tracy Robinson, CEO, Canadian National

"Our goal as a customer-centric organization is to gain credibility as a transparent and trusted service provider so that our customers integrate NS further into their supply chain needs. We can only achieve that goal with proactive communication and planning that minimizes disruption. Our customers have told us that they appreciate our industry-leading communication, and we're confident that our approach will deliver long-term value for Norfolk Southern, for our shareholders, and for our customers." — Ed Elkins, Chief Marketing Officer, Norfolk Southern

"We saw RTMs up six percent in the quarter, yet the network remained fluid and there was no degradation to train speed. Train weights and lengths increased three and four percent respectively. Crew starts rose less than two percent and re-crews improved as well." — Keith Creel, CEO, Canadian Pacific

Canadian National reported third quarter freight revenues increasing 27 percent year-over-year to C$4.4 billion; revenue units gained three percent to 1.5 million with RPU up 24 percent to C$2,972. Merchandise carloads including intermodal were up four percent to 698,000.

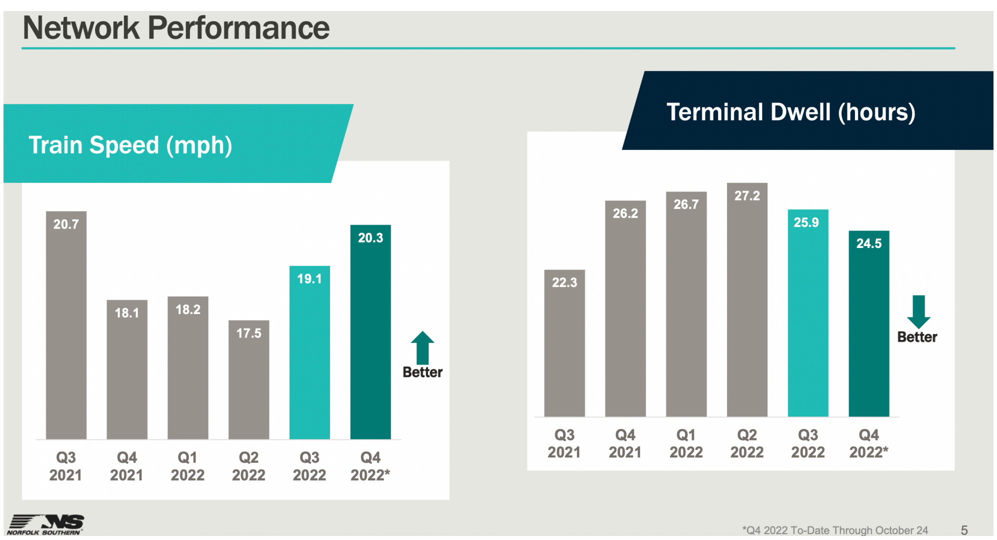
Chief Marketing Office Doug MacDonald (his first appearance in this role) cited significant upticks in grain (both sides of the border) and petroleum/chemicals — refined products, export propane, and domestic crude oil. Forest products and metals maintained their momentum. The late-quarter jump in grain increased weekly shipments by some 8,000 carloads.

Operating income leapt 44 percent to C$1.9 billion, mainly on the absence of last year's C$84 million transaction-related charge. On-time departures at origin drove better asset utilization and car velocity was up five percent to 212 miles per day. This is the best number in six years, despite seeing GTMs up ten percent in the same period. GTMs increased four percent on just three percent more fuel burn and gallons per KGTM dropped a point to an industry-leading 0.838.

Looking ahead, MacDonald says he expects to see increased grain carloads, sustained strength in the petrol/chems areas cited above, and increased demand in metals and forest products. The drop in Mississippi River water levels will mean increased traffic on the old IC, and met/thermal coal movements will continue at a healthy level. Toward the end of the Q&A, MacDonald pointed out that, although southbound grain will do well on the IC, "We can now look at some of the northbound business — steel, fertilizer, other bulk commodities — where we will have new growth opportunities."

Norfolk Southern saw freight revenues increase 17 percent to $3.3 billion though revenue units were down two percent to 1.7 million. RPU increased 20 percent to $1,938, though one must ask how long this rate of increase can continue at what seems to be four times the usual quarterly rate of increase. On the call there were several mentions of pricing to value, and if this is the case and it's working, NS must be applauded.

Operating income was $1.3 billion, up 12 percent, and the OR was 62.0, up 1.8 points. However, this number includes a special $117 million charge relating to the tentative labor settlement. Absent that, operating income would have been $1.4 billion, up 22 percent, with an OR of 58.5, down nearly two points. Reported net income including the labor charge was $958 million, up 27 percent.



I am starting to see signs NS is finally getting its arms around the the revenue potential of the franchise and what it will cost to realize that potential. I'm reminded of Watco's "Activity Based Costing System," where they measure every cost associated with a move, from car hire to diesel fuel to ground crew labor, add a reasonable margin, and present that number to the customer. At NS, CEO Alan Shaw says, "We take a transparent no-surprises approach to communicating with our customers, which helps them make informed decisions about how to keep their goods and materials moving. This is an excellent illustration of what it means to be customer-centric." All of which proves once again that it all starts with the customer.

Rounding out the week, Canadian Pacific in the third quarter moved 730,000 revenue units, up ten percent, bringing in freight revenue of C$2.3 billion, an increase of 19 percent. Manifest carloads including automotive grew four percent with particular strength in potash — a record quarter — and the metals/mineral/consumer (MMC) group, where the diluent recovery crude oil product is beginning to grow nicely.

Grain started the quarter down a point or two but units have quickly ramped up in the last few weeks, making the new high-capacity grain cars (part of a 5,900 car purchase) that much more vital. Frac sand demand remains robust. Intermodal volumes and revenue both gained on growth in both domestic and international boxes.

Operating income grew 21 percent to C$937 million as operating expense was held to an 18 percent increase against the 19 percent revenue gain. Net income nearly doubled to C$891 million, chiefly on the C$275 million equity pickup and other items relating to the KCS acquisition. The reported operating ratio dropped 70 basis points to 59.5. Fuel expenses jumped 80 percent, thanks mainly to the 60 percent hike in price per gallon. Fuel burn increased eight percent on six percent more GTMs, though gallons per thousand GTMs dropped two percent.

As for what's ahead, grain and potash will be up while coal continues to be impacted by a mine outage. Oil E&P is on the rise, creating frac sand demand -- while plastics and refined products will push MMC numbers higher. And intermodal will generate further records in volume and revenue.

CP continues to be the Poster Child in Precision Scheduled Railroading done right. CP increased revenue units by ten percent, better than anybody else. Revenue was up 19 percent, second only to CN, and RTMs gained six percent — another winner. And all was done with the highest revenue percentage of any railroad in the manifest carload side of the house. Color me impressed.