RAILROAD WEEK IN REVIEW
January 27, 2023

'We have demonstrated our commitment to customer-centered growth as reflected in business development wins, and while growth in 2023 may be challenging given the uncertainty of the economic backdrop, we will continue to make strategic capital investments in support of our long-term growth objectives." — Lance Fritz, President, Union Pacific

"Railroading needs to remain simple. I think we got away from that over the past few years. Velocity creates capacity — the faster we are, the more we can handle. And the more we stick to the plan, the more reliable we are, which means that I could provide a level of service that Doug can sell to his customers." — Ed Harris, Chief Operating Officer, Canadian National

"We are making meaningful progress on improving car velocity in our merchandise fleets, and we started to see the results of that increased velocity toward the end of the quarter. Merchandise revenue increased 12% year-over-year to $1.9 billion and revenue per unit, excluding fuel, reached a record level from price gains and positive mix." — Ed Elkins, Chief Marketing Officer, Norfolk Southern

"It is critical that we ensure that our service metrics reflect our customer experience and that we are measuring and evaluating ourselves in the right way. We also know that we have to improve the way that we interface with our customers and make it easier to do business with us if we are going to win market share from trucks." — Joe Hinrichs - President and CEO, CSX

Four of the five Class Is holding earnings calls checked in this week, with UP in the lead-off position Tuesday morning. CN did its usual after-the close call that day, NS led off Wednesday before the bell, and CSX wrapped up the week's proceedings after the bell. CP does the honors next Tuesday after the close, with BNSF reporting along with Berkshire in early Feb.

The common thread running through the calls was one of customer collaboration. The italicized quotes above are definitive proof that the customer focus comes from the top and that everybody in the organization is expected to play by these rules. Unfortunately, the message doesn't always get through. I'm still hearing of too many instances where responsible parties deep in the organization seem to be more interested in protecting their own turf than creating customers.

Union Pacific Q4 revenue units increased one percent to 1.9 million; backing out automotive, "coal and renewables," and intermodal boxes drops you to 832,000 units, down two percent. System RPU was $2,901, up eight percent, mostly on higher fuel surcharges. Factors affecting volumes included some unfortunate weather events, a weaker potash market, and increased coal demand.

Of the 18 carload commodity lines reported to the AAR, eight showed full-year increases. Chemicals and coal were the biggest carload groups and both were up double digits. Forest products — STCC 24, 26 — represented five percent of non-intermodal units and were down two percent and six percent respectively.

For the quarter, total revenue was $6.2 billion, up eight percent; operating expense gained 14 percent so operating income was $2.4 billion, down a point. The operating ratio, 61.0, was up 3.5 points on labor, fuel, purchased services. Net income was $1.6 billion, down four percent (three percent before taxes); earnings per share were flat even though share count was reduced by four percent.

As for the road ahead in 2023, UP sees gains in metals (and their inputs like ore and scrap steel), automotive production and inventory replenishment, biofuels (renewable diesel, especially), coal, and intermodal. Chief Marketing Officer Kenny Rocker says "The forecast for industrial production is to shrink slightly in 2023 and the demand is softening in forest products."

Out on the railroad, cars on line, volume, and car-miles per day are all on the mend. The aggressive hiring program will round out crew availability, and trip plan compliance is in the 70s for intermodal and upper 50s for auto/manifest. I came away from the call with a heightened sense that UP is putting their service wobbles in the rear view mirror.

The Canadian National call was a delight. You can always depend on CN for a clean set of financials and an easy-to-follow presentation. CEO Tracy Robinson is quickly making her mark, Chief Marketing Officer Doug MacDonald clearly has his arms around the commercial side of the house, it's good to see Ed Harris back as COO, and CFO Ghislain Houle is always a reliable source of numbers (dollars below Canadian) well presented.

Fourth quarter revenue hit $4.5 billion, up 21 percent, on 1.4 million revenue units, up three percent. System RPU $3,125, up 20 percent, mostly on fuel surcharges. Operating expense gained 21 percent so operating income was up 22 percent to $1.9 billion with a 57.9 operating ratio — off only 37 basis points.

Net income was $1.4 billion, up 18 percent and earnings per share gained 24 percent to $2.10 after a four percent drop in diluted shares from the buy-back program. But even without the buy-back eps would have been up 18 percent — still a respectable number.

CN again takes a leadership position in capitalizing on a proper Precision Scheduled Railroad. On-time departures increased to 85 percent, a gain of ten points, increasing system fluidity; revenue units are now averaging 207 miles/day, up ten percent, and they have a safer railroad. Says Harris, “We are building resiliency based on running a scheduled operating plan with focus on service, asset utilization and velocity.” Can’t argue with that.

Norfolk Southern was next up and there’s less here than meets the eye. CEO Alan Shaw and Company said all the right things but the numbers do not impress. Fuel surcharges and share buy-backs were largely behind the reported gains.

NS took in Q4 revenue of $3.2 billion, up 13 percent, on 1.7 million revenue units, down a point. Yet RPU jumped 18 percent. (On the call we saw a slide detailing fuel surcharge — $286 per merchandise carload, for example.) Total manifest carloads including automotive were essentially unchanged.

The strongest annual gain was low-rated aggregates — 11%. AAR chemicals carloads slipped four points yet NS reported chems up two percent — I suspect they include crude oil and some non-metallic minerals here. The metals/construction materials group was down four percent on metals (shapes and coiled steel e.g.). Even intermodal was down four points.

Gross ton-miles were unchanged, revenue ton-miles slipped 20 basis points, and there was no change in fuel efficiency (gallons per thousand ton-miles). Operating income was $1.2 billion, up five percent; the OR was 63.5 — 310 basis points worse. Net income of $791 million was up four percent. The reported earnings per share was $3.43, up ten percent, though without share buy-backs the percent gain would have been half that.

In sum, I think Shaw has assembled a strong leadership team that has the potential to overcome NS's institutional inertia. We'll see how this develops in the coming months.

CSX batted clean-up and I was favorably impressed with the whole presentation. They had cleverly put amplifying comments in the margins of each slide and COO Jamie 's presentation was the best he’s ever done. CEO Joe Hinrichs’ closing slide 20 (see below) drills down to the basic tenets of Hunter’s precision scheduled railroading with special emphasis on merchandise service recovery.

Total quarterly revenue came to $3.3 billion, up nine percent, on 2.1 million revenue units, down two percent. Merchandise carloads including automotive brought in revenue of $2.1 million on 632,000 units, down two percent. Operating income was $1.5 billion, up seven percent, though it would have up just five percent without the gain on a property sale.

Here again, fuel surcharges saved the day, bringing in full-year revenue of $1.5 billion, more than what it was last year. That works out to $244 per revenue unit — and it's why full-year revenues are up 14 percent on flat volumes. Net income was $1 billion, up nine percent, with reported earnings per share of 49 cents, up 16 percent. EPS without repos would have been 46 cents, up nine percent.

I think CSX has turned a crucial corner. Hinrichs' retail automotive background will stand him in good stead and I think he'll take to the proper Precision Scheduled Railroad the way a duck takes to water. This slide says it all:

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