RAILROAD WEEK IN REVIEW

April 21, 2023

"Today, we celebrate this historic combination creating a truly unique single-line rail network that begins a new chapter of railroad history in North America, As we mark this once-in-a-lifetime occasion by driving the Final Spike in Kansas City, Mo., where CP and KCS come together, we bring new competition into the North American rail industry at a time when our supply chains have never needed it more.'—Keith Creel, CEO and President, CPKC

"We are very pleased with our merchandise performance this quarter. Revenue increased 13 percent, benefiting from an eight percent increase in revenue per unit and a four percent increase in volume. We are seeing some encouraging signs as customers start to respond to our improved service and reduced cycle times." — Kevin Boone, Executive Vice President of Sales and Marketing, CSX

"We're exiting the quarter on a positive trajectory versus the congested state we were entering this time last year. Our April month-to-date metrics show a network in a healthier state with freight car velocity at 200 miles per day, intermodal TPC in the high 70s, and manifest TPC on the rise as well." — Eric Gehringer, Executive Vice President, Operations, Union Pacific

CPKC Limited, the new moniker of the combined KCS and CP, is a company touching three countries with some 20,000 employees running about as many miles of railroad. In short order CPKC completed the process to change the company's name to "Canadian Pacific Kansas City Limited" effective April 14. CPKC's common shares will remain listed on the Toronto Stock Exchange and New York Stock Exchange under the ticker symbol "CP."

CP is the best example of Precision Scheduled Railroading done right. At last year's Urgent Issues hearing at the STB, the question was asked of CP how they made PSR work when everywhere else it was being excoriated. From WIR 5/6/2022:

> I think CP's James Clements, SVP for Strategic Planning, said it best: We took our time and followed the precepts from asset allocation to hiring the right people, spending more than C$750 million over the past decade for the infrastructure needed to support the service goals.

In doing their homework for the merger, CP and KCS found that the merged, improved railroad would have the capacity "to divert 64,000 long-haul truck shipments to rail annually, reducing total truck vehicle miles traveled by almost 2 billion miles over the

next two decades, saving US$750 million in highway maintenance costs." Can't argue with that. Let the games begin.

CSX posted Q1 gains in ten out of the 17 merchandise carload commodities it reports to the AAR. This is exactly the reverse of the 2022 first quarter when ten of the 17 commodities reported *negative* year-over-year deltas. And for good reason.

This was one of the most powerful and positive quarterly results presentations I've seen in my 20+ years of watching CSX. The focus is on results accomplished and some of how they did it. Revenues increased 11 percent on flat volumes — intermodal was the killer, boxes down 10 percent — while merch and coal carloads grew four and 19 percent respectively.

It was Peter Drucker who wrote lo these many moons ago, "The purpose of any business is to create customer." And it was Tom Peters who wrote in his seminal volume *Thriving on Chaos,* "Quality is in the eye of the beholder and a quality product always commands a quality price."

The CSX presentation slides make it very clear CSX wants to grow the business by creating customers, and one of the best prospects for new business is an old customer. As for creating a quality product, COO Jamie Boychuk nails it on his slide 9 covering the rapid improvements in operating metrics. And Kevin Boone links the eye of the beholder and revenue gains in slide 11.

They're creating new customers by going out and looking for them. The orange dots on slide 14 and the adjacent copy are a measure of their success. Short lines are getting in on the act as well. At the recent NEARS gathering in Newport, CSX's Mike Clements (former Pan Am Rail marketing) showed how many new customers CSX is creating in New England alone — see the Slide 14 orange dots.

Looking at the CSX year-to-date AAR carload report for Week 13, one sees grain, aggregates, petroleum, forest products, and stone/clay/glass all posting gains and together representing about 20 percent of total quarterly revenue units (the whole merch sector is 33 percent).

At the end of the day, I knew the RR could do a lot better than it had been doing. I think the leadership Joe Hinrichs has instilled throughout the management ranks is paying off. Shows what's lacking elsewhere. Look at the sequential jump in performance 1Q2023 over 4Q2022.

Union Pacific, on the other hand, did not have a good Q1 in the revenue units department. Total revenue units slipped 2.4 percent to 1.9 million. Merchandise loads

(all but intermodal, auto, coal, coke) dipped 2.3 percent but were 41 percent of total revenue units. Forest products took the biggest hit, down 17.6 percent with double-digit declines in both STCCs.

Ag Products eked out a four percent loss — mostly export grain. Industrial commodities— everything from aggregates to waste — and Chemicals including petroleum were essentially unchanged. In sum, 11 of the 18 merchandise carload commodities reported to the AAR posted year-over year declines.

Kenny Rocker's 2023 volume outlook sees carload gains in metals/construction and biofuels with grains and forest products holding steady. And please note I am ignoring the commodity groupings UP uses on the earnings calls — coal, coke, crude oil and pulp wood all in the same bucket, e.g. — and using the AAR groups to get a better apples-to-apples comparison between and among railroads.

Total freight revenue increased four percent to $5.7 billion of which $258 million was fuel surcharges. As a result, most commodity groups posted revenue gains even though total revenue units were essentially unchanged. RPU increased five percent to $2,861, of which $131 was fuel surcharge. Total revenue including accessorial charges (off five percent mainly on intermodal demurrage) was $6 billion, up three percent.

Operating expense, unfortunately, increased eight percent on increased comp thanks to the 4Q2022 labor agreements and added purchased services and materials expense. Operating income was unchanged at $1.6 billion and the OR added 270 basis points to 62.1, which ought to come down a point or two by year's end.

Final thought: What if the train that derailed in East Palestine had been on auto pilot with nobody in the cab and PTC controlling train speed and handling? Suppose the track-side defect detector had sent a signal to the train to stop immediately with brakes and power computer-controlled to keep the train stretched so there was no slack run-in against the empties.

I mean, if a qualified engineer with "an ass" can sense how his train is behaving, one should be able install robotics and AI to do the same. The FRA advisory seems to suggest that human lapses in judgement on train makeup have played a part in recent incidents, starting with building the train at the origin yard. If so, the railroads would do well to make up trains so that human lapses in judgement cannot cause further grief.

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