RAILROAD WEEK IN REVIEW

May 12, 2023

"We spoke with an electric utility in the West about recent coal and rail transportation trends. This utility burns PRB coal, and service on Union Pacific has materially improved over the past few months. Our contact is now receiving over 90 percent of requested cars from UP, up from about half six months ago. However, production issues at the mines have forced this utility to reduce burn in order to preserve stockpiles." — Scott Group, Wolfe Research, May 5

"Carloads in Week 17 (April 29) were down 4.9% vs. the same period last year and up 0.8% sequentially. Compared to 2019, what we believe to be a better comp for assessing the overall macro environment, carloads were down 8.0%. Total U.S. carrier traffic was -5.1% y/y and total Canadian carrier traffic was -4.3%. CP was the largest gainer this week, increasing 5.2%. BNSF was the largest decliner this week, declining 9.2%." — Jason Seidl, TD Cowen, Track Work Weekly, May 5

"At Laredo, UP's cross-border traffic has been exchanged with Kansas City Southern de Mexico at the single-track International Railway Bridge, where its tracks converge with Kansas City Southern's. But now CPKC can provide single-line service between the Midwest and Mexico via Laredo — something that neither UP nor BNSF Railway can do. And UP stands to lose the most traffic to CPKC, according to the railroads' merger application." — Bill Stephens, Trains magazine News Wire, May 8

BNSF reported first quarter 2023 results Saturday. Revenue units decreased ten percent YOY to 2.1 million units, freight revenue increased two percent to $5.8 billion as system RPU increased 14 percent to $2,708. FSC tripled to $242/unit; RPU ex-fuel was up seven percent. Revenue units decreased in every commodity group with "consumer" — auto and intermodal — taking the big hit, off 16 percent. Total revenue increased less than a point to $6.0 billion.

Total Operating Expense increased six percent, driving ops income down nine percent to $1.9 billion. The OR increased 336 basis points to 69.2, highest of all Class Is. Net income dropped nine percent to $1.2 billion. However, BNSF winning a seven percent core RPU increase and taking the higher OR hit may bear out the idea that cost-cutting and holding for tonnage can actually cost you carloads because customers see longer and less competitive transit times. We know customers will pay up for quality and that one truck is like any other truck, so all they can compete on is price.

At the Berkshire annual Meeting Saturday, we got the usual question about Precision Scheduled Railroading: if everybody else is using PSR, why aren't you? Chair-elect Greg Abel took it beautifully. "Regarding precision scheduled railroading, the other Class Is in the US and Canada doing it and we obviously pay close attention to their operating metrics...

"Looking at the three-year period of 2019-2021, we're making excellent progress resetting the railroad. We're well aware of where we are relative of the long-term value of our service will continue to see how we can add further value."

Scott Group, lead rail analyst for Wolfe Research, notes that "BNSF seems to have remained disciplined on pricing with stronger yields ex-fuel than UNP for the 6th straight quarter. Given recent share gains for UNP, including the intermodal businesses from KNX and SNDR, we will see if BNSF starts focusing more on volume growth and market share again. But for now, the competitive dynamic appears stable."

Out on the railroad, average train speed barely changed in the week ending April 28 as it sits only a point above the railroad's five-year trailing weekly average. Trains holding for crews was slightly higher, at 26 per day in that week, while trains holding for power continues to look good at just five per day.

The number of loads not moving in 48 hours continues to come down, now approaching the numbers we usually see from BNSF. Manifest on-time performance continues to improve every week.

As I wrote in WIR last week, PSR got its start at the the Burlington Northern nearly 40 years ago under Hunter and it's been a work in progress at BNSF ever sense. Recall Hunter left the BN to run the IC and the rumor is CN bought the IC to get Hunter and his scheduled railroad process. It worked. He then took it to CP and CSX, promoting PSR as *the* way to run a railroad. And that's how PSR got the notoriety it has. And we must remember it all started at BN.

Part of the reason behind the UP court challenge of the CPKC transaction may be the recent activist shareholder move to oust Fritz. Recall the March 2023 Soroban Capital Partners leadership challenge to UP. The investor group wants UP "to install new leadership who can get the trains to operate safely and on time. The Company's key constituents are all aligned with this mission." UP had to do *something*.

You can see where they're coming from with a quick look at the UP one-year stock chart. Shares have been in a steady downtrend since the March 2022 high, are stuck at a $200 support level, and have been since January 2021. The SMA200 is acting like resistance — they haven't gotten above it since April, 2022. Tells me the Street can't see UP getting out of its own way share price-wise for the rest of the year. Seems a little distraction is called for. If I were an institutional investor with a large position I might be getting a little nervous too.

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Rick Paterson's *State of the Rails* report finds that, among the North American Class I railroads, UP is not improving as quickly as one might like in trains holding for power and crews, network velocity, and re-crews. Yet "private car miles per day were flat in the most recent week while manifest on-time performance was up two percent sequentially to 73 percent. For perspective, manifest service accounts for about 57 percent of average daily trains starts at UP."

To my mind, the manifest service improvement means the most in terms of customer satisfaction — and therefore car-counts and revenue. I think Soroban may have been a bit hasty in its move to oust Fritz.

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