RAILROAD WEEK IN REVIEW
June 2, 2023

"At our December Investor Day we shared our strategy to create long-term shareholder value through a balanced approach of reliable and resilient service, continuous productivity improvement, and smart and sustainable growth. At the heart of that strategy is a service product that allows us to compete in that $860 billion truck and logistics market to give our customers the confidence to build Norfolk Southern into their supply chains." — Alan Shaw, NS president, 4Q2022 earnings call

"Regarding precision scheduled railroading, the other Class Is in the US and Canada are 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 and will continue to see how we can add further value." — Greg Abel, Vice Chairman of non-insurance operations, Berkshire Hathaway Annual Meeting, May 6

"To evaluate their progress towards service improvement, the Board directed the four Class Is, in both the 2022 May 6 Order and the June 13 Order, to select key service performance indicators and targets (including, at a minimum, an indicator and target for FMLM service and TPC performance) that each carrier expects to meet." — STB Decision EP 770, May 1

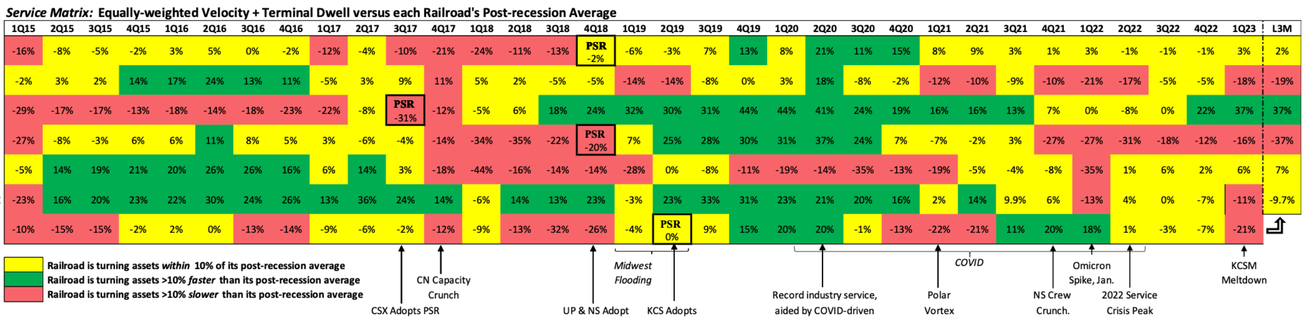
The STB has reviewed railroad performance reports to date and finds them wanting. By way of review, the Board, following the April 2022 Urgent Issues hearings, directed the four US Class Is "to submit recovery plans and progress reports… and report more comprehensive and customer-centric performance metrics and employment data for a six-month period."

The Board issued its report card May 2. In it, the Board expressed its displeasure at three of the four Class Is' continued failure to meet their own "targets for service improvement" and went into some detail about where the shortcomings lay. CSX was the only railroad "currently meeting nearly all its one-year targets."

I am particularly concerned about BNSF. The STB writes, "BNSF has failed to achieve almost all of its one-year service targets" while UP has "made some positive steps towards reducing network congestion." Because BNSF has no shares trading on the exchanges, we have few windows on what it's doing and why.

Morningstar, however, paints a broad picture of the railroad's competitive advantages, particularly for commodities where trucks simply aren't suitable. Says Morningstar, "We believe that operators like BNSF will continue to leverage their competitive advantages of low cost and efficient scale to generate returns on invested capital in excess of their cost of capital; we have awarded them wide moat ratings."

Now comes Loop Capital rail analyst Rick Paterson to offer some pertinent points. Starting with operating performance relative to the other carriers, Rick provides this "quilt chart" showing that BNSF has posted only one green quarter in six years.



Service Matrix: Equally-weighted Velocity + Terminal Dwell versus each Railroad's Post-recession Average

	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
UP	-16%	-8%	-5%	-2%	3%	5%	0%	-2%	-12%	-4%	-10%	-21%	-24%	-11%	-13%	PSR -2%	-6%
BNSF	-2%	3%	2%	14%	17%	24%	13%	11%	-5%	3%	9%	11%	5%	2%	-5%	-5%	-14%
CSX	-29%	-17%	-17%	-13%	-18%	-14%	-18%	-23%	-22%	-8%	PSR -31%	-12%	-5%	6%	18%	24%	32%
NS	-27%	-8%	-3%	6%	6%	11%	8%	5%	3%	-6%	-4%	-14%	-34%	-35%	-22%	PSR -20%	7%
CN	-5%	14%	19%	21%	20%	26%	26%	16%	6%	14%	3%	-18%	-44%	-16%	-14%	-14%	-28%
CPKC	-23%	16%	20%	23%	22%	30%	24%	26%	13%	36%	24%	14%	-6%	14%	13%	23%	-3%
KCS	-10%	-15%	-15%	-2%	2%	0%	-13%	-14%	-9%	-6%	-2%	-12%	-9%	-13%	-32%	-26%	-4%

	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	L3M
UP	-3%	7%	13%	8%	21%	11%	15%	8%	9%	3%	1%	3%	-1%	-1%	-1%	3%	2%
BNSF	-14%	-8%	0%	3%	18%	-8%	-2%	-12%	-10%	-9%	-10%	-21%	-17%	-5%	-5%	-18%	-19%
CSX	30%	31%	44%	44%	41%	24%	19%	16%	16%	13%	7%	0%	-8%	0%	22%	37%	37%
NS	25%	28%	30%	31%	37%	24%	7%	-7%	-2%	3%	-27%	-27%	-31%	-18%	-12%	-16%	-37%
CN	0%	-8%	-11%	-19%	-14%	-35%	-13%	-19%	-5%	-4%	-8%	-35%	1%	6%	2%	6%	7%
CPKC	23%	33%	31%	23%	21%	20%	16%	2%	14%	9.9%	6%	-13%	4%	0%	-7%	-11%	-9.7%
KCS	PSR 0%	9%	15%	20%	20%	-1%	-13%	-22%	-21%	11%	20%	18%	1%	-3%	-7%	-21%	

In subsequent charts Rick shows that the railroad is only now getting back to the trains-held levels that prevailed through 2021. Other metrics show more deteriorating trends resulting in the drop in manifest car miles per day. Finally, there's a lot of red in the volume chart showing where current car counts lag prior performance.

In the STB May 2 report card, BNSF drew sharp words on its handling of the carload franchise — the very place BNSF has a competitive advantage. I think this bespeaks a lack of leadership at BNSF's highest levels. I also think Greg Abel senses that lack and is trying to redirect the capital to more productive areas where there is a clear competitive edge. Intermodal ain't it, at least under the current management.

Norfolk Southern held its 2023 Shortline Meeting in Atlanta May 23-24. The General Business Session Wednesday morning provided an excellent overview of NS goals, how they hope to get there, and the crucial role short lines will play in achieving strategic first-mile/last-mile carload objectives.

CEO Alan Shaw wrapped the morning with candid remarks on rebuilding the customer base with a long-term focus on growth by meeting customer supply-chain needs. He wants to get away from the focus on so-called "shareholder value" metrics and get back to the customer-first principles upon which NS was first founded.

The classroom breakout sessions filled the afternoon. Topics included the usual commodity overviews by business groups — Forest & Consumer, Chemicals, Metals & Construction, and Ag products — plus an introduction to RailPulse, truck-competitive pricing, Network Planning & Optimization, and more. All of which looks good, but it's going to take the market managers to find more ways to say Yes to shortline new business ideas.

As you read above, the STB is less than totally satisfied with Norfolk Southern's progress in meeting the performance goals set out a year ago. First-mile/last-mile service is a particular STB interest, and the NS shortline initiatives laid out at this Atlanta gathering ought to close many loops.

To end on a note of concern, it appears that some Class I train crews may be reporting cars interchanged to short lines when in fact they have not. AAR Rule 15 allows delivering carriers to start the demurrage clock when, through fault of the customer, cars cannot be placed. This is, in effect, constructive placement.

With the STB focus on first-mile/last-mile, it behooves carriers to report as placed as many cars as they can. But suppose a crew is about to go on the law and still has a shortline delivery to set out. Rather than incur the wrath of management by outlawing on time they they skip the interchange and report the cars not placed under Rule 15.

Two things happen: the customer isn't served and the short line gets a demurrage bill plus a Rule 15 notice from the Class I to the effect that the crew reports they could not drop the cars "due to problems with the short line." But for the FMLM report to the STB, cars count in the percentage of "cars spotted and pulled" (EP770 sub-1, Item 5). Which makes one wonder whether the STB performance scorecard presents reality.

I have seen some documentation of this practice and I wish I knew how widespread it is. Readers are invited to send documentation so we can see what's going on out there. Office Car Rules, of course.