RAILROAD WEEK IN REVIEW

July 14, 2023

"Truckload rates remained pressured in 2Q as no notable seasonal spring inflection in volumes occurred through the course of the quarter. The quarter saw a loose truckload market despite FMCSA data suggesting continued exit of truckload capacity." — TD Cowen Research, July 11

"We are trimming our near-term estimates on U.S. pressure pumpers to account for the recent decline in drilling and completion activity over the past few months. We believe the rig count will stabilize around current levels in a $70+ oil price environment, and the combination of pressure pumping industry consolidation and limited net new capacity will keep ***frac supply/demand*** *fairly balanced." — Stifel Research, July 11*

"Second quarter volumes finished below our expectations for the Canadian rails, but above for the U.S. rails. Pricing should remain strong, but fuel surcharge and storage revenues should moderate." — Scott Group,Wolfe Research, July 11

One sees a steady stream of charts depicting carload traffic trends, industry growth/expansion, truck rates, and so on. The trick is to sort the wheat from the chaff. The charts are most useful in tracking commodity carload trends and viewing them in ops performance metrics. Most commodity carloads are still trending down and have been getting worse period-by-period over the last year. Intermodal is the biggest drag — no surprises there — but the drops in forest prods, metals, aggregates are worrisome.

Among the many operating metrics, terminal dwell shows the most improvement. That's the good news. The bad news is that I'm seeing evidence of operating practices being changed to improve the performance status being sent to the STB. Perhaps the most egregious practices have to do with local jobs serving short lines.

There are anecdotal signs of trains being kicked out of yards with cars that don't really fit the job and cars coming in that had not been placed by the job. Sending cars out and not placing them keeps dwell times down and not placing at customers can prevent crews from outlawing. If you can cite AAR Rule 15 saying cars were not placed due to customer fault, you still get STB credit for placement — at least you tried.

As is often the case, reading between the lines yields the most useful intelligence. For example, if you see an AAR Rule 15 report about cars not interchanged, you must go out on the ground and see why. Was the interchange actually blocked, and if so, why?

Or if you see an empty right behind the power on a 65-car train, why is it there and not five cars back per your best-practices guidelines? Look behind the reported stats.

BNSF alone among Class Is reporting service recovery trends to the STB provides in chart form a summary of Key Performance Indicators. The railroad is using 2019 as its base year as that was the last year before the impacts of the global pandemic and the significant shifts in traffic mix.

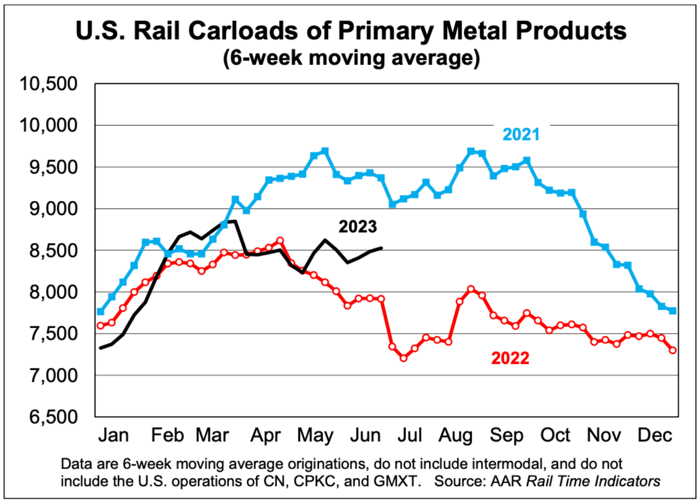
Among significant accomplishments, system velocity has improved by 11 percent, they've cut average dwell by eight percent, and on-time performance is 11 percent better on average. Trains held for power or crews still lag the target KPI but the metric is now within a point of the 2019 percentage.

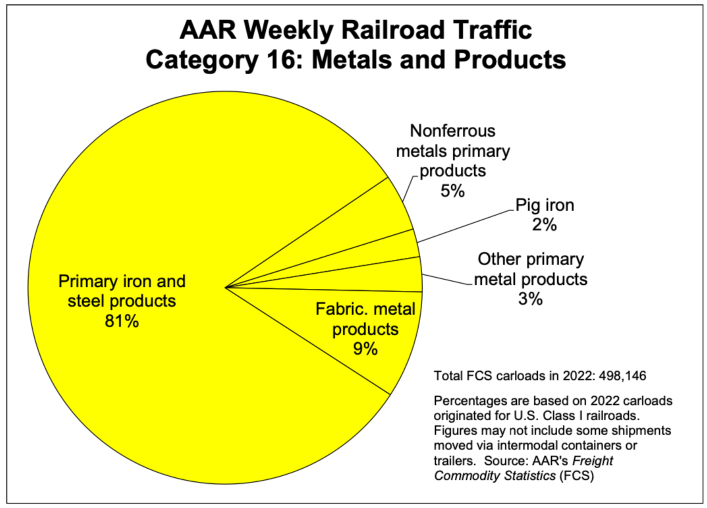
= within 10% of target

Week	18	19	20	21	22	23	24	25	8 Week Average
Train Speed	99%	100%	99%	100%	102%	103%	103%	101%	101%
Dwell	97%	96%	96%	98%	100%	101%	99%	98%	98%
Trains Holding	110%	127%	111%	109%	126%	166%	166%	181%	137%
Local Service	101%	101%	100%	100%	99%	98%	99%	99%	100%
Overall OTP	110%	110%	112%	113%	119%	109%	109%	111%	112%
Intermodal OTP	119%	119%	118%	118%	116%	109%	110%	111%	115%
Coal OTP	92%	95%	90%	98%	111%	103%	99%	110%	100%
Merch OTP	85%	95%	105%	101%	109%	102%	102%	103%	100%
Grain OTP	103%	88%	92%	100%	118%	106%	106%	103%	102%
Crude OTP	75%	72%	76%	76%	95%	82%	82%	79%	80%
Auto OTP	118%	110%	113%	111%	125%	110%	110%	108%	113%
Ethanol OTP	48%	74%	62%	62%	112%	70%	35%	79%	68%

The STB requires these reports to be sent in as excel spreadsheets, but divining the trends from week-to-week is well nigh impossible. Ergo kudos to BNSF for this.

The AAR Metallic Ores and Metals category includes not only the finished metals (primary metals products like slab, coils, rebar) and fabricated metal products like girders, but also their ingredients (ores, coke, steel scrap). And with 90 percent of the carloads on the "finished" side of the ledger, that represents most the metals volume.





Metals et al are up more than nine percent with half the volume on the "primary" side of the ledger. So far this year and with all the fed-speak about infrastructure one would think it would be up more than that. But so far, as you can see from the carload chart above, loads have been essentially flat for five months, reflecting the trends the manufacturing side of the Institute for Supply Management.

> Economic activity in the manufacturing sector contracted in June for the eighth consecutive month following a 28-month period of growth.The June Manufacturing PMI® registered 46 percent. The New Orders Index remained in contraction territory at 45.6 percent; the Production Index reading of 46.7 percent is a 4.4-percentage point decrease compared to May's figure of 51.1 percent.

Which explains why volumes have flattened out. Timothy Fiore, the chairman of the committee that produces the Manufacturing PMI®, summarizes the state of manufacturing this way: "The Manufacturing PMI shrank again...indicating a faster rate of contraction. The June composite index reflects companies continuing to manage outputs down as softness continues."

And it will. The US real GDP year-over-year projections from the Atlanta Fed and others have the growth rates for the four quarters staring with 2Q23 as 2.3, 1.5, 0.7, and 0.4 percent respectively. It's going to be a bumpy ride.