RAILROAD WEEK IN REVIEW

July 28, 2023

"CN's focus on scheduled railroading has resulted in year-over-year improvements in car velocity, train speed, and through dwell. Our disciplined approach to scheduled railroading continues to deliver for our customers. As volumes evolve, we will continue to refine our plan to optimize efficiency and drive further improvements to customer service." – Tracy Robinson, President and Chief Executive Officer, CN

"This quarter we made history by completing our transformational combination to create the first single-line transnational railroad linking Canada, the United States, and Mexico. By uniting the outstanding railroaders at Canadian Pacific and Kansas City Southern to form our new CPKC family, we already are changing the freight rail industry, redrawing the map, and delivering on the many benefits of our combined network." — Keith Creel, President and Chief Executive Officer, CPKC

"During the quarter, we delivered on our commitments to improve service, invest in safety and resiliency, and enhance the quality of life for our craft railroaders. Each of these are foundational to our strategy and position Norfolk Southern well for the future, We are committed to our long-term strategy and are positioning our franchise to take on volume growth and deliver for our customers." — Alan Shaw, President and Chief Executive Officer, NS

"The results this quarter were impacted by softening consumer markets, inflation, a one-time labor expense, and increased workforce levels. We took actions to drive greater network fluidity and provide our customers with better service. We finished the quarter with resource levels more aligned with demand." — Lance Fritz, Union Pacific Chairman, President and Chief Executive Officer, UP

Union Pacific handled 2 million revenue units, down 2%, in the 2023 second quarter and brought in $11.2 billion in freight revenue, down 1%. The softened environment, inflationary pressures, and the one-time labor settlement did not help. The bulk sector saw reduced export potash shipments, weaker beverage imports, and lower nat gas pricing which reduced coal demand. The industrial sector posted strong rock shipments and STCC 29 petroleum products, but the weak housing and corrugated box demand did not help the forest products story.

The second half 2023 volume outlook calls for strength in biofuels, construction, and automotive. Grain, metals, and international intermodal will be unexciting; industrial products, forest products, and domestic intermodal are all looking weak for the rest of the year. Chief Commercial Officer Kenny Rocker sees industrial production essentially flat in the second half, about the same as the ISM factory forecast.

Operating expense was essentially unchanged at $3.8 billion for an operating ratio of 63.0, down 2.84 points, and generating operating income of $2.2 billion, down 12%. Net income was $1.6 billion, down 14%. The new labor agreements added 16% to comp and benefits, though fuel dropped 29%. Gross ton-miles and revenue ton-miles were essentially unchanged as were fuel efficiency in GTM's per gallon and gallons per thousand GTM.

All in all, I would say it was a fairly successful quarter, given the general downturn in the economy. I don't think the three-point rise in operating ratio income is anything to get excited about and being able to hold ops expense flat is a real feather in UP's operating cap. Commercially, I think Rocker and company have got their arms around the customers' demands and will continue to create sticky customers going forward.

Canadian National 2Q2023 freight Revenue was C$3.9 billion, down 7%, due mainly to lower volumes of intermodal, crude oil, U.S. grain exports, forest products (wild fires), consumer goods, and lower fuel surcharge revenue. These decreases were partly offset by freight rate increases, the positive translation impact of a weaker Canadian dollar, and higher export volumes of Canadian grain.

Total 2Q revenue including ancillary services came to C$4.1 billion, down 7%. Operating expense was C$2.5 million, down 5% mainly due to lower fuel prices but partly offset by higher labor and fringe benefits expense — higher average headcount and general wage increases — and the negative translation impact of a weaker Canadian dollar. Operating income was C$1.6 billion; the operating ratio was 60.8, up 128 bips; net income C$1.2 billion, down 12%.

In light of CN's second quarter results and revised expectations of weaker than anticipated volumes in the second half of 2023, CN is updating its full-year outlook. CN continues to assume negative North American industrial production in 2023. The 2023/2024 grain crop in Canada will be below its three-year average (excluding the significantly lower 2021/2022 crop year) and the U.S. grain crop will be above its three-year average. The Loonie will stay in the 75-cent US range and crude will hover around $75 US. CN also assumes that in 2023 there will be no further significant impact from Canadian wildfires.

Canadian Pacific did a million revenue units in 2Q23, up 50%; freight revenue was C$1.1 billion, up 50%, and revenue per unit was $2,899, down 4%. One has to take all the comparison numbers in this report with a huge grain of salt, however.[1] The 2Q2023 numbers necessarily exclude about six weeks of KCS numbers from March 1 through April 14. Similarly the 1H2023 numbers are skewed by that. Ergo we see huge percentage year-over-year deltas everywhere. We will have to wait until 3Q2024 for solid quarterly and annual comps.

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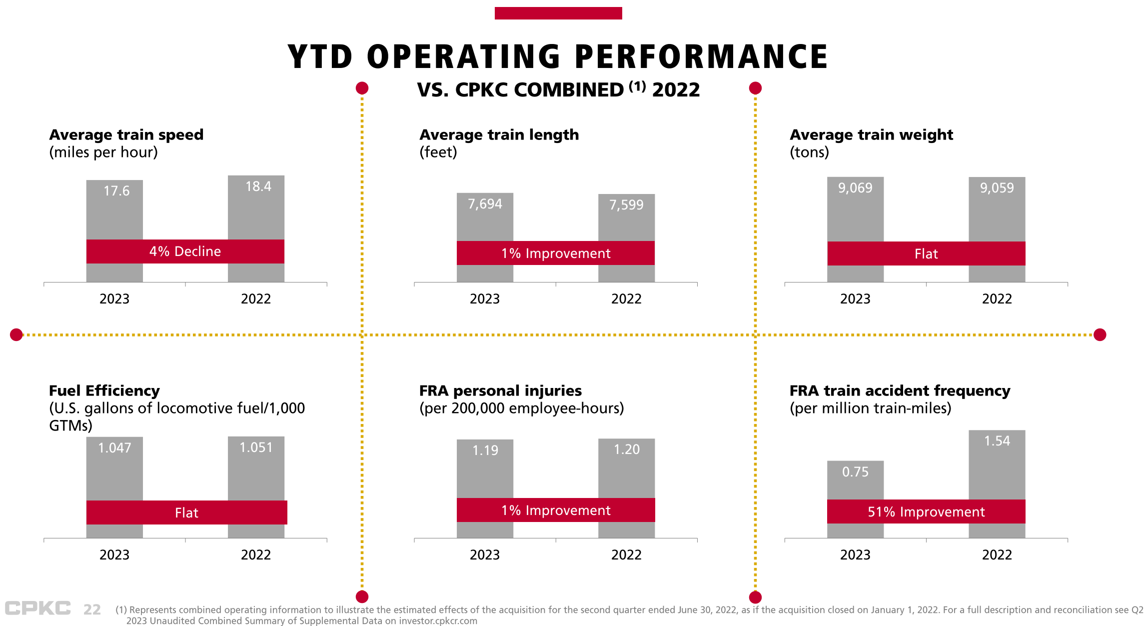
[1] The results of KCS are included on a consolidated basis from April 14, 2023, the date CP acquired control. From December 14, 2021 to April 13, 2023, CP recorded its interest in KCS under the equity method of accounting.

That said, chief marketing officer John Brooks pointed out revenue opportunities across the board. In bulk, he sees a positive second-half due to improved year-over-year comps and new grain flows thanks to the combined network as well as renewed strength in coal. Reduced exports of potash as a result of a short-term shutdown will be a negative play. In merchandise, Brooks sees lower plastics and crude volumes due to maintenance outages. This will be a record quarter for the merchandise group driven by steel and frac sand growth. All in, the second half looks pretty good for the carload groups.

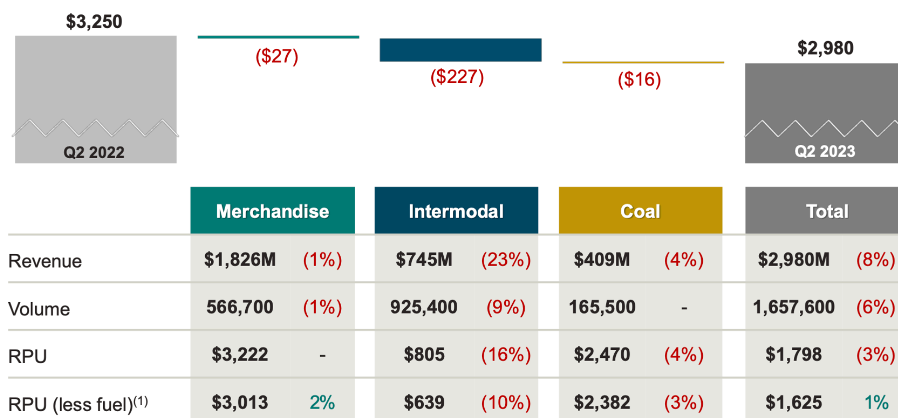
The operating department delivered its usually solid performance:



Norfolk Southern rounded out the week with total revenue of 2.9 billion, down 8%, on 1.7 million revenue units, down 6%. Merchandise carloads brought in $1.8 billion of revenue on 567,000 revenue units; merch revenue accounted for 61% of the total. Operating expense was $2.4 billion, up 22%, for total operating income of $576,000, down 55%, with double digit gains in compensation and materials.The operating ratio was 80.7, down 19.8 points year over year. Net income was $356,000 down 57% from last year.

On the earnings call, Shaw highlighted the greater focus on local service saying, “We made the innovative move this quarter to create the industry's first Vice President of First Mile/Last Mile, building an entrepreneurial spirit and growth mindset into our organizational structure. Continuous productivity improvement through cost management and smart revenue growth is a core element of our strategy.” A close look at the trends in the 18 carload carload commodities NS reports to the AAR suggests this could work as long as its implemented at all NS levels.

Within the merchandise carload segment, forest products revenue units slipped 2%, metals and aggregates were down a point, and chemicals dropped 9%. Automotive saved the day, up 6%. But since automotive really isn't part of the greater non-class I railroad community, it kind of distorts the merchandise carload story. I think this Ed Elkins slide provides a better picture.



	Merchandise		Intermodal		Coal		Total	
Revenue	$1,826M	(1%)	$745M	(23%)	$409M	(4%)	$2,980M	(8%)
Volume	566,700	(1%)	925,400	(9%)	165,500	-	1,657,600	(6%)
RPU	$3,222	-	$805	(16%)	$2,470	(4%)	$1,798	(3%)
RPU (less fuel)(1)	$3,013	2%	$639	(10%)	$2,382	(3%)	$1,625	1%

It appears NS has largely recovered from the effects of the East Palestine incident, and is making changes in operating patterns to deliver on Alan Shaw's remarks. As most of you know, my relationship with Norfolk Southern goes back some 30 years, starting before the Conrail transaction. The railroad has not been performing like the NS I knew so well, but I am hopeful that what we saw and heard on this call tells us we are getting back to NS as it should be.

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