RAILROAD WEEK IN REVIEW
October 6, 2023

"At this time, the company has found no indication that the September 30 technology outage was related to an unauthorized cybersecurity incident, or the outage of August 28. We are continuing to examine the root cause of the incident but believe at this time that it relates to a vendor product defect. Further, Norfolk Southern has undertaken a total review of the resiliency of its data center and network technology to prevent future outages." — NS press release, September 30

"Input costs for everything related to chemicals and energy have dropped materially. If you're a manufacturing company very reliant on energy costs or chemical costs, typically some of the larger input variables in your cost base, you do have a chance here to actually load up on your input." — Andreas Steno Larsen, Steno Research, October 2

Norfolk Southern third quarter revenue units came in at five million even, down less than three percent year over year, suggesting that NS is indeed regaining some of its lost momentum. At the August 15 Deutsche Bank Investors Conference NS reported train speed, terminal dwell, and cars-on-line had all improved markedly vs. YTD 2022.

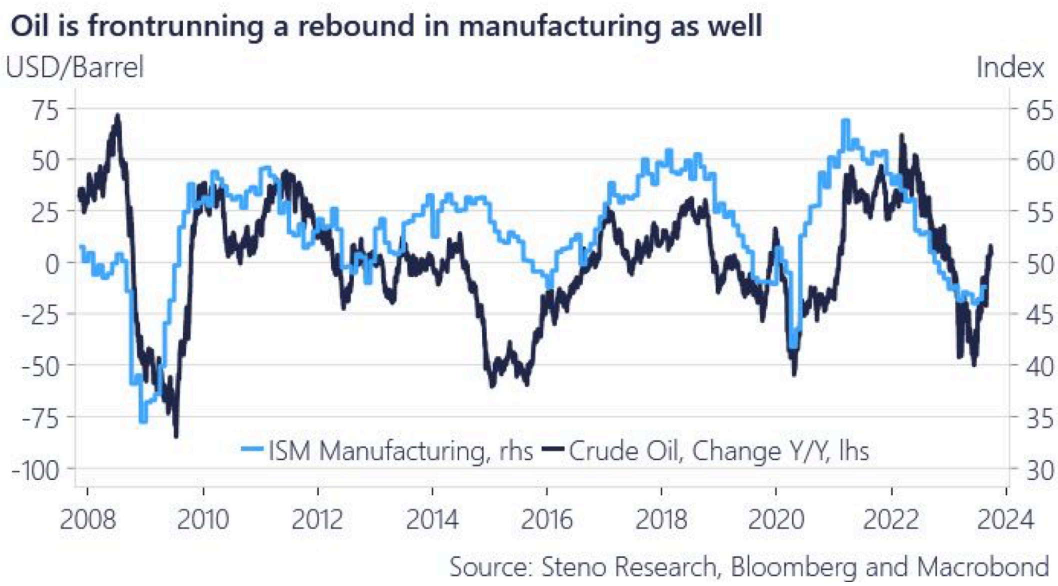
Not surprisingly, intermodal took the biggest hit, down five percent; automotive increased seven percent; and the coal/coke franchise slipped less than two percent. The merchandise carload group was essentially unchanged, down less than a point. The mix was about what you'd expect, given the less than robust ISM manufacturing numbers.

Of 17 commodity groups reported, we saw a nice gain in ag products (grain up five percent), with flat industrial chemicals and lumber. STCC 26 pulp & paper dropped six percent given the state of housing and what's been called "the cardboard box recession." NS reports 3Q results at 0845 October 29 and I'll be watching.

As to last Friday's "technology outage," the NS presser says simply, "Late Friday evening, Norfolk Southern's data center experienced an outage that impacted rail operations. This included our dispatching system, train movements, and functionality of our terminal operating system. Operations were halted until the issue was safely and successfully resolved at 1:30 a.m. ET on September 30.

"All systems are now fully functional, and trains are running. Our Marketing team is collaborating closely with customers to keep them informed. We expect the impact to our operations to last at least a couple of weeks as we work to mitigate traffic congestion caused by the outage." I'll be interested in hearing what NS has to say on the earnings call about having two "technology outage" events in relatively short order.

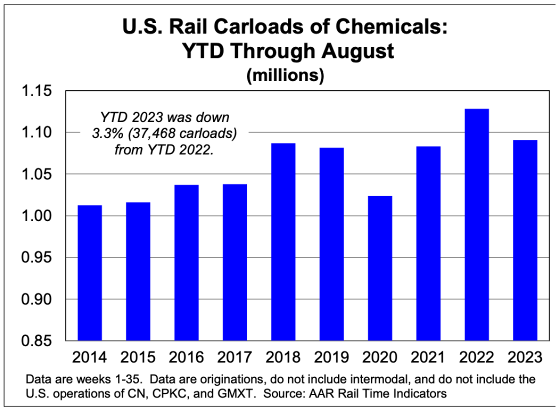
Drilling down into the NS Q3 carload commodities, one sees the industrial chemicals group down a mere 60 basis points year over year. I suspect the increased manufacturing activity reflected in the ISM charts is part of it. I also suspect prices are holding the line thanks to moderating raw material costs (oil is a biggie for plastics, e.g.) and a low raw materials to labor cost ratio. Think of Ford and the UAW at the other end of the scale.



According to Andreas Steno Larsen, "We see purchasing managers across various sectors loading up on raw material inventories as a consequence of the serious drop in the input material price. The opposite seems to be the case when there's a big increase in the price of everything related to the input cost for manufacturers." Having a low labor to materials ratio is a big plus for competitive pricing.

The September *Rail Time Indicators* from the AAR reminds us, "Most rail-shipped chemicals are classified as industrial chemicals (STCC 281), plastics and synthetic fibers (STCC 282), fertilizers and other agricultural chemicals (STCC 287), or miscellaneous chemical products (STCC 289).

"U.S. rail chemical traffic has benefited from more than $200 billion in new chemical industry investments made possible by lower shale-related natural gas prices and increased availability of ethane and other key chemical feedstocks." As I said, oil price is a big factor and even as it approaches $100 a barrel, is still manageable. To a point. And even though the STCC 28 revenue/variable cost remains attractive to the railroads, if your franchise includes STCC 28, attention must be paid to oil price moves.



Finally, there is the Dow Theory, which stipulates that an increase in freight movement signals a rebuilding of inventories. Larsen again: “When inventories are low and new orders are starting to pick up, it is to me an early sign that a restocking cycle is commencing and it is a sign that purchasing managers across sectors are betting that this is a good time to load up inventories.” And it takes boxcars to do it.

The AAR’s October 6 *Rail Time Indicator*s captures the entire Q3 and YTD. Total US carloads for Sep 2023 were up 2.3% YOY, the first increase in four months and their biggest percentage gain since January 2023. Year-to-date total carloads were up 0.3% over 2022 and up 0.7% over 2021; 13 of the 20 AAR commodity categories gained.

Of particular note, US chems rose 4.6%, their biggest year-over-year percentage gain in 18 months. Grain fared less well — US grain carloads averaged 16,873 per week in September, posting one of the lowest weekly averages for grain in 35 years. Overall, rail traffic remains in uncertain territory along with the economy. A sustained boost across rail categories will likely require stronger overall industrial and global growth. And where have heard *that* before?

The Railroad Week in Review, a compendium of railroad industry news, analysis, and comment, is sent as a PDF via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 million annual revenue are $175. Subscriptions for Class I railroads and short line/regional operators with more than $12 million annual revenue are $600 per year. To subscribe, click on the Week in Review tab at www.rblanchard.com.