RAILROAD WEEK IN REVIEW

October 27, 2023

“Our on-train performance and our velocity have remained steady. We've been consistently over 90 percent for the last two quarters versus about 80 percent last year. This is the performance and the resiliency that we’re looking for as the foundation of our growth plan moving forward.” — Tracy Robinson, President and CEO, Canadian National

“As part of our scheduled railroad model we have to minimize car dwell, maximize velocity across the railroad, sustain safe, reliable and resilient service and drive productivity.” — Paul Duncan, COO, NS

“You've seen noticeable progress across all the operating metrics, train speed improvements, terminal dwell reduction, car miles per car day improving, locomotive productivity improving and, ultimately, the most important part, the service experience for the customer.” — CPKC President Keith Creel

Businesses and governments around the world are looking for opportunities to address demographic shifts, make their supply chains more resilient, and improve sustainability. More recently, geopolitical events and the reality of higher for longer rates add to the growing uncertainty. Technology helps organizations better deal with the many challenges they face.” — Arvind Krishna - Chairman and Chief Executive Officer, IBM

Canadian National turned in 3Q results that were less bad than anybody else in the neighborhood. Revenue was down 6.6 percent to $C4.1 billion on 1.4 million revenue units, down 7.1 percent.

CN moved 667,000 merch carloads, up a point, whereas everybody else was down small points. In this regard CN is fortunate to have the highest percentage of revenue (66 percent) in the merch carload sector. (I’m excluding CPKC from these comps as their reported numbers aren’t true YOY comps — see below.)

Operating expense was C$2.5 billion, off 4.6 percent for a 60.6 OR, up 128 basis points, and still the lowest around. Operating income was C$1.6 billion, down 9.6 percent. Fuel efficiency really helps, especially when you're burning 97.4 million US gallons of the stuff. How does less than 9 gallons per thousand GTMs sound?

As everybody knows, COO Ed Harris is retiring — again — only this time he has two replacements: Derek Taylor, EVP and Chief Field Operating Officer; and Pat Whitehead, EVP Chief Network Operating Officer. CEO Tracy Robinson enlarged on the changes thus on the earnings call: "This isn't splitting Ed's role in two. Derek will focus on work that we haven't done before to strengthen our core competencies. We're giving equal importance to the talent we need for building the plan and running the plan."

As for Pat Whitehead, "He and his team own the operating plan and their focus will be on continuing to refine the plan to optimize to our volumes and to improve velocity. They will also develop the longer-term capital to both maintain our network on a lower cost per unit basis and expand it for growth where necessary in a more cost-effective manner."

CN is a merchandise carload railroad, deriving nearly 70 percent of both RTMs and freight revenue from the sector. The seven percent revenue shortfall came largely from lower fuel surcharges and lower volumes, partially offset by solid pricing. Metals and minerals finished with the best quarter so far this year, supported by increased drilling programs in Western Canada. Demand for forest products remains below pre-COVID levels due to a challenging macro environment.

Going forward, Chief Commercial Officer Doug MacDonald sees growth in US (mainly for export) and Canadian grain, potash, met coal for offshore markets, frac sand, automotive, chemicals and crude oil. Carload commodities continue to prevail, which bodes well for CN's regional railroad connections.

Canadian Pacific reported a 44 percent jump in year-to-date freight revenues, but that's based on reported third quarter 2022 for CP alone vs. the present quarter for CP+KCS. In other words, the "official" earnings report shows results "as is" whereas some of the comps in the presentation try to compare current results with "might-have-been" numbers.[1] Here's my revenue spreadsheet based on their published numbers:

[1] Presentation footnote: "Represents combined financial and operating information to illustrate the estimated effects of the acquisition for the third quarter ended September 30, 2022, as if the acquisition closed on January 1, 2022."

Year-to-Date

	2023	2022	Pct Chg
Grain	**$ 1,652**	$ 1,121	47.4%
Potash	**$ 409**	$ 445	-8.1%
Sulfur, Ferts	**$ 276**	$ 244	13.1%
Forest Prods	**$ 489**	$ 299	63.5%
Energy, Chems, Pla	**$ 1,584**	$ 1,010	56.8%
Mets,mins, cons	**$ 1,128**	$ 655	72.2%
Automotive	**$ 648**	$ 322	101.2%
All Carload	**$ 6,186**	$ 4,096	51.0%
Coal	**$ 603**	$ 458	31.66%
Intermodal	**$ 1,795**	$ 1,660	11.0%
Check totals	**$ 8,584**	**$ 6,214**	38.1%

It's entirely possible that we could be looking at mileage-related extensions of traffic they were not handling interline beforehand. Grain is an interesting note. KCS had a grain haulage arrangement with UP KC to Omaha so a certain amount of former ICE and DM&E area grain was already moving.

Auto is an example of traffic that was probably moving interline but was not joint traffic for accounting purposes. I suspect there may have been some internal debate about how to present these figures. Most likely the bean counters won since the "as if" approach tends to damp out the pickup of formerly nonexistent interline revenue. Gotta give it a couple quarters more to get true year-over-year comps.

Norfolk Southern's third quarter earnings call was generally upbeat. The language and energy on the earnings call convinced me the Shaw Team has a good understanding of what it'll take to restore the momentum lost in the last few years. Total revenue fell seven percent to $3.9 billion largely on intermodal revenue's 26 percent dive, exacerbated by lower fuel surcharges and intermodal storage revenues compared to the prior period.

Operating expense declined five percent so, combined with the seven percent revenue decline, operating income was off ten percent to $1.6 billion with an OR of a highly respectable 60.6, up only 128 basis points year-over-year. Below the line, net income slid ten percent to $1.2 billion.

Total revenue units came in at 1.4 million, down seven percent (IM down 11 percent), though merchandise carloads including automotive were essentially flat. Seven of the 17 AAR carload commodity groups posted gains: the agriculture cluster, metals/construction including aggregates, and industrial chemicals (all-in 26 percent of merch carloads) gained. Within forest products, lumber wood products was flat with paper et cetera off 13 percent.

On the call, Chief Commercial Officer Ed Elkins cited 33 out of 34 consecutive quarters of year-over-year gains in merchandise RPU with no help from fuel surcharges. His market outlook calls for modest volume gains in merchandise carloads.

He concluded with this cautionary note: "September presented us with some encouraging data — that the contraction in manufacturing is slowing and onshoring to the US is on the rise. We remain cautious in our optimism as the uncertainty surrounding future Fed actions, auto strike outcomes, and geopolitical tension is very pronounced."

The continuing downside is that I'm still seeing places where market managers deep in the food chain are Doing Business as Usual and resistant to the changes that Shaw et al want to make. There are glimmers of hope and I see ways to break through the inertia. Do let me know of any positive experiences you're having.

Closing on a more positive note, I've included the IBM quote above to frame Norfolk's deploying Digital Train Inspection Portals to enhance rail safety. From the NS presser: "NS Digital Train Inspection Portals that feature cutting-edge Machine Vision Inspection technology and Artificial Intelligence" with more than over a dozen portals to be deployed by the end of 2024.