RAILROAD WEEK IN REVIEW

January 26, 2024

"Predictability is what underpins our velocity and our resiliency. CN's scheduled operating model has delivered seven consecutive quarters of operational and service excellence.The plan is dynamic and adjusts to traffic levels. Departing and arriving trains on time continues to be a key focus of both the network operations and field teams. These are the basics of scheduled railroading."— Patrick Whitehead, CN EVP and Chief Network Operating Officer, Jan 23

"Our fluidity has started to allow us to look deeper at our operating plan so we can better align the hard assets with what's needed to move the volume. Tighter connections in our yards are starting to drive changes to our operating plan and that results in maximizing the train load, while at the same time reducing locomotive dwell and active horsepower on trains." — Mike Cory, COO, CSX

"Key to our strategy is excelling in what we control. We made great progress in those areas this quarter. That provides further proof that we're on the right path for future success." — Jim Vena, CEO, Union Pacific

Canadian National in Q4 handled 1.4 million revenue units, down a point, generating C$4.3 billion, down two percent. Not unexpectedly, intermodal was the big hit: units down six percent and revenue off 20 percent, pushing system RPU to an 80 basis point drop. Manifest carloads including automotive fared a bit better.

The manifest group gained two percent in units and four percent in revenue. Petroleum/chemicals carloads increased eight percent, grain/fertilizers dipped three percent, forest products skidded six percent. (Automotive was a bright spot, with carloads jumping 13 percent.) CN expects the Q4 strength in metals, industrial chemicals, and energy (refinery output, nat gas liquids, frac sand) to continue, aided and abetted by a forest products recovery.

Operating income was C$1.8 billion, down five percent, as operating expense grew 90 basis points against the 1.6 percent revenue gain, including other revenue and trucking receipts. Below the line, net income was C$2.1 billion, up 50 percent thanks to a positive $800 million swing in tax obligations.

As for operations, I was heartened by the emphasis on "scheduled railroading," a topic seriously pooh-poohed by the Street and badly maligned by certain US Class I railroads.

About 90 percent of originating trains left on time, right where CN needs to be to assure scheduled meets; arrivals were about 70 percent OT. Running on t reduces train meet delays and facilitates timely crew swaps at intermediate terminals.

It also does wonders for fuel efficiency. CN continues to lead the pack in gallons consumed per thousand gross ton-miles, now breaking below 0.9 on the downside. Fuel burn was up less than a point on two percent more GTMs and gallons per GTM improved by more than a point. Somewhere in the afterlife, Hunter is smiling.

Also in Q4, CN bought the 175-mile long Iowa Northern Railway, a major addition to CN's US footprint, for $230 million. IANR serves upper Midwest agricultural and industrial markets, with particular strength in biofuels and grain. In Canada, CN picked up a $78 million stake in Genesee & Wyoming's 150-mile long Cape Breton & Central Nova Scotia Railway (CBNS), a 150-mile shortline railroad. The acquisition was accounted for as a business combination.

CSX freight revenues increased three percent to $3.4 billion in Q4; total revenue including trucking and other was $3.7 billion, off a point due to a nine point drop in trucking revenue. Revenue units increased 1.4 percent to 1.6 million. Intermodal was flat, coal was up three percent and manifest carloads gained three percent including automotive. Chemicals, fertilizers, and metals were the leaders.

Operating income dropped ten percent to $1.3 billion as operating expense increased 3.9 percent against the 1.3 percent revenue increase. Labor jumped 11 percent — mostly on new hires, the timing of union employee vacation and sick benefits, and inflation. The OR worsened more than three points to 64.1. Net earnings fell 13 percent to $886 million due mainly to a 25 percent cut in Other Income from property sales.

Kevin Boone's 2024 commercial outlook underwhelms. His presentation slide 12 promises "total merchandise volume growth supported by service leadership, recent business wins, and modal share gains," citing opportunities in chemicals, fertilizers, forest products, and new industrial development markets. For all of this, he sees a mere one point win for the merch carload sector. Sounds like the railroad isn't running that much better than it was a year ago.

I would have liked to hear COO Mike Cory talk about car-miles per day, locomotive productivity in GTMs/gallon, train length, and other Key Performance Indicators seen on other Class I earnings calls. Granted, there were charts on velocity dwell, and trip plan compliance changes, but there was nothing of note. The presentation delivered a lot of promises —let's wait for the results.

Union Pacific cranked out a one percent freight revenue gain to $5.8 billion on 2.1 million revenue units, a three percent revenue unit increase. The bulk commodities group – essentially grain, fertilizers, and coal – posted flat revenue gains on three percent more volume while losing two percent in RPU. The so-called "premium" group (auto, intermodal) was, not surprisingly, down in revenue by three percent even though revenue units grew by four percent. The seven percent RPU haircut is what hurt.

Industrial products got a four percent boost in revenue on three percent greater volume thanks to one percent RPU gain. The STCC 26 Paper category gained 11 percent but STCC 24 wood products (the other half of "forest products") was unchanged for the quarter. Aggregates and metals both slipped a bit. For 2024, UP sees better results from carloads of grain, petroleum, and petrochemicals.

Out on the railroad, UP has a particularly strong story to tell. The system averaged 217 car-miles per day, up 14 percent, 85 percent intermodal trip plan compliance, and 70 percent auto and manifest TPC, both up 12 points. Locomotive and workforce productivity as well as train length moved handsomely in the right direction.

Total revenue was unchanged at $6.2 billion, operating expense was unchanged, for a flat operating income of $2.4 billion. The 61 operating ratio was another no-change. Below the line net income was up a point to $1.7 billion. For the year, net income was $6.4 billion, down one percent. Free cash flow after capex was 4.8, billion down 17 percent.

Looking strictly at the quarter it's safe to say Vena is only getting going — and boring quarterly results will become the rule rather than the exception. Used to be, you'd go out on the railroad and everything reeked of the investment poured into it. Then financialization came to Omaha and the orientation changed from customers to cash. The Q4 results suggest UP is on the road to recovery.

Closing thought: The italicized quotes at the top highlight what the management teams are saying about their accomplishments. Now, whenever things aren't quite right, you can go to your Class I Contact and say, "But on the earnings call so-and-so said such and such." Ask why the results you're seeing don't match what's being told to investors.

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