RAILROAD WEEK IN REVIEW
May 3, 2024

“All this noise about the agreement over the Meridian Speedway is just that. We’re going to have unfettered opportunity to compete in partnership with CSX as well as NS. This isn’t about a share shift. If there’s any, it might be nominal. And in fact, what NS has said is exactly what the truth is. It’s much ado about nothing. Let’s get over this and get on to competing and being great partners with both NS and CSX.” — Keith Creel, CP President, April 24

“We’ve recently introduced a new value-added measure, the Service Performance Index, or SPI. It’s a combined metric that reflects the actual service provided, and we believe is a better measure than trip plan compliance alone. Now customers with specific transit commitments can measure against the SPI. Customers looking at new lanes can use SPI when making their rail transportation planning decision.”— Eric Gehringer, UP COO, from the 1Q2024 earnings call transcript

“What makes us confident is that these CN-specific growth initiatives are very diversified from a commodity and from a geographic standpoint. So it's not a one home run type of thing. It’s a lot of different singles. So if we're wrong on one of them on the negative side, we'll be more right on the positive for something else.” —Ghislain Hoyle, CFO, in the Q&A, 1Q2024 earnings call transcript

Canadian National led off Week 2 of the 1Q2024 railroad earnings calls. Freight revenues were off two points while revenue units and RPU both slipped one point. Ops expense was held to a two-percent gain and ops income was off seven percent. The net fell ten percent, mainly on increased income tax exposure. Owner earnings (cash from operations less capex) fell nine percent. And throughout the call the focus never wavered: running a smarter railroad and giving customers a competitive advantage by using CN to move everything from raw materials to finished goods.

It was a strong call and the slides hit the high points nicely. As for the core carload franchise, retiring CMO Doug MacDonald said on the call, “Higher shipments of potash, refined petroleum products, frac sand, international intermodal, and natural gas

Serving our customers is our priority

- Car velocity and train speed essentially steady despite headwinds in the quarter
- Disciplined network execution and fluid yards are the cornerstone of consistent, reliable customer service
- Running the Plan will drive operating leverage, particularly in our Merchandise segment, as volumes ramp up

Q1 Car Velocity (1)	Q1 Through Dwell (1)	Q1 Local Service Commitment (1)(2)
205 miles/day ▼ 3%	7.1 hours flat	92% ▲ 6%

liquids were offset by lower shipments of coal, grain, forest products and crude oil.

“Petroleum and chemicals led the way in Q1 with six percent RTM growth and record volumes in refined products and natural gas liquids. Aluminum volumes also increased in the quarter and there were new raw lithium interline shipments with the UP to Texas for battery production. Forest products RTMs decreased five percent in the quarter, but center-beam orders for lumber have increased sequentially since Q4 last year.

“Grain and fertilizer RTMs were flat overall as strong potash growth in Q1 fully offset softer grain volumes even though Canadian grain demand was strong all quarter. We moved record grain tonnage in February, and there's pent-up demand heading into Q2. U.S. corn volumes decreased versus last year due to muted domestic and export demand.”

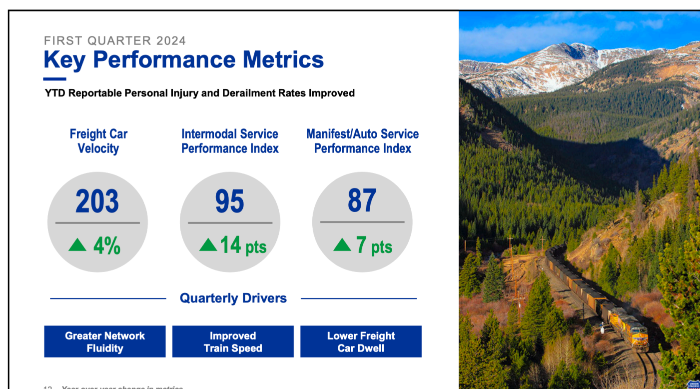
As you can see, running a faster, smarter railroad pays off in market share and financial performance. And, as an aside, I like to see RTMs as a measure of traffic increases. Carloads can be misleading as cars get bigger — higher RTMs suggest more revenue-tons per train start but with the same number of individual cars.

Union Pacific Q1 results on the surface were rather ho-hum. Total revenue slipped one percent to $5.6 billion from $5.7 billion on two million rev units, also down a point, and the downside was all fuel surcharge revenue. But by the time Chief Marketing Officer Kenny Rocker had walked us through the revenue results by commodity group, it all became clear. The big loser was metals/minerals, which includes aggregates. The biggest increase was in “energy and and special markets” which includes coal, drilling supplies, waste, salt, and roofing.

In operations, “greater network fluidity” comes from managing the railroad to fit demand. The “service performance index" is a new measure that combines trip plan compliance and interruptions en route. Perhaps SPI will get us back to the time when a trip plan showed planned elapsed time from release to the railroad at origin to release to the customer at the destination. If the car was delayed en route the trip plan did not change. Nor did it if the car got ahead of schedule.

I seriously doubt whether the trip plan compliance metrics being shown by the other Class Is today follow those rules. My channel checks reveal car delays that occur regularly and all over the system. This makes one wonder whether TPCs touted on these calls measure against trip plans as described above or whether trip plans are being rewritten when cars are delayed. Or whether fudge factors of X hours are built into the trip plans at the start.

Based on Gehringer's remarks I think we can take UP's SPI/TPC guidance to the bank. The only question that remains is how SPI is measured when there is a non-Class I origin or destination. Ideally, these OD pairs would be included. Let me do some drilling.



Canadian Pacific brought up the markers on the week's earnings calls. (All we have left is the BNSF 10-Q, due out tomorrow.) Since the CPKC transaction wasn't finalized until April 14, 2023, the financials show two sets of 1Q2024 results. There are the strictly GAAP numbers showing a straight summing of CP and KC individual results for the quarter. Then we have the pro forma results showing what CPKC would have looked like had it been in existence a year ago. I'm using the latter in what follows.[1]

The operating metrics are getting better all the time, showing that the combined properties in Canada, Mexico, and the US can offer a superlative railroad service product. Quality performance measures are particularly important at this moment because pro forma car-counts, revenues, expenses, incomes etc. show how the combined properties would have performed had they been one railroad starting before January 1, 2023. The actual merger was effective April 16 and only after that can we see CP+KCS today on the same footing as CP+KCS a year ago.

As for the carload side, John Brooks used the pro forma combined railroad figures to demonstrate clearly the power of the franchise. "Starting with bulk, grain revenues were up two percent on one point of RTM growth. U.S. grain volumes grew 19 percent over prior year. Our franchise is benefiting from strong export corn shipments to the PNW along with more shipments of wheat and soybeans to Mexico. We still expect overall year over year comps in Canadian grain to be a headwind until we get to the new crop.

"Potash revenues were up four percent on two percent volume growth and we are well-positioned for solid potash growth in 2024. Energy/Chemicals/Plastics revenue and volume grew two points on higher fuel oil, DRU, and plastics. We see further expansion

[1] Represents combined operating information to illustrate the estimated effects of the acquisition for the first quarter ended March 31, 2023, as if the acquisition closed on January 1, 2022. For the three months ended March 31, 2024, KCS was consolidated.

of this group as a result of new wins in plastics, renewable diesel, and refined fuels as we connect the markets in Alberta, the Gulf Coast, and Mexico.

"Lumber hit new records thanks to new line-haul routes connecting Canadian producers with the strong demand in the Texas market. Metals/Minerals/Consumer Products revenue was down a point on five percent fewer units. Volumes in the quarter were largely impacted by weakness in frac sand to the Bakken and Permian Basins. This was partially offset by ongoing strong demand from our steel production."

REVENUE UPDATE – Q1[1]

BULK

- Strong **U.S. grain** partially offset by lower **Canadian grain** due to weaker harvest for the '23/'24 crop year
  - U.S. grain strength driven by exports, and shipments to Canada and Mexico
  - Combined network delivering customer options and business resiliency
- Higher domestic and export **potash** volumes, bouncing back after slow start from weather impacts
  - Well-positioned for strong 2024
- Lower **coal** volumes due to weather impacts and lower natural gas prices

MERCHANDISE

- Diversified growth in **ECP** from fuel oil, Diluent Recovery Unit (DRU) volumes, and plastics
- **Forest products** synergy gains offset by softer demand in base pulp and paper business
- Strong growth in **metals** driven by industrial growth and nearshoring, offset by weaker **frac sand** demand
- Strong **automotive** performance despite production holds
  - New Dallas auto compound opening in June

INTERMODAL

- Strong **international intermodal** through the Ports of Vancouver and Lázaro Cárdenas
  - Rebound at the Port of Vancouver driven by shipments returning after the work stoppage last summer
  - Strong TEU growth at the Port of Lázaro Cárdenas
- Flat **domestic intermodal** volumes
  - MMX180/181 growth accelerating, with strong uptake from IMC and retail partners
  - Offset by loss of short haul volume

I can only conclude that in these three quarterly results presentations we saw a clear focus on keeping and growing revenue units, supporting present customers and creating new customers in the bargain. We see that Precision Scheduled Railroading can indeed create higher revenues at lower costs. But you have to stick to all five tenets religiously. Using PSR solely to cut the OR and increase earnings per share by shifting capex money into share buy-backs will only get you in trouble. See also Lance Fritz and Jim Squires.

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