RAILROAD WEEK IN REVIEW

January 31, 2025

Norfolk Southern's 4Q2024 car-count and revenue results needle didn't move much year over year. But dig into the financials and some of the finer measures and you'll come away not a little impressed. Fourth quarter freight revenue actually slipped 2% to $3 billion on 1.8 million revenue units, up 2.8%. System RPU was off 4% mirroring the lack of any appreciable fuel surcharge dollars.

Operating income was up 40% to $1.13 billion as GAAP operating expense came down 16% in the quarter with a 62.8 OR. The FASB reporting rules say you have to put things like the East Palestine accident expense and related restructuring charges into the operating expense column, thereby distorting any measure of how the railroad was really running. For that we need to turn to the non-GAAP numbers.

Operating income gained 10.9% to $1.06 billion as expenses were more than cut in half going the non-GAAP route, yielding a much more respectable 56.1 OR. Below the line, reported net income jumped 39% to $733 million. Backing out the East Palestine numbers we get non-GAAP net income of $688 million, up 7.5%.

Commodity carload revenue units were mired in the low single-digit and even negative year-over-year deltas. Total merchandise loads increased only half a point. Coal carloads slipped 0.9%; tonnage was down only 2% in the Q (bigger cars?); utility coal was down a not unexpected 13% whereas export and industrial were up 13% and 23% respectively. Once again intermodal saved the day, up 4.8%.

COO John Orr is bringing about some much needed improvement in how the railroad is operating. Looking at bar charts comparing Q4 results with Qs 1-3, one sees improvement everywhere: accident rates, terminal dwell, car-miles per day, train speed, and GTMs/available HP, and trip plan compliance. Orr also noted a reduction in handlings per car, an enhanced connection plan, fitting the mechanical infrastructure to the service plan, and improving the fuel numbers.

Chief Commercial Officer Ed Elkins cited the revenue gains and volume increases mentioned above. There were, unfortunately, some "adverse mix impacts" in the full-year results. His market outlook for the rest of the year calls for increased manufacturing activity and improved chemicals results in the industrial sector, and an improvement in intermodal volumes, offset by continued softening demand for coal.

As a general rule, I don't generally drill down into financial results, but in this case I must make an exception. Cash from operations increased 28% to $4 billion even, owner earnings (cash from operations less capex) doubled to $1.7 billion, and retained income leapt 133% to $1.4 billion.

Not only was I impressed by the call, but so also was Wall Street. NSC shares opened the day at $252, hit a $270 high, and had settled back to $257 by the bell. The chart trend year-to-date indicates we could be in for a nice ride. A *Market Edge Early Buy* candidate.

Canadian Pacific, another Market Edge Buy candidate, checked in with freight revenues of $C3.8 billion, up 3%, on 1.1 million revenue units, down 4%. Commodity carloads including coal were down 2%, due mainly to the 14% drop in coal carloads — Chief Commercial Officer John Brooks attributes the drop here to a "customer facility incident" exacerbated by weather and labor disruptions. Grain was the hero in the commodity group, up 12% in revenue and 9% in volume.

Operating income increased 8% to $C1.6 billion as operating expense actually came down a point, owing to reduced expense for payroll, fuel, and purchased services. Below the line, net pre-tax revenue increased a whopping 18% to $C1.2 billion (I am using pretax here because the $C246K tax credit kind of distorts the comps.)

CFO Nadeem Velani continues to keep the CP house in order financially. Cash from operations jumped 27% to 142% of net (as a general rule, I like to see this number north of 125%). This in turn lend to a 46% jump in what Warren Buffett calls "owner earnings" (cash from operations less capex). Retained income was up 18% to $C19 billion, enough to keep the railroad running without depending on the kindness of strangers for more long-term debt.

Revenue ton-miles increased 2% with merchandise carloads ex-coal providing 70% of the total. Unfortunately, commodity carloads only generate 2/3 of total revenues, whereas auto, for example, generates 7% of revenue on just 2% of the RTMs, suggesting to me they're not charging enough for merchandise. It's not a good sign to see where merch RPUs increased in the low single digits or even went negative.

I wanted to get a sense of how the Mexican political situation and tariffs could affect CP results. Chat GPT is an excellent source for information like this. The response:

"Keith Creel's confidence in the stability of U.S.-Mexico trade relations, despite political uncertainties, underscores Canadian Pacific Kansas City's (CPKC) strategic focus on cross-border commerce. His optimism is evident in the company's recent infrastructure investments, such as the new bridge at Laredo, Texas, which enhances capacity and efficiency for U.S.-Mexico trade.

“This proactive approach positions CPKC to capitalize on cross-border traffic growth, aligning with [any railroad] investment strategy. The company’s commitment to infrastructure development and operational excellence suggests a positive outlook for stakeholders.” Indeed. And these results paired with those of the full year show why.

Canadian National wrapped up the week’s earnings festivities with operating income down 11% to $C1.6 billion due to revenue units down 5% to 1.3 million and freight revenue off 3% to $C4.2 billion. Operating expense was up 3% on 8% gains in both labor and purchased services/materials. Net income before taxes came in at $C1.5 billion, down 19%. (The $C362 million tax recovery makes after-tax comps meaningless.)

CEO Tracy Robinson summarized the Q4 results, citing their “disciplined execution and adherence to the operating plan, allowing the swift return to fluid operations.” She added that “CN-specific initiatives delivered volume growth, despite the weaker than expected macro environment and various supply chain disruptions.” The 2025 plan calls for further volume growth, continued strong pricing, and operating leverage.

Operations in the quarter started out well enough, but December got hammered with extreme cold so that month’s results were decidedly inferior to the first two months of the Q. In spite of it all, CN improvements in trip plan compliance, GTMs per employee, and the 6% increase in tie-gang productivity all contributing to added capacity.

As noted above, commercial results were uninspiring. Merchandise carloads plus coal fell 3% while declines in automotive and intermodal units both contributed to the drop in revenue units. Merch revenue including coal was flat. However, one should look for improved comps this year with particular contributions from petroleum products (NGLs and refined fuels), industrial chemicals/plastics, and domestic intermodal.

I think it's safe to say that with the operating and commercial progress made in 2024, CN ought to see a fairly strong 2025. For the quarter of a century that I’ve been working with and following CN, their continued focus on results and doing what they say will they will do always carries the day. Says CEO Robinson, “Managing the tension between volumes and resources will enable further growth at lower and lower cost.” An excellent notion.