

Greetings from Ottawa

....And here's hoping everyone had a terrific Thanksgiving, whether last Thursday or last month. Hopefully your Black Fridays went well, too, especially with the glut of product as supply chains ease in time for a buyer slowdown (toy imports up by a *third* YOY). Speaking, obliquely, of Canada, as stated I am Ottawa today and tomorrow seeking an update on Canadian regulation (etc) after all of the focus on the US side, ramped up again after the STB Chairman's fiery speech at **RailTrends**. Ahh, yes, time for my take a few days off, time to reflect, thoughts on perhaps, just perhaps, our best Conference yet. But first, one major topic not discussed much (ratification votes as yet unknown) was labor, so:

Rail labor update:

As er know, the two major T&E unions split the vote, both closely ([Railroad Unions Split Over Labor Contract - WSJ](#)). I discussed the ramifications on FreightWaves ([FWNOW TonyHatch.mp4 - Google Drive](#)). And, yes, I was on Fox! (<http://video.foxbusiness.com/v/6316273480112>). 4 unions representing ~56% of the total are holding out; 8 unions have ratified. So what now?

- This is NOT AN INVESTABLE EVENT – Seeking Alpha quoted an analyst saying that investors are “sleeping on this”; no, they understand that the outcome is important (compensation inflation vs productivity) – with the PEB guidelines as the framework but that the process is not....
- Any strike (I am still betting on settlement – too many have too much invested) would be short, short, short. The impact on rail volumes could last over a month (and delay service recovery) but would have no impact on the long term rail “story”
- *President Biden is planning to implore Congress to intervene in stalled negotiations between rail unions and operators to prevent a strike, per the Washington Post*
- For logistics managers I see why this is a big deal – its like a hurricane coming to their (plant/port/warehouse etc) with a very long lead time. But they must always think tactically not strategically. And it is in the interests of rails and shippers to cry “catastrophe!!” – they are just playing their dealt cards as the unions play their own.
- A bigger short term issue is the possibility of “take the money & run” attrition after back payments
- The key date is December 9
- My position hasn't changed – this is the best – unusual - time to be a union in a regular labor compensation period. Think of Aaron Judge in his “walk year’ – not a bad time to hit 62 home runs. Now if the unions didn't hit over 60 bombs, they are benefitting from the political/labor/inflationary/supply chain issues of the day. So why not play to the very end?
- All unions would respect the picket line; all unions have the unfortunately named “me too” clause (i.e.; any benefit granted to SMART to get them on board accrues to all twelve). All have agreed to no work stoppage is Congress isn't in session (another hint that they are counted on to end any work stoppage).
- The issue has created strange bedfellows – note Tuesday's panel to be run by the AAR supported by shipper trade associations most often seen on the other side of the table (RILA, NGFA, API & TFI).
- Much more important is after this issue is behind us all – will individual railroads and unions be able to rectify their relationships? Bargain for productivity/technology in return for quality of life that eases attrition?

*This just in - **The Class One rails see a second COO switch-out in a matter of days!** “Effective immediately” CN replaced Rob Reilly, once BNSF's rising star (and soon someone's), with “industry vet” (and PSR pioneer) Ed Harris, giving up 15 years in age. Ed is incredibly well respected but at 72....so this*

can't be the end of the story....And CN is having its first Robinson-led Investor Day in May....and for Reilly, he withstood the proxy fight centered more than a bit on CN's ops performance (with Jim Vena waiting in the wings) to land with a new CEO, Tracy Robinson (below) returning to the industry, who needed an operational ally....and CN reported the best quarter in the industry in Q3/22....So.... Never a dull moment...

RailTrends Top 10 Reflections – the underlying theme was the need for culture change in terms of customer and labor relations, which should lead to improvements in Washington relations as well. The rails continued to talk about growth – but as was pointedly remarked, that was the theme of **RailTrends** last year, as well. Starting with the skeptical side:

1. *STB Chairman Marty Oberman not surprisingly took the US Big 4 rails to task, but in perhaps the most persuasive way yet.* He claimed that rails are monopolies (again, see highways, publicly supported) that do not serve the public interest – and that through their labor reductions that have, in effect, already caused the industry and its customers to suffer the effect of “a partial lockout”. Furthermore by using the AAR’s estimate of a \$2B/day impact from a rail work stoppage, the economic impact was in range of \$100B! while I don’t really agree with that, and I don’t fault the rails (or any industry) for layoffs in March-May 2020, it was hard to argue that the rail industry was and is less resilient.
 - a. At least three of his fellow Commissioners were in the audience
 - b. His best line: “rails said at RT21 that they were pivoting to growth and all I got was this lousy T-shirt!” Look for merchandise tables at **RT23**....
 - c. He hinted that the Board would look at embargoes as a way of managing rail congestion and so he/they did (see UNP, below). Therefore I would take seriously his hinting that common carrier obligation would be a means to an end in 2023.
 - d. It was hard to argue with the complaints, as stated – and given that he did not propose any government-intervention solutions, so far, so good.
 - e. The excellent rail trade association (AAR & ASLRRA) fireside chat/panel which preceded the Chairman’s would agree; they see for all of the “*sturm & drang*” a clearer path to success than in the legislative threat era (circa 2009).
2. *Oliver Wyman’s Adriene Bailey once again called for broad changes in the railways in order to address the significant decade long loss of market share; she had the following suggestions:*
 - a. Acknowledge the need for change (I would say, given for example recent conversations with the new CSX CEO Joe Hinrichs at a RT dinner – that is happening)
 - b. Use the downturn as a runway to change (and not in the traditional way of cost cutting to maintain near term earnings) – which we shall see and which also relates to:
 - c. Convince investors of the value of growth – again, rails have been talking that talk, so I believe that, despite the usual dumb OR cult remnants, is also happening (or beginning to)
 - d. Foster supportive regulatory regimes (the jury is out here, with the focus on the near term)
3. *The Analyst Panel was supportive of Bailey’s call* – particularly Rick Patterson, who continued his clarion call that the pursuit of shareholder value has removed rail from the public interest obligations – which are supportive of *long-term* growth, citing my “Cult of the OR” as an example. Hard to argue with that – in the past (although, of course, *everyone* in the supply chain is pursuing shareholder value to some extent). I would argue that is past behavior – and that the growth pivot is the only option – but the facts on the ground support Rick, for now.
 - a. Larry Gross gave a rather pessimistic outlook for intermodal – though not because of rail strategy (sure, service isn’t helpful – “cycle times nor on-time measurements are not at

- all truck like” - but Larry sees the entire IM supply chain) but because of weakening domestic IM trends since Spring (“really a market demand issue”), a “non-existent” fall peak, and accelerated West-to-East port migration, some of which might revert.
- b. My slides are attached....

And now from the more optimistic side:

4. *Short Lines! Of course, from the entrepreneurial side there's always optimism.*
 - a. *Firstly, Rick Webb of Watco deservedly won our annual Innovator Award.* Watco recently made the Forbes list of best mid-sized companies, the only rail to do so. Rick also emphasized culture, service and logistical solutions, which Watco has perhaps best exemplified in the entire freight rail industry, from switching to ports to traditional short line creation. And, he offered a lesson for the big guys – grow volume not just price ((big SL theme), balance stakeholder interests, and embrace technology.
 - b. *The Short Line CCO panel is always my highlight.* Again, culture was stressed (RDC); cooperation with the big rails as well (despite the coming general “war for talent” and the impact of the C1 labor inflation on SAL compensation). The SLs pushed back on the new trend of C1s to push back on certain growth (or “curate” – see below) because of their inability to handle it (Anacostia); there’s hope that with crew hiring that might change. There have been successes of note – RJ Corman added a line in NC; GWR added a Hyundai plant (!!) in Georgia.
 - i. CPKCS was seen as either a great direct benefit (Watco) or an indirect one (Anacostia, noting the deal might allow more focus on N/S opportunities); RDC noted that Davenport floods a lot....
 - ii. The panel was worried about deal valuations (no surprise – they are at least partially in the deal business) , with some wondering if some of the big funds might sell out and what that might mean....RJC saw a cooling off period after a hot half decade (but there were a *lot* of PE/Infra folks in the audience lapping that up!).
 - iii. The SLs are extremely confident in *themselves* and their individual ability to grow and to serve – but they have a, shall we say, healthy skepticism about rails’ growth pivot (I *almost* placed them in the top, warnings category). But there wwork as a buffer, switcher, promoter, entrepreneur makes me place them overall on the optimistic side....
5. *Technology!* They predicted Rick Webb’s clarion call; and RT has always tried to focus on tech & rail. We were blessed by two tech presentations (and many tech attendees).
 - a. *RailPulse gave an update – it’s getting closer!* It was a great coming out party for the new GM, employee #1 David Shannon as well as UNP for the first time, for me, anyway (Josh Perkes of Loup), as well as the Moses of the RP tribe, NSC’s Mike McClellan and the always quotable Eric Monger of KBX (“Covid killed JIT”; just one nugget). R/P is in the second of three pilot stages with various equipment types and still is sticking to an H2/23 rollout
 - b. *Rahul Julani, SVP/CIO of UNP and ex-Wal-Mart, gave the last but potentially the most critical presentation.* He is one of three CIOs to enter C1 railroading from outside the industry and is charged with taking UP’s big tech legacy, with historic successes and historic baggage (and size, and bringing a real sense of speed to market (for example the SAP/Cloud conversion in Omaha). He emphasized that the UP Board showed its backing by outlining a multiyear rather than annual budget, and temped us with discussion of

automation (mobile yard switching, train pacing – the latter a key to onboarding the big new IMC customers UP has won).

- c. *Maybe we'll get another temptation of rail autonomy as CSX has just applied to the FRA (not a sympathetic audience) for the right to use Wabtec's Trip Optimizer to stop/start trains....But this "zero-to-zero" program is being pitched not at labor but fuel – and emissions savings. Wicked smaht...*
6. *The big new deal – CPKC!* We heard from *both* sides, country (Keith Creel of the CP) and western (Pat Ottensmeyer – not his farewell he insisted, from the KCS).
 - a. *Pat and the KCS have gone on a memorable journey* – not just from inception/concession, TFM, Mike Haverty, etc but in the near term, starting with the election of 2016 when Jim Cramer listed KSU as the number one short after the Trump victory. And the battle from NAFTA to USMCA was stressful and ultimately victorious, in part after Pat got seriously politically involved (I would argue it was heroic victory in restoring the status quo ante bellum). When you're dealing with the opportunities in Mexico and linking USMCA, the war is never over -after the AMLO fight over refined product imports, quieter but hardly over, now the talk is banning US -GMO – corn by '24. As with energy, it is a battle between political rhetoric and economic reality. Meanwhile, KCS plus away – the 2nd Laredo bridge, just one example. Most of the CPKC transition team was in the audience at RT....
 - b. *CP is excited, boy howdy!* (Yeah, I know I assigned Pat the western role in this Blues Brothers bit). Keith C emphasized that “the mandate is growth” – for some reason no one is skeptical when *he* says it. In response to my question about the relatively low estimate for “trucks off the highway” (~160-170K) versus rail competitive wins, he hinted strongly that the estimate was low – noting the Laredo opportunity as an example (I reiterate that my belief that the CPKC emphasis on rail-rail competition, while real, is also political). Aside from the growth mandate, KC stressed a few politically correct themes:
 - i. *Stakeholder growth*
 - ii. *Scalable infrastructure (and not “over-subscribing”)*
 - iii. *Hydrogen loco development* – after he left he sent a short film of his new power unit on its first revenue run!
7. *CN – Tracy Robinson's first RT*, after the hurricane-aborted attempt when she was at CP a decade ago. Now, we now know more than we did then....so when I look back at her comments, which were very well received, about “team building from within and without” I wonder....but, at the time what I took away was that the so-called “curation” of the book of business was mostly done by now, and that after a few good quarters (getting their mojo back) that there was “meaningful growth to be had”.
8. *NSC's CMO Ed Elkins is a great communicator*, even if he was hamstrung to a certain extent by being a few weeks shy of NS' own Investor Day (12/6). *So while he was unfortunately revelation-free, he was confident*. Ed noted as marketer he was (finally?) benefitting from “boots coming on the ground” and improving sequential numbers, starting with crews and moving to metrics. He sees highway conversion still as the greatest opportunity, as well as market reach extension through short lines, transloading etc.
9. *CSX and Jim Foote's farewell*. OK, this will also be sort of revelation-free. I can sum it up as: *you had to be there*. Jim off the leash; peak Foote. Unfortunately, though we had (and are thankful for) 4/5 of the ST Board in attendance, we did not have Commissioner Primus or we might have been able to stage the “Reprise at the Marquise”. Jim noted many events of his long career (so, cleaning grain cars is not actually glamorous), that PSR worked at CSX, that the North American

Freight rail Industry, while hardly at its peak, remains the envy of the world, that rails must improve in two major areas – labor relations and first and last mile, and that he was off into the sunset....Dinner with his successor gives me confidence that major changes and successes at CSX are not riding off with Jim but will continue.

10. *The rest of the conference and the attendees* – OK, look, I needed *ten!* So, time and events preclude me from going into details about the Associations panel (consider attending NRC in January and the big, 10,000 man Railway Interchange in October), Dick Kloster's annual rolling stock review (contact us for info), or a great presentation by the CEO (Andrew Harding) of the largest railroad in Australia (Aurizon) – a truly fascinating Rubik's cube of opportunity and challenge worth the time to look into (contact me). Also note again the power of the audience – the majority of the STB as noted and of the KCS portion of the transition team, as well as retired PSR officer Sameh Fahmy; Cos from two Class Ones; major leasing company CEOs and supplier leadership; etc. All of that may not make it into my Top 10 but they will inform me as we head into 2023....

(There's a fair amount of) ALSO:

- NSC paid \$1.6 billion for the Cincinnati & Southern, a rail line that it currently operates. This trend follows the BNSF purchase (buy-in) of the MRL for ~\$2B last year – but that came with capturing revenues. This is a bit more mysterious, without much management enlightenment (yet). Surely it is not to improve OR as one “analyst” stated (by....lowering lease payments). NSC will get ample opportunity to discuss this and other issues at their Investor Conference on December 6 (I will be on-line).
- Another topic they can discuss is the resolution of the long-contentious *Amtrak Gulf Coast* issue (no details at all on that)
- Could *re-shoring* prove to be another, future *mea culpa*? See attached chart, courtesy of RSI President Patty Long's presentation. To be fair, it's not from an unbiased source, but still....
- Ag uncertainty persists despite Mexico buying pre-ban corn (“buy before you ban”). Otherwise exports are looking iffy and CY23 looks like a down year, at this point. The winter wheat crop isn't in good condition, the impact of the Ukraine war isn't as big as expected, Brazil's cropm looks huge, etc. On the positive side crop land is going for record amounts, even as crops seem to be staying in the bin....
- Preview of capex? The Railway Tie Association expects tie purchases to increase by 1.1% in 2023
- Those of you in greater Chicagoland on *December 13 come to my NUTC Annual Holiday Luncheon!*
- That is, if you're not heading to DC for *the coming STB hearings on UNP and their use of embargoes (27 in 2017 to over a thousand this year)....*
- The shift toward *passive investment funds* from active ones is another trend that accelerated during the Pandemic – from 23% of assets under management in 2019 to 29% August 2022. This has a big implication for *proxy* proposals – and fights.
- And as the WSJ points out, changes to proxy rules likely to embolden *activist* funds in 2023 and beyond.
- *Hub Group transitions from Yeager (Dave) to his son (Phil) as CEO on January 1* (having transitions from Phil (the founder) to Dave in 2012....

- After the shutdowns of the Ford/VW AV departments among other setbacks and delays, Bloomberg noted that the key phrase in the AV world these days is the “*trough of disillusionment*”!

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