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Union Pacific Corp. (UNP)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Union Pacific's First Quarter 2023 Conference Call. At this time, all participants are in a listen only mode. A brief question-and-answer session will follow the formal presentation. [Operator instructions] As a reminder, this conference is being recorded, and the slides for today's presentation are available on Union Pacific's website.

It is now my pleasure to introduce your host, Mr. Lance Fritz, Chairman, President and CEO for Union Pacific. Thank you. Mr. Fritz, you may begin.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

Thank you, Rob; and good morning, everyone, and welcome to Union Pacific's first quarter earnings conference call. With me today in Omaha are Kenny Rocker, Executive Vice President of Marketing and Sales; Eric Gehringer, Executive Vice President of Operations; and Jennifer Hamann, our Chief Financial Officer.

The story of the past quarter for Union Pacific is one of resiliency. Battling heavy snow, Arctic temperatures, flooding and tornadoes, the team maintained service levels and exited the quarter on a positive trajectory. Persevering through those harsh conditions, our employees delivered for our customers, which demonstrates again that our people are the foundation for the great things that lie ahead.

Turning to the first quarter results. This morning, Union Pacific is reporting 2023 first quarter net income of \$1.6 billion or \$2.67 per share. This compares to first quarter 2022 results of \$1.6 billion or \$2.57 per share. Our first quarter operating ratio of 62.1% deteriorated 270 basis points versus 2022, driven by excess costs, inflation and lower volumes.

A series of weather events throughout the quarter had a real impact on our ability to capture demand, especially within our coal business, as well as added costs to the network. Through those events, our service product showed greater and greater resiliency, quickly rebounding each time as we were better positioned with crew resources to support our customers. And with April month-to-date freight car velocity at about 200 miles per day, we are operating a network that is positioned for consistent and reliable service. While a more difficult start to the year than expected, it doesn't reduce our expectations for 2023. As you will hear from the team, all of our goals are still in front of us.

Let me turn it over to Kenny for an update on the business environment.

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

Thank you, Lance, and good morning. Freight revenue for the first quarter increased 4%, driven by higher fuel surcharges and solid pricing gains, partially offset by a 1% decline in volume. Bulk volumes were muted in the quarter as weather and service-related challenges impacted shipment. Additionally, weaker market conditions for premium also drove lower volumes for the first quarter. However, our strong focus on business development and new business wins partially offset by some of that decline.

Let's take a closer look at each of these business groups. Starting with Bulk. Revenue for the quarter was up 4% compared to last year, driven by a 7% increase in average revenue per car, reflecting higher fuel surcharges and solid core pricing gains. Volume was down 3% year-over-year.

Grain and grain products volume was down 1%, driven by weaker export grain shipments as world demand for US grain has softened coupled with drought impacts affecting supply in UP-served regions. Fertilizer carloads were flat in the quarter. Strong export potash was offset by a decline in phosphate volume from weather conditions delaying shipments.

Food and refrigerated volume was down 6% due to reduced beer imports and weather conditions negatively impacting both fresh and canned shipments. And lastly, coal and renewable volumes was down 4% compared to last year, driven by weather interruptions and associated service challenges that impacted our locomotive and crew resources.

Moving on to Industrial. Industrial revenue was up 5% for the quarter, driven by a 5% improvement in average revenue per car due to higher fuel surcharges and core pricing gains. Volume for the quarter was flat. Industrial chemicals and plastic volume was down 2% year-over-year, driven by lower industrial chemical shipment due to challenged industrial production and reduced housing demand. Metals and minerals volumes continue to deliver year-over-year growth. Volume was up 3% compared to last year, primarily driven by growth in construction materials and increased frac sand shipments along with new business development wins.

Forest products volume declined 19% year-over-year, driven by soft housing starts and lower corrugated box demand for nondurable good shipments. However, Energy and specialized shipments were up 6% versus last year, driven by strength in demand for LPG and petroleum products. These gains were partially offset by fewer soda ash shipments due to weather and service-related challenges.

Turning to Premium. Revenue for the quarter was up 3% on a 1% decrease in volume compared to last year. Average revenue per car increased by 5%, reflecting higher fuel surcharge revenue and core pricing gains. Automotive volumes were positively driven by strengthening OEM production and dealer inventory replenishment for finished vehicles. Domestic intermodal business wins were offset by a weak freight and parcel market, driven by high inventory, increased truck capacity and inflationary pressures. On the international side, despite weakened imports, more containers shipped inland versus the first quarter last year, resulting in year-over-year growth.

So now moving on to slide 7, here is our outlook for the rest of 2023 as we see it today. Starting with our bulk commodities, we expect grain to be challenged near term as export demand softens and supply tightens throughout this crop year. However, as we look ahead towards the next crop season in late fall, we are encouraged by the initial forecast. For coal, low natural gas prices and a milder winter allow utilities to build more inventory. We are experiencing normal softness through the shoulder months. Looking further out in the year, demand will largely be dependent on natural gas prices and summer weather. Lastly, we expect biofuel shipments of renewable diesel and their associated feedstock to grow due to solid market demand, new production coming online and business development wins.

Moving on to Industrial. The forecast for Industrial Production is to shrink in 2023 and the demand is getting weaker in forest products. However, we expect to see continued strength in construction and metal with new business wins.

And finally, for Premium. We expect near-term challenges in the intermodal market from high inventory levels, inflationary pressures and weak consumer spending as people shift back to spend more toward services than goods. We will be closely watching for a potential market uptick in the latter part of the year. In addition, we expect automotive growth to continue, driven by strong OEM production and dealer inventory replenishment.

So, to wrap up, we are facing economic uncertainty and a tough price environment in a few of our markets, but we expect to see strength in some other commodity areas. Our diverse portfolio allows us to maintain our pricing guidance. To capture more demand, we are working closely with Eric and his team to be agile and have resources available in locations where we need them. I am confident that the team's relentless focus on business development will drive volumes to exceed Industrial Production this year.

With that, I'll turn it over to Eric to review our operational performance.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

Thank you, Kenny, and good morning. Starting on slide 9, we continue to make great strides on safety, as evidenced by our 10% improvement in derailment performance for the first quarter. While encouraging progress on safety, our goal remains a future with zero incidents and zero injuries. We've made progress on derailments by implementing state-of-the-art technology like Precision Train Builder and our geometry inspection fleet. This is on top of our network of more than 7,000 wayside detection devices and our 24/7 Operating Practices Command Center.

Further supporting our efforts, in March, the industry announced a set of key safety actions. These include the installation of additional wayside detectors and enhanced standards for how we proactively use and share critical data. In addition, the industry is expanding efforts in first responder training and deploying technology to provide real-time railcar condition monitoring. The railroad industry remains one of the safest transportation modes in the nation. And through our capital renewal program, Union Pacific invest almost \$2 billion annually back into its network to further improve safety.

Now moving to slide 10 for a look at our current operational performance. As Lance mentioned, Mother Nature made her presence felt across the Union Pacific network this season, bringing extreme weather in many forms. UP crews in California battled flash flooding, persistent mudslides and heavy snow. The Central Sierras, for example, recorded over 700 inches of snow this season. That's 222% above historical averages. Employees across our Central Corridor and Upper Midwest portions of our system also worked through prolonged blizzards, ice and Arctic temperatures. These events challenged our ability to maintain a fluid operating state on specific portions of the system. However, thanks to the dedication and proactive efforts of our employees, the network quickly recovered after each event.

And as the chart on slide 10 demonstrates, we're exiting the quarter on a positive trajectory versus the congested state we were entering this time last year. Our April month-to-date metrics show a network in a healthier state with freight car velocity at 200 miles per day, intermodal TPC in the high 70s, and manifest TPC on the rise as well. That result also reflects our hiring efforts as we focus on backfilling attrition and targeting locations where crew challenges persist. We currently have around 1,000 employees in training, which is an increase of approximately 500 versus last year. In addition, we have utilized borrowed-out employees to address hard-to-hire locations and get crews where needed.

Now let's review our key performance metrics for the quarter starting on slide 11. Sequentially, we held our ground through the obstacles of the quarter. Both freight car velocity and manifest and auto trip plan compliance

made slight improvements from last quarter's results. Intermodal trip plan compliance remained effectively flat as we battled resource imbalances driven by weather interruptions. With our current traffic mix, freight car velocity consistently running around 200 to 205 miles per day will strengthen our entire service product, including bulk, manifest and intermodal performance.

Turning to slide 12 to review our network efficiency metrics. Locomotive productivity dropped 5% versus first quarter 2022. However, it remained flat sequentially from last quarter's results as we continue to operate a larger locomotive fleet in an effort to support the recovery of the network. In the second quarter, the team is focused on moving more freight and rightsizing the fleet. To that point, we are in the process of storing over 100 units to at-the-ready status.

First quarter workforce productivity declined 6% to 991 daily miles per FTE, driven by an increased number of trainees and lower volumes. Our strong training pipeline supports our ability to capture available demand and future growth while managing attrition and reducing borrowed-out employees. As employees graduate from training, we expect productivity to improve.

Train length is effectively flat compared to last quarter's results. Lower intermodal traffic coupled with extreme cold temperatures across the northern tier of our network presented a headwind to our train length initiatives for the quarter. The team remains committed to strengthening the network while recovering lost productivity.

Wrapping up on slide 13. The success drivers for 2023 remain unchanged, and the entire team is dedicated to building on the momentum gained as we exited the quarter. We remain committed to addressing employees' quality of life feedback and are pleased with the recent agreements regarding paid sick leave. We will continue to work diligently in finding win-win solutions that enable a strong service product and provide our employees with more consistent work schedules.

In addition, as you heard from Kenny, we continue to aggressively look for opportunities to strengthen volumes. With the service product demonstrating resiliency, we have added back train sets and targeted freight cars to the network to capture available demand. I am confident that the foundation we're laying will provide a safer, more consistent and reliable service product to meet the growth needs of our customers.

With that, I will turn it over to Jennifer to review our financial performance.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

Thanks, Eric, and good morning. We'll start on slide 15 with a look at our first quarter income statement. Operating revenue totaled \$6.1 billion, up 3% versus 2022, despite a 1% year-over-year volume decline. Other revenue decreased 5%, driven by \$30 million of increased subsidiary revenue, which was more than offset by a \$50 million reduction in accessories. Lower intermodal volume and greater supply chain fluidity drove the accessory decline.

Operating expense increased 8% to \$3.8 billion, resulting in first quarter operating income of \$2.3 billion, down 3% versus last year. Below the line other income increased \$137 million year-over-year, largely driven by a \$107 million one-time real estate transaction that contributed \$0.14 to earnings per share. Interest expense increased 9%, reflecting higher debt levels.

Net income of \$1.6 billion was flat versus 2022, but when combined with share repurchases resulted in a 4% increase in earnings per share to \$2.67. Our first quarter operating ratio increased 2.7 points to 62.1%. Falling

fuel prices during the quarter and the lag on our fuel surcharge programs positively impacted our operating ratio by 190 basis points. Core results offset the fuel benefit and were a 460 basis point drag to operating ratio. Included in that is the impact of weather, which is difficult to quantify, but between both lost revenue and additional expense, we estimate to be in excess of \$50 million.

Now looking more closely at first quarter revenue, slide 16 provides a breakdown of our freight revenue, which totaled \$5.7 billion, up 4% versus last year. Lower year-over-year volume reduced revenue 150 basis points. Total fuel surcharge revenue of \$883 million added 475 basis points to freight revenue, reflecting the lag in our programs. The combination of price and mix increased freight revenue 75 basis points as ongoing pricing actions were mostly offset by our business mix. Fewer lumber shipments and more short-haul rock shipments were the primary drivers of the negative mix.

Turning now to slide 17 and a summary of our first quarter operating expenses, which totaled \$3.8 billion. Compensation and benefits expense increased 7% versus 2022. First quarter workforce levels increased 4% with transportation employees up 5%, the result of our dedicated hiring efforts over the last 12 to 15 months. Cost per employee only increased 3% in the quarter as wage inflation was partially offset by a larger training pipeline.

During the first quarter, we signed agreements with the majority of our labor unions to provide paid sick leave to our employees. These agreements became effective April 1 and represent just under half of our craft professionals. Assuming we are able to reach agreements across the board, we would expect cost per employee to be up mid-single-digits for the year, consistent with what we discussed in January.

Fuel expense grew 7% on a 9% increase in fuel prices as we moved less freight. Our fuel consumption rate deteriorated 1% as the impact of our fuel conservation efforts was more than offset by reduced network fluidity. Purchased services and materials expense increased 16%, driven by maintenance of a 3% larger active locomotive fleet and inflation. Equipment and other rents was up 9% as a result of increased car hire expense related to elevated cycle times. And the other expense line grew 6% related primarily to higher environmental remediation costs.

Turning to slide 18 and our cash flows. Cash from operations in the first quarter decreased to \$1.8 billion from \$2.2 billion in 2022. The primary driver was Presidential Emergency Board back-pay settlements paid in January, which totaled \$383 million. That payment also impacted our quarterly cash flow conversion rate and free cash flow, with both roughly in line with last year's performance when you exclude that payment. In the quarter, we returned \$1.4 billion to shareholders through dividends and share repurchases, and we finished the first quarter with an adjusted debt to EBITDA ratio of 2.9 times, as we continue to be A rated by our three credit agencies.

Wrapping up on slide 19. We are maintaining our 2023 full year guidance: to achieve volumes above Industrial Production; price gains in excess of inflation; and operating ratio improvement. Our plans for capital allocation also are unchanged. As with every year, there are puts and takes to how the year plays out. While 2023 started a bit slower than expected, I need to remind everyone it is only April 20. We have 8.5 months in front of us and many opportunities with volume, service, and productivity.

Before I turn it back to Lance, I would like to express my thanks to the UP team. We are skilled in running the outdoor factory that is our railroad, but Mother Nature seem very focus on testing those skills this year given the extremes we face and yet, the team forged ahead, keeping the network fluid and our customers served. Fantastic work by everyone.

With that, I will turn it back to Lance.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

And thank you, Jennifer. As Eric discussed, we continue to make great strides on safety. Derailments have been in the spotlight recently. The entire industry understands the critical role we play in support of the communities we serve. In fact, since 2000, Union Pacific's mainline derailments are down almost 30%, helping make this past decade the safest for the rail industry. Working collaboratively and proactively, the industry can further improve on that safety record.

Looking forward, as you heard from Kenny, consumer-facing markets are in rough shape right now. Importantly, though, there remain opportunities to capture additional demand in a number of markets. The entire team is executing a plan to capture those additional carloads, supported by an improved service product.

Finally, with Earth Day approaching, I'd like to highlight the actions Union Pacific is taking to protect our planet. At the end of 2022, we released our second annual climate action plan, highlighting updates to achieve our greenhouse gas emission reductions targets. This includes our goal of net zero emissions by 2050.

Over the past year, we've turbocharged our locomotive modernization program, we've committed to both battery and hybrid electric locomotive, and we've increased our biodiesel blend to over 5%. And we're being recognized for that work. This past year, Union Pacific was selected as a member of the Dow Jones Sustainability Index for the first time, and we were the highest ranked railroad in the transportation category on Fortune's Most Admired Companies. Union Pacific is committed to being a sustainability leader, driving long-term value for all of our stakeholders.

Before turning to Q&A, as it relates to the CEO search process, the board is fully engaged and executing its duty to identify the next leader. And I can say from personal experience, what a wonderful job it is to be at the helm of a company like Union Pacific. I'll continue to lead the team until the new CEO is identified, and I'm energized by what we can accomplish in the coming months as well as the great potential this company has for years into the future.

With that, let's open up the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting the question-and-answer session. [Operator Instructions] Thank you. And our first question today comes from the line of Scott Group with Wolfe Research. Please proceed your question.

Scott H. Group

Analyst, Wolfe Research LLC

Q

Hey thanks. Good morning. Lance, any timing on CEO search and any thoughts on what you and the board are looking for? And then, Jennifer, margins down 270 basis points. Obviously, we need some nice improvement the rest of the year to get to full year improvement. Can you help us – bridge us to that full year improvement? And any thoughts on second quarter? It's an easier comp. Do you think margins inflect positive in Q2? Just any thoughts. Thank you, guys.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Yeah. Thank you, Scott. So I'll just circle back to the press release that the board sent when they announced earlier in the year that we were in the process of identifying a new CEO. They were clear on what they were looking for then, right, a track record and experience in safety and customer service, business development, a clear vision on culture, and good operating experience. So they are crystal clear on what they're searching for. And the only update I have for you is we're using an excellent third-party external consultant, and they're being very thorough in their search, which is underway.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

So then, Scott, to your OR question, I mean, you're exactly right. We need to make sequential improvement through the year, and then that needs to become year-over-year improvement at some point for us to be able to meet that guidance. The factors that are going to help drive that, certainly fuel is something that is looking different to us this year than it did last year. Particularly, right now, you saw the 1.9 points that it benefited our OR in the first quarter. That comparison will get a little tougher in the back half, so it may look different than 2022 did. But certainly fuel I think is something.

But then it's the main levers that you know that we have available to us is volume, price and productivity. And of course, volume – it depends a little bit what that is, but we also have pure cost control. So if volumes are something that are not our friend and we are not able to get that leverage, we also have the ability to control costs through being very careful and diligent in our management.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

And Jennifer, one last thing, what gives us a ton of confidence as we look into the year is how the network is operating right now. It's in a place where we can get the volume and we can squeeze out the excess costs.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

Absolutely.

Operator: Thank you. Our next question comes from the line of Tom Wadewitz with UBS. Please proceed with your question.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Yeah. Good morning. Wanted to ask you about the head count level. I think the training pipeline for [ph] T&E (00:25:23) looks like it's larger, but I think that the level of people that you had that are training on the system seems like it's been static for a while. And so I'm just wondering what do you think about in terms of where you need to get for TE&Y that are trained in on the system. And I guess, in terms of attrition, has attrition been an ongoing problem? Has that stabilized? Just thinking about that head count dynamic and then, I guess, how that fits into how you would expect network performance to go from where we are? Thank you.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Yeah. So, Tom, we entered the year saying total head count hires addition to the TE&Y would look kind of like what it did in 2022 predicated on our plan for volume. Volume is looking a little cloudy right now to us certainly in the first quarter in the back half. And so, of course, that hiring plan is being looked at and adjusted. Net-net, in the second quarter, you're going to see us add to the active TE&Y head count coming out of the training pipeline. The question really is what's the training pipeline look like for the rest of the year. Having over 1,000 in the pipeline is a very strong pipeline for us.

In terms of attrition, we tend to have about a 10% turnover in our TE&Y workforce. That really hasn't changed over the course of the last five years. We don't necessarily see it changing right now. So one of the adjustment factors is if we find ourselves getting out over our skis a little too far, attrition can help us adjust pretty quickly.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

So, it sounds like – I guess, trained level goes up, but overall head count kind of static as the training pipeline comes down is maybe the best way to look at it.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

I think it really does depend on the volumes to a degree, Scott. And so certainly, as Lance said, second quarter I think you certainly see our total headcounts going up. It's going to be probably different than last year. First half – we've got the training pipeline loaded in the first half. I think the question is going to be what does the second half look like.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Yeah. Okay. Thank you.

Operator: Our next question is from the line of Ken Hoexter with Bank of America. Please proceed with your question.

Ken Hoexter

Analyst, BofA Securities, Inc.

Q

Hey great. Good morning. So just – it look like the operating on the service levels were flat. You mentioned that a couple times, I guess Eric did, but velocity really came down the past few weeks, I guess, during the quarter, and then more recently showed a pretty solid rebound, I guess, maybe the last week or two. Is there anything changing with the operating plan? Was this, I don't know if Eric or Lance you want to throw in some thoughts or was this just kind of the end of some of the weather stretches that you were talking about? Maybe just talking about how operations are doing now and what's changing. Thanks.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

Yeah. Ken, thanks for the question. Your summary is exactly accurate. It was towards the tail end of winter is really where we were about three weeks ago. Having come out of that with all the work that we've done on the hiring side is amongst other actions, you're seeing the output of having two to three weeks of that weather being that headwind. With weather largely, if not entirely behind us with winter, you suspect us, as our customers expect, to maintain where we are. We've reinforced that 200 to 205 miles per day is what drives our TPC metrics to the level our customers expect.

Ken Hoexter

Analyst, BofA Securities, Inc.

Q

Okay. Thanks, Eric.

Operator: The next question is from the line of Chris Wetherbee with Citigroup. Please proceed with your question.

Christian Wetherbee

Analyst, Citigroup Global Markets, Inc.

Q

Hey thanks. Good morning, guys. Maybe one quick follow-up on the head count point. I guess, I'm just curious given what you guys have been able to do with some degree of service recovery. Would you think about pausing sort of the hiring as you sort of reassess volumes depending on sort of how that plays out in the second half of the year? Curious about that. And then maybe on that point for Kenny, just in terms of like what you're seeing in the month of April. It seems like we've seen March and April be a little bit softer across the board of transports, not necessarily Union Pacific specifically, a little bit softness there. Kind of curious what you're hearing from the customers. Has there been a bit of a spring lull here or maybe that picks up in the near term? Just kind of some thoughts there would be helpful.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Hey good morning, Chris. This is Lance. I'll start and then turn it over to Kenny on your second question. So let's unpack the head count question a little bit. We are in much better shape this time this year versus same time last year. The hiring pipeline is full, but more importantly, we've been filling our classes everywhere we've been looking for people across the railroad for about the last three or four months. That is very different than our experience last year where we found it very difficult in about six crew hubs all in the northern region to be able to find candidly the workforce to be able to hire. So we've been much more aggressive in the back half of last year, amping up things like hiring bonuses, finding creative, unique ways to create a workforce, a pool to hire from, and that's paying dividends right now.

So you're exactly right in terms of, as we look into the year, right now, we're starting to evaluate our original plan for hiring versus what volumes are doing and what the back half of the year balance is going to look like. Our longer-term guidance remains in place, and that is we fully expect to be volume variable and have ultimately our head count grow at less than our volume numbers are growing. But clearly, coming out of last year, we had to fix the ship and get our crew boards healthy, add a little excess – not excess, add a little factor of safety to the crew boards so that we could take events and recover quickly so that our service product was consistent. And we're in that place right now. We're essentially there. We're solving some of the problem with borrow-outs. So hiring is going to have to replace them because they're expensive, and it's a burden on our employees to be borrowed-out. But we are in much better shape looking into the rest of the year.

Kenny?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. Hey Chris. So let's just start off. You look at our coal, we're expecting it to have a seasonal low this time, the shoulder months that I mentioned. If you look at it last year, natural gases prices were much higher, so this is more of a normal look for us. Domestic intermodal, we'll keep an eye on it. It's a very loose market right now. There's quite a bit of truck capacity that's out there, so we'll be watching that. And then also last year, if you look at it, our grain business was still pretty strong this time of year. Now we're seeing more global grain going to places where we exported last year. Now, having said all that, looking forward to the rest of the year, hey, we're still bullish about some of these markets that I mentioned, whether it's finished vehicles, the metals, rock that's in our construction area is one and then biofuels.

Christian Wetherbee

Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's helpful color. Appreciate the time, guys.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Yes.

Operator: The next question is from the line of Ben Nolan with Stifel. Please proceed with your question.

Benjamin Joel Nolan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Thank you. I appreciate it. Maybe, Kenny, if I could just follow up with that, we've been hearing a whole lot of noise about nearshoring/reshoring specifically around Mexico. I was curious if you can maybe put a little color around if that's something you're seeing, if there's any notable business wins or anything specific to the moving of manufacturing back to North America that you're hearing from your customers.

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

We are seeing a little bit of that. We've seen production related to the auto's OEM. There was one pretty large highly public announcement that came out. And with that, you got to remember there is a lot of other inputs that move by rail, whether it's soda ash for the glass, the metals that comes in for the car. That's great for us. Also, in

our bulk commodities on the ag side, we're expecting some new production and [indiscernible] (00:34:06). So, yes, it is looking pretty encouraging, and this is the first time that we're seeing tangible things that we can point towards. So, that's a positive for us. I won't go on and on. We enjoy a fabulous network there. I'll leave it at that.

Benjamin Joel Nolan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Just to clarify, how should we think about the timing of an impact on that? I mean, is this something that could happen near term or is this a big picture longer-term kind of a dynamic?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

This is big picture longer term. I mean, you've got to get time for these locations to actually build out the physical infrastructure there in the plants.

Benjamin Joel Nolan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Hey but – and, not but, Ben, it's wonderful to have new production facilities spot in the North American market. We will get our fair share. We have a wonderful franchise to and from Mexico, and any time industry shows up in the North American continent, it's good for us. It's good for railroads.

Benjamin Joel Nolan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. And I appreciate it. Thank you.

Operator: The next question is from the line of Justin Long with Stephens. Please proceed with your question.

Justin Long

Analyst, Stephens, Inc.

Q

Thanks and good morning. I wanted to circle back to the full year guidance. Obviously, the start of the year has been more challenging than you anticipated. So, in order to hit your outlook, do we need to see a meaningful positive inflection in the freight market? And if so, when does that need to occur? And then, Kenny, maybe just a clarification on intermodal. I think you said international volumes were up, but I was wondering if you could share the percent change you saw on both international and domestic intermodal. Thanks.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

So I'll take the first part of that question. Again, our guidance relative to volumes is exceeding Industrial Production. We came into the year, Industrial Production was forecast to be down about 0.5%. It's actually gotten a tad bit worse. It's now down about 0.7%. So that's not a huge [indiscernible] (00:36:11) to exceed. And, yes, we started a little weaker, down a point-and-a-half here in the first quarter. But you just heard Kenny talk about kind of the different markets that are available to us and the fact that, as our service product is improving, we're putting more assets into play to move more carloads. And that's giving us greater flexibility to move those assets around

to hit the markets that are available to us. And so, we feel quite confident that we will be able to reach that goal as it relates to volumes and the rest of our full year guidance, obviously, which we've reiterated.

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. I don't think I'm going to break out domestic and international here. But what we saw and I mentioned that is just because you do have a more fluid intermodal network on the international side, we don't have a lot of the stack boxes on either end. More of those ocean carriers are moving inland, and we're seeing that. We put in products up against that that's helping that with our grains facility down there. On the Dallas side, with the KTN, they hit their largest volume record in the first quarter. They just announced they're going to expand, and so we feel good about that that we can move more of that inland.

Justin Long

Analyst, Stephens, Inc.

Q

Okay. Thanks.

Operator: Our next question is from the line of Jordan Alliger with Goldman Sachs. Please proceed with your question.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Hi. Morning. Just sort of curious I think other than volume, you talked about other productivity or costs. Other than fuel expense maybe going down, what are some of the other cost levers that you could use to help drive OR to improve over the course of the year? Obviously, volume-dependent would be things like purchase transport. Just trying to get a sense. Thanks.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

That's a great question, Jordan. So, as you think about that and the progress we're seeing right now, it's impacting nearly every one of our cost lines in a positive way. The big ones that we talk about is certainly starting with fleet size. In our prepared comments, I mentioned the fact that we're taking 100 locomotives and then putting them in storage, but they're in a storage state in which they can still be there quickly to gain volume. Next after that, it's all about crew utilization, all right, which stretches everything from re-crew rates to deadhead heldaways to how do we think about over time and making sure that we're being judicious with the use of over time.

From there, we certainly do – even though you mentioned it, we do focus on our fuel consumption. And I'm really encouraged actually by the first quarter because if you look at January, we came out very strong. February was kind of okay, and March was certainly weak, which means with weather behind us, there's no reason that we shouldn't snap right back to that great progress that we saw in January.

So, it's those, others, but I've listed the biggest ones.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Our next question is from the line of Jason Seidl with TD Cowen. Please proceed with your question.

Jason H. Seidl

Analyst, Cowen & Co. LLC

Q

Hey thanks, operator. Good morning, everybody. Appreciate you taking the time. Two quick things. Kenny, I think you said there were some pricing pressures in a few of your industries. And I understand intermodal. Would love to hear what else is being pressured out there. And also, in terms of the West Coast port labor situation, how much freight do you think got diverted? And if we get a resolution here hopefully in the near term, do you think it would come back quickly or would take some time?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. So before I talk about domestic intermodal, which I think is your question, I just want to reiterate that we've got a broad, diverse set of customers and markets that we get the price. And we've said this publicly, call it, approximately roughly half of that business we get to touch every [ph] year (00:40:00) outside of just one particular market. Now there is a lag impact to that, but the sales leaders, the commercial teams have done a really fabulous job going out, articulating, hey, we're spending quite a bit in CapEx. We're putting quite a few resources out there. They understand what's taking place in the industry with our business on the labor side and the labor negotiations. And candidly, they are experiencing the same inflationary pressure. So you've got that piece.

Now talking about domestic intermodal. Yeah, domestic intermodal has been a pretty loose market, quite a bit of truck capacity that's there. We're seeing it in our bids and RFPs. We've got mechanisms that are in place for our suite of intermodal customers to go out there and compete and win business based on their own strengths and capabilities, which give us confidence. And the other part of that is the fact that, as the market tightens up, we can quickly capture that upside.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

And, Kenny, Jason's last question about the West Coast ports and ILWU?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. We've been in close contact with the West Coast ports, and they believe that there should be an agreement here near term. I'll tell you it's hard to quantify what's been diverted away because of some of these labor challenges. I'll tell you when we look at the order book going out to, I'll call it, the West Coast ports, it looks like the negative delta that we saw year-over-year is becoming less and less.

Jason H. Seidl

Analyst, Cowen & Co. LLC

Q

That's good. And you think if there was an agreement, again, knock on wood, because everyone wants that, that you would receive it back quickly or would come back over time?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

I think that's just – ii can't be that precise, Jason. We could be positive about it, but to be precise probably just wouldn't be a good idea.

Jason H. Seidl

Analyst, Cowen & Co. LLC

Q

All right. Sounds good. Appreciate the time, as always, guys.

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Thanks, Jason.

Operator: Our next question is from the line of Brian Ossenbeck with JPMorgan. Please proceed with your question.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

Hey good morning. Thanks for taking the question. Kenny, just to follow up on the pricing reset. Is that kind of going as expected? Do you still have a little bit more of a lag impact because volume's maybe a little bit weaker than you had thought? So, I guess, is that going to accelerate here? And same sort of question with price/mix. Is that probably the worst you would expect in the near term here as you look at the different end markets as they're developing?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. Certainly, the way we calculate price, volume increasing and improving helps us. So I'll say that. Also, because it is April and not December, we have time to get more of that volume into play as we move throughout the year. I would not say that there are some markets that are harder to capture [ph] price in (00:43:10) other than those areas where we have mechanisms in place aligned with domestic intermodal. We've been very disciplined in our approach to take price, and in some cases we've also taken some risks there to make sure that we're pricing towards the market.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

And, Kenny, what you said about domestic intermodal to a lesser degree is true in coal where you've got – natural gas can be a driver of some pricing.

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Absolutely. We'll be watching natural gas pretty closely.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

Yeah. And to the mix part of your question, Brian, coming into the year, our view was that mix would likely be negative throughout the year primarily around the fact that we were expecting to see more growth on the intermodal side. Obviously, that's changed a bit, and so looking to the second quarter at least, we're probably expecting a bit of a positive mix. Beyond that, I think it's too soon to say, but I do think that's something that is different as we sit here today than when we came and talked to you in January.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

Thank you. Just a quick follow-up for Lance on the regulatory and legislative side. A lot of noise coming out of DC, some of the safety things you mentioned earlier and some of the stats on UP specifically. But what are you most focused on when it comes to the different topics that are being discussed down there? We tend to focus on train lengths, which was obviously an FRA safety advisory recently, but I just wanted to hear what was important and what you thought we should focus on when it comes to the various topics being discussed after the safety issues that we have seen in the industry over the last few months. Thank you.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Yeah. Brian, that's a great question. So, in engaging the legislators in DC, we help them understand what would actually move the ball in terms of safety where regulatory effort would make a difference and where it wouldn't. To your point, train length wouldn't. Statistically on UP since 2019, train length is up something like 20% in our mainline and siding derailments are down 26%. So, there is zero corollary between train length and derailments. But there are other things that they can help with. We're taking action right now on wayside detection, that's a place where the FRA can step in. Things that we emphasize that really don't have a corollary impact, another one is crew size and whether conductors are redeployed to the ground. That has no impact on safety around the world empirically. So we just broadly try to help them understand that and stay deeply engaged, Brian. This is a deep engagement all the time right now.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

Thank you very much for the color. Appreciate it.

Operator: Our next question is from the line of Allison Poliniak with Wells Fargo. Please proceed with your question.

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities, LLC

Q

Hi. Good morning. I just want to ask on the new business. I guess, first, is there any way – I know there's a lot of moving parts with volumes, to maybe quantify or help us understand the contribution of the new business wins and volume? And then, second, as part of that, just in terms of the new business pipeline, any notable trends in sort of the conversion that you're seeing in terms of bringing on new business on to the rail? Thanks.

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. Hey Allison. It's pretty broad because obviously in all three of our business teams – I mean, if you look at it, biofuels, renewable diesel for us is an emerging market. Have been very encouraged by our ability to land new customers, new production sites to move out of the Midwest going into the West, and those are attractive margins to us. On the industrial side, the same thing is true. If we look at our metals business, some of the metals business tied to that. Same is with rock. Those are areas that are positive and they have structural increases related to population growth down in Texas, Louisiana and the Gulf, and so those are great.

And then you all are aware – you are aware, Allison, of some of the new recent wins in our intermodal sector and, again, we feel really blessed that we've got a fleet of highly capable customers that can go out and grow business [ph] over the row (00:47:43) and it complements very nicely our UMP – our UMAX and EMP products that we have in the marketplace.

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities, LLC

Q

Thanks. And just any color on the conversion trends of the new business opportunities out there?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

We see the pipeline is still there. Well, the thing that we are keeping an eye on is, are they actually moving the forecasted amount that they initially told us. So, no concerns with the pipeline, just a little bit of concern with making sure the volume that they committed to is still there.

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities, LLC

Q

Understood. Thank you.

Operator: Our next question is from line of Amit Mehrotra with Deutsche Bank. Please proceed with your question.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Q

Thanks, operator. Hi everyone. Jennifer, are earnings going to be up as you move from 1Q to 2Q? Because there's a big fuel benefit in the EPS line in 1Q and we calculate, it's like \$0.25 or something like that and a lot of that's going away because of the lag on fuel. And so, you're starting kind of [indiscernible] (00:48:50) to build back on as you move from 1Q to 2Q. I know there's weather, but I'm trying to understand the cadence of earnings growth from 1Q can actually grow in 2Q because of that operating income impact from fuel.

And then just related to that because volume seems to be the fulcrum for all of this, the average weekly volume in the quarter was 152,000, seven-day car loadings, and I think last week you did under that, and the weather is a lot better. And so, I guess, the question really is, is that like when are we going to see – if weather was a big problem in the quarter, you exited lower than you average for the quarter, when are we going to actually see some of the volumes show up in the weekly carloads? Thank you.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

Well, so let's start off on the fuel piece. And we agree with your math on the \$0.25 for the first quarter. That's exactly right. You have to think about fuel in two pieces and that you have to think about the fuel surcharge fees and then the expense piece. And while in the first quarter, the fuel surcharge piece was a positive. As we look what our current prices are for fuel right now, call it, \$3 a gallon, when we paid \$4 a gallon a year ago, that's going to flip on us. And so, that is going to have a different dynamic, but our fuel expense is going to be less as well. And so, you really have to think about it in those two parts and separate that out, I would say, in the analysis.

The other thing I want to remind everybody about 2Q of last year was we did have an \$0.18 benefit from a landfill Illinois Tollway, and that was within our results. And then we also had \$35 million extra in some casualty expenses, so that goes away. So you get some puts and takes there. I just want to make sure everybody's thinking of as you're putting that together. Our goal is going to be to continue to drive as much volume as we can across the network, do it as efficiently as we can, and improve the service product. And the output of that will be the output of that. I'm not going to give you specific earnings guidance on that.

And then to your other question about volumes, I think you need to factor in the Easter holiday. That does have an impact on our volumes. And so while, yes, weather was clearing, we did have a holiday impact there. And I think, again, we're putting the assets into place, and we're going to be moving the volumes that are available to us.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Yeah. I'm confident...

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Q

Got it.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

[indiscernible] (00:51:15) talking about in reported numbers this week and beyond.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. That's great. And just related to that, Kenny, I don't know if you have a view on intermodal yields. I know fuel, there's a lot of noise in intermodal yields in fuel. But are we holding the line on intermodal yields ex-fuel? And is that the expectation kind of over the next few quarters?

Kenny G. Rocker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

Yeah. And I said that, Amit, we feel really good about the mechanisms we have in place for our customers to go out there and compete and win and retain business based on their capabilities and their strengths. And I also feel good about, again, as the markets move that we'll be able to move more real time with it. And so, that's a positive for us.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Okay. Thank you very much. Appreciate it.

Operator: Our next question is from line of Jon Chappell with Evercore ISI. Please proceed with your question.

Jonathan Chappell

Analyst, Evercore ISI

Q

Thank you. Good morning. Eric, I want to go back to the productivity, which I seem to go back to every quarter. But just as it relates to getting to these full year targets, one of your peers has kind of laid out what a fluid network could mean from a cost perspective. So, is there any way for you to quantify what you think the productivity improvements can contribute in the final three quarters of 2023 and also any way for us to kind of understand the timing? You're still digging out of the weather mostly. They're still taking people out of training. Is this like 90% second half productivity improvement type story or can you start to get some significant improvement in 2Q?

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

Hi Jon. Thank you for the question. Obviously, we won't guide you to the specifics on the timing of the productivity. What I would reinforce is that based on the performance that we see on the railroad right now, it's bringing me and others greater and greater confidence that we'll see that productivity continue to grow throughout the rest of the year. To say, as you look into the second quarter, the headwind of winter behind us and the forecast of being able to grow the volume, that's what's going to drive that. Beyond that, I'm not going to guide to it. We're just now focused on making sure that we drive that productivity safely.

Jonathan Chappell

Analyst, Evercore ISI

Q

Any just broad range of numbers? I mean, if we go back to the Investor Day, any starting point there? Any way to kind of parse that out even in a broad range?

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

No. Jon, I think that'd be unwise for us to do that. We are not going to try to pace our productivity improvement, and so we want to do that as fast as we can, as safely as we can while providing a really good service product so that we can ultimately drive greater volumes across the network. That's the real leverage and it fuels the productivity quite frankly.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Yeah. Hey Jon. This is Lance. So just putting a bow on that, our expectation is in Q2 with a fluid network, we really squeeze out a bunch of the excess cost created by kind of weather and variability from those events, and then we start stretching our legs beyond Q2 to continue to recover some of the productivity and ultimately all of the productivity that we [ph] forewent (00:54:32) in 2022 and then start growing from there. We've got a fair amount of inflation that's in front of us that we got to offset this year and going into next year. So we're going to be fighting that battle through the whole year as well.

Jonathan Chappell

Analyst, Evercore ISI

Q

Got it. Thanks, Jennifer and Eric.

Operator: Thank you. In the interest of time so we can accommodate as many analysts as possible, we'd ask everyone to please limit themselves to one question. Thank you. And the next question comes from the line of Ravi Shanker with Morgan Stanley. Please proceed with your question.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Good morning, everyone. So, two regular follow-ups here. One is I know mix was a headwind in the first quarter, but can you confirm that dollar price was above dollar inflation in the first quarter? And if not, kind of how does that trajectory change the rest of the year? And second, if you're going to have a pretty significant inflection volumes currently running down 2.5% year-to-date and if we get to better than down 0.7% for your full year guide, what macro assumption does that involve for the second half of the year? Are you counting on an improvement in macro conditions and/or a restock to get you there? Thank you.

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

A

So I'll hit the first part of your question and, yes, our pricing gains in the first quarter did exceed our inflation. Kenny?

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

I'll hit the second. In terms of macro assumptions, we do not have planned in a recession, right. So, a recession would be a problem for us. Absent that, what we need is markets to continue to just behave reasonably, i.e., we need consumers to continue to be healthy, spend some. They don't have to go crazy, they just need to not pull in their horns, and we need the industrial economy to continue to do what it's doing. And we need inventory and this whole destocking to calm down after the first quarter or first half. All of those I think are pretty reasonable expectations. The wild card would be a recession.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: Our next question is from the line of Brandon Oglenski with Barclays. Please proceed with your question.

Brandon R. Oglenski

Analyst, Barclays Capital, Inc.

Q

Hey. Good morning. My one question for Lance or Eric, your trip plan compliance on manifest remains in like the low 60% level. And I know there's definitional issues, but there are carriers out there delivering much higher than that. So I wonder – we've talked a lot about service product on this call today. What's the right target for trip plan compliance and what are the steps to get there?

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

Yeah. So, to focus in on the manifest and auto, when that starts with the 7, so 70%, 75%, that's in a place where our customers are giving us feedback that says we are meeting their expectations. Now, as far as steps to get

there, you're going to always have manifest and auto lag the intermodal TPC, and it's simply because the cycle time of those cars is longer. It's a conversation we were just having the last two weeks to make sure that we are doing those actions. So when you look at the velocity picking up, that's a tailwind to it. When you look at our [ph] uses counts (00:57:52) which means that we are making connections in the terminals to the right trains, that's up. Just those two things alone drive TPC in the right direction. And we are driving that as fast as we possibly can because we want to send the message to our customers that we understand first quarter was difficult, but we are in a better place now and it's for their benefit and ours.

Brandon R. Oglenski

Analyst, Barclays Capital, Inc.

Thank you.

Q

Operator: The next question is from the line of Walter Spracklin with RBC. Please proceed with your question.

Walter Spracklin

Analyst, RBC Capital Markets

Yeah. Thanks very much. Just want to come back to service levels and the regulatory spotlight. Clearly, the whole industry, Union Pacific included, is under a bit of a spotlight from the regulator for the service issues. And when I look back historically, whenever a railroad is needed to promptly address a service issue, operating metrics almost always deteriorate rather than improve. So I don't know if this is best for Jennifer, but I want to come back to that question about, are you expecting an OR improvement as early as Q2 based on what you're seeing now? I know you said you saw some pretty good exit trends in Q1. Whether it's behind you? Easter was more of a – it was more of a numbers event or a year-over-year numbers event as opposed to anything fundamental. So, would you see yourself as on track to achieve Q2 improvement despite your efforts to address service and that that Q2 improvement should continue through the rest of the year?

Q

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

Yeah. Walter, I'm going to resist the temptation to give you 2Q guidance and stick with the full year guidance, but you all can do the math. I mean, we have to make improvement quickly, and it's got to be sequential. And at some point, obviously, that has to be year-over-year, and that is our focus and that is our intent, and we're very confident that we will do that.

A

Walter Spracklin

Analyst, RBC Capital Markets

Okay. And barring that, then perhaps your full year is at risk if you can't see that quickly – the quick turnaround that you're mentioning, Jennifer, is that fair?

Q

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

The longer you go into the year without improvement, it gets more difficult, yes. So I'll agree with that.

A

Walter Spracklin

Analyst, RBC Capital Markets

Okay. All right. Okay. Thank you very much for the time. Appreciate it.

Q

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

Thank you, Walter.

A

Operator: Our next question is from the line of Bascome Majors with Susquehanna. Please proceed with your question.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Thanks for taking my questions. Can you talk a little bit about how your relationships and engagement with the STB has evolved over the last few months? And any expectations of how they'll extend the service period – sorry, the service oversight period [indiscernible] (01:00:21) expires in a few weeks here. And maybe walk in that forward next 12 to 18 months, where do you think their eyes will be most focused? And how do you engage with them as the CPKC deals stop sucking up oxygen in that room? Thank you.

Q

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

Thank you for the question, Bascome. So we are deeply engaged with the STB. There is an executive level interaction with an STB either staff or member virtually every day, certainly several a week. What is helping in those conversations right now is demonstrably the service product is better and customers' temperatures are down. The other thing, if you recall, late last year, there was a hearing at the STB that focused on Union Pacific in our use of embargoes. And we, to the STB and to our customers more importantly, made the commitment that we're going to both look at how we use embargoes and have an eye towards essentially getting back to a place where they're rare. Year-to-date, this year, 65% reduction in the use; in the last two months, 75% reduction as the railroad is getting better. And I have all the confidence in the world that kind of progress is going to continue.

A

So what I expect at this point, the STB is a bit of a wild card. I won't predict what they do in May as regards to the service reporting period. But I know the overall industry, and certainly Union Pacific, is in a place where our service product is not prompting more scrutiny and significant temperature coming into the STB from customers. And that's their purview. That's what they're built for, is to react to customer feedback, and that's what they've done in 2022. So the fact that if we can get customers to a place where they're satisfied with the service product and in good dialogue with us on it, that takes a lot of the pressure off the STB.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Thank you for that. And maybe the longer-term part of that question, over the next 12 to 18 months, where do you think they will focus most? And how do you make sure that your shareholders and customers' interest are protected there? Thank you.

Q

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

Yeah, Bascome. So what we keep an eye on is the fulsome docket that they've got in front of them, things like final offer rate review versus this alternative dispute resolution mechanism, forced open access, the use of revenue adequacy as a rate-setting mechanism. Those are things that we're working hard with the STB for them to understand what the ramifications of some of those decision points are, what is and is not justifiable by data in fact. And then, of course, we engage fulsomely with them to help make sure the regulation coming out of the STB

A

makes sense and accomplishes what they're trying to accomplish, which is very good service product and growth in the rail industry.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Thank you.

Q

Operator: Your next question is from the line of Ari Rosa with Credit Suisse. Please proceed with your question.

Ariel Rosa

Analyst, Credit Suisse Securities (USA) LLC

Great. Thank you. Good morning. So really quickly, I was wondering what was the real estate transaction? Maybe you could give a bit of color on that. I don't think we saw it. And then, Lance, as you approach perhaps the final months, perhaps quarters of your time as CEO at UP, I was hoping you could just kind of take a bigger picture, step back and reflect on what are the accomplishments you're most proud of and how you think about where you'd like to see the future of the railroad go from here. And in particular, I was hoping you could touch on your thoughts on the ability of UP to grow volume and take share over the next 5 or 10 years. Thanks.

Q

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

Yeah. In terms of the real estate transaction, Ari, it was a fiber-optics deal.

A

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

And Ari, thank you very much for the question and the opportunity to reflect just a moment. If I look back over the last eight years, now working on year nine, the things I'm most proud of is what we of a team have accomplished in terms of moving our transportation plan to a PSR model, doing that over the course of the last four years and doing it in a way where our customers weren't damaged by the transition, they were benefited from it.

A

I think we've done stupendous work on sustainability, as I mentioned in my opening comments. We've done terrific work on diversity, equity and inclusion. We're recognized for that right now in the industry and in our communities. We've done really good work on setting ourselves up to be able to grow. We've got a wonderful stable of partners, IMCs, that are world-class in [ph] HUB (01:05:34), in Schneider and Knight-Swift and XPO in its current form. So I am really, really pleased with that.

As I look into the future, we are poised to be able to grow. We have to be consistent and reliable in our service product. That means we have to get our five critical resources right all the time. We got one of them wrong last year, part our issue and part the fact that the world blew up to a degree. But we have to be stable and consistent for our customers. They tell us they want that, and they will grow with us as we deliver that.

So I know the growth potential is there. Their supply chains want to use rail more, and the concept is really simple and straightforward. It's in our strategy: serve with consistent reliable service; grow with service product and products that meet our customers' needs; do that in a way where we are the provider of choice, the partner of choice that allows us to win in the marketplace; and do it together with all four of our stakeholders being benefited from it. We think the strategy is sound, and we're ready and executing on it.

Ariel Rosa

Analyst, Credit Suisse Securities (USA) LLC

Great. Thank you. And congratulations.

Q

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

Thanks, Ari.

A

Operator: Our next question is from line of David Vernon with Bernstein. Please proceed with your question.

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

Hey good morning. Jennifer, a couple questions for you. Within the guidance that you're giving for a full year OR improvement, is that all just the mechanics of fuel or is there some improvement in the underlying business? And then, as you think about costs from 2022 to 2023 on a full year basis, can you give us some sort of absolute numbers around inflation and what added cost is being put in there for PTO and additional enhancements to the compensation package?

Q

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

So, in terms of our inflation guide, we said 4% with our inflation guide for 2023. And we said on the employee side, the comp for employee would be up mid-single-digits. And those things still hold, and that takes into account what we have negotiated for and plan to negotiate for in terms of paid sick leave. In terms of how we're going to get there and how we're going to improve, it really is the basis for the service product, the pricing. Fuel will be a component. I mean, it obviously is a component in there, but we have the other levers and that's where we're very much focused. Fuel is going to be what it's going to be. We're going to go after those items that we have the greater control over. That's winning new business, pricing it appropriately, and moving it efficiently.

A

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

All right. And then maybe, Eric, just as a quick follow-up. As you think about the FTE count for the full year, where are you sort of targeting the business to be at year-end 2023?

Q

Jennifer L. Hamann

Executive Vice President & Chief Financial Officer, Union Pacific Corp.

I think Lance already answered that question. Our hiring levels for this year are roughly – we came into the year assuming that they were going to be roughly similar to last year. Attrition is roughly similar. In terms of what happens in the back half, we're really watching that from a volume standpoint.

A

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

Okay. Thank you.

Q

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Thank you [indiscernible] (01:09:00).

Operator: Thank you. Our final question today is from the line of Jairam Nathan with Daiwa. Please proceed with your question.

Jairam Nathan

Analyst, Daiwa Capital Markets America, Inc.

Q

Hi. Thanks for squeezing me in. I just had a question on the EV penetration. And does UP need to make investments given the fire risk of batteries within EVs?

Kenny G. Rucker

Executive Vice President-Marketing & Sales, Union Pacific Corp.

A

I'll say that we have not seen that risk right now. We have very close relationship with the EV leaders. We've enjoyed growth there. Our ramps are prepared to handle those EVs. And then we're looking at the forecasts and the size and then what we need to do, if anything, from an investment perspective and make sure that we can efficiently move those off and on the ramps and do it safely.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Jairam, I think fundamentally the answer is we've not seen a shift in risk based on our shipments of EVs.

Jairam Nathan

Analyst, Daiwa Capital Markets America, Inc.

Q

Okay. Great. Thank you.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Thank you.

Operator: Thank you. There are no further questions at this time. And I would like to turn the floor back over to Mr. Lance Fritz for closing comments.

Lance M. Fritz

Chairman, President & Chief Executive Officer, Union Pacific Corp.

Thank you, Rob, and thank you all for joining us today and for your questions. We're looking forward to talking with our owners again in May at our Annual Meeting. Until then, take care.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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