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Union Pacific Corp. (UNP)

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to Union Pacific Fourth Quarter 2022 Conference Call. At this time, all participants are in 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. Mr. Fritz. You may now begin.

Lance M. Fritz

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

Thank you, Rob, and good morning, and welcome to Union Pacific's fourth 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 fourth quarter and 2022 overall were challenging for Union Pacific and our employees. The lengthy labor negotiations tested our workforce, while customers felt the impact of our service issues. Two things are critically important as we turn the page to 2023.

First, is the trend line of improving freight car velocity since late summer, although acknowledging there were bumps along the way. And second, is how we move forward, establishing consistent service for our customers, day in and day out and demonstrating to all stakeholders, our commitment to excellence.

Now, turning to our fourth quarter results. This morning, Union Pacific is reporting 2022 fourth quarter net income of \$1.6 billion or \$2.67 per share. This compares to fourth quarter 2021 results of \$1.7 billion or \$2.66 per share. Our fourth quarter operating ratio of 61% deteriorated 360 basis points versus 2021, driven by continued service challenges and the impact from winter weather.

For the full year, reported operating ratio finished at 60.1%, deteriorating 290 basis points, driven by operational inefficiency, inflation and higher fuel prices.

The entire Union Pacific team recognizes that 2022 did not meet expectations. Crew constraints in critical locations, impacted by shifting demand, had a real impact on our performance.

As you'll hear from Eric, we are building resiliency into the network through hiring efforts, shipping critical resources and better operations to address that shortfall. And you're seeing those benefits manifested in how the network has responded since Thanksgiving, through the ups and downs of extreme winter weather.

These challenges aside, we achieved volume growth for the year. We demonstrated our commitment to meet customer needs with business development wins that are critical to long-term financial success. The recent onboarding of Schneider is a great proof statement of delivering on that commitment. We also made significant progress towards our climate goals.

In 2022, we increased our biofuel blend to over 4.5% on pace to achieve our 2030 target of 20%. This is a key initiative in achieving our 2030 greenhouse gas emission reduction targets.

In addition, for a fourth consecutive year, we improved our fuel consumption rate on a year-over-year basis, lowering it 1% to an all-time record. This helped our customers avoid 23.4 million metric tons of greenhouse gas emissions by using rail versus truck. Union Pacific will continue to be a rail leader in sustainability.

Now, let's start with 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. Fourth quarter volume was up 1% compared to 2021. Gains in our premium business group were partially offset by a decline in our Bulk area. However, freight revenue was up 9%, driven by higher fuel surcharges and strong price.

Let's take a closer look at each of these business groups. Starting with Bulk, revenue for the quarter was up 7% compared to 2021, driven by a 10% 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 2%, driven by a decrease in export grain shipments. Despite strong market demand, we faced service and weather challenges that slow shuttle cycle times as well as having a tough 2021 comparable.

Fertilizer carloads were down 15% year-over-year driven by reduced shipments of potash due to market softness along with another tough comp, the 2021 fourth quarter. Food and refrigerated volume was down 8% due to reduced shipments of finished beverage products and their associated raw materials.

And lastly, coal and renewable carloads remained flat in the quarter as our ability to capture demand from favorable natural gas prices was impacted by weather and service challenges, particularly in late December.

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 somewhat offset by a negative business mix. Volume for the quarter was flat.

Industrial chemicals and plastic shipments were down 4% year-over-year, driven by lower industrial chemicals demand. Metals and minerals volumes continued to deliver robust year-over-year growth, driven in part by our business development efforts.

Volume was up 8% compared to 2021, primarily driven by an increase in frac sand shipments and growth in construction materials. Forest products volume declined 17% year-over-year, driven by weak corrugated box demand and softness in the housing market.

Energy and specialized shipments were up 2% compared to 2021, driven by an increased waste and soda ash demand, partially offset by pure petroleum shipments from regulatory changes in Mexico markets.

Turning to Premium. Revenue for the quarter was up 15% on a 3% increase in volume. Average revenue per car increased 12%, due primarily to higher fuel surcharge revenue and core pricing gains.

Automotive volume was up 9%, driven by strengthening production and inventory replenishment for finished vehicles. Intermodal volume was up 2%, driven by increased international shipments, mainly due to an easier comp in 2021.

Although domestic volumes decreased due to soft market demand, declining truck rates and increased over the roll capacity. The aforementioned negative impact was partially offset with the Schneider conversion in December.

Now as we look ahead to 2023, you can see the macro indicators that we are watching along with inflation and interest rates. And you'll notice that we have some challenges with industrial production, imports and housing starts. However, we remain optimistic that we will beat industrial production with our strong focus on business development.

So, now moving on to slide 8. Here is our market outlook for 2023 as we sit here today. Starting with our bulk commodities, we expect a challenging year for grain based on drought conditions, which will affect crop availability in UP served origin.

However, we expect to see growth in coal, even though natural gas prices have come off their highs, low inventories will support continued demand. We are keeping a close eye on natural gas prices given the price impact of our indexed-base contracts.

In addition, we expect biofuel shipments for renewable diesel to continue to grow due to solid market demand, new production facilities coming online and business development wins.

Moving on to Industrial, the forecast for industrial production is to shrink slightly in 2023 and the demand softening in forest products. However, we expect to see continued strength in metals with new business wins.

And lastly for Premium, we expect the entire intermodal market to be challenged, both international and domestic by high inventory levels, lower truck rates and tempered consumer spending.

We expect to outperform that market, however, through our new business with Schneider as well as opportunities to grow with other private asset owners and our strong IMC partners. We expect automotive growth to be another bright spot in this segment driven by production strength and inventory replenishment.

As I wrap up my comments, I want to take a moment to express my gratitude to our customers and the operating team. Over the past month, extreme weather events impacted large portions of our network. And I want to thank our employees who safely work around the clock in harsh conditions to keep the railroad running for our customers.

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

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

Thanks, Kenny, and good morning. Starting on slide 10. Safety is at the foundation of everything we do. We have enhanced our training programs and are working to solidify our safety culture through ownership and personal accountability. These efforts drove an 18% improvement in our 2022 full year personal injury safety results, which is at the lowest level in five years.

We look to leverage these gains to improve the derailment performance in 2023. While good progress overall, our goal remains returning each employee home safely at the end of the day.

Moving now to slide 11 for a look at our current operational performance. Our attention throughout 2022 was focused on onboarding the necessary crew resources to operate a fluid network and meet customer demand. I would like to thank our partners and workforce resources and the operating team for their great work in recruiting and onboarding new team members.

We currently have around 600 employees in training as our pipeline is significantly stronger than it was a year ago. That being said, our hiring efforts will continue in 2023 as we backfill for attrition and target locations across the northern region, where crude challenges persist. In the near term, we will continue to utilize borrow-outs to supplement crew shortfalls.

Another key element in increasing fluidity is the reduction of excess inventory, which builds the foundation for a strong and resilient service product. I am proud of the progress we made, which would have not been accomplished without the dedication and tireless work of the commercial and operating teams.

Mother Nature threatened to derail some of that progress in the last weeks of December with blizzard conditions and extreme cool temperatures across much of the network. However, our team responded, and we quickly rebounded demonstrating greater resiliency that we can build on in 2023.

With current freight car velocity around 210 miles per day and trip plan compliance measures demonstrating sequential improvement, we look to maintain that progress as volumes strengthen into 2023.

Now, let's review our key performance metrics for the quarter, starting on slide 12, which continue to trail 2021's results. Both freight car velocity and manifest and auto trip plan compliance were flat sequentially from last quarter's results.

Importantly, however, intermodal trip plan compliance did improve 11 points sequentially, as supply chain congestion alleviated, resulting in less stacked containers at the inland ramps. Near the end of the quarter, we successfully onboarded the Schneider intermodal business and remain actively engaged to manage that transition.

Turning to slide 13 to review our network efficiency metrics, which also lagged 2021's fourth quarter measures. Locomotive productivity, workforce productivity and train length all declined sequentially, driven by lower volumes in the back half of the quarter and winter weather challenges. Entering 2023, the team remains focused on strengthening the network, while recovering lost productivity.

Moving to slide 14. We continue to exercise discipline in our capital spending, while delivering value to our shareholders. We are targeting 2023 capital spending of \$3.6 billion, pending final approval by our board of directors.

While a projected increase from last year, we expect capital spending to remain in line with our long-term guidance of less than 15% of revenue. As always, our first capital dollars will support our existing infrastructure. This spending will harden our infrastructure, renew older assets and support safe operations.

For 2023, in addition to a higher inflationary environment, the elevated capital spending will be driven by increased locomotive spending of \$175 million. With 430 modernized locomotives currently in the fleet, we will bring the total modernized to over 1,000 by the end of 2025.

These modernizations not only help build resiliency into the network through enhanced reliability and productivity, but also further the progress towards our carbon emission reduction goals. We continue to invest capital for growth.

On the intermodal front, we are investing in additional capacity at the Inland Empire Terminal, and we will be expanding our footprint in Kansas City. And on the capacity side, we will continue to invest in projects like sidings that drive productivity, allow us to handle more car loadings and improve our network efficiency.

Wrapping up on slide 15. We are dedicated to improving our service product in 2023. Slide 15 provides a road map of the key activities to achieve that goal. We demonstrated meaningful improvement in our safety results in 2022 through an enhancement to our safety management systems and continue towards the goal of world-class safety.

Additionally, we recognize the importance of quality of life concerns that our agreement professionals voice. We continue to work closely with Union leadership to find win-win solutions that enable a strong service product and provide our employees with more consistent work schedules.

As we sustain improved operational performance, use our resources more efficiently and reduce variability, we will generate productivity. At the same time, technology enhancements will drive further productivity and support a consistent and reliable service product for 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. Let's start with fourth quarter income statement on slide 17. Operating revenue in the quarter totaled \$6.2 billion, up 8% versus 2021 on a 1% increase in volume. These gains were more than offset by a 14% increase in operating expense, which totaled \$3.8 billion. Excluding the impact of higher fuel prices, expenses were up 7% in the quarter.

Operating income of \$2.4 billion declined 1% versus 2021. Other income remained strong, up 11% to \$92 million, driven by higher real estate income and pension benefit, which offset 2021's \$36 million gain on the sale of a technology investment.

Interest expense increased 13% as average debt levels increased more than \$3 billion year-over-year. Net income of \$1.6 billion declined 4%, but when combined with share repurchases, resulted in essentially flat earnings per share at \$2.67.

Fourth quarter operating ratio of 61% increased 360 basis points, driven by higher inflation and operating cost. Falling fuel prices during the quarter had a favorable 20 basis point impact.

Looking more closely at fourth quarter revenue, slide 18 provides a breakdown of our freight revenue, which totaled \$5.8 billion in the fourth quarter, up 9% compared to 2021. Volume contributed 75 basis points.

As fuel prices stayed high year-over-year, fourth quarter fuel surcharge revenue also remained elevated, totaling \$975 million and increased freight revenue, 850 basis points.

Strong core pricing gains that exceeded inflation dollars were more than offset by a negative business mix, resulting in a 25-basis-point decline in freight revenue. Fewer forest product shipments combined with higher international intermodal and rock shipments drove the negative mix.

Turning to slide 19 for a summary of our fourth quarter operating expenses. The largest driver of the overall expense increase was again fuel, up 43% as fuel prices rose 46%. Combating these higher prices, we continue to drive productivity, improving our fuel consumption rate two points to produce a fourth quarter record.

Our compensation and benefits expense was up 10% versus 2021. Total fourth quarter workforce levels increased 4%, reflecting our hiring efforts throughout 2022. Cost per employee grew 6%, primarily driven by wage inflation. In addition, cost pressures from network inefficiencies in the form of higher overtime and borrow-out costs continued in the quarter.

Purchased services and material expense remained elevated, up 18%, driven by cost to maintain a larger active locomotive fleet, volume-related purchase transportation expense at our Loup subsidiary and inflation. Equipment and other rents increased 3%, driven by the impact of slower cycle times on car hire expenses.

Other expense was flat in the quarter as higher travel and casualty expenses were offset by a partial insurance recovery related to 2021's bridge fire as well as lower state and local taxes.

Looking to 2023, we have opportunities across the board to improve efficiency and that's job one as we recover our service product. Although, we still expect to be more than volume variable with our workforce, we will continue to aggressively hire crews in critical locations and to backfill attrition.

For 2023, we expect our all-in inflation to be around 4%, while cost per employee is expected to increase in the mid single-digits as elevated wage inflation is partially offset by productivity. Depreciation expense should be up around 3% versus 2022.

And below the line, similar to last year, we expect other income to remain elevated versus historic levels, driven by higher real estate and interest income. Finally, we expect our 2023 annual effective tax rate to be around 24%.

Moving to slide 20 with a quick recap of full year 2022 results, which are shown on the slide as reported and include the impact of the third quarter PEB adjustment.

Revenue was up 14%, an annual record, driven by increased fuel surcharges, strong pricing gains and 2% volume growth. Record operating income increased 6% to \$9.9 billion, which includes a net increase of just under \$700 million from fuel surcharges. Our full year reported operating ratio of 60.1% deteriorated 290 basis points versus 2021.

Network inefficiencies and inflation were the primary components of the degradation, with the PEB adjustment and higher fuel prices impacting the full year operating ratio by 30 basis points and 20 basis points, respectively. Earnings per share finished the year at a record \$11.21, a 13% increase versus 2021 results.

Our consistent and disciplined approach to deploying capital back into our railroad, coupled with volume growth that produced increased operating income, drove a 90 basis point improvement in return on invested capital to a record 17.3%.

Turning to shareholder returns on the balance sheet on slide 21. Full year cash from operations increased over \$300 million to \$9.4 billion, a 4% increase from 2021. The first priority for our cash is capital investment, which finished 2022 at \$3.4 billion or just under 14% of revenue.

Our cash flow conversion rate finished 2022 at 82% and free cash flow totaled \$2.7 billion. Although a decrease of nearly \$800 million versus 2021, that includes an almost \$700 million increase in cash capital, a more than \$350 million increase in dividend payments and \$70 million for PEB backpay settlements.

Our dividend payout ratio for 2022 was around 45%, in line with our long-term target as we rewarded shareholders with a 10% dividend increase in the second quarter and distributed nearly \$3.2 billion.

We also returned cash through strong share repurchases, buying back 5% or \$27 million of our common shares at an all-in cost of \$6.3 billion. In total, between dividends and share repurchases, we returned \$9.4 billion to our owners in 2022, demonstrating our ongoing commitment to deliver significant shareholder value.

We closed out the year at an adjusted debt-to-EBITDA ratio of 2.9 times, consistent with our resolve to maintain strong investment-grade credit ratings as we finished the year A rated by Moody's, S&P and Fitch.

Turning now to our view on 2023. We think about the year ahead in two parts, what we can control and what we cannot. We don't control the markets we serve. And as you saw on Kenny's slide of economic indicators, it's a mixed bag in terms of expectations. We do control the way we compete in those markets with the great foundation of the UP franchise.

Onboarding Schneider is clearly the marquee win for 2023, and with Kenny's team posting profitable wins across the board, we are positioned to further outperform the market. In 2023, that will be evidenced by car loadings that exceed industrial production.

Another area where we don't have direct control is the current inflationary environment, which continues to be elevated. However, we know we have it within our control to improve operations.

As you heard from Eric, it's imperative that we improve the reliability of our service product, while regaining lost productivity. In addition, as we've demonstrated consistently, we expect to generate pricing dollars that exceed inflation dollars in 2023.

Assuming current fuel prices and our thoughts on volume, productivity and price, we expect to improve our full year 2023 operating ratio on a year-over-year basis. That said, there will be a lag to fully offset the impact of inflation on our profitability until we are able to actively touch or reprice our business, while also further improving productivity.

Turning to capital allocation. We continue to make significant investments into our business with an expected 6% increase in capital investments versus 2022 to \$3.6 billion. Growth is the cornerstone to the long-term financial success of Union Pacific, and we are continuing to invest in opportunities that support that strategy.

In addition to the locomotive and intermodal investments Eric described, we also are investing to support carload growth. The remainder of our capital allocation plans remain unchanged, rewarding our owners with an industry-leading dividend payout of around 45% and returning excess cash through share repurchases.

With our balance sheet currently leveraged at the desired levels, the amount of cash available for repurchases will be less than in prior years and predominantly funded from cash generation. With the New Year, comes new opportunities. And by focusing on what we can control, we are confident in our ability to provide strong value to all of our stakeholders in 2023.

So with that, I'll turn it back to Lance.

Lance M. Fritz

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

Thank you, Jennifer. Let's wrap up on slide 24. We made great strides on personal safety in 2022, and it's imperative we continue that momentum. The commitment made by our employees to care for one another has been exceptional, resulting in our best employee safety metrics in five years.

We look to further translate these gains into better derailment performance in the upcoming year. We understand that safety is about culture, and it's about engagement. Listening to and responding to our employees' needs and ideas, will continue to improve our safety performance.

Our robust hiring pipeline and improving network fluidity strengthen crew availability. That leads to a more efficient and better service product that enables us to recapture lost productivity. Over the past couple of years, we've demonstrated our commitment to customer-centered growth, as reflected in business development wins.

And while growth in 2023 may be challenging given the uncertainty of the economic backdrop, we will continue to make strategic capital investments in support of our long-term growth objectives. Our fundamentals for long-term success have not changed, powered by our best-in-industry employees and franchise, a strategy built for profitable growth and a more efficient and reliable service product, Union Pacific is poised to do great things in 2023, and we are ready to prove it.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. And our first question today will be coming from the line of Jon Chappell with Evercore ISI. Please proceed with your question.

Jonathan Chappell

Analyst, Evercore ISI

Q

Thank you. Good morning. Eric, kind of bigger picture question for you. If we go back to the Investor Day and you laid out a multi-year productivity improvement for the network. Obviously, some of that's been delayed given the macro challenges, but are you confident that you can eventually obtain the aggregate plan over time or does the slower macro backdrop, higher labor costs, some of these recent service challenges, weather, etcetera, mean that the total aggregate improvements are reset at a lower level going forward?

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

Yes, Jon, thank you for that question. As we think about that, certainly, as we look at the environment right now and what lays in front of us, it may be over a longer period of time that those actually come to fruition.

But everyone here remains focused prepared comments, and you see that in the activities that we've taken on. In some of my prepared comments, I talked about some of the technology initiatives that are more focused not only in 2023, but even beyond that.

What's sitting in front of us right now is the biggest opportunity, is to improve that service product that from it drives out that excess cost when we think about our locomotive and our workforce productivity. That's job number one right now, but we're all still focused on the long-term targets that we gave you on the Investor Day.

Jonathan Chappell

Analyst, Evercore ISI

Q

Thank you, Eric.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

Thanks, Jon.

Operator: Next question comes from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your question.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Good morning. Hi, everyone. I just wanted to ask about yields, particularly intermodal yields and how we should expect intermodal yields to develop in 2023, excluding the impact of fuel.

There were some reports in the trade rags back in December that UP is cutting intermodal rates by 3% effective February. I just want to get – maybe this question is for Kenny, but just get a little bit more color on that specific item and then how you expect overall intermodal yields to trend as the new business comes on? Thank you.

Kenny G. Rocker

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

A

Yes. Thanks a lot, Amit. First of all, we're in the early stages of bid season, call it, 10% to 15%. You heard me call out in my notes, we are seeing some softness there in the marketplace. We've been encouraged that we're retaining all the business that we're out there competing for.

I think it's too soon to call out what will happen in terms of pricing. But what I will tell you is that we do have mechanisms for our business to make sure that we can remain competitive in a challenged market like this, but also price to the market and make sure that we're capturing some of the upside as things get tight throughout the year.

Lance M. Fritz

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

A

And Kenny – Amit, this is Lance. But Kenny, you're also remaining confident that as we put our plan together, all that included, we're still – we see a clear path for pricing ahead of inflation.

Kenny G. Rocker

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

A

Absolutely.

Operator: Thank you. 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, everyone and thanks for taking my questions. So maybe on the back of that answer, Jennifer, you did talk about a lagged ability to recapture some of the cost inflation on the price line.

So, I was wondering if you could expand on that and maybe also just discuss your fuel surcharge revenue that does appear to be above fuel expense for a certain period of 2022 and the mix impact that Kenny was just speaking about.

Jennifer L. Hamann

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

A

That's a lot there in one question. But in terms of the lag part, so there is that piece when you think about our contract structure. So, in any given year, call it, [ph] 50 plus percent (00:30:39), we're able to touch directly. The remainder is longer-term contracts, and they roll over in some segments over periods of years.

Now those generally have escalators, but there can be limits on the escalators, and those are lagging as well. So that's what we're referring to as having a lag impact as well as kind of going back to the first question to Eric, still very confident in our productivity initiatives, but we did take a step back this year, and we have to acknowledge that and it's going to take us a little bit to gain that back because the inflation is real. That's a real factor that is

certainly above what we have seen historically when you think about 4% kind of number for 2023. So that's that piece.

You also mentioned fuel surcharge. And yes, that was a positive contributor to us on an EPS operating income front in 2023. And so depending on what you estimate for fuel prices that could be a headwind for us at some point.

Overall, we averaged, I think, \$3.65 for the year. Right now, we're paying closer to, call it, \$3.15, \$3.20. So that could certainly be a difference when you think about year-over-year comparisons on the fuel surcharge revenue.

Lance M. Fritz

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

A

I think he also asked about mix.

Jennifer L. Hamann

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

A

Mix. I knew there was one more in there. So, from a mix standpoint, yes, I mean, fourth quarter mix was certainly negative when you look at it. And one of the things probably that really jumps out at you think about intermodal, but in particular, international intermodal and the year-over-year comparison, when you think about last year, international intermodal was down substantially.

And then we saw it grow here in the fourth quarter this year, plus forest products, some of the industrial segments a little weaker in the fourth quarter and higher rock shipments. So, it's kind of that all-in look there, Brandon. Now I think...

Brandon R. Oglenski

Analyst, Barclays Capital, Inc.

Q

Thank you, Jennifer. Yeah, you did.

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

Ariel Rosa

Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Good morning. So, I wanted to ask about the target for growth to exceed Industrial production. It seems like a little bit of a low bogey given the service improvement that's expected for 2023, given the cost advantages for the railroad, and then in particular, the addition of Schneider's intermodal business.

You've obviously seen a lot of volume in recent years, but I wonder – get a little bit more clarity on kind of what that means in terms of that expectation for industrial production – I'm sorry, for growth to exceed industrial production? And then over kind of a longer three to five-year time horizon, how you're thinking about the prospects for UP to grow volume significantly ahead of kind of economic growth?

Lance M. Fritz

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

A

Yeah, Ari, this is Lance. So, I'm going to start and I'm going to focus my commentary on 2023, and then I'll turn it over to Kenny to broaden that out. Clearly, what you're seeing from us is a perspective that says there's a lot of uncertainty as we enter 2023.

You could see it in some of the macroeconomic indicators that Kenny shared, but you can hear it and see it across the board in many markets right now.

And so while we're confident, we can outperform industrial production, which is an underlying driver for a fair amount of what we ship, going beyond that and becoming more granular just is – it's a little too early in the year given all the uncertainty that we see. So, hard stop on that.

Kenny G. Rocker

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

A

Yeah. So Lance, I want to hit hard for those on the call, the mindset of this management team and the commercial team is really to drive business development. And so that's one thing that we can control. There are some markets out there that we really want to go after that we think are right. Renewable diesel is one of them, and we feel good and confident about the wins there.

If you look at finished vehicles, both the finished vehicle side and also the auto parts side is an area that we feel good about. There are some expansions that are coming along our line that we won in the petrochem area with plastics and industrial chem.

And then also, we've talked and been very bullish about metals as we've seen some wins come up there. So, very focused on the things we can control and been encouraged that car velocity has been improving along the way.

Operator: 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. So, I wanted to touch a little bit on some of the price commentary. Can you say like, kind of, broad brush, what you're assuming on intermodal revenue per car and coal revenue per car? What are you assuming when you talk about pricing dollars above inflation?

And then maybe, if you can just offer a comment and kind of broader pricing. Is the dynamic changing in rail competition? You've won a bunch of business over the last, I don't know, 18 months. Is that having an effect on the competitive dynamic or would you say things are pretty stable?

Jennifer L. Hamann

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

A

So Tom, let me take the first part of that question, and then I'll let Kenny address the second part. We're not going to give comments on directional guidance for RPU for various line items. You know the factors that are going to drive that.

It's certainly the pricing, but also fuel surcharge and then the mix of the business within that line. So those will all be things that will play into what that turns out to for 2023.

Kenny G. Rocker

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

A

Yes. Let me lead again with something Lance mentioned that we feel very confident that we'll be able to price over the inflation dollars. So, I want to say that, our commercial team has done a great job of articulating the need to price to the market.

When we talk about price into the market, we've talked about some of those dynamics. Inflation is one our customers are facing that, too. They understand that. But we also talk pretty broadly about investment.

When I say investments, part of what I'm talking about is what Eric is doing with our capital plan. The other part is us making sure that we're resourced [ph] to helm the growth (00:36:58). So, we're down in on that. We're having those conversations with customers and we are articulating that.

Lance M. Fritz

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

A

Tom, this is Lance. We've also got to recognize that I think underlying your question certainly in the intermodal space is that the truck market is pretty darn loose right now. And certainly, it's not as fruitful of an environment to be pricing in as, let's say, a year or 1.5 years ago. But that doesn't change any of what Kenny just said. It just makes the job harder.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

So, you assume that in your pricing guide that you have those pressures on intermodal price, I guess?

Lance M. Fritz

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

A

Yes. All in.

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

We understand it, and it's assumed in there.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Okay. Thank you.

Operator: The 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 wanted to talk on that growth and sort of that service product commentary. A lot of investment obviously being put into the productivity head count and so forth to drive that this year.

But as we look past that, are you thinking through that service product differently in terms of investment, whether it's trying to improve the ease of doing business with you or transparency with customers? Just any thoughts there on how that might be evolving over time?

Lance M. Fritz

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

A

Yes, Allison, thank you for the question. This is Lance again. We are thinking more broadly about what is necessary to support growth in our service product. And it takes a lot of different forms.

I'll start in the intermodal space. We've made investments in things called UPGo and Precision Gate Technology. PGT allows trucks to essentially enter and exit the ramp without stopping. Paperless, and uses technology and pre-clears, if you will, the load with machine vision before the truck even gets there.

UPGo is a holistic tool that our IMCs can use and it can be embedded on their own platforms, so that once a driver is on our property, they know exactly where to go. They know exactly where all the facilities are. They know a map of the facility, and we've done a hell of a job signing and improving the signage on our properties.

So that's just one example where if truck drivers, if dray drivers have a better, faster experience on our property, we might be able to help them get an extra turn now and then, that helps move boxes off our ramp, and that's a better service product in the end. But why don't I turn it over to Kenny, you first and then Eric for more detail.

Kenny G. Rucker

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

A

Yes. Lance, you talked about our premium network. And again, Allison, those products show up in terms of Inland Empire and our product in Twin Cities that we feel very encouraged and confident about and filling those areas out.

And it also shows up in other areas like our investments in GPS, our investment in chassis. On the carload side, we're really excited about what's taking place with RailPulse. So, you're seeing it across the board, both on our carload side and in our intermodal network.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

And Allison, as we think about consistent and reliable service, a couple of examples from the operating side that we're all involved in is – and when I talk about modernizations, an improvement in reliability of 50% in those locomotives once modernized, it's significant. It's meaningful. It's less variability that will drive improved service.

And even as we think about even on our crews, and we're talking about how do we approach that differently. When we talk about consistent schedules for our crews, we're talking about the trade – the benefit for us collectively which has improved availability. Improved availability again reduces variability and drives a more consistent and reliable service product.

Allison Poliniak-Cusic

Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Lance M. Fritz

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

Thank you, Allison.

A

Operator: The next question is from the line of Scott Group with Wolfe Research. Please proceed with your question.

Scott H. Group

Analyst, Wolfe Research LLC

Hey, thanks. Good morning. So, if inflation is running around 4% and price mix is running flat, slightly negative right now. I guess, how do we get confidence in margin improvement for the year?

I guess maybe, Jen, do you think, is it that price mix reaccelerates from here? Is it cost getting better? Just help us sort of get confidence in that margin improvement? And then just separately, any color on this – on other revenue and how you're thinking about that for the year?

Q

Jennifer L. Hamann

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

Yes. So, I'll start with the confidence around the margin improvement. And we are confident in our ability to do that. Certainly, there are headwinds, and you've just pointed to a couple of them.

But then go back to the things I talked about in terms of how we're looking at the year and the key levers, which, as you know, are volume, price and productivity. So, volume certainly is a wildcard, and we'll see how that plays out.

Pricing, we are confident that although it is going to lag a bit, we are confident that our price dollars will exceed inflation dollars. And then the productivity side, we know we have upside there.

Yes, we're still adding resources and taking some steps to heal the network today, but we also know that there's a pipeline of opportunities to improve, and we have those identified and we know what actions we need to put up against that to do that.

And then as you do that and as the network heals, that gives us more opportunities on the volume side. We still know we're mixing bulk loads today. So, those are opportunities for us to get more leverage across that cost base.

And then obviously, there's fuel, which I mentioned before. And we'll see how that plays out. But right now, we're certainly playing a little bit less, call it, \$0.40 or so less than what we were paying a year ago or what we paid for the full year 2022.

So, those are all the things that we're looking at, Scott, and we believe that those combination of factors are setting up in a way that we will be able to drive OR improvement.

To your question on other revenue, so I think that's really a question maybe more geared towards accessories and what we see playing out there. As the supply chain has healed, as we're seeing a little bit of softness in that

A

intermodal market, we have seen accessories come down a bit. They were down a little bit for us here in the fourth quarter, and that would probably be my expectation going into 2023 as well.

Lance M. Fritz

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

And that's a good thing, right? I mean...

Jennifer L. Hamann

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

Yeah, absolutely.

Lance M. Fritz

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

...we want that fluidity. We want the entire network to match the kind of fluidity that we're putting up post-Christmas holiday. There's still – in the intermodal supply chain, there's still some elevated street time for boxes and chassis. And that's the last piece that reflects excess inventory that's going to have to get worked out.

Scott H. Group

Analyst, Wolfe Research LLC

Thank you.

Operator: Our next question is from the line of Fadi Chamoun with BMO Capital Markets. Please proceed with your questions.

Fadi Chamoun

Analyst, BMO Capital Markets Corp. (Canada)

Thank you. Good morning. Question on the operating side a little bit. Maybe Jennifer, if you can help us understand what were these unique costs in network congestion in 2022, so we can kind of play those numbers going forward.

But the main question I got is, if I look at your operational productivity data in the fourth quarter and compare that to a couple of years ago when you were running well, locomotive productivity, car velocity are still 13%, 14% lower than they were and head count is 5% higher, but volumes are flat.

Do you have now the resources you think to get back to those levels that you've had a couple of years ago? Like what are the really remaining things we need to do to get the network to spend a lot higher than it has been in the last few quarters?

Jennifer L. Hamann

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

Yeah. I don't know that I totally caught the first part of your question there, Fadi, but I think you were basically asking to quantify what the congestion costs were for our network for 2022.

And we have not quantified that other than we – when you look at our operating ratio and the degradation that we had on a year-over-year basis, 290 basis points, 50 basis points of that was a combination of PEB and fuel. The

rest of that was inflation and congestion, and probably fairly equally weighted between the two. So, that's how I would think about that.

That is our opportunity, certainly and that feeds through all of the lines. It feeds through wage inflation. Now some of that, obviously, is real. We have the PEB, we know that's real. But then it's how we use the crews, and you've heard us talk about the fact that in 2022, we had higher re-crew rates, we have higher borrow-out costs, more deadhead and held away, more vans. Those all inflate those cost categories.

Purchased services, as we were putting more locomotives into service, that inflated those costs on a year-over-year basis in addition to some of just the contractor inflation that we saw as all of our suppliers were faced with higher inflation, and you saw that come through.

And then on the other line, we know we have opportunities there from a casualty standpoint. You heard us talk about casualty a couple of different times in 2022 and the higher cost that that brought to us. So, those are all elements that we are now very much focused on attacking.

You asked are we right-sized yet. You've heard us say, we still are short crews in critical locations. We're still hiring.

Fadi Chamoun

Analyst, BMO Capital Markets Corp. (Canada)

Yeah.

Jennifer L. Hamann

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

So, we still need to bring folks onto our network. That does two things that helps – well, three things, it helps improve our reliability and our fluidity. It helps us move more volumes. And as we're able to hire folks in those critical locations, we then move the people that we have working there in terms of borrow-outs back to their home location, and that reduces our cost base as well, and you can improve your re-crew rate.

So, a lot of different moving parts there, Fadi. Our business isn't just one element, but that's how we're looking at it. Those are the things that impacted us in 2022, and that's what we're looking to do in 2023.

Lance M. Fritz

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

Yes. I think the other part of Fadi's question is a structural question, like did something structurally changed. And on the five critical resources, nothing structurally changed on line of road and terminal, how you achieve freight car utilization, how you achieve locomotive utilization.

We probably look at crews differently, look going forward than we did historically. That means a little bit more on board so that we're not staffed at the tight end. We're staffed a bit looser, that's hundreds, if not thousands, and then also making sure that we have [indiscernible] (00:48:09) back in place to the extent that we've got counterparties that want to negotiate that. So, that's probably the only thing, and I think that's probably an asterisk as opposed to a major headline.

Jennifer L. Hamann

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

And helps us with more volume.

Lance M. Fritz

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

That's right. It supports us for growth.

Fadi Chamoun

Analyst, BMO Capital Markets Corp. (Canada)

Thank you.

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

Justin Long

Analyst, Stephens, Inc.

Thanks and good morning. I guess to follow-up on that last question. If I just run the quick math, it seems like there was around 120 basis points of headwind to the OR last year from congestion.

So, as you think about kind of recapturing what I'll call lost productivity, do you need to see volume growth in order to get that back or can you see improvement in the absence of volume growth?

And I guess, on the cadence of the OR Jennifer, is it reasonable to say that first half OR probably doesn't improve year-over-year, so this is more back half weighted?

Lance M. Fritz

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

Yes. Jennifer, why don't I start with, can you recover productivity without volume growth? The answer is yes. And we anticipate volume growth as well, which is a tailwind.

Jennifer L. Hamann

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

Yes. So, the only thing I'd say in terms of cadence there is really pointing out to the fuel piece of it and where you saw fuel was a bigger headwind to us in the earlier part of the year than the latter part of the year.

You saw some of the inflation pick up in the latter part of the year. So, there are some trade-offs there either way that I would just ask you to look at your models pretty closely there because there are differences first half, second half in 2022 that you need to be thinking through there.

Justin Long

Analyst, Stephens, Inc.

Okay. Thank you.

Lance M. Fritz

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

Thank you, Justin.

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

Walter Spracklin

Analyst, RBC Capital Markets

Q

Yeah. Thanks very much. Good morning everyone. So, I just want to come back to the yield question, sorry to focus on that. But there were – and Jennifer, you mentioned a number of the key drivers being core price and fuel surcharge and mix and so on.

I just wanted to make sure that we're understanding the charges that you were levying on the congestion side, I'll call it congestion surcharges for lack of a better word, that you registered through 2022. With them going away, is that not another factor that will weigh against your revenue per carload or is that just not meaningful enough to enter into the equation?

Lance M. Fritz

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

A

Jennifer, you want to take that?

Jennifer L. Hamann

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

A

I think you were referencing congestion surcharges?

Lance M. Fritz

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

A

I think he's talking about accessorial.

Jennifer L. Hamann

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

A

Accessorials. Okay. Again, we do expect that they could be less year-over-year, but I don't see that as a significant driver for us.

Walter Spracklin

Analyst, RBC Capital Markets

Q

Okay. Fair enough. And just on the coal side, there's a lot of talk about deteriorating coal statistics, just understanding your catchment area. I know you got a plus on that outlook. How does that compare with what we're hearing from the EIA and what you're seeing in your catchment area?

Lance M. Fritz

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

A

Kenny?

Kenny G. Rucker

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

A

Yes. We feel good about being able to move coal in these natural gas prices and even the forward curve for the rest of the year. I'll tell you, there's still quite a bit of low inventories out there. So, I can assure you, those customers are willing and able to receive that coal demand that's out there.

Walter Spracklin

Analyst, RBC Capital Markets

Q

Okay. Thanks for the time.

Lance M. Fritz

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

A

Yes. Thank you, Walter.

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

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Q

Lance, thanks for taking my question. As the Chairman of UP, can you talk a little bit to the longer-term transition plans? What skill sets do you think the board is really focused on for the next leader of the business. And any time line around that as we've seen some of the leadership at the other Class 1s start to change? Thank you.

Lance M. Fritz

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

A

Sure, Bascome. So, we have not announced any leadership transition or timing. We do periodically, as a board, review what our needs are, both the skills matrix of the board and also the skills and development of our leadership team or the management team.

And so yes, board has a strong eye on that, knows on a running basis, what we're looking for, what we're thinking about. And while we don't have anything announced, I will make sure, and we, as a company, will make sure that it is transparent when it does occur.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Q

Thank you.

Lance M. Fritz

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

A

Yes.

Operator: 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

Yes. Hi. Good morning. Just, sort of, curious what are customers – I mean, obviously, intermodal is a big part of the longer-term story and important near-term, too. But what do customers tell you in terms of hey, rails have had a tough time service-wise the last year or so when are they going to be open to really trying you guys again and maybe shifting some of that business back from truck? And could that happen in an environment where truck rates are so beat up right now as well? Thanks.

Lance M. Fritz

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

A

Yes, Kenny, you want to take that? Because we are still winning business off of truck.

Kenny G. Rocker

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

A

Yes. I mean, we're definitely still winning business from truck. And what I would tell you is that we haven't seen any large pieces. And I've said this earlier, move away [ph] from them (00:54:09).

A lot of that is driven by the economy. Clearly, some of the service challenges we have, we may have seen some lanes move out [ph] whether it be (00:54:21) truck or maybe another mode. But our customers realize that this is a short-term phenomenon and that we're investing. We've been very transparent in our investment again in hiring and our investment in our CapEx, so that they can stay with us.

Lance M. Fritz

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

A

Well, Kenny, sustainability has also been playing a bigger and bigger role in that. Some of our sophisticated customers, we're helping them understand and they're asking us for greater detail on, how we can be part of their sustainability initiatives, and that's driving more look at us as opposed to less look at us. We just joined the Dow Sustainability Index, and that's just one marker of many that say that we're quite serious in making good progress in those areas.

Kenny G. Rocker

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

A

I mean, Lance, you talked about it a little bit earlier. If you look at our car velocity from the summer to now, we've seen some improvement. And Eric and I were talking about this a couple of days ago. If you look at third quarter to fourth quarter sequentially on our premium network, that is improving as we onboarded Schneider, so that gives us a lot of confidence.

Lance M. Fritz

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

A

Right.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Q

Just continuing on that, I mean, the other side of shares, the West Coast probably lost to the East Coast this year for a myriad of reasons. Do you think some of that shifts back over the course of 2023?

Kenny G. Rocker

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

A

Some of that was really, I think, labor challenges that you saw in the ports and a little bit of ambiguity on what they thought might happen. I think as we see that clear up on the ports that you'll see a little bit more of that volume come back to the West Coast ports.

Again, everything that we're doing, all of our investments around Inland Empire, the G4 [ph] reload with ag (00:56:12) in Dallas. I'm telling you we're bullish to make sure we can make those areas more competitive for the customers.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Thank you.

Q

Lance M. Fritz

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

Yes. Thank you.

A

Operator: The next question is from the line of Cherilyn Radbourne with TD Securities. Please proceed with your question.

Cherilyn Radbourne

Analyst, TD Securities, Inc.

Thanks very much and good morning. My question sort of picks up on that last one. I did want to ask about the next outlook for international intermodal. Clearly, the inventory cycle is the most important factor there. So, I'm curious whether implicit in your guidance is the potential for a second half recovery in intermodal.

Q

And then along with that, I was also curious on your thoughts regarding the timing of a labor settlement on the West Coast and what you thought for that would mean for market share in L.A. Long Beach, which I think you just addressed.

Lance M. Fritz

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

Let me start, Kenny, and I'll talk to the labor negotiation that's going on the West Coast. So that started up, I want to say, in July of last year. There has been a negotiation. There hasn't been a lot of progress announced publicly, but the port directors, share with us that they have confidence they're going to reach an agreement that there's – the temperature is low, and there's a line of sight to reach agreement. So, from that perspective, I think we're going to be okay.

A

Kenny G. Rocker

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

Yeah, as we're spending time with customers, it's a mixed bag when they think some of these inventory issues will get resolved. So, some are saying summer, some are saying back half of third quarter.

A

For us, we're not going to try to time that or be so precise to time it. What we're really focused on is making sure that we've got the service product where it should. And I just want to double down on what I said, sequentially, we're seeing that improvement. We've onboarded a large customer, and we're walking towards trying to capture that growth when it shows up or it pops.

Cherilyn Radbourne

Analyst, TD Securities, Inc.

Thank you.

Q

Operator: The next question is from the line of Ravi Shanker with Morgan Stanley. Please proceed with your question.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Thanks. Good morning, everyone. Two-part question here. I think quality of life is a big focus area for you and a lot of your peers. What does that mean exactly in terms of kind of what you're negotiating and what your prospective employees are looking for, how do we think about that in terms of OR costs, etcetera.

Q

And just also, I don't think you've said the word 55 OR on this call so far. And obviously, that seems like a fair way away, given where we are macro-wise. What is the path to get there? Kind of given the quality of life, given the kind of EV inflation, everything else kind of – is that just going to need like a really big lift from the top line to bridge that gap in the coming years?

Lance M. Fritz

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

Yes. Thanks for the question, Ravi. So, I'll start with just a quick comment on quality of life. And then maybe, Eric, you can follow-up on what we're negotiating there. And then Jennifer, you can handle 55 OR.

A

So, one thing that came out of the PEB and is in the tentative agreements that were signed and now agreed to was a directive to negotiate things like unscheduled work going to scheduled work. There are other things bundled into quality of life issues for our craft employees, but that's a big one.

There's a fair amount of our craft employees that are on call in an unscheduled job. And that's the way that the staffing for the railroad is handled. And so we're actively in those discussions because there is a path forward to be able to create more predictability in that work for those craft professions. I'll let Eric kind of get into the detail.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

Yes. So Ravi, as one example, we're engaged right now in a pilot where we're focused on some adjustments to the way that we collectively do the work where we actually have a group of people in the state of Kansas that are working a defined schedule. So, to Lance's point, today, the vast majority of our employee base is on an on-call basis. So that's on the TE&Y side of the transportation side.

A

In this pilot, we've carved out a handful of people where they actually are in a specific schedule. And what we're watching for is to ensure that the actual days that we have planned for them to have off occur and that that's translating then to more availability on the days in which they're scheduled to work.

That's the win-win solution that we're looking for, and we're focused on. And we're working on it for the entire period of this year. And I bet it carries into the next year because we're putting so much thought into making sure that the net impact is beneficial for both sides.

Jennifer L. Hamann

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

A

Yes. And then Ravi, to your 55 question, I mean you've heard us talk that, that is still our goal, and I'll reiterate that again. We have not put a new timeline on that because of all the things that you've heard us talk about here today in terms of the challenges that we're facing.

But that doesn't mean we can't improve. That doesn't mean we don't have a path to improve and a path to get there. And relative to the quality of life, it really goes back to what you've heard from both Lance and Eric, as we improve crew availability, as we improve predictability, that improves our service product and it improves our ability to grow. And with that service product comes further pricing opportunities as well. So, it's a virtuous circle in my view, and that's how we're going about pursuing those things.

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

Chris Wetherbee

Analyst, Citigroup Global Markets, Inc.

Q

Hey, thanks, good morning. Maybe I wanted to come back to head count and resources as we're thinking about sort of improving the network and efficiency and ultimately getting back up to sort of optimal performance.

Can you give us a sense of sort of how long you think it'll take until you get hedged to sort of where you think [indiscernible] (01:02:10) growth that you have and maybe is that a first half, second half kind of dynamic as you think about the relative growth in both periods?

Lance M. Fritz

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

A

Yes. Chris, you broke up a little bit at the end. But what I heard you asking is about, we're adding head count and resources to support network fluidity, particularly in some part of the network where we're tight on crews. And how long is that going to take? Is it a first half, second half?

So, we're not putting a fine button on when exactly we declare victory. What I will say is, you look at how we're performing coming into 2023 and the network is fluid. We've still got tight spots in the network that are limiting our ability to grow and ship all the demand like in coal, maybe to a lesser extent in rock.

And we're hiring actively in those areas that would support the network for that growth. The pipeline is full. We've got 600 people in the pipeline, and we're graduating something like 150 to 200 a month at this point.

So it's, kind of, fundamentally being pretty well healed is happening this year. It's just hard to say exactly when given that demand could shift around. We're still not meeting all demand. And the game plan is operate a fluid network like we are right now, continue to add resources to support the demand that wants to ship and grow that volume as we're able to.

Chris Wetherbee

Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Lance M. Fritz

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

A

Yes.

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

Ken Hoexter

Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Thanks for taking the question. Just Jen, maybe can you put a range on the OR improvement? I know, you said you're looking for improvement. Given the background issues that you talked about, can you clarify how much of that is impacted by service?

And I guess you typically see 200 basis points of deterioration from fourth quarter to first quarter. Is there anything unseasonable or different this year? You pointed out a couple of things that should look different.

And then a second one just for Lance, something totally different. Any thoughts on the STB Open Access mandate? Anything that you expect out of that or remediation expectations from CPK issue?

Ken Hoexter

Analyst, BofA Securities, Inc.

Q

So Ken, I'm going to refrain from giving the order of magnitude on the OR guide or giving you a range. It really is just too soon in the year. We're sitting here on January 24th to give that to you. I could try, but I'm sure, I'd be wrong. So, we're going to resist that temptation.

I think the important thing to think about is, we are going to work to improve as fast as we can, as hard as we can. You've seen us do that and demonstrate that. We're not trying to meter any progress. Our goal is to deliver that better service, be more fluid. And with that, leverage more volume across the top-line. There are some other things that influence it, obviously, when you think about fuel and inflation.

But the team knows what those are, and they know how to go about it. I'm also not going to give you any guidance relative to sequential and whether we're going to have normal sequential patterns.

We had a really hard hit here the end of 2022 with the weather, the way it impacted our volumes here at the close of the quarter. We've had some weather here, again here in the start of the year.

So just hang with us, watch the volumes, watch the service metrics. Those are your best barometer to know how we're operating and how we're generating positive growth and positive financials across the network.

Lance M. Fritz

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

A

Yes. Amen. It really does all start with our service product. In terms of the STB and Open Access, Ken, so that's a pending decision on their part. Clearly, we've fed back for quite some time now to the STB that we think Open Access is a bad idea from the following perspective.

It puts interchange where investment has not occurred. It would negatively impact the service product for those demanding open access and anyone else riding the trains and the service product that those particular customers are using.

We've looked at this a lot of ways. We don't say hell no. When allowing access in a certain circumstance makes sense, we've done it. We've negotiated it. We've done it in short periods to help a customer out. But in the broader context of allowing customers to determine where their interchange point should be, we think, as currently conceived, it would be bad for overall service product, not better.

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

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

Hey. Good morning. So, a couple of different follow-ups, if you don't mind. One, just on mix for Jennifer. It sounds like the trends impacting the fourth quarter probably will continue for 2023. I just didn't hear if you confirm that or not?

And then for Eric, you're talking about getting to a better spot with head count. Do you expect any attrition from when all the back pay clears as maybe some of the more senior folks take that retire or look for something else as that comes up in the next couple of weeks?

And lastly, Lance, another hot button topic for the STB embargoes, a little hard for us to tell exactly the implications of the two-day hearing from last month, but would be great to hear your thoughts on what changes, if anything, after that. Thanks very much.

Jennifer L. Hamann

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

A

All right. I'll start with your mix question, Brian. So, for 2023, we are expecting to have a negative mix for the year. And really, it's pretty simple when you think about it with increased intermodal shipments with the onboarding of Schneider.

And then you heard Kenny talk about tough grain markets and then also some of the question marks and toughness that we're expecting on the industrial product side. Those things add up to negative mix for us in 2023.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

On the attrition side, we have not seen any attrition post the payment of the PEB. We continue to watch that very closely and where necessary, we'll incentivize.

Lance M. Fritz

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

A

Yeah. And the last big back pay happened January 13th, right?

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

That's correct.

Jennifer L. Hamann

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

A

Yes.

Lance M. Fritz

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

A

So it's in hand. And to your point, Brian, if something occurs, we should be seeing that basically right now, it should start.

In terms of the STB, on embargos, so yeah, we were called in for a two-day hearing. The reason is that Union Pacific, historically, in 2022, had used embargoes more so than all of our peers. We use it for a very specific reason, and we use it as a last resort. The reason why we use embargoes is either if something has occurred in the network like, call it, Winter Storm Elliott that really negatively impacted the Great Lakes region.

So that we don't get overwhelmed as we're trying to recover from the winter weather, we'll use an embargo in that circumstance to control product flow. That's not to stop growth. It's basically control product flow, so the network can get its feet back under it. It's worked wonderfully in that area, because you can see in our car velocity and the overall network fluidity, we're operating quite well.

We'll also use embargoes to control excess inventory in very targeted circumstances as a last resort. We engage the customers. Help them understand what we see and what they could do to help control that excess inventory. And then as a last resort, we would use an embargo. The vast majority of them are about protecting the serving yards for our customers. That's where cars end up.

And before the last mile delivery to customers, they get inventoried at the serving yard. And if a particular customer has way more inventory in that serving yard than what they can handle or what supports their business, it can crowd out the service product for others.

So, that's the reason we were called in, is we use those more so than anyone else. I'm not sure exactly what's going to come out of that hearing. What we heard from our customers and through the STB and in continuing conversation with our customers is they want to know why and how to remedy with a lot more granularity.

So, we've modified what we communicate to our customers so that they understand that. And our commitment was we're going to pause on the level of embargoes that we've been using so that we can absorb the feedback and make some additional changes in how we approach excess inventory and serving yard excess inventory and engage with customers more effectively on it. Kenny?

Kenny G. Rocker

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

A

All right, Brian, you win the title for getting us all to talk, so I'll make this quick. Two things. One, yes, we've had some pretty difficult conversations with customers. But one of the positives that has come out of that is creating tech solutions for them to give them the visibility that Lance was talking about.

Whether it's inventory on our line, the release rates, number of cars that are in the serving yard. We've shared those tech solutions with them here a couple of weeks ago, and we're working with the customer so that they can integrate that into their supply chain.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Thank you all very much.

Lance M. Fritz
Chairman, President & Chief Executive Officer, Union Pacific Corp.

A

Thank you, Brian.

Operator: Our next question is from the line of Jeff Kaufman with Vertical Research. Please proceed with your question.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Thank you, very much. I'll just make this quick because a lot of mine have been answered. Kenny, what do the changes in China with their COVID policy and reopening the economy potentially mean for Union Pacific?

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

A

We'll have to see what plays out there. Historically, what we've seen is a little bit of fits and starts. I think what we'll also be looking at is the inventory levels, at least in the near term.

It may not have that much of an impact as – if they start up a little bit later it may be right in time. So, a lot of uncertainty there, definitely some fits and starts. What we really need is the consumer spending and a little bit more demand to be out there, more so than the issue in Asia.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Thank you.

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

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Q

Hey good morning guys. I wanted to come back to resourcing questions really quickly here. I'll try to keep it at one in the team and as opposed to make all you guys kind of go around the table.

What is the exact number of heads we're looking to add in 2023? And if we're thinking about adding more crew resources and [ph] automotive (01:13:38) resources to get a service level that's more resilient, how does that change the dynamic of adding future resources to support growth? I know it won't be one for one, but are we looking at a little bit less leverage here going forward based on the changes you're making to the resourcing model right now.

Jennifer L. Hamann

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

A

Yes, you were breaking up there quite a bit, David. But I think what your basic question was, was how many do we expect to hire in 2023? And do we think about hiring at a different cadence maybe versus volumes going forward?

In terms of hiring for the year, I think we've said it would be similar probably to 2022 levels. But that obviously carries with it some attrition assumptions and what we see happen with volumes. And so, if we would see a change positive or negative relative to volumes that obviously could impact that, we're just going to make sure that we have the right crews in place to be able to take advantage of the demand that's there for us. We know we're still not meeting it all today.

In terms of how we think about hiring, I mean, I think you've heard Lance and Eric talk about the fact that we would maybe keep our boards a little bit larger, establish [indiscernible] (01:14:52) if we can. And those will be things that can give us, I'll say cushion, as you see fluctuations in demand.

Again, we expect to be able to leverage that service reliability into more volumes and better pricing and overall better productivity. And so when you think about the bottom-line impact of that, we think it should – worst case, be neutral, but really be a positive for us in the long-term.

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

Q

Yes, I understand the foundation will be positive in the long-term, but I mean, we are adding more resources to do essentially the same amount of volume right now, right?

Jennifer L. Hamann

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

A

Yes. I mean you're seeing that flow through today, I would say. When you've got 600, 700 people in training today....

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

Q

Yes.

Jennifer L. Hamann

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

A

...not out actively moving freight, that is a headwind that we have in those numbers today that I would say is already there.

Lance M. Fritz

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

A

Well, and it's substantial because they're completely unproductive from a moving freight perspective.

Jennifer L. Hamann

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

A

Right.

Lance M. Fritz

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

A

But we anticipate we need them to both backfill attrition and to support growth.

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

Q

Right. Thanks a that added color guys.

Lance M. Fritz

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

A

Yes. Thank you, David.

Operator: Thank you. Our final question is from the line of Jason Seidl with Cowen and Company. Please proceed with your question.

Jason H. Seidl

Analyst, Cowen & Co. LLC

Q

Thank you, operator. The Anchorman position, I won't make any Ron Burgundy references here. I wanted to get back to domestic intermodal, guys. I'm assuming the positive growth outlook is basically the Schneider business and some of the freight that you guys lost last year that's more of a natural rail fit flowing back to the network.

But I want to look a little bit longer term, sort of, as you look to the competitive marketplace with the trucks, where do you think the visibility needs to be and will RailPulse help you improve that? And then where do you think trip plan compliance needs to be? And what else do you need to do to get that up there?

Kenny G. Rucker

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

A

Yes. I'll tell you, thanks for that question, Jason. We've been encouraged as the management team with all the investment that we put into the railroad to support growth. And we've talked about those products here a little bit today.

We do think that Inland Empire is transformative for us. We do think that the Twin Cities Intermodal facility is transformative for us. We do think that the focus on technology, some of which Lance mentioned a little bit earlier that'll help drive our experience would ultimately help our customers reduce their costs with their drivers, will have an impact.

And then Jason, everything you just said, RailPulse is for our carload business, and we put a lot of focus on making sure we can do ease of business and know exactly what our customers are asking for.

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

And on the performance side, from a service product, Jason, we've been very consistent over the last handful of years that our intermodal trip plan compliance, starting with a like 80, 85 is where we want to be. And we're also very close to our customers over the last two years to continue to make sure that what we're measuring is most reflective of their experience and what's most important to them. So, stay tuned as we continue to evolve how we think about customer service in line with the customers' voice.

Jason H. Seidl

Analyst, Cowen & Co. LLC

Q

And is there – if you guys get to that 85 or above, is that when it starts inflecting in a normalized demand market in terms of getting more freight on the network?

Eric J. Gehringer

Executive Vice President-Operations, Union Pacific Corp.

A

The way to think about that is really when you get to 85%, what we're recognizing is we are an outdoor factory. We are 32,000 miles. We do deal with winter, etcetera, etcetera.

There's nobody here that gets to 85 and says we've done our job. But it's a place to strive to get to and then reevaluate even within the challenges of being an outdoor factory with 32,000 miles, hey, what's the next opportunity still?

Jason H. Seidl

Analyst, Cowen & Co. LLC

Q

Fair enough. Appreciate the commentary as always.

Lance M. Fritz

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

A

Yeah. Thank you, Jason.

Operator: Thank you. At this time, we have reached the end of the question-and-answer session. And I'll turn the floor over to Mr. Lance Fritz for closing comments.

Lance M. Fritz

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

Rob, thank you very much for your help this morning, and thank you all for your questions. We're looking forward to talking with you again in April about our first quarter results. Until then, please take care.

Operator: Thank you. This will conclude today's conference. You may disconnect your lines at this time. We do thank you for your participation.

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