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The Railroad Week in Review 6/8/2002

Norfolk Southern put a fine foot forward at the all-shortlines meeting in Roanoke this week. This was the first in several years, however in terms of new and useful stuff it won Best of Class. The shortlines got their at-bats right away, with a "Sandhouse Session" report from ASLRRA's Frank Turner and a panel presenting the shortline viewpoint of what needs to be done.

In response, NS provided substantive details of what they are doing to improve the shortline-NS interface in terms of operations, data exchange, and the scheduled railroad. VP Transportation Services Mark Manion described how the Thoroughbred Operating Plan (TOP) has sped up the core manifest business and how that in turn will bring greater precision to shortline interchange. He was then backed up with remarks from the National Customer Service Center.

All of which framed the merchandise marketing group's thumbnails on what they are doing and the scope of shortline operations (see attached chart). It's a given that the preponderance of shortline traffic is "merchandise" – not coal, not intermodal. Using the percentages from the various group VPs, the bottom line is that shortlines touch 27% of all merchandise loads and 11% of loads system-wide. They also touch 14% of total revenues.

What NS has in its shortline group is a 700,000-car customer generating $900,000 in revenues. Scheduled, consistent service is a necessity and there's no more room for local managers coming to work saying, "Let's see…what shall we do today?" How fast that's going to disappear was driven home for me over dinner with John Kraemer, NS shortline AVP, Eastern General Manager Wayne Mason, Northern Region GM Dave Brown, and Tim Heilig from the Service Design group in Atlanta. Suffice to say I was pleased with what I heard about trip plans and shortlines.

But there is a caveat. NS includes as "shortlines" the likes of the BRC, the Steel Roads, Guilford, the FEC, and others of that ilk. That still leaves about 180 separate properties each handling at least 30,000 carloads a year. There's some double-counting as many shortlines interchange with others beside NS, with the likelihood of multiple connections decreasing with size. None the less NS has a very real need to work very closely with its shortlines. The message of this meeting was clearly that NS intends to do exactly that. Shortliners tell me they agree.

Shortline operator Eric Lee (Meridian Southern) forwarded a timely article from the Topeka Capital Journal on the importance of small railroads to Kansas' agriculture. The lead is that abandonment of Kansas' 1700 miles of shortlines would cost the state an extra $50 mm a year in highway maintenance expense. Rail handles more than a quarter of the grain from the elevators in the study, though that's down considerably from what it was ten years ago as the truck optoin gained in favor. Keep this up, says the study, and "the long run viability of Kansas short-lines could be threatened"

Nothing new here. Farmers load big trucks in the fields and once in the truck the grain might as well stay in the truck for a longer haul if it means a few cents more per bushel at the end of the day. We've seen shortlines quit in Idaho and know of lines close to quitting in Montana because the highway replaced the railway.

But let's face it: the highway is as important a feeder to the core rail system as the branchline network, and as long as economics favor the highway some feeder lines will be at risk. Some states – like Pennsylvania – are more enlightened when it comes to shortline preservation vs highway degradation. It's up to the shortlines themselves to make the case.

Iowa Pacific is a new shortline holding company, first coming to our attention in the context of RailAmerica's transfer of two lines in Texas (WIR 6/1/2002). The URL is www.iowapacific.com and Ed Ellis, late of Amtrak's Mail & Express business unit, heads it up. The company's mission is to find turn-around opportunities with growth potential beyond the limits of the right-of-way. I've dropped a note to Ed for details.

Dell Chairman Michael Dell knows a thing or two about customer satisfaction. At a *Fortune Small Business* lunch in Chicago he talked about "friction" as endemic to business development. That's what you get with what he calls extra costs or markups, and what you don't get with technologies like the Internet. In a railroad context friction includes the costs of anything that gets in the way of a flawless transaction.

Moreover, says Dell, "on the Internet you can experiment for free and see what works." The entire railroad transaction from ordering the empty to paying for the shipment ought to be doable on the Internet, regardless of what company serves the origin and destination. You can select airline O-D pairs, schedules, seats, and payment options on line. Railroads are no different. But there are signs the friction is lessening. Ask Cathleen Regan at BNSF.

Amtrak remains poised to drop The Other Shoe. Friday's Phila *Inquirer* says new Prez David Gunn will shut the whole thing down absent a $200 mm loan against FY 2003's $1.2 bn appropriation. Gunn wants to cut the number of VPs to 20 from four times that and to streamline the organization from business units to departments, sort of the opposite of what NS is doing on the ECBU.

Rail stocks this week were spared some of the humiliation of the broader market. There are several possible reasons. One, rails are undervalued Vs the market with PEs in the teens while the S&P average is in the high 20s. Two, rails are not sexy, like chips or telecoms, something everybody's "gotta" have. Three, the NY market makers' rail experience is limited to the LIRR, Metro North, New Jersey Transit and Amtrak. If they could see the UP's Nebraska triple track train density looking at times like the 7th Ave. IRT it might be different.

While the DJIA slipped four points on the week the Big Six rails ranged from flat (CSX) to up a point-plus (UP, BNSF). KCS, RRA and GNWR matched the DJIA, down 4%, while FEC followed the telecoms, down 12% on the week. If you look at the DJ Railroad Index vs. the DJ total market index since 1998 they are mirror images. Total market rose through 1Q00; rails declined in the same period. As the Total Market peaked, the rails started to climb. For the five-year period total market is up 15% and the rails are about back to zero. Remember, though, Total Market peaked at +75% back in 1Q01.

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Roy Blanchard provides railroad financial and operating performance measurements for shortlines and shippers. Disclosure: Blanchard may from time to time hold long, short, or debt positions in the companies mentioned here. A list of such holdings is available on request.

Shortline share of Norfolk Southern Carloads by Commodity, Jan-Dec 2001

Commodity	Pct SL	Total CL (000s)	SL CL (000s)	Revs PC	SL Contrib ($thous.)
Ag/Cons.	18%	509.2	91.7	$ 1,185	$ 108,612
Auto	25%	621.8	155.5	$ 1,423	$ 221,205
Chemicals	14%	431.9	60.5	$ 1,742	$ 105,332
Met/Constr.	42%	702.7	295.1	$ 959	$ 283,034
For Prods	26%	450.5	117.1	$ 1,357	$ 158,945
Mdse CL	27%	2,716.1	719.8	$ 1,298	$ 877,128
Coal		1,695.4			
Intermodal		2,213.5			
Total CL	11%	6,625.0			
Total Revs	14%				$ 6,170,000

Source: NS shortline meeting; NS Quarterly Financial Review, January 2002