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The Railroad Week in Review

12/13/2002

CSX this week concluded its 14th consecutive annual shortline gathering, the longest running show in the business. More than 200 shortline personnel were in attendance, representing some 85 operating companies, many of which own more than one shortline railroad. This is a major constituency for CSX, accounting for about one of every five carloads moving over CSX.

Moreover, shortlines YTD have increased revenues at a 6% per year run rate, thrice that of CSX itself. Shortlines YTD have handled about 500,000 carloads worth some $643 mm in revenues to CSX and $160 mm to the shortlines themselves. The group represented by this week's gathering operates almost 20,000 miles of railroad with a combined fleet of roughly 1,600 locomotives exclusive of the so-called "S&Ts" – Switching and Terminal railroads (BRC, IHB, PTRA, e.g.).

The theme of the session was "It starts with the customer," and everything fit from the shortline panel on new business initiatives to the customer panel on what's right and wrong with the railroad product from their point of view. It was particularly good news to see and hear how much effort is going into eliminating random events, running to plan, and making it easier to do business with CSX and its shortlines.

CSX is clearly putting more emphasis on managing the top line. The 3Q02 operating ratio was 87, the highest in the business, and the percentage of revenue represented by each of the expense accounts (compensation, fuel, rents, etc.) is on the high side. The message writ large at this week's session is that CSX knows that revenue increases boost the OR faster than expense cuts and that a better product can generate more revenue. And that starts with the customer.

To get things rolling, SVP Clarence Gooden said CSX would pay a reward of $10,000 to the first shortline to add 1,000 revenue carloads to its 2003 CSX traffic base. From the dais Merchandise VP Jim Howard told Ohio Central President Bill Strawn CSX would test a novel waste paper back haul for a year if the shortline would initiate and package the deal. And Randy Evans, VP for Industrial Development, ponied up a $10,000 reward for the biggest industrial center constructed on a shortline in 2003.

To my mind, this is the very first time we've ever seen a class 1 step up to the plate with specifics like these at a shortline meeting. We heard several presentations on service design, the need to Run to Plan, and the shortline role therein. We heard that 90% of CSX's more than 200 shortline and regional railroads have signed ISAs and it'll be 100% shortly. The seeds have been planted to fine-tune the organization, and they've been planted because it all *does* start with the customer. I look for three points off the OR by March oh-three.

RailAmerica increased November carloads system-wide 20% for November and 17% YTD. Not surprisingly US and Canadian loadings accounted for four-fifths of the total for both periods. Same railroad results were up a point-plus in North America and unchanged offshore. The easy comps of course are due to the StatesRail and Park Sierra acquisitions earlier this year. Once we get past those anniversaries the comps will be more meaningful.

Still, US traffic (62% of total) gains were 30% or more in seven carload commodity groups and of these five have above average revenue per car. In the aggregate these seven groups accounted for roughly $12.4 mm revenue for the month based on the averages from the October 10-Q. This goes directly to RRA's stated goal of increasing the value of the railroad property portfolio.

Best-kept Secret of the Week: The Bush white house gets the prize for its stealth-tapping CSX's John Snow to head up Treasury. The timing couldn't be better. Just last Friday the FRA held a RRIF workshop in DC and FRA chief Allan Rutter was heard to say there would be money and that the $3.5 bn in funds would be unlocked. Confrerees told me that there had been some disputes with OMB as to why railroads were even asking. Evidently one staffer was so out of touch that he had to ask what country all these "foreign cars" belonged to. One can only hope Snow's confirmation moves ahead without delay.

By way of review, the RRIF (Railroad Rehabilitation and Improvement Financing) program offers freight railroads large and small throughout the country financial flexibility in improving rail infrastructure under TEA-21. The RRIF Program authorizes the FRA to provide direct loans or loan guarantees for the acquisition, improvement or rehabilitation of existing or new intermodal or rail equipment facilities. See also the FRA's website at www.fra.dot.gov.

Canadian National provided the second surprise of the week with the announcement that Paul Tellier will leave his CEO post of ten years effective Jan 13 to become President of transportation equipment supplier Bombardier. He was already a Director. CN Chief Operating Officer Hunter Harrison will become President and CEO effective Jan 1. In his remarks during Friday's conference call Harrison cited high customer satisfaction and leadership in the merchandise carload business as the ongoing focus. He said his strength is "running a railroad" and he intends to keep doing that. From that it does not appears another COO is likely to be tapped.

Tellier's mark on CN was to turn what once was a bloated, money-losing Crown corporation into a nimble, customer-focused and profitable shareholder-owned enterprise. On his watch there was a near quintupling of shareholder value. Hunter Harrison is probably best known for his design and implementation of the scheduled freight railroad. The discipline and structure -- now being embraced by other major railroads -- have made CN the service and efficiency leader of the North American rail industry. Investors have done well with a doubling of the split-adjusted stock price since the November 1997 IPO vs. a 30% appreciation in the DJIA.

Norfolk Southern is being sued by the Pennsylvania BMWE. The union alleges that the railroad encouraged 401(k) employees to buy the stock regardless of its poor performance. In a statement the union said it seeks "restoration of the losses suffered by plan participants." IMHO this is a cheap shot. Over the last two years NS is up 37%, second only to CN among the Big Six NA Class 1 roads. The Dow is off more than 20% on the same period. Where do they *get* this stuff?

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