Blanchard's Week in Review
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Philadelphia was the setting for this week's annual meeting of the American shortline and Regional Railroad Assn. (ASLRRA). All and sundry generally agreed it was among the best – if not *the* best – ever. Two conclusions come to me. First, in the seventeen years I've been in the shortline business the group has never had a better sense for or track record in developing and keeping customers. In one panel alone the three speakers were able to list tens of thousands of carloads of new business.

Second, and less encouraging, is the conclusion that there is still too wide a range of shortline perceptions among and even within the Big Six class I railroads. Shipper spokesmen from Big Customers said that absence of ISAs and continuing "black holes" of interchange data were major deterrents to doing more shortline business. Just yesterday a shipper said there can be up to three day's delay at interchange because the shortline is not e-connected. That results in needless extra inventory carrying cost to the beneficial owner and puts this lane at risk.)

Clearly it's in the Class I shareholders' own interest to get ISAs and e-connections in place if only to expand the reach of the scheduled railroad and carload trip plans. And since more and more of the higher-margin carload growth involves Class II and III roads, getting timely interchanges established is just good business sense. Every Class I railroad marketing and commercial officer has to make solid shortline relationships a top priority.

British Columbia's Liberal Party government remains intent on finding a non-public entity to lease BC Rail's 1,500-mile ROW to a private sector operator. Plagued by sky-high levels of debt the railroad has been the subject of debate in Victoria for more than a year. Potential players include CN, already negotiating with the Province of Ontario for the Ontario Northland, BNSF and shortline-operator OmniTrax of Denver.

It may be a daunting task for a non-Class I operator. BCR projects about $300 mm in annual revenues through 2005 with an OR around 60. The *2003-2005 Service Plan* (available for downloading from the website) is light on the expense detail but does note high labor, fuel and insurance costs. The lost-time injury rate hovers around 5.0 per 200,000 hours, it's a tough, steep, curvy road, and is almost totally reliant on forest products. Sales of $300 mm on a narrow business base is a drop in the bucket for any of the Class I bidders but could be risky for a Class II or smaller operator.

RailAmerica said Thursday that the Tranz Rail deal (WIR 5/16/2003) is off the table. As previously indicated, the decision to proceed with an offer was predicated upon a satisfactory due diligence investigation of Tranz Rail. According to a press release RRA "determined that, under current circumstances, the proposed acquisition does not represent the opportunity for enhanced shareholder value that we had originally contemplated."

By way of background, the RRA offer of NZ$0.75 per share implied a value of NZ$158 mm (US$92 mm). There is also debt of US$135 mm that must be covered. The offer came at a time TranzRail Holdings (NZSE: TRH.NZ) is in the midst of a two-year restructuring process during which it has sold off assets. There have also been reports that the government of New Zealand has even considered buying the whole thing back from the private sector.

Meanwhile, back at the ASLRRA Annual Meeting, COO Gary Spiegel told me they are putting about $90 mm a year in North American track rehab to get a "solid foundation." His argument is simple. Shortline railroads must run on schedule to meet Class I interchange requirements. That means being able to snag the inbounds, do the work, and get back with the outbounds in a timely fashion. Track has to be maintained to the FRA track class appropriate to that service plan.

RRA has a North American 2003 capex program of about $50 mm, of which $40 mm is earmarked for track. The other $50 mm is labor and material expense. Recall the Rule of Thumb that a FRA class 2 track needs about $5,000 per mile per year to keep up to spec on a shortline (ask me for the spreadsheet if you're not familiar with the math). The RRA system spans some 8,000 route miles – say $40 mm a year in program maintenance, so the numbers fit.

We really struck a chord with our remarks on sales reps. A former Class I sales rep and present shortline consultant writes, "I've watched the RR sales vs. marketing relationship evolve over nearly forty years. And you still need to have people out there to call on customers and gather intelligence. Face to face relationships are important; this is one of the reasons for the success of short lines.

"Calling on a customer demonstrates that the business is meaningful to the carrier; worth more than a e-mail, phone call, or mass-mailed brochure. Since cell phones, desktop PCs, laptops, faxes, scanners, and multiple phone lines are now so widely available, can't understand why Class Is don't have more people out in the field working from their homes. But regardless whether one works from home, from a car, or out of one's hat, Meridith Wilson's line from The Music Man still holds. You gotta know the territory."

Regarding merchandise carload information, a former regional RR operating manager writes, "I think that a more appropriate definition of merchandise carloads would be less coal, grain, metallic ore, and autos. These commodities move primarily, though not exclusively, by unit train. To the extend there are some carload moves here, I believe they are offset by unit moves in the other categories (phosphate rock trains, steel slab trains, etc.)

"Using this definition, I find that intermodal units now exceed single carload shipments by a good number (I calculated 4.3 mm vs. 3.4 mm from the Week 19 report). Obviously that's not quite apples and apples; the average intermodal shipment probably weighs 15 tons and the average carload shipment probably weighs 85 tons or so (just guesses on my part). Still, it's an interesting dynamic at work. If we don't get the carload problem solved relatively soon, it may not be around to solve." Ain't it the truth.

Canadian National's shortline conference presentations are now available at www.cn.ca and downloadable as PDF files. Each of the commodity groups lays out the basics of the business and the forward outlook with a shortline slant. The best slide sets are, IMHO, the 2002 shortline conference follow-up report, Chief Transp Officer Ed Harris' service design remarks, and the Shortline Council Feedback (sandhogs session). Nobody else does anything like this, and CN is to be commended for the initiative. Shortline managers everywhere, regardless of class 1 connecting roads, would do well to take heed.