THE RAILROAD WEEK IN REVIEW
MAY 20, 2005

What do shortlines, airlines and General Motors have in common? Each represents opportunity for investors to do very nicely indeed by recognizing untapped value in a property that's not performing up to its potential. Kirk Kerkorian sees untapped value in General Motors – so much so he's plunked down a $900 mm bet on GM's future. Rick Schiffler and David Bonderman reorganized both Continental and America West through their Texas Pacific Group, buying properties at a low ebb and brining back rational thought to their running.

Similarly, GWR, RRA and a handful of private operators continue to cherry-pick underperforming shortlines and make something of them. The recipe is not that difficult. Drive out inefficiencies like too many locos and bad track, don't spend a dime unless it can return twelve and a half cents and practice service design that commands a premium price.

The CN Eastern Region Shortline meeting held in Montreal this week (see below) put its spin on the recipe thus: move the assets, grow the top line through market share gains, and give employees a stake in the organization's success. It may be a tough road for some, though. One guy said to me, "None of these new-fangled tricks mean a thing. I've been working for railroads for 33 years and I ought to know what works." I think I'll put his railroad at the top of my acquisition list.

Canadian National's Montreal shortline meeting was informative, insightful and delightful. Janice Murray, VP Network Strategy Development, and her team put on a program that went right to the heart of the shortline-CN relationship and what's being done to make it better. That they pulled it off in spite of a threatened strike (resolved literally in the 11th hour) on the eve of the program's start speaks volumes about the thought and energy they invested in assuring the session's success.

The Eastern Region generates nearly half (49%) of all shortline revenues (Tables 1) on 31% of the shortline mileage and 21% of the carloads, indicating a better density-mix combo than the other two regions. At 95 carloads per route mile it still falls short of the 100 cars per mile per year rule, but it's more than double the west and 20% better than the CN shortlines in the US. About 95 % of revenue comes from Metals and Minerals, Grain and Ferts, Forest Products (wood and paper) and Pertoleum and chemicals. As is so often the case, CN sets the performance bar for the other Class Is and this level of shortline detail would be greatly appreciated from the other five.

Cliff Carson, VP Regional Sales, set the tone with the need to push the yield envelope by stressing service reliability over pure speed, cycle times, fleet triage and routing protocols. Moreover, said Cliff, "We have to get the sales force selling again." What a concept: actually going to see the people seeking ways to make the railroad relevant again. Look for Cliff's highly informative PPT slides (as well as those of the other presenters) at www.cn.ca this coming week.

If there was a single common thread it was CN's "Five Guiding Principles of Successful Railroading," to wit: Service, Cost Control, Asset Utilization, Safety and People. The presenters wove them together in a cohesive whole, so that the success of one depends on success in the other four. And nowhere is that more evident than in CN's focus on trip plan consistency and asset velocity, looking beyond the trip plan to terminal process and customer interface, and implementing gateway routing protocols.

Routing protocols are agreements between and among Class Is that seek to route cars the over the most efficient route in terms of transit time and asset utilization. These are not necessarily the long-haul roués for the originating Class I but they get the cars back fster for their next loads. Take Quebec City to Harrisburg, PA for example. CN's long haul routes over Buffalo and is about 900 miles. Using the shorter D&H route the customer saves 350 miles and CN gets the car back that much faster.

There are three steps every shortline can take to improve consistency and velocity. First, move to seven day service and encourage customers to load and unload seven days. This is so important to CN that shortlines may be well-served by re-evaluating handling fees to recover added cost of increased frequency. Second, use demurrage as a tool to encourage better equipment turns as customer dwell is the biggest cause of poor car cycles. Third, make sure event-reporting begins and ends at the customer, not the CN interchange.

CN is spending C$55 mm on about 700 new generic Plate F 125-ton boxcars in 2005 and the best way to see them on your railroad is to embrace the seamless service plan, manage contribution per car day, and report every movement event on time every time. Above all, keep the Five Attributes first and foremost: Service, Cost Control, Asset Utilization, Safety and People. We'll all benefit.

BNSF held its first-ever regional shortline meeting in Spokane and based on feedback from BNSFers and shortlines both it was a great success. Host Ron Jackson, GM of the PNW Region, told me there was a huge benefit from having all the right players in one room at one time. He said they got a good cross-section of shortlines from the big holding companies like GWR, RRA and Watco to the regional operators like Washington Central and Pend Oreille.

There were BNSF reps to cover transportation, marketing, equipment management, customer service, network development and others. The level of give and take, says Jackson, was most gratifying and getting the right BNSF regional players with the right shortline counterparts was invaluable. Still, challenges remain. Whether tis better for customers to order cars direct from BNSF or through the shortline; identifying the right NCSC contacts for waybilling, advance consist, interchange time and place, e.g. But all seem to agree on the value of pre-blocking on both sides of the interchange.

John Brown of Watco's Eastern Idaho Railroad reiterated the value of the face-to-face contacts beween and among Class I and shortline managers. As some of my readers may know, EIRR has been the poster-child of my series on event reporting and being part of the Class I trip plan process. Here again, Brown cites the importance of improving velocity and throughput of shortline-Class I network. He notes – correctly – that the shift in attitude toward "what's in it for mutual benefit" and away from "what's in it for me" is essential for improving productivity and customer value.

Reading between the lines – and knowing the players as well as I do – I got the sense not only from Jackson and Brown but also from others with whom I've discussed this meeting, that it gave many BNSF transportation folks at the division and terminal level a better sense of what shortlines are all about. And in this regard, let me suggest to both CN and BNSF – and anyone else contemplating regional meetings – let the shortlines put on a panel demonstrating how shortlines are improving productivity of physical assets as well as the talent on the payroll.

Shortlines excel at gathering and distribution. I think the local Class I managers would benefit from some hands-on tales of why the shortline TOOL (as BNSF so accurately puts it on the website) works and how it can make the Class I terminal sup's job easier. Two meetings, two approaches, same result: a better appreciation of what each brings to the table and at the end of the day happier customers.

RailAmerica held its Analyst Day recently and Baird's Jon Langenfeld was there to capture it all. Jon, a WIR subscriber and contributor, brings a refreshing view on shortline developments and his observations are always welcome grist for the WIR mill. He writes, "We reiterate our Neutral rating. EPS slightly below expectations negatively impacted by higher casualty costs and fuel expenses. Looking for progress in taming the elevated expenses and for reaccelerating organic growth.

"Revenue growth was 10%; same-rail revenue growth improved 4.5% driven by yield gains (+2%), currency (+2%), and fuel surcharge (+1%), offset by a 1% decline in same-rail carloads. The OR worsened to 88.1% from 80.4% last year, largely due to higher casualty and fuel costs, which combined to negatively impacted EPS by over $0.10 compared to 4Q03.

"The 2005 guidance is unchanged at $0.94-1.02 (which includes a $0.25 tax benefit) and assumes revenue growth of 8-10%, same-rail revenue growth of 5-7%, and an expected 84-85% OR. We remain encouraged by the increased focus on N.A. operations, an improved balance sheet following divestitures, and good pricing momentum moving into 2005. The elevated cost structure combined with modest organic volume growth within the existing rail lines are the primary challenges."

For my own part, several of my RRA friends were at the CN shortline meeting and it was good to see the momentum they have in New England. My sense is that the senior operating and marketing teams are making great strides lower operating ratios and improved ROIC. Like CSX, though, they still have too much railroad soaking up precious resources. My sense is that too will improve.

The AAR on Thursday awarded gold, silver or bronze E.H. Harriman Memorial Safety Awards in four separate categories to a dozen railroads. In his remarks at the awards lunch, Ed Hamberger, CEO of the Association, said the 2004 employee casualty rate was 9% lower than it was in 2003, a record year itself, adding that in Jan-Feb 05 the employee casualty rate is down an additional 20% yoy.

In Group A, 15 mm or more employee hours, NS won its 16th consecutive Gold while BNSF took silver and UP the bronze. In Group B (4 to 15 mm hours) the Chicago METRA got its second gold in two years, Soo got the silver and the IC got bronze. Guilford won the Group C (fewer than 4 mm hours) gold, the Wheeling took silver and Prowidence & Worcester the bronze.

For Group S&T, switching and terminal companies, the Terminal Railroad Association of St. Louis won the gold medal for the third consecutive year. Conrail was named winner of the silver medal, also for the third straight year, while the Alton and Southern Railway took the bronze medal. Four railroads received special certificates of commendation for continuous improvement in safety performance. They were the BNSF Railway; Long Island Rail Road ; Canadian Pacific Railway's Delaware & Hudson unit; and Conrail. Congratulations to all.

Table 1. Canadian National 2004 Shortline Performance by Region

Region	Miles	Cars	Revenues (C$ 000)	CPM/Yr	Pct Miles	Pct Cars	Pct Revs
Western	2,992	132,000	$ 421	44	29%	14%	27%
Eastern	3,244	308,000	$ 778	95	31%	21%	49%
US	4,255	336,000	$ 381	79	41%	66%	24%
Total	**10,491**	**776,000**	**$ 1,580**	**74**	**100%**	**100%**	**100%**

Source: CN Shortline Meeting

Table 2. Canadian National Eastern Region Shortline Performance by Commodity

Commodity	Loads	Pct Loads	Revenues	Pct. Revs	Yield*
Coal	3,000	1.0%	$ 11	1.4%	1.45
Forest Prd	102,000	33.1%	$ 297	38.2%	1.15
Mets/Mins	60,000	19.5%	$ 158	20.3%	1.04
Grains/Fert	48,000	15.6%	$ 114	14.7%	0.94
Pet/Chem	76,000	24.7%	$ 168	21.6%	0.88
Automotive	9,000	2.9%	$ 18	2.3%	0.79
Intermodal	10,000	3.2%	$ 12	1.5%	0.48
Totals	**308,000**	**100.0%**	**$ 778**	**100.0%**	**1.00**

* Percentage of revenue divided by percentage of loads. Though not strictly a carload contribution measure, volumes greater than revenues as a percentage of the whole can indicate pricing opportunities.

Source: CN Shortline Meeting