THE RAILROAD WEEK IN REVIEW
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"We have always held that price alone is not sufficient to generate brand loyalty." – Gary Kelly, CEO, Southwest Airlines, interviewed in the Wall Street Journal, 12/19/2006

Sharp shortline operators know that the key to remaining in business is providing a superior transportation product at a cost they can afford. They know that if a thousand board feet (mmbf) of 2x4x8s in Quebec is worth US$300 and $400 in central Pennsylvania then the $100 spread is transportation. Regardless of what it costs to move the mmbf the market price is $400 of which the mill is going to take $300.

If I can move the mmbf over my railroad for $30 in expense, there's $70 for me in operating income. But if it costs me $130 to provide a competitive service I'm not going to bid on it. Yet there are still those who will price on cost-plus and even a few who will take the loss just to get the carloads. In the former case, you're leaving money on the table; in the latter you're not going to be around very long.

So, to take the Southwest example to heart, rails large and small must give shippers a reason to use their product and low price is never a unique selling point. LUV knows people will fly in droves between Pittsburgh and Philadelphia for $50 each way – the market price. LUV also knows how to produce a marketable product that includes some of the industry's best stats for $50.

I frequently get calls from shortlines owners who have identified new business but can't get the connecting Class I market manager to give them the time of day because it's too short a haul, too congested, they don't have the equipment, etc. too many crews, etc. Yet when it is suggested that a light-density branch ought to be shortlined, the same market manager will argue the crew is on duty anyway and only goes up there twice a week and we need the revenue.

Now comes the shortline to say for the proposed new business it will provide the equipment, pre-block the interchange and run on schedule to meet existing Class I trains, how can the market manager say NO? You can't have it both ways. The trains are running anyway, there's room on the trains, and they're running to plan. How can this be? Simply because many market managers don't really know what it costs to run a train in a given lane.

LUV knows its network costs and that a $50 PHL-PIT product can make money. With the computing power now available, the RR market manager ought to have network costs by lane at his fingertips. Until he does, money will be left on the table and profitable new business will go to the trucks.

Case in point: The North Shore Rail Group in Central Penna ran a 12-car rock shuttle between a quarry and the user twice a day five days a week for eight years and made good money. The 4 mm tons moved would have filled 160,000 truckloads at 25 tons per trip, something neither Penn DOT nor the neighbors really wanted. Most important, they met the market price by costing out the network, not the carload.

There are other similar boxcar moves between shortline origins and shortline destinations with a Class I in the middle. In one, the shortlines will pre-block the cars and deliver them to the serving yards at either end. The move was developed and sold by the shortlines, so the Class I has nothing in the move save an existing core train between the two serving yards, making it very much like an intermodal move only the shortline is the drayer. The market price is below the Class I quote with itself in the route. Will the Class I price it as an overhead move? What do *you* think?

Troubles at GM and Ford may yet wash ashore in shortlinedom. A friend who is close to both the auto industries says NS could be hit to the tune of $100 mm or so. According to RMI's RailConnect the auto sector represents only 2% of shortline loadings. But it's safe to say that for the Class II and III roads that do handle autos and or parts it's a significant contributor to the bottom line. Think Ann Arbor an FEC.

The relative importance of same-store sales (WIR 12/16/2005) is always good for triggering comment. A shortline operator who's been around the block a few times writes, "You and I have a bit of a philosophical divergence with respect to the importance of "same store" sales comparison. I tend to look at things more from an industry perspective and am less concerned with the financial performance of GWRR and RRA.

"Looking at the global perspective, however, it appears that the shortline contribution to Class I merchandise traffic growth is ebbing. The RMI RailConnect index (which does represent same store numbers as I understand it) shows week 47 YTD carload growth of 3.0% x-intermodal. Intermodal is a funny animal in the short line world; Pacific Harbor Lines and Montana Rail Link account for large numbers but are not involved in marketing the business per se.

"On the other side sits FEC which does quite a bit of its own marketing. This analysis naturally omits the trainload business in other commodities such as coal, grain, iron ore, aggregate, potash, etc., but I don't expect they would change the final outcome much since the overall traffic numbers in some of these categories offset.

"I'm not sure the significance of these numbers, but I do think that sometimes in the shortline industry we tend to believe our own press releases. The acquisition-oriented companies tend to concentrate their efforts in that arena and I think pay somewhat less attention to organic growth. Given their increasing representation in the overall short line segment that understandable tendency may influence overall growth; similarly the much-publicized Class I yield improvement programs have impacted the shortline traffic base. As you've pointed out, it tends towards the lower-yield end of the spectrum."

This is good stuff. RMI's RailConnect does indeed report gross numbers irrespective of who owns the railroad. Take GWR: last year's RMI data included Earl Durden's Rail Manangemen Corp lines and GWR's lines. Thus year RMI reports shortline carloads up 7% through 11/26 while GWR reports carloads up 17% after absorbing the RMC lines. My correspondent is right: shortlines en masse are regressing to the norm where their yoy changes mirror the Class Is more closely than before. Yes, from a strictly financial point, GWR's 17% increase is impressive. But all that really happened is that what were Earl Durden's cars became Mort Fuller's.

What my friend calls "the much-publicized yield improvement programs" are definitely affecting shortline loadings, especially where market managers continue to price by the cost of the car rather than the yield to the network. In this regard the Best of Class has to be CN with the highest percentage of revenue coming from the single-car network and the lowest OR by lots.

Shortline fuel use WIR 12/9/2005) drew some helpful observations from a former Class I manager who was in charge of fuel efficiency. He writes, "I noticed your comment about FEC units using more fuel per unit than other short lines. That hit an old nerve in me. I was always amazed that non-locomotive efficiency people (who were just about everyone) would always be befuddled when they found that locomotives use differing amounts of fuel per mile. I was always amazed that it was often somewhat similar, and so much so that in certain circumstances, like run-through locomotive fuel contracts, you actually use a burn rate per mile and almost fairly represent what was happening in a corridor if it was applied correctly.

"If you are going to look at unit fuel consumption, the only thing that really has meaning is fuel cost per ton mile or revenue ton mile. There are ways to drive that down - go too far and the trains do not move at all, go the other way and locomotive productivity is horrible but the trains go nice and fast (productivity versus utilization arguments). Like anything, fuel cost management requires goal-setting and, at least in my experience, there was always a patent refusal to address the issues required to optimize fuel use as a part of overall optimization of operations. It would be ceding control.

"Back to your observations about short line fuel consumption, part of the problem is that they're small railroads. Every route has very different fuel consumption characteristics. Comparing one line versus the other when their physical terrain, speed limits and traffic mix is different is like comparing apples with oranges. The question for each is whether the fuel being used is the minimum required to allow maximized profitability and customer satisfaction on that line. Whether that line can compete or exist in the rest of the world is another question.

Of course, I can say stuff like that now - back while I was working for railroads it was very politically incorrect to point things out like that. I really loved being involved with fuel issues. It always seemed so important to me, and I'd always run into a sort of dismissive attitude. That was caused by the it's-not-my -budget attitude. It's very difficult for railroads to manage fuel use - it's very out of the natural training that goes on. Anyone who tries to do it automatically steps on lots of toes. Maybe it's different now."

Well, except in a few places one may be able to enumerate on the fingers of one hand, it's not. Look at the shortline conundrum where the terminal manager needs to put more assets against the core business but the market managers don't want to share revenue with – gasp! – a shortline. As for carloads vs GTMs for measuring fuel efficiency, the reader is right. But shortlines don't measure GTMs, so we have to use what we have. And a dozen gallons or so per revenue move is about average based on my recent survey of more than 20 shortlines of all sizes in all parts of the country.

Correction: Katie Farmer (WIR 12/16/2005) took George Duggan's spot as VP Sales, Industrial Products at BNSF, along side Denis Smith, VP Marketing for Industrial Products. Both report to Dave Garin, Group VP. Steve Branscum's job as Group VP Consumer Products is safe.

This is the last WIR for 2005. Thanks all for your continuing good humor, for your contributions, and for your encouragement. Best wishes to all for a joyous Holiday.

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