THE RAILROAD WEEK IN REVIEW
JANUARY 13, 2006

"The railroad is an industry of increasing returns. Economists define an industry of increasing returns as one in which an increase in the output (traffic in the case of the railroad) does not involve a corresponding increase in the cost of production (or transportation)." Eliot Jones, The Principles of Railway Transportation,© 1925, page 71.

The Midwest Association of Railroad Shippers (MWARS) held its Winter Meeting in Itasca, IL this past week. January in Chicago ??? You gotta be kidding! But as it turned out there was no precip, temps were in the 40s or better, and more than 150 souls turned out.

And what a program it was. There were presentations on CREATE, fuel surcharges, managing rail capacity from the shipper's point if view, shortlines, an equipment trend update, Sarbanes-Oxley and freight payment and the Wall Street view as seem by Morgan Stanley's Jim Valentine. The group very kindly invited me to give the opening presentation, a short discourse on what we called "The Value-Added Shortline. See www.rblanchard.com for the PPT.

As usual the Q&As following the speakers provided a valuable window on the real concerns of the group. Concerning demurrage, I had remarked there shouldn't be any, and if there was, it was a sign something was broken. My questioner said his company paid six figures in demurrage charges annually and that was just a given. How could that ever change? My answer was that they needed to manage inventory more tightly and invest in some queuing software lest they suddenly find themselves with no freight cars because the RR needs them elsewhere.

On the subject of equipment management, GATX Rail's Paul Titterton noted that the demand for rail cars is "self-reinforcing" and that a lack of cars caps growth opportunities for shippers, car suppliers and railroads, reinforcing the idea that using cars for storage hurts everybody. Continuing the thread, UP's Brad Thrasher said their equipment strategy is to have a "reinvestable fleet" that could be in constant motion with minimal "no-value" time – yard dwell, idle time between loads, etc. He added that idle cars eat up track space at a new track cost of a $million-plus a mile, a nice touch.

During on of the breaks a shipper told me his serving railroad recently had a change in local management and their rail service reliability has gone to hell. This was particularly disturbing news since all railroads – Class Is and shortlines alike – are trying to act like a network, where every piece works the same as every other piece. That's what's behind programs such as CSX' "Industrial Service Excellence" and Norfolk Southern's "Local Operating Plan Adherence." Somebody needs to get out there in the ground and do some drilling down.

Finally, there were the usual questions on pricing – will the increases end any time soon? Valentine handled that one elegantly: not bloody likely. Truckers pretty much set the price floor; their labor and fuel rates are still going up at a double-digit clip. The rails still have about 40% of the portfolio to re-price to market levels, particularly ex-coal, IM and agricultural goods. In conclusion, Jim noted that the continued positive pricing environment will lead "to the industry's best returns in decades."

That means more railroads covering their cost of capital, meaning more capacity investment, meaning better transportation values for shippers. What a fitting wrap for the conference. Shippers clearly want better value for their money and are willing to change practices to help. Railroads are looking for more efficient ways to provide the equipment and move the trains. And suppliers are looking to serve both. With programs like this MWARS ought to continue to break the 100 mark in attendance.

I had breakfast Thursday with RMI's Gary Griswold, AVP Sales, and Jay Whitelaw, Account Executive for Shipper Services. It was particularly fitting as RMI had just issued a press release on the recent growth its Transportation Management System or TMS, one of the four components of the RailConnect ® suite of web-based railroad management systems. Though the press release does not tell us much about TMS, what is called "IRCS-Connect" on the website, www.railcarmgt.com , does. It's an internet-based on-line application or O-LAP that supports train operations, yard and car inventory control, waybill management, ancillary services (intra-plant switch, demurrage, etc.) billing and adds a query/trace feature.

IRCS has come a long way from the inscrutable DOS-based resident program of a decade ago. According to RMI, more than 300 shortlines use one or more of RailConnect tools, representing a 75% market share of the shortlines. (That implies a market of 400 shortlines, yet by my count there are 600, of which roughly 550 belong to the ASLRRA. But then, two thirds of my 600 aren't big enough to take full advantage of what RMI offers, so it's a reasonable number).

The RMI release says that 70 more roads signed up for TMS in 2005, though they did not say how many of their 300 shortlines already use it. That's a key distinction because, says Whitelaw, RMI's "Integrated Services Suite" comprises four segments: TMS, Revenue Management Services (RMS), Equipment Management Services (EMS) and Freight Management Services (FMS). I have asked Griswell to send me some case histories of RMI success stories because I believe these are a great way to tell the story. In the meantime, be sure to visit www.railcarmgt.com for the official word.

Speaking of which, there is one thing all the event-reporting vendors – RMI, Railinc, SDS-ROCS, et al – need to get together on. And that's taking steps to make sure car counts on both sides of the interchange match. Word has reached me that they don't necessarily match all the time and if that's so then the shortline car counts from RailConnect and the AAR are suspect. Recall my periodic suggestions that gains in shortline carloads may be offsetting organic losses to Class Is. Well, if the car counts at the interchange don't match, who's to know? Reader comment is invited.

An old PRR hand writes, "I read with some amazement in WIR for 1/6/2006 the somewhat disparaging comments about the Pennsylvania Railroad. Another person caught on to this yesterday as well and phoned to point out PRR had indeed been the FIRST Class 1 railroad to start developing a specific costing system while everyone else used ICC Rail Form A.

"We all know there were huge outside forces at work in the northeast that would rationalize the rail system quickly from the empires of the past, however I will never become accustomed to the New York Centralese that they had it right and everyone else was an idiot. Stuart Saunders' biggest mistake was merging with the NYC when he should have merged with N&W. Interesting to note that eventually happened almost 40 years later." Thanks, friend, for continuing the thread where Richard Saunders left off.

Re incremental pricing, Kel MacKavanagh, himself a graduate of the NYC School of Marketing, writes, "I was absolutely delighted to see Mike and Ike's illustration of the One Train Railroad in WIR. It bears out the point that railroads make money when they handle a lot of cars without especially worrying about whether or not the individual car covers its own cost of capital.

"Of course before you get to determining the profit and whether or not it covers the cost of capital, the cost depends on the volume of cars the railroad handled. Consider effects on costs and revenue for Philadelphia Electric or other utilities if you turn a light off. When the light goes off the utility loses all the incremental revenue it had when the light was on; its cost savings are miniscule. Suppose a utility required each residential customer to cover its cost of capital and priced the service to the customer accordingly?" What a concept.

Livonia & Lakeville Railroad President Bill Burt adds, "For at least four decades, marketeers have befuddled themselves and everyone else with their floating definitions of variable cost. All costs are fixed or variable depending on the decision you are making: add a car to the train or add a train-start to the service. Or do you simply walk away and abandon the line?

"If the last named, everything, including the president's salary, is variable. If you're only looking at tacking another car on a train that will run anyway, that approaches the other extreme. So what decision are you making? The tendency of experts to speak in tongues and avoid a general explanation of the problem was a frustration early in my career and I sympathize still with those who are trying to understand."

Re getting into the shortline business, LAL Chairman Gene Blabey writes, "Your advice to non-railroaders seeking to enter the shortline business (Jan. 6, WIR) is on target. There is very little opportunity for non-railroaders. Class I spin-offs provide the principal feedstock for shortline startups and the spin-offs fall into two categories.

"(1) Line segments that are marginally profitable and/or have potential, with needs for infrastructure investment that the Class 1 is unwilling to make. These segments are offered for sale or lease to a shortline operator with a track record (no pun intended) in railroad management and marketing. The line's contribution to the Class 1's system revenues is secured through contractual interchange commitments, and both the new shortline bets that the pending investment requirements will be addressed through grants and low-interest loans. Access to public capital is a key asset that shortlines bring to the table in any deal with a Class I.

"(2) Line segments that are truly unprofitable and lacking in any growth potential. These branches are offered to outside buyers as a 'last chance' alternative. The terms are likely to be full payment of the NLV since the Class 1 knows it can cash in its chips through abandonment.

"In the first category, the Class 1 seeks a 'partner.' In the second, the Class 1 is looking for its money. With partners, you want the best -- and that's not likely to be a novice. On the other hand, if your only concern is whether the check clear, prior railroad experience isn't a requirement. So the very properties that a Class 1 might sell to a novice are the dogs that the novice shouldn't touch with a barge pole."

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RailConnect Index of Short Line Traffic

Traffic Type: All

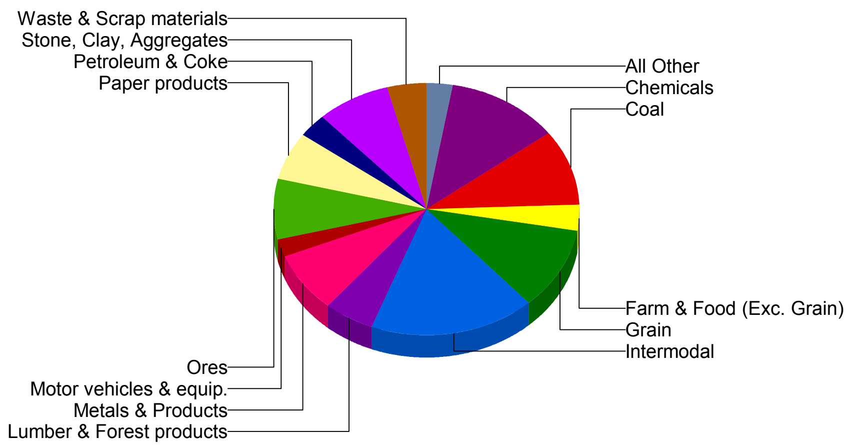
For the week ending: 12/31/2005

Week Number: 52

Carloads Handled	Current Week			Year-To-Date		
	2005	2004	% Change	2005	2004	% Change
Coal	10,025	8,870	13.02%	491,363	504,685	-2.64%
Grain	8,887	8,260	7.59%	538,431	524,549	2.65%
Farm & Food (Exc. Grain)	3,356	2,921	14.89%	177,763	160,971	10.43%
Ores	8,897	7,795	14.14%	403,879	410,970	-1.73%
Stone, Clay, Aggregates	6,453	5,172	24.77%	396,429	353,238	12.23%
Lumber & Forest products	4,319	4,103	5.26%	263,218	252,295	4.33%
Paper products	6,281	5,660	10.97%	315,908	303,212	4.19%
Waste & Scrap materials	4,241	4,082	3.90%	218,988	219,024	-0.02%
Chemicals	11,011	9,792	12.45%	619,021	580,941	6.55%
Petroleum & Coke	4,620	3,277	40.98%	145,866	127,783	14.15%
Metals & Products	9,149	8,027	13.98%	405,928	394,960	2.78%
Motor vehicles & equip.	1,381	1,517	-8.97%	106,402	108,843	-2.24%
Intermodal	13,866	11,485	20.73%	893,104	711,686	25.49%
All Other	2,249	2,917	-22.90%	139,373	154,748	-9.94%
Total	**94,735**	**83,878**	**12.94%**	**5,115,673**	**4,807,905**	**6.40%**

RailConnect Index

Year-To-Date



All Other	2.7%
Chemicals	12.1%
Coal	9.6%
Farm & Food (Exc. Grain)	3.5%
Grain	10.5%
Intermodal	17.5%
Lumber & Forest products	5.1%
Metals & Products	7.9%
Motor vehicles & equip.	2.1%
Ores	7.9%
Paper products	6.2%
Petroleum & Coke	2.9%
Stone, Clay, Aggregates	7.7%
Waste & Scrap materials	4.3%
Total:	100.0%