RAILROAD WEEK IN REVIEW
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"The most important thing that can happen is to get two Class I CEO's motivated to improve their shared interline merchandise business." -- Charles N. Marshall, SVP-Farmrail, Transportation Clubs International, Cherry Hill, New Jersey, September 15, 2006

Charlie Marshall's remarks touched on a number of excellent points in what he calls "the loose car business," meaning the single carload merchandise commodity trade not associated with unit trains of coal or intermodal. As you know, *Week in Review* still calls ag, auto and aggregates part of the single-car franchise even though a lot of into morphs into unit trains. Some excerpts:

<u>Rethinking gathering and distribution</u>. "There is a negative way to look at merchandise and a very positive way. The negative way is what we talk about most. Single-car moves require a web of service, a web of cost, and a web of capital investment that dwarf that which is required to run unit trains. Think of switch engines and yards and branch lines and crews and twenty-ton pieces of iron that get only one load a month. When the railroads add up these costs, they often conclude that they prefer unit train traffic. When shippers add up the costs and look at the service they get, they usually decide that they prefer trucks. If this continues, it will be bad news for those short lines that depend upon merchandise freight."

<u>Opportunities to increase market share</u>. "[The positive news is] the opportunity for growth through merchandise share gain is enormous. This is in contrast to the unit train business, where the railroads have fully penetrated the market and can grow only as fast as the market itself grows. So it is merchandise carload traffic that offers the railroads the opportunity to become a true growth business once again.

"Two years ago Mercer Management did a study that tried to evaluate the potential for revenue increases based upon modest improvements in service combined with the kind of information support that one takes for granted when dealing with any internet retailer or parcel delivery service. The short of it was that Mercer found the present value of combined higher prices and increased volume to exceed $14 billion for the rail industry."

<u>Move faster but above all move.</u> "Start by thinking of the problem as having two parts: Cars moving slowly, and cars moving not at all. A well-advanced attack on the moving slowly problem is the 'precision railroading' concept of Canadian National, [where running the railroad] according to a trip plan for every railcar has led to reduced transit times, improved consistency, enhanced productivity, and [greater] network capacity.

A project involving cars not moving is being pursued by BNSF and the Rail Committee of the NIT League. BNSF has observed that its merchandise cars spend 82% of their time standing still and that an important part of the problem is the variability of switching complexity by location. The 'First and Last Mile' initiative hopes to improve switching efficiency. The two main subjects of attack are switching complexity and physical challenges." [See also Dave Garin's Oct 2005 shortline presentation, WIR 10/28/2005]

<u>Data Transparency</u>. "Why is data transparency important to the merchandise freight business and not just a wonk issue for back-office people? There are two big reasons. First is cost. Right now, there is a three-layer system of reporting information that provides poor results at high cost. First is

individual railroad websites. Many of them are excellent, but few shippers use a single carrier and cannot rely on a single website.

"Second is Railinc, which attempts to pull together some, but so far not all, of the information available from individual carriers. Third is third party vendors hired by the shippers to try to pull together the railroad information from diverse sources. All of these three layers impose real costs on the merchandise system that could be reduced with a unified reporting system.

"So the first issue presented by lack of data transparency is cost. The second issue is quality. Because interline movement data are not collected and displayed in a uniform way, and because shippers must do this privately and internally for their own movements, there is no systematic interline effort to create the kind of interline service predictability that CN and BNSF are trying to achieve internally. The first step toward interline service improvement will require open display of performance information.

"If you doubt the importance of this, look at the Mercer study for Northwestern that I adverted to earlier. Shippers told Mercer that improved car information was more important to them that substantive improvements in service quality and made a substantial contribution to that $14 billion NPV of new revenue to the railroads that Mercer calculated."

<u>Some Suggestions</u>. "First, trip planning needs to be constructed on an interline basis as well as a local one. Second, comprehensive measure and display of both interline and local dock-to-dock transit times. Forgive my skepticism about the existing measures of "velocity" and "cars on line," but I just don't see that they have much to do with the needs of customers. Until there is a uniform and widespread measurement and display of dock-to-dock service, there will be neither an understanding of what service is nor a focused effort to improve it.

"Third, some merchandise traffic may be susceptible to handling in unit trains, with shippers or short lines or third parties taking over responsibility for marketing and any assembly or disassembly of those trains that might be necessary. Farming out the ancillary services will make it much easier for Class I railroads to price merchandise service: A merchandise train slot can be valued and priced at the same level as the least valuable unit train slot, because the service will be the same. (Yes, I recognize the HUGE cultural barrier to pricing single-car traffic on a trainload basis, but remember that we are already there in the intermodal business.)

"Fourth, the large railroads may find it desirable to pass on to others all of the car handling functions associated with merchandise. This includes local trains and the operation of classification yards. Rail labor could be expected to be wary of such arrangements, but the potential for traffic (and job) growth is such that eventually some measure of labor acceptance should be attainable.

"Finally, and here is the zinger, the most important thing that can happen is to get two Class I CEO's motivated to improve their shared interline merchandise business. Once they succeed, others will follow. All of us need to consider how to find those two pioneer CEO's and persuade them to get the ball rolling. The payoff for them, the payoff for all of you, will be enormous." Thanks, Charlie. And let me add my congratulations as he has been tapped for TCI's *Person of the Year* award.

You can look at all the financial reports you like but there's nothing better than going out and looking at a railroad to get an idea of what kind of results they will post for the next quarter and years to come. It's all a matter of attitude, and house-keeping is a great place to start. Take a walk around the engine terminal and see how repair parts are stored – on pallets with tarps with like next to like is a good start. How many drink cups and soda cans are on the ground? Are areas where oil is likely to drip protected with fabric or are the ties and ballast fouled? How about fresh paint on the woodwork?

This way of looking at a railroad has its roots in the first time I ever saw the Santa Fe, when I was in the artillery officer career course at Ft Sill in the late 1960s. That every structure had coat of fresh paint was what struck me most. Locos were clean, coaches gleamed, and there wasn't a lot of trash along the right-of-way. The track structure itself was immaculate and it was clear to *this* easterner that pride, leadership and esprit de corps were in great abundance. And so it was that ATSF was the first RR stock I ever bought.

Fast forward 40 years and I'm looking at another railroad with the same eyes and seeing the same signs of leadership, pride and esprit. Only this time it's a 343-mile Class III railroad with 13 train-starts a day plus two Amtrak trains and an interchange turn from one of its connecting Class Is. They're averaging well over the 100 cars-per-mile minimum. Volume is up 13% in five years and at an accelerating rate.

It's partly CTC and partly dispatched by track warrant from a central office. The warrant system is computer-directed so that meets, over-takes and MOW crews are accommodated with minimal time lost. For example, a track crew is waiting at MP 35 for a southbound freight before continuing its work northward. The southbound has a warrant from MP 30 to MP 40. As soon as he clears MP 35 the southbound's warrant between MP 30 and MP 35 has been fulfilled and the MOW warrant from MP 35 to MP 30 goes into effect. Thus the MOW guy gets back to work before waiting for the southbound to clear MP 40.

I rode the Amtrak train not only because I hadn't been on this piece or RR in ages but also to get a good look at it. The line runs through four states, only one of which is provides any financially meaningful infrastructure support. Yet the track structure – lots of CWR and 100 RA jointed – let us roll merrily along at about 60 mph without spilling a drop of my coffee. The brush-cutters had cut a path equal to a full track-width on either side of the main. There were no dips at crossings or sudden changes in vertical alignment on the bridge approaches.

Back at the engine house, Safety First was very much in evidence. They have a rule that everybody in the company gets $2 a day bonus for every quarter with no reportables – that'll buy a few bags of groceries – and their low injury rate shows the message is hitting home. One thing I liked in particular was where they did not have a particular piece of equipment, they'd make it rather than buying it off the rack – like a home-made flange-turner or test power grid made out of a recycled dynamic brake unit or an indoor transfer table for changing out traction motors.

You'll never see any of this in a 10-K. But increasing revenues, car counts, and an improving operating ratio *are* there, and the analyst community needs to make the connection. A trip to St Albans on the New England Central would be in order before they write their next RRA reports. (Pix at http://www.flickr.com/photos/42871912@N00/248434439/in/set-72157594288509028/)

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