THE RAILROAD WEEK IN REVIEW
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"How the bail-out works. Young Chuck buys a donkey from a farmer for $100. The farmer agrees to deliver the donkey the next day. The next day the farmer tells Chuck the donkey died. Chuck says OK, gimme my money back. Farmer says he can't because he spent it. So Chucks asks for and gets the dead donkey and raffles it off – without saying anything about the donkey's demise. He sells 500 shares for $2 apiece. When the guy who won the raffle complains, Chuck gives him his two bucks back, pocketing $998. Chuck now works for Goldman Sachs."— a fable making the Internet rounds.

The ASLRRA Eastern Region meeting in Williamsburg at the beginning of the week was, according to many of the folks with whom I spoke while there, one of he best regional meetings they've attended. The DJIA soaring nearly a grand Monday didn't hurt the festive air, as most shortliners seemed to be of the opinion that the current economic malaise will not be any particular hardship to them. Others were less sanguine; see below.

The general tenor of the presentations, from ASLRRA President Rich Timmons' opening remarks through "The Night at the (Washington) Oscars" spoof by ASLRRA General Counsel Keith Borman, was upbeat. There were detailed and instructive shortline presentations from the Norfolk & Portsmouth Belt Line, the Finger Lakes Railroad and the RJ Corman group. We heard from experts in rail technology as applied to the short lines, from the FRA on upcoming regulatory changes and from the Coalition Against Bigger Trucks and how their partnership with short lines helps the cause.

Personally, I thought Noel Perry's lunch-hour talk about the economic outlook and what's ahead for transports was particularly well done. He beat many of the same drums I've been beating in these pages, but with greater emphasis on the shipper behavior and decision-making. In particular, he noted the general slippage in single-car shipments and how short lines can offset this by playing to the beneficial owners' need to combine the economy of the long-haul batch process (trains of cars) with the flexibility of the short-haul custom process (local truckload).

This provided a beautiful segue to the afternoon panel on Class I-shortline initiatives to make the carload business work better. CSX' Charles McSwain, AVP for Regional Development, talked about "stalking opportunities" and how a fifth of all CSX' new business development sites are on short lines. Norfolk Southern AVP for Shortline Marketing, Rob Robinson, countered with fifty-two new business opportunities worth some 3,700 revenue units in New York and Pennsylvania alone. Finger Lakes' President Mike Smith rounded out the discussion with specific ways to make hay out of the shift to regional manufacturing and consolidations among manufacturers.

And to round out Day One, the entire group was led by fifes and drum from the Williamsburg Lodge, past the Powder Magazine and down Duke of Gloucester Street to a delightful eighteenth century meal at Sheilds Tavern, hard by the capitol building where it is said Patrick Henry gave his "Liberty or Death" speech. How fitting. The conference message was clearly shortlines are at liberty to pursue all manner of creative ways to win new business, even in this market.

As if to prove the positive outlook from the shortline meeting, CSX on Tuesday night let it be known that third quarter revenues were up eighteen percent to a record three billion dollars. Operating expense was held to a fifteen percent increase, leveraging a respectable thirty-one percent operating income gain. Below the line, net earnings decreased six percent though the eight-percent decrease in diluted shares let earnings-per share ooch their way up to ninety-four cents from ninety-one cents a year ago. But strip out the hundred-and-ten million dollar discontinued operations credit from the shipping lines sale and CSX earns kudos for boosting earnings-per-share from continuing operations by a whopping forty percent. And the operating ratio dropped to seventy-five point two.

Above the line, there was low double-digit revenue growth in phosphates and fertilizers, metals, and chemicals with agricultural products posting a staggering thirty-six percent revenue gain. Coal got second-best with revenues up thirty-one percent. Volumes were nowhere near as robust: down two-point-three percent. Every commodity group but metals, agricultural products, coal/coke/iron ore and intermodal shows negative revenue-unit deltas, with the last two up less than a point.

Most operating expense categories held their gains to single digits though fuel was up fifty-four percent (no surprise here – CSX averaged three-fifty-six a gallon in the period against two-and-a-quarter a year ago) while "materials, supplies and other" gained twenty-one percent thanks mainly to added costs related to floods and hurricanes, expenses related to the proxy fight and inflation. Back these out and the year-over-year expense delta is less than ten percent.

As we've said before, a faster, safer railroad costs less to run, and CSX proves the point. Fuel burn dropped three percent though gross-ton-miles were unchanged. The personal-injury rate and train-accident rate improved twelve and ten percent respectively. Terminal dwell dropped to twenty-four hours from twenty-eight hours a year ago. On-time originations and departures increased by more than half again what they were in the third quarter of 2007.

Better operating practices lead to improved service and that in turn leads to increased pricing power, a continuing mantra throughout the sales and marketing portion of the presentation. Though we see a slowing rate of increase in "same-store" pricing (same commodity-origin-destination pairs and car type) it's still north of six percent, a third of the twenty-one percent system revenue-per-revenue-unit increase this quarter. (During the question-and-answer session it was pointed out that most of the revenue-per-unit delta is from fuel surcharges, or "recovery" as CSX delicately puts it.)

The fourth quarter revenue outlook is positive for agricultural products, chemicals, coal/coke/iron ore, emerging markets, food/consumer and metals. Intermodal, phosphates/fertilizer and forest products are neutral and automotive is decidedly negative. Overall revenue-unit counts are expected to be in the negative two-percent range in the first half of 2009, though pricing power and value-added service will keep revenue gains at levels that will support earnings targets and an operating ratio in the upper sixties. Good show.

The College of William and Mary hosted an "economic forum" web event Wednesday night on "Understanding the Current Financial Crisis." I listened in because it *is* difficult to understand exactly what's going on and how it affects the shortline railroad industry. The insights were helpful and let me share some excerpts and their application to our concerns.

The panelists began by saying there is a general lack of confidence and transparency in the financial markets and that in turn creates the sense of crisis. Housing prices have more than doubled over the past seven years though incomes have risen on average just four percent in the same period. How can this happen? Blame the low-interest rate environment that caused five times as many risky mortgages to be written in 2006 than just six years prior. And with wages only up a fraction of home prices, it was inevitable that it had to come to an end. Prices have fallen forty-three percent in the last year and a half.

The result has been a shut-down of credit availability that is spreading out from housing into the general economy. Consumer durable goods and retail sales are down in the United States and it's spreading, so the ability to "export ourselves out of a recession" is gone. The best way out is to lower rates and encourage investment in other sectors. However, it may get worse before it gets better with unemployment hitting eight percent fairly soon.

The good news is we've seen this movie before and lived to tell about it. That was in 1977 when the price of oil tripled and we were in a deep recession. We learned to live with less then and we're seeing that trend now – see comments re consumer durables above. The bad news is the seven-hundred-billion-dollar bailout package is morphing into something even bigger as politicians all try to lard on their favorite projects. This will not do. The move is to address banks sitting on losses they have not recognized – mark to market -- using the treasury and its seven-hundred billon package as the buyer (capital provider) of last resort. Cleaning up the balance sheet and taking the hit makes the sale easier as Merrill found out in its deal.

The lesson for short lines it to grow operating income through new revenue streams and expense control, de-lever and preserve capital. We're pretty much guaranteed higher taxes regardless of who takes the White House, so tax credits will be even more valuable. With more money going to fixing the financial problem, there will be less to pass around in rehab grants and RRIF loans. And if that isn't enough, the tea leaves as read by the FRA man in Williamsburg point to an increasing cost of compliance with the new safety rules. The W&M panel lead-in encourages one to sit back, relax and think long term. Seems like good advice to me.

Book Corner. *Switch Points: Culture Change on the Fast Track to Business Success* tells the story of how Canadian National changed its corporate culture to shift modes from a fuddy-duddy, slow moving, crown corporation into the profitable power house we know today. The book uses the railroad as an example of what managements *should* do when coping with change, using the metaphor of switch points to introduce decision points in any culture where choosing the main or the runner can affect the results for the entire enterprise.

The entire text is loaded with railroad terms applied to non-railroad cultures – aligning the switches, setting the trip plan, saw-bys – with examples of how to use these tools in non-railroad situations. And though the culture change at Canadian National is the theme, the lessons here are as applicable to business in general as are , say, the points made in such tomes as Tom Peters' classic, *Thriving on Chaos*. (And for dessert pick up Hunter Harrison's *How We Work and Why* for the inside CN story.) Hard cover, 254 pages. From Wiley Books at your local book seller or by calling 800-225-5945.

Union Pacific Streamliners is yet another coffee-table beauty from the Voyager Press "Great Passenger Trains" series. Lavishly illustrated, author Joe Welsh takes on a tour of the Great Trains from the "*City of*" trains to some of the lesser names like the *San Francisco Overland* with its through cars to and from the east via the New York Central and the Pennsylvania and the *Portland Rose*, a creature of the depression. Having just missed the great age of Pullman travel myself, I'm always pleased to read about car interiors and formats and here the present tome does not disappoint. We are treated to a full-train diagram of the M-10002 bull-dog nose 1936 *City of Los Angeles* as well as numerous photos and plans for coaches, sleeping room configurations – even a "Wild West Saloon" car that ran on the *City of Denver* in the 1930s. Hard cover, 160 pages, 90 color and 90 black-and-white photos, $37 US.

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