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"Legislation removing limited railroad antitrust immunity appears to represent an attempt to overturn long-established regulatory policies that have provided enormous benefits to shippers and American consumers." -- J. Michael Hemmer, senior vice president-law and general counsel, Union Pacific Railroad, in testimony to the House Judiciary Committee, May 19, 2009

Norfolk Southern CEO Wick Moorman was quite direct in his remarks regarding re-regulation at his company's Investors' Day conference in Atlanta Wednesday. He suggested that the current environment in Washington presents "incredible ironies" as the forces of change would interfere with the wide range of economic benefits the rails have wrought over the years since the Staggers set them free to engage in contract and market-based pricing.

On a more optimistic note, he said conversations to educate Senate staffers have had "positive effects" and that many more Members of Congress than one might think actually *do* understand what's at stake and there are more rail allies emerging every day. "NS will fight a bad bill," said Wick. As for what's a good bill, we'll just have to see what comes out of committee.

Jason Seidl of Dahlman & Rose was the first hand up for the Q&A and he asked Wick to posit a "worst case" in the event of regulatory price caps on what the railroad can charge for the movement of goods. Wick replied that they would have to shift their focus to those high-yield lanes where the pricing permitted still offers good returns. By inference, low-yield lanes, precisely the lanes that are a short line's bread and butter, might suffer as assets from cars to people migrate to the lanes with better returns.

The unions get it, too, he added, saying, "In a Democratic Congress it's the jobs impact that matters." And in this context, Wick concluded his response to Jason by noting that NS is a "car hire negative" carrier (the CY 2008 R-1 shows NS a net negative $35 mm in railroad-owned car time charges alone; boxcars represent a quarter of the payout) and this would have to be addressed. On the other hand, "Coal is good for us" but "we will manage the network to go get the business that's out there."

If the Investors Day Presentations had a central theme, it was how NS is using technology – much of it home-grown – to create a better, more reliable, more consistent transportation product. The terms "customer value" and "supply chain management" came up repeatedly in the formal remarks, starting with Wick's opening: There are three main elements to NS strategic direction: (1) Superior customer service aided and abetted by integrated technical systems built on the TOP as the foundation: Operating Plan Developer, Unified Train Control System, LEADER; (2) Cost control in which safety is a major role; (3) The franchise itself where capacity is maximized through the coordinated efforts of all the players.

There were many take-aways for short lines. One way to reduce foreign car hire is to turn cars faster. NS has shown how they can deliver consistent car miles-per-day, trip cycle times and so on even as crew-starts come down. [Some short lines have complained as their interchange frequency drops yet the metrics show no effect on transit time or reliability seen by the customer. Message to short lines: Continue to place cars on the interchange as usual and NS will take care of the rest. Just get 'em off your clock.]

The NS Track 2012 initiative is a set of cross-discipline initiatives aimed at running a better railroad. The emphasis is on asset utilization and strategic initiatives related to the present econ environment. SVP Planning Deb Butler showed now NS is cutting back the capex numbers announced in Jan in all areas but corridor development and info tech. Once again the message to short lines is what you see locally does not necessarily represent what's happening beyond your front door. Technology and trackwork make the corridors run faster – for all movements, not just coal grain and intermodal.

Moving to the commercial side, EVP Marketing and Sales Don Seale talked up growth initiatives in auto, coal and agricultural products, particularly ethanol and chicken feed, but did not dwell long on the so-called merchandise single-carload sector. He did allow, however that merch carload – "industrial development" – revenue growth including agriculture and auto 2000-2008 took top honors at $1.9 billion vs. $1.7 billion for coal and $939 million for intermodal.

[That said, I just checked he last five quarter's results and find that the agriculture, government & consumer commodity group hit its peak in the third quarter of 2008 with the first quarter 2009 down 18 percent from that and only ten percent from fourth quarter 2008. The metals & construction , paper-clay-forest and chemicals groups hit their peaks in the second quarter of 2008. Overall, the merch group hit its peak in the second quarter of 2008 with first quarter 2009 loads off a third from that. The good news is the rate of change appears to be slowing; the first quarter 2009 deltas from fourth quarter 2009 are mostly in the negative teens with chemicals at minus five percent and autos minus thirty percent.]

In his projections, Seale carefully avoided any prognostications as to where the carload general merchandise carload sector is headed. It would have been instructive had somebody challenged this during the Q&A, to wit: The volume change for first quarter 2009 from the fourth quarter 2008 was less worse than the change from second quarter 2008. Are we seeing a leveling off, and if so what re the odds merchandise carloads will remain at about the same levels into at least third quarter 2009?

One particularly helpful question had to do with assets stored and what volume level increases might be attained if all that's stored were put back in service. The answer was about forty percent. However, if you add in the efficiency brought on through the various tech innovations presented here today, it could be more than that. Wick would not say how much, but one got the sense it would be more than a rounding error.

My read? "Manage the network to go where the business is" implies they will also manage the network to not go where the business isn't, implying more short line participation as they grow the business or fewer shortline interchanges as the volumes drop. NS is open for business, is coping with the present downdraft, and is ready come back full bore if needs be or else to rebuild the traffic base load by single carload. Message to short lines: Bring us solid business that will not be at risk in a worst-case scenario.

The trend is your friend. Believe it or not, the stock market can be a pretty good predictor of company performance, be it your customer, your Class I connection, or even your truckload competitors. The folks at Janney do one of the better technical strategy newsletters and the June 1 issue encourages investors to take their clues from the 50- and 200-day moving averages of stock prices. Since institutional investors own 85% of rail shares, watching what they're buying and selling can often help double check what we're seeing in the field.

Janney suggests watching for the point where a firm's share price crosses the 200-day line to the upside as buyers outnumber sellers and demand runs ahead of supply, pushing up prices. Applied to the rails, BNI, UNP, GWR, CNI, CP meet the price passing through the 200-day test. A further test might be whether the 50-day average has crossed the 200-line to the upside. Among the rails only CNI passes the test. Another point in CNI's favor is the downward slope of the 200-day curve is growing less steep sooner than the others. Again, demand is outrunning supply as more players see Canadian National as a leader in the field. A look at the operating discipline and financial performance of CN the company shows clearly how one supports the other. QED.

Providence & Worcester first quarter 2009 operating revenues came in at $4.7 million, down 18 percent year-over-year as carload revenue slipped 17 percent and intermodal revenue declined 31 percent. Commodity carloads skidded 19 percent, though P&W was not forthcoming with details other than to cite the general malaise of the economy. At least they were able to take a three percent hike in revenue per carload. Intermodal units were off 38 percent though a fortunate change in mix helped boost revenue per container by 12 percent. Happily, intermodal has dropped to six percent of revenues from seven percent as P&W management appears to be putting more emphasis on the highly lucrative high-rated carload commodities.

Back to the bad news. Operating expense came down only five percent, dragging operating income down 48 percent and pushing the operating ratio to a spectacular 144.7, a number I for one have never seen. Comp and benefits now account for 78 cents out of every dollar of revenue; railroads of this size may see as high as forty cents in only the worst of quarters. Trackage rights fees, mainly paid to Amtrak for the Groton-Boston Switch segment, increased 31% and maintenance of equipment expenditures jumped 86 percent. The $278 million reduction in fuel expense was totally absorbed in these other extravagances, though comp and benefits actually was down two percent.

Cash flow, however, turned positive in the quarter. Cash from operations increased by more than $800,000, albeit helped in large measure by a two-million dollar swing in accounts receivable. Capex got cut in half, to $733,000 from $1.5 million, creating free cash flow of $163,000 vs. a seven-figure negative number in 1Q08.

Below the line, there was nothing spectacular -- no million-dollar land sales -- however the $650,000 income tax benefit for the quarter sopped up a third of the pre-tax loss of $2.1 mm. Thus the operating loss was $1.4 million, 29 cents a share, down from a loss of $922,000 a year ago, pasting shareholders for a nineteen-cent loss per ticket. But, hey, I was out on the property in September 2008 and was well pleased with the level of maintenance and volume of high-rated carload business. Now if only we could get comp and benefits in line and get rid of the intermodal business -- which as to be a drain on assets -- we might see positive earnings numbers on a regular basis.

Next week: The Warren Buffet remarks promised for this week but pre-empted by my longish NS rant. New, rejuvenated, extended and challenged short lines.

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