THE RAILROAD WEEK IN REVIEW

March 11, 2011

"Customers are demanding more reliable service, loadable empties and information that allows them to manage their businesses more efficiently." -- Clarence Gooden, CSX

CSX held its 22d annual Short Line Workshop at the World Golf Village resort near St. Augustine, Florida March 6-8. The theme was "Powered by Partnership, Aligned for Growth" and the program really lived up to its name. To me, the big take-aways were three. First, CSX's senior management team is all working from the same playbook with the same agendas and each listening very closely to what the other is saying.

Second, they took great pains to address things short lines care about in their remarks. (More than once I had a question all teed up and the presenter answered the question in the next slide.) Third, the company is built around creating and nurturing stakeholder value, whether superior service for customers, a safe work environment for employees or shareholder return.

Point Two above reinforces Point One above. Chief Operating Office David Brown opened the session by demonstrating the CSX commitment to "What Really Matters" in the carload franchise and shortline relationship. Chief Transportation Officer Cindy Sanborn put Brown's remarks in perspective with her views on Total Service Integration: how the first-mile, last-mile shortline strength supports the One Plan and CSX core operations.

Of course, you can't do any of that without cars and AVP Car Management Shelly Cooper laid out what they're doing to get the right cars to the right customers at the right time, starting with daily rather than weekly car orders. With 26 percent of all shortline loads originating in CSX equipment, it's imperative that the short lines be true partners in the order-place-pull report process. And, to drive that carload commitment home, Cooper spelled out what kinds of cars CSX is rebuilding for what commodities and why short lines have a significant role in each commodity carload category.

[*As an aside, and in line with my above observation regarding management speaking with one voice, CSX Director of Car Management David Sellers spoke at Railroad Financial Corporation's 25th annual Rail Equipment Finance Conference in Palm Springs last week, saying brown paper is the driver in forest products. Railway Age reports his remarks thus: "Such factors as electronic media, internet buying, and recycling have changed the industry, shifting it toward "brown paper" (for example, packaging needed for shipping items purchased on line at sites like Amazon.com). Boxcar average load cycles need to drop from 30 to 27 days to meet projected demand by 2015. CSX is developing strategies on customer dwell for continuous improvement in cycle dwell time." -- rhb*]

CFO Oscar Munoz drilled down into the "Grow to 65" program -- getting to a 65 operating ratio and lower. It's been important, says Munoz, to show private equity fund investors as well as the rest of the investment community that owns 74 percent of CSX shares how the company has moved so quickly from one of the worst ORs in the industry to one of the best. What it takes is a relentless focus on price and yield (CSX has under its belt five consecutive years of same-store pricing gains north of 6 percent) and it is here that short lines can contribute with incremental new-business margins that increase year-over-year. That covers my Point Three.

Now comes Chief Commercial Officer Clarence Gooden to tie it all together. Right off the bat he reminds us of Item Number One of CSX Core Values: It begins with the customer. After a brief review of recent commercial growth patterns, he dives right into how CSX expects to get the OR down to 65, and there's a definite role for short lines. Joint-line price gains plus productivity improvements drive volume growth, which in turn drives operating income and the OR. Short lines that turn cars faster and focus on high-yield new business opportunities play a crucial role.

He looks for price increases at "inflation plus" (same-store price gains *average* six percent year-over-year, meaning some will be more), productivity improvements worth another $130-140 million and volumes "above GDP and IDP" (read north of three percent; CSX 2010 total revenue-unit volume was up 10 percent over 2009 but still down seven percent against 2008). These elements combined ought to yield the 65 OR, he says. Finally, he points to specific growth in metals, chemicals, agriculture and waste/machinery with forest products "turning the corner" with brown paper in the lead. All are vital shortline commodities.

The Trade Show featuring booths, tables and displays from 45 different disciplines came after lunch. It was most refreshing to make the rounds chatting with CSX reps covering commodities from Agriculture to Waste and support services from car accounting to warehouse services. Like the Short Line Conference itself, theTrade Show is another CSX first.

At dinner CSX Chairman, President and CEO Michael Ward reinforced the message that short lines are a major component of CSX's service business and shared some of his views on the regulatory and legislative hurdles ahead of the industry. Then it was Q&A time. The assembled multitude did not disappoint with its many intelligent Qs; Ward gave as good as he got with his As, adding much color to the evening.

One final note. Tuesday's breakout sessions covering five commodity groups plus three support services are, to my way of thinking, a much better use of everybody's time than trying to schedule individual sit-downs. Each group of presenters presents four times over three hours, meaning they get to see and respond to maybe 40-50 individuals in open session and then set up side conversations as needed. Shortliners get in-depth presentations on commodities and services of interest and can drill down or not as they wish. Would that other Class Is would follow suit.

In port-morteming the session with a lot of folks as we wended our ways to our cars for home, I came away with the strong sense that CSX had addressed concerns and opened new eyes. Yes, the odd glitch occurs here and there but as a whole the CSX product works well, starting as it does with the customer.

Pennsylvania's Reading & Northern Railroad has garnered the coveted *Railway Age* Regional Railroad of the Year award for 2011; the 2011 Short Line Railroad of the Year Award goes to the

Blacklands Railroad in east Texas. Both awards are to be presented at the ASLRRA annual meeting in early May.

The 300-mile Reading &Northern is cited for "leveraging eastern Pennsylvania's heritage role in anthracite coal and tapping into the state's emerging role as a natural gas resource." R&N interchanges cars with Canadian Pacific, Norfolk Southern and four area other short lines. This is R&N's second trip to the podium for the award, having won the regional award in 2002.

Blacklands operates on 73 miles of ex-Cotton Belt track between Mt. Pleasant and Greenville. Most of the track structure is owned by the Northeast Texas Rural Rail District; some trackage is leased from the Union Pacific. Blacklands Railroad also operates the eponymous Henderson-Overton Branch railroad, a non-contiguous former UP branch (before that part of Jay Gould's International1Railroad). Interchanges are with UP, KCS and RailAmerica's Dallas Garland & Northeastern Railroad.

Oil and Gas Exploration was a hot topic at SWARS in Galveston, writes independent railroad analyst Tony Hatch. "Rail is crucial because it offers speed to market and flexibility in destination -- this rolling pipeline can go to where the arb spreads are most favorable. NIMBY objections and EPA rules are less onerous, too. Trains may not be super-popular neighbors, but they are surely favored over pipelines.

"For the most part, the rail infrastructure is already in place. [*Sand transload facilities on the Reading & Northern and Lycoming Valley Railroads in Pennsylvania are on the footprints of former Lehigh Valley, Reading and New York Central classification yards, e.g. -- rhb*]. Finally, the capital commitment is much less. As a rule of thumb, it takes three years of pumping to break-even on rail infrastructure as opposed to 15 years for transmission pipe. And so it is that the merchandise carload business, long thought to be DOA, looks to be anything but.

"The rail opportunity is huge. North Dakota's Bakken shale area alone is looking to drill 1,800 new wells, each requiring 23 carloads of construction material, even before the sand/liquid business starts. BNSF's partner in a lot of the Bakken business is Rick Webb's Watco, which itself just signed a partnership deal with Kinder Morgan. Car makers are ramping up covered sand hoppers, and leasing companies are trying to buy them ASAP. This will come with capital cost, as the shale basins are off of the main lines, though, from a shrinking-capacity point of view, that might be a good thing." Thanks, Tony.

Maine DOT has a short list of bidders for the troubled Montreal Maine & Atlantic's ex-Bangor & Aroostook lines north of Millinocket: Patriot Rail, RailAmerica and the Eastern Maine Railroad. Chop Hardenbergh writes in his Atlantic Northeast Rails & Ports letter, "Rail Administrator Nate Moulton, is finalizing due diligence and final presentation schedules with each party with a goal of choosing an operator by early April."