THE RAILROAD WEEK IN REVIEW
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"Creating value is the key to success." -- Jack Koraleski, CEO, Union Pacific

Union Pacific's annual gathering of short lines followed hard on the heels of the company's strong third quarter earnings call and built on it. Koraleski opened the proceedings by noting that a quarter of the railroad's $21 billion annual revenue stream involves freight moves that touch one or more of its direct connections with some 180 Class II and III railroads. (UP also touches another 90 Class II and III names beyond.) Creating customer value, says Koraleski, takes clear communication, teamwork and agility. And it's here UP's "diverse franchise" -- a term he also used on the third quarter call -- plays well to short lines.

Those who listened to the third quarter call may recall what Jack said about the UP core business ex-coal and petroleum: industrial products, agriculture, chemicals, metals, etc. -- the stuff that goes into making other stuff.

> I kind of take my book of business and I say, okay, take the coal downturn off the table, take out the global impact on the steel market and set the shale business aside because those really aren't the economic barometers. And to the level that I can, I look at the rest of the business, things like lumber up 12 percent; automotive up 13 percent; rock up 6 percent; plastics up 8 percent. And domestic intermodal is still trending higher, so -- putting it all together -- we're in all likelihood going to have record performance again this year.
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> That says the consumers aren't really pulling their horns in and that the overall economic activity is in kind of a slow-growth mode, which is what we expected going into the year. And at this point in time, despite all the handwringing over the fiscal cliff and sequestration and all those other kinds of economic barometers, the economy seems to be moving ahead in a slow-growth trajectory, and that's where we are.

These groups combined represent, says Jack, "the foundation of the US economy." This is precisely where short lines can and do bring added value to the UP franchise. And as challenges in the Eurozone and the Pacific Rim create a rebirth of US manufacturing, the short line's innate ability to communicate, work together with UP and stay nimble all at once is unequaled. So the more each short line knows about how its franchise can extend UP's access to markets, and communicate that to UP, team up with UP to earn money from it, and be nimble in execution, the stronger the competitive advantage. That's Take-Away Number One.

Next up was Beth Whited, VP and General Manager for Chems, with the commercial picture. The message was very much along the lines of what EVP Marketing Eric Butler said on the earnings call with a number of interesting twists for short lines. First, shortline participation in the crude oil boom is limited. It's point-point unit trains from well-head to refinery. On the origin end, it depends on where the exploration and development firm puts the racks (Watco in eastern Montana, e.g.). Destinations are refineries with enough spaces to take and turn a whole train in a day or less. Transloading or splitting a train defeats the purpose of unit trains, namely, quick turns (we're hearing tank car lease rates of $1,200 a month).

Second, automotive growth is almost exclusively in finished vehicles. The automotive line in the RMI RailConnect index reflects traffic a literal handful of short lines like the Puget Sound & Pacific (and Providence & Worcester in the east). Lumber (dimensional and panel), energy-related pipe and sand and construction aggregates will be good for short lines, as will food products from grains to granola. Ethanol and DDGs will be OK but not spectacular. In every commodity O-D pair, however, the move has to support equipment reinvestability or it won't move on UP. So Take-Away Number Two is focus on lanes that have solid yields.

EVP-Operations Lance Fritz brought up the markers on the C-suite presentation portion of the program. His was a very personal message: there are no trade-offs when it comes to safety, service and value in the eye of the transportation buyer. He showed how being a safe railroad adds to the value proposition by reducing the chance for expensive errors. In service, the goal is to eliminate delay and the cost associated with delay. And you add value to the transportation product by examining every part of the process -- "granularity" -- and involving operating crews and customers in local service design.

One of his best examples has to do with equipment days between loads. Right now it's eight and a half days, just slightly more than the record set in 2009, but it does not include time on a short line. I remarked during the Q&A that not including the interchange-on to interchange-off time on a short line can convey an inaccurate picture of how cars are really turning. Which leads me to Take-Away Number Three: the best short line is a safe short line that can design service around customer requirements and turn the cars.

The talks that followed built on these three take-aways. Let give you two outstanding examples. Lynn Kelley, VP for Continuous Improvement, talked about how attention to detail, worker involvement and follow-up can eliminate wasted time and needless repetitive actions. She used the examples of tools on an MOW truck and track materials inventory management.

In the first, the three men assigned to the truck took everything out of the vehicle, inventoried what they had, determined what they had too many of and not enough of, came up with a Basic Load list and assembled the requisite pieces. Before reloading the truck, they tagged each item with a splotch of green paint, identifying it as theirs. Savings: no more wasted time looking for tools and no more trips back to the shop for what was lacking for the job. That's not rocket science you say, but somebody had to take the initiative to do it. Short lines, take note.

In the second, the track materials storehouse had one man-sized door and bins of stuff not neatly kept, meaning it was time-consuming to find what was needed for the job. Once found, you had to pick it up and take it out to the truck. Two simple fixes fixed all that. They reconfigured the building to have a truck-size door at either end and racks of track supplies on either side sorted by type. Now you drive in, put what you need in the truck and drive out. Not only is the process speeded up but also the risk of injury from carrying too much too far is gone. A minor detail, to be sure, but it saves time and money and adds value to the work at hand.

Tom Jacobi, vp for ops systems and practices, talked mostly about yard ops and showed how short lines can help cut dwell times. The conventional wisdom is every time a car hits a class yard between origin and destination it loses a day. The lag between interchange arrivals and departures adds additional delay en route, making matters worse.

Jacobi shows how customers that can arrange shipments by distant node and build blocks for them can cut days from transit time -- and improve the load-to-load cycle time Lance Fritz mentioned. For proof that it works, one short line rep told me they have two big customers sending cars to the same destination. The volume is such that they can build a single train for the destination, hand it off to UP, and see it pass through intermediate class yards without going over the hump.

It's another relatively easy fix, and goes back Koraleski's communication, teamwork and agility. The short line saw how it could help UP enhance cycle time and create customer value by running non-stop through the class yards. They built a fact-based case and communicated that to UP effectively enough that UP bought in, and UP was agile enough to make it work. After Jacobi's talk I heard about a short line that has a way to reposition empties without going through a class yard, creating a new business opportunity. Tom's talk helped.

And that, I think, was what this meeting was all about: giving short lines access to more tools, neatly arranged for ease of access, to bring more business to the railroad. Well done, Union Pacific. That's for the chance to observe.

The Annual UP Analysts' Day Event took place in Dallas Tuesday, which is why the senior UP managers split right after their Monday morning shortline presentations. I have the published notes from five analysts and the consensus is generally upbeat and complementary, closely mirroring what I took to be the overall shortline impression. Tony Hatch sums it up thus:

> We got a great sense of the depth of UNP's bench, a sense of their goals and, a sense of how they aim to achieve them over the next five years. Piece by piece, business group by business group, UNP built a case for secular growth as we have been arguing on their behalf for some time. They followed revenues with details from operations and productivity, and wrapped up with finance to show both the muscle behind the plans. While the sub-65 OR target by 2017 will no doubt garner the headlines, the fact is UNP believes it can maintain its first class network and find opportunistic growth.

Nebraska Northeastern Redux. Larry Kaufman often brings those institutional insights that can be helpful putting recent events in perspective. Such is the case of the NENE (WIR 10/26):

> The NENE deal reminds me of Dick Grayson's thinking when he was BN's CEO 1980-83. He picked up short lines back then when everyone was shedding them because of his "Iowa corn strategy." The original BN had wonderful long-haul grain business to West Coast terminal elevators, but its lines in Iowa were handicapped by ferocious barge competition that made a lot of BN short-haul grain business less than highly profitable.
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> By picking up the former Milwaukee main line that came across SD, entered ND Hettinger, and then hit the BN Montana main line at Miles City, BN was able to load corn from southern and western Iowa and bring it up over Omaha and use the former Milwaukee main to get it to Montana. Thus my Grayson parallel to the present transaction.

Mergers, spinoffs and acquisitions regularly reflect route structures that were first envisioned a century or more ago based on where stuff was (and is). The reason a railroad existed in northeastern Nebraska at all was due to agriculture that needed to go west. All that's changed is the name on the the side of the locomotive.

Genesee & Wyoming was to report third quarter results Thursday but Hurricane Sandy had other ideas. In a brief note out Wednesday, the company says the call is postponed to 11 AM Monday, Nov 5 "as a result of power failures affecting our corporate headquarters and the Greater New York City area caused by Hurricane Sandy." Look for my comments next WIR.