THE RAILROAD WEEK IN REVIEW

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"Industrial prices are declining because demand is going down." — John Butler, Amphora Capital, realvisiontv.com

The ASLRRA Annual Meeting in Orlando last weekend brought together more than 1,700 souls representing short lines, regional railroads, holding companies, suppliers, consultants, and Class I representatives. Happily, the meeting format gave over the most informative presentations to smaller breakout sessions instead of grand-hall slide shows. There were nine "tracks" ranging from Engineering & Mechanical and Finance & Administration to Marketing and Technology with four sessions in each.

Best of all, there was ample time among the exhibitor displays to meet and greet and exchange views with one's peers. I did not get any sense of great volumes of new business coming the short lines' way; however, most railroad reps I spoke with had one or two small success stories, like the chap who replaced a fading lumber company customer with a robust and aggressive building products distributor. I also got the downside, as in the case where a Class I's service failures were so bad the customer has abandoned the railroad altogether, going to contract long-haul trucks for raw material supply.

Linda Darr, the new ASLRRA president, said in her formal remarks that we need to be more aggressive in selling the shortlines' business capability among Class Is and customers — to be, in her words, the bear in the business rather than the bear cub. She said we must "manage the data for mutual benefit," which I took to mean getting our arms around shortline costs, finding innovative ways to fund vital capex improvements, and measuring which lines of business are most profitable.

In that vein, Paul Titterton of GATX talked about the perfect match between his operating lessor model and the short lines, where there is an increasing skew to the bulk side (think plastics, ethanol, frac sand, grains, e.g.). The problem is where lower Class I velocities diminish car-miles per day, meaning you need more cars to move the same amount of goods. The bulk side (covered hoppers and tank cars) now represent two-thirds of the order book, and this is not sustainable. To which I say, if we run off the boxcar, mill gon, center-beam, and flat car business, what's left?

From the ASLRRA in Orlando Tuesday I segued directly to Tony Hatch's "Salon" event at the Harvard Club in NYC. This is a gathering of what Tony calls his League of Extraordinary Gentlemen (LOEG) comprised of senior railroad professionals, active and retired, writers and consultants who've each other and the RR guys for years, plus members of the investment community, young and old, to share observations on the contemporary railroad scene.

Three themes in particular emerged at my end of the table. First, the new CSX operating plan (see below). The discussion centered around why it was created in the first place, the need for a high degree of discipline to execute it as designed, and a willingness to wait and see how it plays out. Second was CP. Is another round of mergers needed (no) and what does CP do to keep the present momentum going? The general consensus is the CP franchise is weak, and no matter where they go CN goes better (shades of the Rock Island), and increasing organic volumes may be problematic as a result.

Third, and perhaps the most important question of all, is whether recent operating ratio gains are coming more on the heels of freight rate increases than operating improvements. A subset of that is how much share buy-backs are goosing earnings-per-share. If it's rate increases, that's worrisome as the rate of annual increases in freight volumes is stuck in the two-percent range, as is the rate of operating expense increase. We're seeing anecdotal signs of Class Is managing carload traffic to maximize yield, thus letting some percentage of "economy class" customers move elsewhere. But what happens when you run out of price elasticity? The first class customers bolt, too.

CSX last Friday embarked on a major reconfiguring of a portion of its manifest train network to improve service reliability, asset utilization, and efficiency. Some trains that have been running seven days a week with set departure and arrival times will now run six days a week, but will depart the initial terminal yards fours hour later each day, so train-starts are 28 hours apart, not 24 hours. Trains running fewer than seven days and local freights are not affected at all, nor are trains outside the general manifest network.

For example, a train that up to now departed the origin yard at midnight seven days a week will go to six days a week, departing at 0001 Friday (Mar 27 was Day One for the new plan), 0401 Saturday, 0801 Sunday, and so on through 2001 Wed with Thursday off. The cycle starts again on Friday.

Frank Lonegro, VP Service Design at CSX, tells me the idea is to run seven days' worth of freight in six trains over six days, freeing up the locos and crews for other work on Day Seven. Moreover, says Frank, every train you take off a busy corridor increases fluidity of that corridor, cutting the need for hold-outs and making sure the power is in the next terminal for the scheduled outbounds.

Look at it this way. On earnings calls we've heard the ops guys say they can run bigger manifests without increasing power or crew requirements. Say a 7-day job is running 75 cars a trip, 525 cars a week. Put those cars in six trains of 90 cars and you've not only saved a day's worth of train-starts but also have sped up the railroad, improved service, and increased efficiency. I've written before about how speeding up AAR train speed one mile an hour can save X locos a day, so even without doing the math, you know you're doing the same work with fewer locomotives.

There is a downside, however. One of the greatest complaints of general merchandise shippers for decades has been the lack of reliability in arrivals. Michael Ward himself has said repeatedly on earnings call that the greatest contributor to late departures is late arrivals. We saw it in Chicago last winter and the previous winter. Trains couldn't get into plugged yards and as a result trains couldn't get out because they needed the inbound power. What happens now to the scheduled departure of a six-day train when you slip the seven-day train's arrival by four hours?

A former Class I senior ops manager, and a good friend for more than 20 years, writes,

> While superficially attractive, this strikes me as a desperation attempt to reduce ops expense and it may well fail due to its complexity. If they can't run a train on time on a daily basis, how do they expect to meet a different schedule every day? The implications for crew and power turns are staggering. What about multi-block trains? Will the set-out cars simply sit around?

He cites the need for discipline (Southern's Brosnan was the other night cited as a railroad disciplinarian *par example*) and questions whether today's railroad managers are of that stripe. The woods are full of railroads that got into trouble because they either couldn't put the capex money where most needed as soon as it was needed or weren't willing to do so. It's doubtful a Brosnan would allow either.

Another reader of the same stripe sees this "rolling four hours scheme" as an elegant way of holding for tonnage. "At some point you are going to miss shipper cutoffs as weekdays slip into weekends, etc. Two questions: will other links in the chain respond and will shippers tolerate it?

Personally. I'm willing to give the plan houseroom to see how it works in terms of operating discipline and customer satisfaction as measured by volume deltas in the cyclical commodities. My fear is that, while earnings will improve at first, customers will take out their impatience on carloadings, and operating practices — and revenues — will gradually deteriorate. Within a year, a new generation of CSX managers will introduce yet another operating plan based on consistency and simplicity.

And even though the plan is not written for local freights, the question of dwell times and making connections still exists. As we've seen this winter, yard dwells have increased to the point that cars for shortline customers were taking days to get out of town. If you start bringing inbounds in four hours later each day, you seem to run the risk of being 24 hours late by the end of the week. The proof, as they say, is in the pudding. I just hope it isn't served up half-baked.