RAILROAD WEEK IN REVIEW

March 10, 2017

"The current economic recovery has peaked and rolled over. Car inventories are up nearly 10 percent over last year, GM is choking on incentives for its hottest selling pickups, and State Farm has just swallowed $7 billion in auto loan underwriting losses (gulp!)." Danielle DiMartino Booth, Money Strong, March 1

"If you had invested in industries where the top companies were growing more dominant, while betting against sectors whose top firms were becoming weaker, you would have outperformed the overall stock market by an average of roughly nine percentage points annually between 2001 and 2014. — Jason Zweig, WSJ, March 3

Hunter Harrison stepped in as CEO of CSX March 6. He brings a commitment to implement "Precision Railroading" — what the press release calls "a model proven to improve safety, and create better service for customers," and which Hunter has successfully employed at CP and CN.

The term is best explained in Hunter's book, *How we Work and Why: Running a Precision Railroad*. There are five parts: service, cost control, asset utilization, safety and people. *Service* is all about customers and the premise that the better your service, the better for the customers' business and the more they'll use you.

Cost control has to do with winnowing down the way of doing business to the bare essentials: can we do X at lower cost, and do we even need to do X at all? Same for *asset utilization*. Are we getting our money's worth out of the asset, is it adding value to our service offering at a reasonable price, and do we need it in the first place?

Safety on the railroad means people not getting hurt or worse, assets not getting broken, and customers' goods not getting damaged. It's measurable (injuries per hour worked, derailments per mile, loss and damage on the income statement) and demands that everybody look out for everybody. The *people* part of Precision Railroading means creating an atmosphere that encourages what former ASLRRA President Rich Timmons calls "a passion for the work."

These five elements are in place on every railroad, so why is Precision Railroading any different? It boils down, I think, to the unforgiving environment. Railroading is absolute: the train is either where it's supposed to be or it isn't. The crew finishes in ten hours or it doesn't. The car is fit for loading or it isn't. All of which requires leadership and follow-through at all levels. Precision Railroading means having every element doing what it's supposed to do. Failure is not an option.

You can't say you're running to plan and have a crew skip a pickup to get an early quit. You can't have an Interchange Service Agreement that's optional in the eyes of the Trainmaster. You can't say you're pricing to market yet offer non-competitive pricing and transit times. Yet on a nonlinear railroad like CSX, with a few core routes and myriad branch lines and yards, there are many more opportunities for Stuff to Go Wrong. Let's see if Hunter's brand of Precision Railroading can make a difference at CSX.

I'm still hearing that the practice of pricing out some moves lives on. The most recent iteration comes from a shortline customer who had been receiving raw material from a distant supplier and it came by rail. He found a closer supplier that could meet his needs at a lower delivered cost, pre-empting the railroad's long-haul move. However, all is not lost.

The closer supplier is local to the Class I serving the short line and would like to use rail, however that Class I is asking for a rate and offering a circuitous routing that makes it non-competitive to truck. So, rather than go for a competitive rate and retain the cartload volume, the Class I loses the traffic entirely. I mean, who would pay more for worse service? (See Precision Railroading Principle Number One, above.)

Yet, even as the pricing and operating departments are pushing business away, the Chief Operating Officer is saying on the Q4 earnings call, "We know we've got capacity on our trains, particularly on the merchandise networks. We spend time working with our customers on ways we can increase train lengths so we both benefit." But from this example it looks like they want to run longer trains comprised only of traffic that meets certain internal needs rather than the customer's needs. No wonder Class 8 truck build rates are up.

Price isn't the only consideration, and today's younger breed of computer-savvy transportation buyers knows it. I'm looking at a covered hopper move where the rail rate is competitive but the embedded extra costs just at origin work against the railroad. Placing an empty requires a series of slow and potentially unsafe steps, starting with a car-mover retrieving a car from the storage track and placing it under the loading chute.

One or two guys use iron bars to make sure the hopper gates are secure and then climb to the top of the car to open the top hatches. Once all compartments have been filled, somebody has to climb back up to the car roof to seal and and close the hatches. Once he's clear, the car-mover spots the car on the outbound. Lather, rise, repeat until all cars have been loaded.

Now a truck shows up at the gate to receive a load. The driver enters the property after getting instructions via CB Radio from the plant, weighs his empty on the scale, and enters a code on an ATM-like key pad to pick up the order. The driver positions his trailer under the loading chute and opens the hatches with the push of a button. The load loads, the driver gets an email document on his cab's laptop, and he drives away. He never leaves his cab. No plant personnel involved, no exposure to injury, no gates to open and close manually.

Now back to the railroad pricing manager. He plugs the move data into his computer and gets a per-ton rate for moving a loaded railroad-owned carload of this commodity from A to B. The transportation buyer takes this rate and adds his per-ton activity-based plant costs for loading the car. He also considers the cost of the lead time to get a car from the railroad vs. an empty truck and transit inventory cost in value per load times days en route. That's why railroads lose loads.

Tim Tierney takes the reins as President and CEO of Conrail, effective April 1. He succeeds Ron Batory, who is retiring after nearly 46 years in the railroad industry. A 39-year veteran of Conrail, Tierney most recently served as VP and Chief Engineer, managing all of the company's engineering functions, and assuming responsibility for locomotive assets, mechanical policy, and planning in 2002.

Prior to this role, Tierney worked in various positions of increasing responsibility within the engineering department, including division engineer of the Buffalo, Albany, and Philadelphia divisions. Between 1996 and 1999, he worked assignments at Philadelphia headquarters, becoming Chief Engineer during the planning, transition, and implementation of the Conrail acquisition by CSX and Norfolk Southern.
Following that transaction, Tierney played a critical role managing capital expenditures and overseeing the design, development, and project management of infrastructure projects. Says Batory, "Tim has served Conrail with distinction and proven himself to be a successful, trusted leader with an exceptional commitment to hard work and safety. Tim brings a wealth of knowledge and experience in the rail industry and will guide Conrail's continuing commitment to providing safe, efficient service."

Batory joined Conrail in 1998 as VP Operations and was appointed President and Chief Operating Officer in 2004. Prior to Conrail, Batory served as president of The Belt Railway Company of Chicago. He spent more than 20 years working for both eastern and western Class I railroads in addition to assisting a court-appointed trustee's successful oversight of a regional railroad bankruptcy.

Conrail is a unique operation, functioning as a terminal and switching service provider for its owners, CSX Transportation and Norfolk Southern, running the yards and serving local rail freight customers in Detroit, northern New Jersey, and the Philadelphia market.