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The Railroad Week in Review 1/13/2001

The *Blue Chip Economic Indicators* newsletter said this week the mean estimate of leading economists surveyed predict growth of 2.6% in 2001, down from the 3.1% increase projected in December. An increase of 2.6% would represent the smallest gain since the 0.5% contraction in 1991. Then the WSJ reported that the last time the consensus dropped this quickly was back in the summer of 1990 and that brought in the 1991 downturn.

Blue Chip also says economists believe GDP grew 5.1% in 2000 and that the growth estimate for 2002 had been around 3.4%. Now the question is whether or not this is the beginning of a recession. Some say two consecutive quarters of economic contraction marks the start. Others like the National Bureau of Economic Research say it starts whenever you want to call it. For more on this august group, and for more than 100 years of US economic data, check out www.nber.org.

Recession or no, the fact remains the rails are scrambling to increase revenues and lower costs. Let it be said at the outset that not all revenue is created equal, and low-rated individual car merchandise traffic for a customer at the end of a branch line needing a lot of repair is not the best prospect. However, as much as 10% of the large railroads' revenue comes from just such branchline customers, except that the care and feeding of these customers has been outsourced to shortlines.

In these instances the shortline interchanges with the class 1 at some economically sensible place and the switching cost to the class 1 is pretty much a constant. Ergo the clever class 1 will incent their shortline partners to increase revenues from those customers shipping higher-rated commodities in equipment under shipper control thus helping lower "equipment rents" in financial-speak.

Take NS, for example. The estimated total revenue for 2000 is right around $6 bn, of which the shortlines will contribute around $600 mm. If each shortline could increase revenues by 10%, it would mean another $60 mm to NS. Most shortlines operate on "allowances" which give them a fixed number of dollars per car, regardless of commodity and car ownership, and than can further boost operating income. Here’s why.

The operating ratio on high value merchandise in shipper-supplied equipment should be well under 70, so conservatively $60 mm in new shortline-generated revenues would drive something like $18 mm in new operating income. By comparison, $60 mm in new business on NS direct, where the 3Q00 OR stood at 86, would produce about $8.4 mm in new operating income. You can bet that if I were a shortline, I’d be pushing this tidbit most aggressively.

Last week we asked for your “New Year’s Resolutions for Railroads. True to form, you responded. A manufacturer of consumer goods writes, “My New Year resolution for the railroads is ‘Seek First to Understand.’ My experience is railroads want the consumer to understand them rather than they understanding consumer needs. The reality is the railroads – if they truly want to be successful -- need to worry more about understanding what the customers really want and where they are going. Then work as a cohesive team to provide it at a reasonable cost and in a reasonable time frame.”

A Professor of Marketing at a large Midwestern University offers a true gem. “New Year's Resolution for rails: Clean up your image and build a new one. Start by cleaning the graffiti off of your cars. Graffiti makes people feel unsafe, and graffiti appears in areas that ARE unsafe. A train with graffiti is perceived as dirty and unsafe. And the attitude carries over to your company.” [WIR readers have seen this before from Peter Gilbertson of the Louisville & Indiana and from WC’s Reilly McCarren.]

A former Conrail Officer sends a timely resolution. “Quit managing as if the industry were labor intensive when it is, in fact, capital intensive. Try calling the rate departments of several truck lines and see how your call is handled by people who *really want your business* (emphasis supplied). And above all make sure new business commitments are backed up with sufficient help, technology and service to make them happen.”

Coal. The Monday WSJ ran a Page Two article on coal’s new appeal to utilities given the high price of natural gas, shrunken stockpiles, and colder weather sooner than usual. There’s talk of government funding to find ways to clean up coal-burning technology since at present only about a third of the energy potential is captured in the burn.

Coal is cheap, there’s lots of it and known supplies are good for another 300 years at current burn levels. That’s why more than half the electricity in the country comes from coal-fired generating facilities (the rest is mainly NG and nuke). Gas got a big boost from the Clinton Administration back on ’93 when the EPA went looking for ways to reduce urban smog. In the meantime, pollution from coal smoke is down a third in 30 years according to the EPA.

More energy with less pollution is behind an industry push to talk up these advances. Concludes the paper, “Given what is happening in California, analysts and industry leaders feel there will be less inclination to pass strict new rules governing emissions from the burning of fossil fuels to slow global warming.”

The Power Struggle at WCLX appears to be over. Former CEO and WC founder Ed Burkhardt said in a press release that his group had failed to deliver the consents necessary to replace the WCTC board with its own nominees. The view from here is this is good news. I know what McCarren and his group are doing in North America. They are clearly on the forefront of the way the industry absolutely must go with respect to economic realities and customer service.

What I saw in the UK last month convinced me the situation between Railtrack and the TOCs is such that EWS absolutely must focus on ROIC and customer value drivers. WCLX has really become a marginal player in Southeast Asia and would not be hurt if the TranzRail team decided to go it on their own.

Is this regard, WCLX is most emphatic about one thing: possible sale of EWS. “In a press release issued earlier today Burkhardt asserted that our exploration of the sale of our interest in English Welsh & Scottish Railway had been canceled. For the protection of the market, let me say categorically that this is absolutely false. We continue to actively pursue sale opportunities with qualified bidders.” All’s well that ends, say I.

Roy Blanchard