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The Railroad Week in Review 3/2/2002

***Quote of the Week**: "The KCS has one foot in each of two worlds. We're the smallest of the large railroads and we're the largest of the small railroads." KCS Chief Operating Officer Gerald Davies at the IME conference on Railroad Finance.*

Rail stocks this week blasted off with the rest of the stock-trading world on Friday. The Dow was up 276 point -- 2.6% -- to close at 10,369. According to briefing.com "buy interest was driven by a batch of economic releases with mixed implications. The most significant report was the February ISM index (Institute for Supply Management, formerly the National Purchasing Manager's Index) which rose to a strong 54.7% from 49.9% in January."

Transports rose 3.1% with all the rails firmly in the positive column led by NS up 4.9% and UP up 3.4%. For the year, NS leads the pack, up more than 30% against the rest of the class 1s. Even star-performer CN is a bit off its feed, trading in a range since Jan 1 such that its 200-day average has barely budged – to 48 from 46. A cautionary note must be sounded, however. With these prices most of the rails are getting a bit pricey, notching up 2002 earnings multiples in the high teens. *Caveat emptor.*

NIT League President Ed Emmett told a railroad finance conference that there is a disconnect between what he hears from senior rail managers and what NIT League members are hearing from their daily rail contacts. The occasion was The Seventh Annual Global Forum on Railroad Finance, presented in NYC this week. Emmett noted there's a whole new world of young transportation buyers out there who are not used to being told by their vendors how they must behave. They don't get it at the Gap or Amazon.com and it's not part of their culture.

He has a point. How many times have you heard a rail rep say, "The customer has to understand…" and so on? What the rails need, says Emmett, are ombudsmen who can cut across disciplines and get operating as well as marketing answers. In other words, the rails have got to make themselves more customer friendly. In that vein, and to provide some incentive to that end, the NIT League and the Alliance for Rail Competition (ARC) have announced a new joint venture that will be called the Coalition for Rail-to-Rail Competition.

Starting out the Coalition will be directed by a steering committee comprised of equal representation from both organizations and speaking with one voice. It's been said that many rail users found themselves belonging to multiple organizations that have the same basic purpose, but with diverse strategies. This goal of the Coalition is to give rail customers a unified voice. Maybe so, however as long as the rails are hard to do business with and insist on their way or the high way the trend toward the latter will continue unabated.

STB Chairman Linda Morgan got the floor next and said the industry is now looking more at what can be done with the tools at hand and less at "the next merger." The result is a renewed focus on customer service, running a better railroad, and improving profitability. As several speakers noted, the rails have not been earning their cost of capital for some time, and the only way to increase the revenue stream was to buy it.

Morgan said the STB is encouraged by the small railroad restructurings – StatesRail to RailAmerica, Emons to GNWR, IMRL to the DM&E, etc. During the Q&A Chairman Morgan noted that shortlines excel in access to customers. Combine that with what she called a "creative thought process" and there is great potential for earnings growth. And now that the class 1s are looking more toward alliances and partnerships that can only be good for the small railroads.

BNSF President Matt Rose met with the Pacific Northwest Association of Rail Shippers in Portland Thursday. He said there's been a complete redesign of the BNSF carload service network in an effort to root out the inherent inefficiencies of the traditional onsey-twosey "loose car" business. As a result, the BNSF carload network redesign "has as its basis the development of new gathering and distribution networks."

Here's what Rose had to say about shortlines: "We made intermodal trains and unit trains work because we could shrink the number of O-D pairs in the service equation. Shortlines have started down that path already. Distribution center strategies involving centralization at common points can leverage the rail and highway networks. Well-defined micro-networks, such as the BNSF rock transportation network in Texas, can achieve trainload efficiencies on a small geographic scale. The possibilities are limited only by our creativity and responsiveness."

What this means is that the benefits of trip planning and scheduled carload service will become available to a wider audience, not just the intermodal and bulk service users. Going hand-in-hand with the new operating structure will be a new pricing structure designed to reflect the value-service ratio.

To be sure, some will grouse this is another rate hike in disguise. I think not. NIT League's Emmett wants better dialog with his rail vendors and he wants his rail vendors' commercial processes to be less of a challenge. Done right, the scheduled carload takes the random events out of the system thereby lowering customers' inventory management costs, demurrage exposure, and non-productive administrative expense

An item from Knight-Ridder/Tribune Business says the Express Lane perishables service run by UP and CSXT is earnings its stripes. UP reports FY 2001 reefer loads grew 20% to $130 mm and expects a repeat performance in 2002. Shippers cite the service as a "welcome alternative" to trucks, especially in peak season when rates spike and availability plummets. Savings can run as much as a dollar a carton of canned fruit.

Express Rail is beginning to look like "if you build it they will come" personified. Everybody knows the best new business prospect is an existing customer. Happily, the number of individual Express Rail shippers is growing. Some start with seasonal moves, filling in the gaps when they can't get the trucks they want as a price they're willing to pay.

UP estimates the rail share of the perishable trade runs about 5%. This tip of the iceberg already includes fruit from the PNW, Idaho potatoes, and from California carrots, oranges, onions, melons, broccoli and celery. UP also says shortlines are major gatherers of goods; a reader asks whether shortlines have a role on the receiving end. Anybody?

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