The Railroad Week in Review
March 19, 2004
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(215) 985-1110

Tony Ingram, 57, has retired from **Norfolk Southern** after more than 33 years service to take up the reins as Chief Operating Officer for formal rival **CSX Transportation**, reporting to Mike Ward, CEO and Chairman of both the railroad and the holding company. This is an excellent move for both Tony and CSX.

One of Ward's biggest challenges has been getting the measurements in place and then getting his operating people to use them. Recall his complaint not that long ago about the extensive use of "audibles" – changing the plan because something unexpected comes along. But if you start your plan under the 90-10 rule there's less need for last-minute changes.

By 90-10 I mean start with the assumption that 100% of trains will move according to plan. We know from experience that there is always a 10% failure rate and 90% make plan. An engine stalls, an air hose breaks, a crew outlaws short of home, etc. A terminal manager who fails to plan his moves because something *might* go wrong will start with no plan and will be forced to call the audibles. Mike needs help here and I think Tony's the guy. Congrats and best wishes to both.

Strikers at **Canadian National** have ratified new labor agreement and are scheduled to return to work on the first daylight shift Saturday. The union reports that among the 5000 workers who walked four weeks ago shop-craft workers voted 69% in favor of the agreement, while the clerical, customer-service and intermodal-yard workers voted 81% in favor. The new agreement is retroactive to Jan 1 and has three years to run.

There is bound to be fallout. As shop work becomes more expensive relative to production there will be less of it. Moreover, what remains in-house will be highly skilled work requiring more brains than brawn. Those that can expand their skill sets will; those that can't will have to find other opportunities. Ditto for the clerical and intermodal workers. Higher comp and benefits drives more automation and greater skill sets. All the strike accomplished was to speed up the process whereby the unskilled become the unemployed.

Contribution is what's left after paying all the operating costs directly related to the movement of freight. As a general rule crew, fuel and equipment (e.g. car hire, loco ownership and maintenance expense) make up 75% of the total per-car operating expense. Another way, one minus the operating ratio times revenue divided by carloads equals contribution per carload. A decrease in operating expense improves the operating ratio even if revenues remain flat:

Revs	$	1,000	$	1,000	$	1,000	$	1,000	$	1,000
Exp	$	1,000	$	900	$	800	$	700	$	600
OR		100%		90%		80%		70%		60%

However, if revenue goes up and expense remains the same the effect on the OR is more dramatic. You can tell by inference what happens to the OR when revs go down on flat exp:

Revs	$	1,000	$	1,100	$	1,200	$	1,300	$	1,400
Exp	$	900	$	900	$	900	$	900	$	900
OR		90%		82%		75%		69%		64%

Now put a shortline in the picture and pay it 25% of the Class I revenue. The large railroad operating expense does not change because it costs as much to move a private car of plastics as it does a car of private car of wood chips. And this, folks, is why Class I market managers are reluctant to do business with shortlines on low-rated commodities.

Revs	$	1,000	$	1,100	$	1,200	$	1,300	$	1,400
SL Allow	$	250	$	275	$	300	$	325	$	350
Net to Host	$	750	$	825	$	900	$	975	$	1,050
Exp	$	900	$	900	$	900	$	900	$	900
OR		120%		109%		100%		92%		86%

On the other hand, look what happens when the shortline gets a flat fee out of expenses as opposed to taking it off the top in revenue. Suddenly the low-rated commodity works.

Revs	$	1,000	$	1,100	$	1,200	$	1,300	$	1,400
Exp	$	600	$	600	$	600	$	600	$	600
SL Allow	$	200	$	200	$	200	$	200	$	200
TTL Expense	$	800	$	800	$	800	$	800	$	800
OR		80%		73%		67%		62%		57%

Of course, this only works when the shortline allowance is less than the Class I would have spent doing the work itself. In this case the shortline did the work for $200 when it would have cost the Class I $300. The concept proves its worth, for example, when consolidating shortline interchanges or bringing the shortline interchange into the serving yard. The point of all this is to increase Class I contribution per carload.

It’s clear from the tables above a carload that carries a 1.05 revenue/cost ratio might well become something less than 1.00 after a shortline allowance out of revenue. Shortlines, be careful what you ask for.

Lumber prices hit $400 per mbf last week but those lofty levels may be short-lived if the torrid pace of housing starts – 2.1 mm units in Dec – begins to slow. However, there are signs a shortage of rail cars may be a factor. If lumber supplies are growing at the mill because there aren’t enough cars to move all that’s cut, then what can be moved is worth more at the market.

Say the mill-market price spread is $1,000 and the rail freight rate is $800. The beneficial owner makes $200 assuming he can get the cars. But if cars are tight and the going truck rate is $900 the B-O makes $100 less. A market like this is where guaranteed car contracts pay off. Mills that can predict production can also predict rail car needs and contract for ‘em in advance.

It’s the guys who are cutting on spec that get hurt and make the nightly news: “Railroad Car Shortage Bankrupts Area Mills.” The tools are available – *viz* CN’s Guaranteed Car Order program and LOGS and COTS at BNSF. Both programs extend to shortline shippers and drive economic benefits for shortline operators. Predictable traffic volumes, shorter on-line dwell, lower car hire, greater contribution per crew-start… the list goes on.