THE RAILROAD WEEK IN REVIEW
September 17, 2010

“Nothing succeeds like concentration on the right business,” -- Peter Drucker, Management Tasks, Responsibilities and Practices.

More than 200 souls descended on the Renaissance Baltimore Harbor Place Hotel this week for the annual fall meeting of the ALSRRA Eastern Region. From my rough count, there were slightly more vendor representatives than folks affiliated with actual short lines, which is and of itself, is not altogether bad. The region, comprising the northeastern states from Maine to Virginia and west through Indiana, plus Canada west to the Ontario-Manitoba border, has more than 150 short lines by name, many of them very small, so to have a goodly portion of the major players represented was most encouraging.

Seeing so many vendors is also a good omen. It tells us there is a solid cadre of vendors who have a stake in the shortline space and are willing to invest their time -- and money -- in these events. There are a couple of things the ASLRRA can do, however, to make these sessions even more valuable. First, allow more presentation time for vendors to give case histories on how they solved particular shortline challenges. These must not be “infomercials” that pitch the company but rather must be how challenges were met in partnership with the short line doing the work.

Second, vendors need face time with the folks who actually use the material. That means mechanical and track people. And to make the program more appealing to that audience there has to be more podium time for the solutions-oriented program material above. My fear is that unless the Association can add value to the vendor experience the vendors may be less apt to experience these shortline gatherings.

As for the program itself, I was particularly pleased to see several hours devoted to the care and feeding of customers. Mike Smith, President of New York’s Finger Lakes Railroad, has been and is to this day one of the most tireless and effective promoters of the shortline carloads franchise, so it was entirely appropriate that he host the three panels. First, New York & Atlantic President Paul Victor gave us some insights on car design, particularly where shippers have designed cars to meet specific supply-chain needs.

Bob Holland, semi-retired after a 37-years costing career with NS and predecessors, took us through the basics of figuring out what it costs to run a particular commodity O-D pair, why we need current costs, not legacy costs, and how short lines can become part of the Class I costing process. Finally, John McCreavy of New Jersey’s SMS Rail presented a tag-team of speakers on site selection. The combination worked well, I thought, and I look for more of same to come.

Let me enlarge on Mike Smith’s theme of the carload business on short lines. From his very first slide, Mike drilled down into the shrinkage of the carload franchise in general over the past five years. It has hit the short lines particularly hard because they are so volume-dependent. And

where the class Is can sustain same-store price increases year-to-year, the short lines can't because their customer bases are so small and -- in most cases -- they have no pricing authority.

This creates a disconnect between the short line and the Class I market manager where the former is trying to protect specific moves and the Class I counterpart is looking at the yield of a system-wide database of commodity OD pairs, trying to maximize revenue-cost ratios while minimizing transit times. Worse, since FASB rules dictate that short line divisions and allowances come out of revenue, the shortline fee shrinks the numerator. So, if the shortline fee is equal to or greater than what it would cost the Class I to do the work itself, the short line loses.

Going back to Bob Holland's comments, the URCS data available for downloading is *historical* data. Yet as operating plans get better and faster, and as trip plan compliance improves, actual costs are going to be degrees-of-magnitude less than legacy costs. KCS, for one, has turned to the "Eyeris" costing system and I'm hearing others are following suit.

Go to www.eyeris.com and read how the tool captures the cost of empty moves, sharpens track, train, and locomotive capacity and utilization, pro-rates revenue by train and track segment and provides local views of profitability. But the surprising thing is it's really not all that new. Friends who were with the USRA in the early years tell me disciplines forced railroaders to "deal with the world as it was and would be, not as they would have liked it to be."

It boiled down to the fact that there was too much railroad chasing too little traffic and nobody -- from railroad management through the union leadership and into the government -- wanted to admit it. The reality is that companies have to be able to sort out which products achieve economic viability and eliminate those that fail the test. Using reality-based costing as opposed to legacy systems helps get rid of the non-strategy of "Should have been, could have been." In other words, concentrate on the right business.

Thus it behooves the prudent shortline operator to get educated as to real-time class I costing and the particular short line's financial exposure by revenue unit. Next, one must figure out ways to lower the total cost of the short line-Class I joint move, making short line fixed costs volume-dependent wherever possible. The class Is have been talking about this in their quarterly calls for some time now and shortline survival depends on following suit. The tools are at hand; if you need some suggestions, drop me a note.

Lycoming Valley Railroad Marketing Director Todd Hunter passes along some encouraging news from the September 2010 newsletter of the American Institute for International Steel. Excerpts: "The primary metals sector added jobs in August, although at a modest rate over July, and primary metals added 20,500 jobs over August 2009 according to the Bureau of Labor Statistics....Steel, whether semifinished or finished, is a prime example of imports supporting further American manufacturing activity. Historically, therefore, when the trade deficit increases, that is a sign of a healthy economy and when it declines, we are usually in a recession."

And, "For steel, the summer slump appears to be over. The improvement in exports, the domestic auto market, oil and gas drilling and equipment over 2009 are sustaining the steel market so far this year at the modest recovery levels we have experienced. Non-residential construction

remains the weak link in the marketplace and the key to a return to robust levels of demand for domestic and imported steel alike. Some believe it will take until 2013 for the turnaround.

"For the steel market, therefore, the summer slump appears to be over and the domestic market is staging a bit of a come-back for many products. Prices are rising and for some products, like SBQ bars, rising strongly with lead times lengthening too. Import arrivals for most products remain at modest levels, as consumers and distributors continue to buy steel on an as-needed basis."

To conclude, "Going forward, there appears to be little that could effect a change in the domestic steel market, but the export business continues to be a bright spot for the domestic industry and their trading company partners. Continued growth in the developing world fuels this bright spot, India, China and other markets." Short lines with strong franchises in metallic ores, met coal and steel fabrication take heart. Thanks, Todd.

Railroad re-regulation is back in the news. Per the *Railway Age Newswire* for September 15: "Timed to coincide with the opening of a hearing Wednesday afternoon on federal railroad policy, Sen. Jay Rockefeller (D-W. Va.), chairman of the Senate Committee on Commerce, Science, and Transportation (SCC), released a committee staff report charging that the 30-year-old Staggers Rail Act "gives railroads the authority to charge many businesses extraordinarily high shipping rates [and] needs to be reformed."

The SCC report claims, "While the railroads tell their regulators they are not making high enough profits to cover all of their long-term capital investment needs, they are using billions of dollars of their profits to buy back stocks and boost the short-term values of their stocks for their shareholders. Although the railroad industry claims that it still has difficulty attracting sufficient amounts of investment dollars, Warren Buffett and other investors have been pouring billions of investment dollars into the companies."

Them's truly fighting words for the AAR's Ed Hamberger: "The report makes profits and corporate efficiency sound like dirty words. The reality is the railroad industry's return to financial health has resulted in private capital—not taxpayer dollars—getting turned back into building and maintaining the nation's rail network. This report is aimed not at leveling the playing field, but at justifying attempts to regulate lower rates for some large shippers.

"The STB has determined that lowering rates for some shippers through re-regulation would result in increased rates for other shippers, or decreased investments in the rail network. We've run smart, successful businesses, improving efficiency and service for our customers, while keeping prices below what they were 30 years ago. Now is not the time to inject greater regulatory involvement but instead to keep letting the current balanced system work."

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