THE RAILROAD WEEK IN REVIEW
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"Customer satisfaction is the best indicator of what customers think of our value proposition." -- Jack Koraleski, EVP Marketing & Sales, Union Pacific Railroad

The 2010 fourth quarter and full year earnings season is upon us. By way of a reminder, the *Week in Review* approach to earnings is not the same as what one sees from the Wall Street analyst community. Whereas the Wall Street crowd wants to help you make money trading railroad stocks, *Week in Review* aims to help shortline owners make money by trading carloads with their connecting Class Is.

Every Class I railroad has a unique culture that drives the way they work their franchises. At Union Pacific, it's the customer satisfaction measure they report every quarter. Norfolk Southern is strong on performance management through systems of feedback and control. "It begins with the customer" is the Number One item on the CSX "Core Values" list. The "ALIGN" initiative that BNSF announced at its November, 2010 shortline meeting (see WIR November 5, 2010) is the first "adult" approach to shortline relations that I've seen. "Precision Railroading" is the CN's unique selling point and CP is particularly adept at finding new and better uses for existing technology.

RailAmerica and Genesee & Wyoming earnings reports are each useful as a mirror on the shortline community at large. With more than 100 railroad names between them, these two companies' results reflect on what's working and why in their Class I relationships. RailAmerica's widely-scattered properties look very much like the 300+ independent lines that subsist entirely on their own wits yet -- with the support of RA's Jacksonville HQ -- find the economies of scale to juice results. Genesee & Wyoming's strength is its "Genesee Value Added" that codifies how and where G&W spends its money (see *Trains* for June, 2010, pages 38-45).

If the short line-Class I relationship is a true partnership, then each party builds and reinforces the strength of the other. Wooing, winning and keeping customers is the common goal. The short line brings nonpareil strengths to its locally managed, first-mile last-mile retail business model. The Class I brings its long-haul economies of scale and leadership. So when the Class I senior managers bare their souls every quarter, they are telling us what they're doing and why. And it's the why that *Week in Review* delivers.

Jack Koraleski, Union Pacific's Executive Vice President for Marketing and Sales, set the tone of the fourth quarter 2010 earnings call when he said, "Customer satisfaction is the best indicator of what customers think of our value proposition." That term -- value proposition -- came up repeatedly through the call, whether CEO Jim Young, EVP for Operations Lance Fritz or CFO Rob Knight. It's easy to see why. You make your money on revenue units and it takes satisfied customers to keep putting revenue units on your railroad.

The proof is always in operating results. UP quarterly operating income was up 31 percent year-over-year to $1.3 billion, revenue units increased nine percent to 2.2 million, and total revenue was 17 percent to $4.2 billion. The company held the operating expense increase to 12 percent for a record fourth-quarter operating ratio of 70.2, three points better than a year ago. Although the third quarter number came in at 68.2, Rob Knight said in his remarks that new hires were up and will continue at an accelerated pace to meet the demand of increased volumes and to offset attrition.

Drilling down into commodity carloads, The Industrial Products Group -- where short lines live -- was up 24 percent over the 2009 fourth quarter. Koraleski cited particular gains in non-metallic minerals (drilling sand, e.g.), aggregates, steel and scrap. Of interest to eastern coal-hauling short lines, Koraleski said coal suppliers in Utah and Colorado were going through some changes that could open new doors for eastern suppliers.

Chemical shipments increased 11 percent on double-digit volume gains in petroleum products and fertilizers, with industrial chemicals "stable" -- up a mere six percent. On the agricultural products side, wheat was the big winner in export grains, soybean meal increased 10 percent and STCC 20 canned goods and import beer gained seven percent.

The 2011 volume outlook points to continued strength in metals, petroleum, minerals and export grain with some signs of life in the lumber space. Volumes will "moderate" in paper, industrial chemicals, fertilizer and ethanol/DDGs. Soda Ash, plastics, LPG, packaged food and domestic grain bring up the markers.

Operating Executive Vice President Lance Fritz said the personal injury ratio dropped six percent to a best-ever 1.37, thanks mainly to enhanced training while more grade crossing closings (something dear to the hearts of shortliners) ought to help cut the growing number of accidents there. Making more of the operating plan "volume variable" meant it took only seven percent more "first crew" starts (read train starts) to handle the nine percent volume increase.

Fourth quarter average train speeds handily beat the 2010 average speed of 26 mph though the dip in weekly revenue units from the third quarter may be a contributing factor. Fritz said the increased manifest carloads -- industrial products, non-unit grain trains, chemicals, etc -- mean more crew-starts per carload. [*Short lines can help this metric by keeping interchanges fluid and reporting outbound manifests even before the interchange train is at the junction. Inaccurate or late advanced consist reports from the Class I don't help, either, as one eastern Class I is discovering of late. -- rhb*]

RMI has to be congratulated for its FastTrack Awards. Though they limit their universe to short lines that show "how they have maximized the use of RMI solutions to improve their productivity," the Award is an indicator of the tools that are out there and how the short lines are using them to to streamline processes and improve procedures.

The awards went to 13 railroads and cover a vast array of RMI's suite of tools to increase event and interchange reporting accuracy, improve advance consist reporting to customers, create more accurate car repair billing, and automate blocking tables. What follows represent just the highlights; for the full list go to www.rmiondemand.com/news_and_events .

Shortline FastTrack award winners start off with Brownsville & Rio Grande International Railroad and the Canton Railroad for their new RMI-based automated railroad operations. Western Pennsylvania's Carload Express group is using RMI tools to automate its three railroads; Genesee & Wyoming has used RMI to eliminate many manual and repetitive tasks on its Georgia Southwestern Railroad. Indiana Eastern Railroad, Iowa Interstate Railroad, Massachusetts Coastal Railroad, and California's venerable Modesto and Empire Traction Company (MET) are all heavy users of the RMI suite of services.

Rounding out the list are Houston's The Port Terminal Railroad Association, RailAmerica's New England Central Railroad and the Tacoma Municipal Belt Line Railroad. The common themes among all these roads include dollar savings in six figures, streamlined car hire accounting, reclaim and demurrage bills, and reducing or eliminating clerical errors.

Car miles-per-day and car cycle times are continuing mantras among the Class Is in their analyst communications (see UP, above, e.g.). One of the leaders in this area is Canadian National and this week I learned how they are extending that discipline to help short lines capture new back-haul business.

The present case concerns RailAmerica's New England Central. Doug Low, Director of Marketing & Sales for NECR, writes, "We have a customer in Palmer, Massachusetts who receives CN-marked boxcars loaded with paper products from origins local to CN. The receiving facility also generates outbound loads of "ONP" (old newsprint) for CN's Canadian customers.

"Cars made empty on us are reloaded right at the same rail door, eliminating the need for us to move the car between spotting the inbound and pulling the outbound. This is the ideal first-mile last-mile situation and with CN we've been able to be very aggressive on pricing. The low freight rates for ONP work solely because the equipment is CN's and the boxcar of ONP will again be re-loaded at the Canadian mill with another outbound paper load.

"Another factor is the turn time that CN expects -- they can't allow their high-quality, paper-grade boxcars to sit at a destination point waiting for an ONP backhaul load. As a result, loaders that have only 'dabbled' in this market -- a week or more to load the boxcar, poor boxcar cube utilization, damage caused by sloppy forklift driving, etc. -- have been driven away. Consistency, quick turns, and precision railroading have paid off for our customers, our railroad, and our partner, Canadian National." Thanks, Doug.

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