

# THE RAILROAD WEEK IN REVIEW

March 12, 2010

**CSX wrapped up** its 21st Annual Shortline Meeting in Jacksonville on Tuesday. I've been to most of them and every year they get better. It is, after all, the longest running show of its kind and features a number of industry firsts. To begin, CSX was the first Class I road to establish a Shortline Caucus Group, a rotating panel of shortline leaders to gather up membership concerns and interact with CSX management to resolve same.

The "Trade Show" where the various commodity and service groups set up tables to show what they do and interact with short lines is another CSX first and it gets bigger every year. This year there were 44 booths from Aggregates to Waste Marketing plus tables for E-Business, fleet management, law, new business development, service start-up & integration and several others. The show ran for two-and-a-half hours Monday afternoon and was very heavily attended. Finally, CSX was the first to offer consecutive breakout sessions by commodity with individual short lines to present their own success stories in these mini-groups.

Len Kellermann, CSX' Director for Short Line and Regional Railroad Development, opened the program with some impressive data about short lines themselves and how they relate to the CSX story. More than a quarter of all the revenue moves ex-intermodal on CSX touches a non-class I at some point between O-D pairs. Non-Class I volumes are north of 800,000 units a year, generating annual revenues \$1.4 billion. Total 2009 revenue unit volume with its 240 non-Class I connections dropped 16 percent year-over-year vs. down 15 percent for CSX all-in and down 18 percent ex-intermodal, a number more closely aligned with where the short lines live.

Something else CSX does exceedingly well is to bring shortline aspects into every senior management presentation. I wish the other Class Is would follow suit and avoid the "30,000-foot view" perception so often voiced elsewhere. It was gratifying to hear, for example, Chief Transportation Officer Cindy Sanborn talk about local accountability for making shortline interchanges work the way they're supposed to. VP Service design Alan Blumenfeld got everybody's attention when he said he was "bullish on the carload business" and why.

CFO Oscar Munoz talked about his experience dealing with Warren Buffett when working for Coke, how the latter's business approach is likely to shape BNSF going forward and why the Berkshire-BNSF relationship may have wider effects on the railroad industry as a whole. Chief Commercial Officer Clarence Gooden kept everybody glued to their seats in his pre-lunch talk about the economy's effect on railroad operations, the outlook for coal, how demand is driving more transportation than simple inventory replacement, and reminded us that 70 percent of the Members of Congress have at least one short line in their districts.

As noted above, the commodity group breakout sessions were particularly effective in bringing out benefits of the CSX-shortline relationship. In agriculture, for example, it was noted that 26 of 40 unit train grain loading sites (90-car unit train operations) are on short lines and most have

good enough track to take CSX six-axle power on run-through trains. Asked about cycle times, the presenter said they get two turns a month and they expect unit trains to be on and off short lines within 24 hours. Ethanol is another key play with shortline destinations in several states; Greenville & Western president Steven Hawkins gave a great presentation on how he perceived an ethanol need three years ago and has recently opened a new terminal -- entirely self-funded.

It's programs like these that continually get rave reviews and thus attract a goodly number of shortline owners and operators -- 215 at this outing, excluding spouses, of which there were many. All-in, approximately 60 percent of CSX' 240 shortline partners attended the meeting. Moreover, the number of CSX staffers attending in support of the program, the trade show and the breakout sessions added another hundred-plus to the number of people swirling around the halls. Kudos to all once again for a show-stopping show.

**Shortline carloads through February** were a mere three-hundredths of one percent behind the comparable 2009 period, so says RMI's highly informative RailConnect Index. The ores commodity group was the big driver, up 18,000 units or 164 percent. Grain gained 15 percent -- significant because grain is 15 percent of shortline loads. Auto and "other" also gained handsomely, however at only three percent of total vols they don't get me too excited.

RailAmerica Feb 2010 carloads increased one percent year-over-year with significant gains in ag products, metallic ores & metals and STCC 20 food. Coal was essentially unchanged while non-metallic minerals (mainly aggregates), petroleum, auto and other took the hits. Sequentially, Feb was off a point and a half from Jan; for the quarter to date RA is up three percent year-over-year.

Genesee & Wyoming Feb 2010 loads fell nine percent year-over-year. The coal coke & ores, farm & food, forest products (both STCC 24 and 26), and "other" commodity groups all posted double-digit declines. Feb 2010 loads were a mere 40 basis points behind Jan 2010; for the quarter thus far GWR is off nine percent.

**As for the Class Is**, Jon Langenfeld at RW Baird writes, "The 2010 rate of growth for rail volumes could exceed 10 percent. We are overall positive on the rails as attractive early-cycle investments into improving domestic freight trends... Consensus volume expectations are in the 4-5% range however normal seasonal progression based on ytd and 4Q09 volumes compared with the 8-year average sequential progression suggests this range is probably too low."

As for specific names, Langenfeld writes, "Our analysis suggests that UP and NS could grow 2010 volumes 10-13 percent and CSX 8 percent (normalized for the UP intermodal volume losses) if normal seasonal trends progress. Easer Auto and Intermodal comps and strong absolute chemical volumes are driving upside."

**That some short lines** are having trouble finding financing is well known, but what about the independent truckers? Could it be they're having a tougher time than the short lines? Dan Behr, a transportation and infrastructure investment banker with Jordan, Knauff & Co. in Chicago writes, "From what I see and hear, ma and pa truckers are not getting capital for lots of reasons and I count eight strikes against them right off the top."

First of all, he writes, many of them are running cabs that will very quickly not be compliant with emissions standards, that is, trucks manufactured before 2004. With the cost of new tractors, they don't have the EBITDA to support payments on the replacements. "Then we have the untold numbers going after loads at such ridiculously low rates that they don't cover their cost of capital (sound familiar?) and the one-man owner-operator typically lacks the economy of scale to even hire other drivers to fill in. The one-horse operator is out of business if he breaks down and will find it tough to get loads from the most stable shippers and third-party logistics providers. Only the big boys get the steady loads.

"The hours of service laws and enforcement thereof have eliminated logbook fudging while -- on the west coast at least -- inability to meet the Transportation Worker Identification Credential requirements has kept a lot of guys parked, exacerbating the effects of the 30 percent volume drop at the west coast ports. Then there's the upsurge in domestic rail intermodal and the proximate retirement of many older drivers with no youngsters to fill their cabs.

Finishing up on this thread, Dan writes that many more truckers are either going out of business or, if large enough, being consolidated into larger operations, often sans the trucks, and not unlike the first-generation short line owners we all know who are getting long in the tooth and would like to swap their shortline equity for nice 401-K.

I just hope Dan is right but we've been hearing that the small guys are about to go over the edge for decades and it never seems to happen. Still, with the new pressures on banks, maybe this is the time. If the short lines play their cards right, they will partner with some solid truckers and let them squeeze the little guys.

**The plight of the Montreal Maine & Atlantic** (WIR 3/5/2010) brought these comments from Chop Hardenbergh, observer of the New England scene through his *Atlantic Northeast Rails & Ports* letter: "For some reason MDOT is linking the \$20 million to the purchase of the 241 miles of track, and is ignoring the years of deferred maintenance. Bob Grindrod estimates another \$20 million to improve the track. MDOT thinks it can piecemeal the work.

"As you point out, while the shippers call the rail line vital, they're not willing to use it. I could give you examples of people who could use rail but decline to do so. I feel very sad about this, not just the loss of rail, but the impact on Aroostook County. And, unlike you, Roy, I do see state ownership as a solution. In fact, I would subsidize the rail shippers to the extent we can save on highway maintenance, a figure some estimate at \$3.5 million per year. That would pay for a lot of rail maintenance!" Thanks, Chop.

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