The Railroad Week in Review
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Transport stocks had a field day Wednesday as BNSF, NS, RailAmerica, Yellow Freight, J B Hunt and Hub Group hall hit new 52-week highs. Among rails NS took the honors as percentage gain leader, up nearly 4% on the day. CSX, RRA and KSU all saw increases around the 3% mark while BNSF, GWR and UP rallied round the 2% level. The Canadians both gained less than a percent and FEC was essentially unchanged. Among railroad equipment suppliers GATX and Trinity were up less than a percent while Greenbrier and Wabco treaded water.

Union Pacific chart watchers this week were cheered as the technical signs pointed to a reversal of trends. The rating services continue to knock UP on near-term performance fundamentals, though the buyers now seem about ready to come out of the woodwork. The 50-day curve is flattening after having crossed below the 200-day curve back in April. There are indications the stock is nearing the over-sold point and that bodes well. The resistance at $60 has held twice in two months and it's being tested a third time. Support at $56 is holding. Market Edge calls UP a buy at this point and I can't argue that.

The fact of the matter is UP has the strongest merchandise carload franchise on the continent and has some of the sharpest measurement and control tools. For example, on UP (and not many places else) shortline customers can get a trip plan practically at the moment a car is waybilled and released, even if the destination is beyond the UP territory. Yes, some shortlines report problems with even small volume increases, but here again it depends on commodity O-D pairs and a whole hatful of variables. Because what feedback and control mechanisms *don't* do is fund the asset base. That's what managers are for.

As for the congestion etc on UP, I'm reminded of the movie "Moonstruck," where Kosmo exclaims, "It's *temporary*." Ain't it da troot. Recall that not too long ago NS was at $11 and Wall Street was hanging out the crepe. Now it's 5% above the 50-day curve, 38% above the 52-week low, and everybody loves it. Could UP at $56 is a bottom?

Greenbrier Companies (NYSE: GBX - News) has in the last seven weeks received orders for nearly 7,000 railcars valued at approximately $400 mm. Included are 4,700 double-stack intermodal wells and 400 boxcars for TTX, the largest single award Greenbrier has ever received. Double-stack wells from various rail operators accounted for most of the balance of the orders.

The combined North American and European backlog as of June 17 stands at a record $860 mm for 14,600 units. Two thirds of the orders have come in since September 2003 and are extensions of current production runs. Resultant economies of scale should lower unit cost and improve profit margins. On Wednesday GBX intraday high hit $20, a level not seen since Jan 2004. First Call gives GBX a Strong Buy, estimating the current quarter net up 37% yoy and FY 2005 up 7% over FY 2004 (FY ends Sep 30).

The whole car supply matter is quite revealing. The AAR says there are 1.5 mm cars in service in the US, excluding those belonging to the Canadian-owned US Railroads (AAR Railroad Facts, 2002 edition). Since 2001 total US railroad ownership is up 200,000 units with private owners doing most of the buying and now private cars outnumber railroad-owned cars by about 1.3:1. A further indication that private fleets are the buyers is the fact that private owners account for two-thirds of all cars under 20 years old and 80% of cars bought in the last ten years. Private covered hoppers ten years old or less outnumber rail-owned by 4:1; private open-tops of the same age outnumber rail owned by 3:1. So increasingly shippers are buying their own equipment to meet their own particular needs.

Shortlines too are stepping up their purchases. Three years ago non-class I railroad ownership was about 125,000 units. By January 2004 that number had increased to 180,000, 28% of all railroad-owned cars. But I suspect it's more a matter of selling "marks of convenience" than of filling in where Class Is are short cars to meet shortline shipper owners. For example, the largest non-class I "owner is the 2-mile Northwestern Oklahoma with more than 31,000 cars bearing its NOKL marks. Another is the 105-mile Arkansas & Oklahoma with 18,000 AOK cars.

IMHO fleet expansion is a double-edged sword. The lower the railroad velocity the more cars one needs to handle a given volume of freight. The more cars on line the lower the velocity, and so on. The real question thus becomes whether car builders are kept busy by increased traffic volumes on faster railroads or the same traffic volume on slower railroads. Indications are it's largely the latter. BNSF has ordered 6,000 hi-cube covered grain hoppers and NS has a major rebuild program for 100-ton Plate F box cars. Yet both rails are operating at or only slightly below the average system velocities posted last year at this time.

Marybeth Luczak's "on the record…"column in the June 2004 *Railway Age* is a must read. She captures NITL President John Ficker's view of the rail industry and the need for buyers and sellers of transportation services to work more in harmony than in isolation. Says Ficker, "Shippers are like water running downhill: they seek the course of least resistance." Moreover, "shippers want consistent, reliable service. If consistent service is there price and rates are going to be less of an issue."

Except that transportation managers' careers are made on how much they can pare prices. The price of fir two-by-four eights may be $400 a thousand board feet in Seattle and $500 a thousand in Chicago. That $100 spread is transportation regardless of mode. The carriers' costs have nothing to do with it. All one accomplishes going below market rate is to weaken the carrier and open the door to the next guy.

Personally, I'd rather deal with a few strong carriers than with a phone book full of also-rans. Reliability and consistency cost money and that goes to the old "Three Choice Rule" for goods and services. You have three choices: cheap, fast, and good -- but you can only have two at a time. Cheap and fast isn't going to be any good, cheap and good isn't very fast, and good and fast ain't cheap. Says Ficker, "We want the rails to be stronger, provide reliable service, and grow share." But buyers have to be prepared to pay the rails to be fast and good.

Back in Marketing 101 we all learned about "unique selling points" and "competitive advantage." Pure price can never be a unique selling point because whatever number you name I can name a lower one. But a rail car moving four truckloads for the price of three works because of the economies of scale at both ends of the trip. Competitive advantage means capitalizing on your USP to deny the competition access to your customers. Nothing's changed.