THE RAILROAD WEEK IN REVIEW

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Quote: "Before 1980, the federal government tried to run the railroad business, and the results weren't productive. Virtually all aspects of rail operations were subject to federal regulations that controlled pricing, stifled innovation and mandated unprofitable services." State Sen. Matt McCoy, Democrat from Des Moines, in the Des Moines Register*, June 7*

There is yet another sign of opposition to the railroad re-regulation bills working their way through Congress. The Des Moines *Register* carried an opinion piece by the Hon. Matt McCoy who writes, "In the past five years, we've seen a huge increase in the use of rail to transport goods and raw materials across our nation. Railroads offer an attractive option for Iowa and the nation as gas prices rise and major highways become more congested.

"Railroads help to keep our economy rolling and save businesses and consumers billions of dollars by carrying coal, which generates electricity, and goods such as clothes, food, computers and automobiles." Yet now comes the infamous (to some of us) HR 2125, a creature of Jim Oberstar (D-Minnesota) with the potential to derail much of the post-Staggers railroad progress.

McCoy trots out some of the post-Staggers growth figures and notes "infrastructure investment has soared - more than $370 billion has been spent to maintain and improve infrastructure and equipment." Then he acknowledges that HR 2125 "would set the rail industry back to pre-1980 conditions. It would dictate fee structures by which rail operators would have to abide and essentially treat the industry as one size fits all. Many smaller lines would be unable to develop the necessary improvements to remain efficient, safe freight carriers for customers."

This is something the AAR, the ASLRRA, the analyst community and yours truly have been saying since HR 2125 first appeared on the scene. The good Iowa Senator concludes, "When you see products being shipped across our state by rail, ask yourself: Why would we want this freight back on the highways? That's especially true given the high cost of fuel, the air-quality issues presented by increased truck traffic and possible harm to economic development in both urban and rural communities. Let's have a common-sense approach: Don't re-regulate the railroad industry."

Regular readers of these pages will recall that a year ago *TRAINS* Associate Editor Andy Cummings and I visited Dan Sabin's Iowa Northern to gather material for our August 2007 ethanol story. One of the most creative aspects is the Manly Terminal, where they bring in ethanol from many makers by truck and rail and assemble it into unit trains.

The premise is that Manly can assemble unit trains more quickly and with better car utilization than any individual producer. Since the stuff is fungible (it *is* just grain alcohol, after all), it loses its maker's mark once in the holding tank and thus can be sold along with every other producer's ethanol to make a market. The idea is to let CBOT sell trains of "Manly ethanol" the same way "Chicago corn" is sold. Getting back to the good State Sen., there is no way this would work in the bad old regulated days.

Railroad infrastructure investment is alive and well. On Tuesday Pittsburgh-based L.B. Foster Company (Nasdaq: FSTR) said orders received during the month of May were the highest in Company history. The Company's three major distribution products lines -- Piling, New Rail and

Relay Rail -- along with its Coated Products and CXT Concrete Buildings businesses, all reported a strong booking month and were the key reason for the performance.

As of the end of the month, the Company had recorded almost $77 mm in order bookings, easily surpassing the previous monthly record of $64 mm hit in February 2007. According to Stan Hasselbusch, President and CEO, the level of order entry was the result of solid end market demand. “We think there is some pent up demand in both the rail and construction segments of our business.

With the price of scrap rail and OTM now north of $600 a ton in some markets, and decent relay rail (no 1920 B&O sections of 125 please) an eye-popping $800 a ton in some markets, that FSTR is doing well by doing good is to be expected. Short lines in particular are in a great position to pick up their used rail and sell it for scrap or to be turned into fence posts or bed rails. Who ever thought track could be a profit center?

As for FSTR itself, the stock has been in a downtrend since the late Dec high of $60. Even with the DM&E investment, I had felt it was getting a bit ahead of itself (I sold at $40 and change, taking my double off the table). However, at today’s $34, FSTR is back where it was last August and it might be time to ease back in. My intrinsic value calculator suggests $43 a share.

Now comes a piece in today’s *Wall Street Journal* that tells of manufacturers repatriating work that had been shipped offshore. The argument is that transportation costs have risen to the point that any margin gains from sending work to, say, China, are being eaten up in the higher cost of moving finished goods to customers in North America. “The cost of shipping a standard, 40-foot container from Asia to the East Coast has already tripled since 2000 and will double again as oil prices head toward $200 a barrel. For every 10% increase in the distance of a trip, energy costs rise 4.5%.”

Moreover, “The higher costs are particularly problematic for lower-value goods: The cheaper a product, the more significant transportation costs are in the final price. That may help explain why Chinese exports of some ‘freight-sensitive’ goods to the U.S. are now falling for the first time in more than a decade.” Even Mexico, while closer to home than Shanghai, still has its added costs.

The paper cites an industrial battery manufacturer who sees transportation adding 5-10% to the cost of his Mexican product. That, added to quality-control problems, makes the homegrown version a better value. The trend might dent the international intermodal volumes a tad, but it sure could benefit the short lines that remain close to the customer.

Art Shoener has resigned the role President and CEO of KCS Railway. His successor is David Starling, who comes up from the Panama Canal Railway subsidiary. In a press release KCS Chairman and CEO Mike Haverty said the move will “strengthen the company’s growing international marketing initiatives and take advantage of its increasingly important international rail corridor linking North America to global markets. Mr. Starling’s 23 years of operating experience will help us build on our current operating efficiency.”

Starling began his railroad career with the Frisco in 1971, and for 14 years held positions in operations on the Frisco and on Burlington Northern. Starling joined Mi-Jack Products in 1984 to help create a terminal operating company, In-Terminal Services. In 1988 he joined American President Lines as managing director of stack train operations for the Chicago region and later for the southern region. In 1995, Starling became APL’s managing director for Hong Kong/South China, and then served as vice president-Central Asia. In 1999, Starling was named president of the Panama Canal Railway with responsibility for reconstruction of the line and its subsequent operation.

To me, this is an intriguing shift -- to have a marketing man running the RR rather than an ops guy. It is a good move, especially with respect to building the new business pipeline that KCS has stressed in the last few earnings calls. Clearly, Shoener helped make the railroad run better with new power, better track, integrating the Mex and US ops, and improving operating income.

KCS reported revenues of $1.7 bn in FY 2007, up from $636 mm in FY 2004, a gain of 174%, and took 2007 ops income to $362 mm from $101 mm, up 258%. The OR dropped nearly five points, 84.1 to 79.2 in the bargain. Granted, creating one big Class I from two regional railroads was a major part of it, but the benefits are a fact and to Shoener goes a lot of the credit. Thanks, Art. And, David, though we've never met, let me say to you what they say before a Broadway opening: Break a Leg!

Gary Marino takes the fifth. Short line, that is. His Patriot Rail holding company has closed on its acquisition of the Louisiana & North West Railroad out of Homer, Louisiana. Patriot now operates a total of 321 miles of rail line in seven states. Incorporated in 1889, the LNW operates 68 miles of track from Gibsland, Louisiana, to McNeil, Arkansas. Major commodities shipped by the railroad include chemical products for Albemarle Corporation, wood products for Weyerhaeuser and Partee Flooring, steel products for CMC Steel Arkansas, and plastics for Berry Plastics.

The LNW, which interchanges traffic with UP at McNeil and with KCS at Gibsland, handles approximately 5,000 carloads of freight annually. The railroad also owns 845 acres of real estate, operates five locomotives and has 27 employees. Says Marino, "The LNW has a solid customer base and considerable growth potential. It's a very well-managed and efficient railroad operation focused on providing customers with reliable and safe rail service. We anticipate implementing a number of new business initiatives that will grow the business significantly over the next several years.

I photographed the LNW only once -- at Gibsland in Dec 1961 as I drove across the southern route from my home in NJ to my first military assignment in Abilene, Texas. A notable fixture of that interchange was a pair of gates with highway-type stop signs on them across the LNW track on either side of the KCS diamond. There was a crisply striped and lettered SW-1 and a caboose with an IC-type sliding door on the side plus a tow cable slung under the car body. Fast forward to 1996 and Ed Lewis' classic *American Short Line Railway Guide* shows LNW owning seven locos including a couple of FRS. The 41, the loco I saw, was not among them, alas.

Porter Collins, a close friend for more than 40 years, passed away last Sunday at home in Salem, Ohio after a long siege with cancer. We first met as volunteer firemen (literally) on New Jersey's Black River & Western, moving a couple of tons of coal a day from tender to firebox on the end of a shovel. Porter was truly – and often described himself as -- the last of the boomers, having collected paychecks from something like 18 railroads, mostly short lines, from the BR&W itself to both sides of the Winchester & Western. He also had stints with the Wheeling, Ohio Central and the Adirondack railroad in upstate NY.

Memorial contributions may be made to the Winchester Chapter of the NRHS, 19 Brighton Drive, Gaithersburg, MD 20877-1809.

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