THE RAILROAD WEEK IN REVIEW

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"The undeniable fact is that the short line model of intense sales and marketing focus and a keen awareness of economic trends in the service area is working."—Len Kellermann, CSX

I closed last week's letter chiding, "Enough of the doom and gloom already." Well, there's still plenty of that around as I write this Wednesday noon (DJI down 230 points) however it is nicely offset by many encouraging words in the Fall, 2008 issue of the CSX Short Line newsletter, "Interchange."

There are several success stories of short lines identifying and capitalizing on customer needs to reshape their supply chain patterns. And though each story has a slightly different angle, the common theme is being close to the customer, not surprisingly number one on CSX' Core Values hit parade. Len Kellermann, CSX Director of Regional and Short Line Development, put it this way: "The undeniable fact is that the short line model of intense sales and marketing focus and a keen awareness of economic trends in the service area is working."

And how. Dick Abernathy's Alabama-based Sequatchie Valley Railroad (SQVR) has negotiated a long-term contract to handle synthetic gypsum, a marketable by-product of the scrubber system used in coal-fired electric power plants, with an eventual volume approaching 6,000 loads a year in 60-75-car unit trains of shipper-supplied rapid-discharge cars. Mississippi's Columbus & Greenville (CAGY, a June-2008 GWR acquisition) takes scrap into the new ServerStal steel mill in Columbus and handles outbound coil steel.

Further north, Connecticut's Housatonic River Railroad has teamed up with the eponymously named Southern Railroad of New Jersey to supply the Salem (NJ) Mannington Mills floor tile plant with high-performance dolomite limestone. It's only 300 miles door-to-door by Interstate and an easy seven-hour truck drive if you end-run NYC on 287 to Exit Ten on the NJTP. Here, it was business once on the rails, 600 cars a year worth, lost, and recovered to reach new highs by July 2008.

CSX also lists twelve short lines in the running for the Sixth Annual Short Line Award program, six for carload gains ranging from 2,000 to 8,000 units and six for triple-digit percentage gains ranging from 200% to more than 400%. While conceding weakness in building materials, forest products and auto, CSX cites shortline strength in coal, metals, agricultural products and fertilizers. Year-to-date through July CSX short lines handled 555,645 units, up about one percent from 551,035 in the first seven months of 2007.

System-wide, excluding intermodal boxes, CSX did 2.8 million revenue units, down three percent or 85,000 units year-over-year. Thus CSX short lines participated in nearly twenty percent of CSX merchandise and coal moves, up a point over the 2007 number. Moreover, the trend continues. CSX says twelve of fifty-four announced industrial development projects are on short lines, worth some 21,000 revenue units, 31% of all carloads expected from these projects. So if 22% of the projects are on short lines and these account for 31% of the new business, then the short line model must be working. Especially since by the end of the third quarter YTD total short line cars were up two percent or 15,000 units and now represent more than 20% of CSX total carload business.

CP held its annual Investors Day in Toronto November 12. Slides are posted at www.cpr.ca as is a rebroadcast of the presentations. The themes were efficiency and growth with special mention of the DM&E acquisition, though not much was aid about the railroad east of Chicago which was kind of surprising as the CP website lists quite a few eastern short lines, some of which handle upwards of 30,000 merchandise loads annually. But then, the "market pillars" are agribusiness, trade and energy, most of which happens west of Chicago.

SVP for Marketing and Sales Marcella Szel said grain is 73% of the agribusiness group and has a five-year CAGR of 10% with 80% of loads originating from high-throughput elevators, many of which are in North Dakota while there are country elevators strung along practically the entire length of the DM&E. The other 27% of the agribusiness unit is fertilizer and its 3% five-year CAGR (it helps that CP has 100% of the market for Pacific export potash).

Energy -- coal, oil shale, and natural gas -- and the commodities that support its extraction (pipe, frac sand, clays in; sulfur out) -- is 18% of the CP business portfolio (coal is 13%) and sports a three percent five-year CAGR. And ethanol production along CP lines is expected to hit a billion gallons a year. Trade, the third leg of the CP trinity, has propelled container growth at a five percent CAGR over the past five years and they expect CP-Vancouver export volumes to nearly triple by 2025. Moreover, CP -- like KCS -- reports on its pipeline of new business, now worth more than $100 million.

Looking ahead, CP says volumes will be "slightly reduced" (Credit-Suisse rail analyst Chris Seraso pegs 2009 revenue unit growth at negative two percent) with negatives in STCC 24 and 25, auto not quite do bad and industrial products a mixed bag where chemicals and energy-related metals may mask weaknesses elsewhere.

Rate hikes ("core price expectation") are expected to remain in the mid-single-digit range, essentially a continuation of what we heard on the 3Q08 earnings call. CP plans to improve margins through value-added services and reaching out to new customers (Pennsylvania and New York would be a good start) supported by improved velocity, pipeline management, train design and fleet productivity (no more six-day dwells, short lines).

Operations SVP Brock Winter said they're approaching $C100 mm in expense reduction this year by running a faster, smarter railroad and has the ops metrics -- velocity, year dwell, car miles per day, cars on line, etc. -- to prove it. EVP and CFO Kathryn McQuade said the 2009 capex program (including DM&E) will be down about $C200 million year-over-year and car hire will come down thanks to bigger trains, less terminal dwell, and better reliability. (These are all things where shortline performance can make a difference and the short line than can make a difference is a more desirable short line).

Larry Kaufman writes, "I can't help but comment on the HRB red state/blue state item (WIR 11/14/2008). I put that in the category of figures don't lie, but liars can figure. Having lived in red-state South Carolina and now in suddenly blue-state Colorado and having just gone through a vicious and stupid state constitutional amendment fight over the so-called right-to-work issue earlier this month, I have some views that may interest you.

"Proponents of RTW like to cite higher rates of job creation and more rapid income gains in RTW states. True, but they never acknowledge base numbers that show a lagging economy. It's easy to create more jobs if you start with very few in the first place. Other factors that may or may not have been considered by the authors of the HBR 'study' include education, housing, and all of the other factors that go into businesses decisions where to locate facilities.

"I'm trying not to come across like an ardent unionist because I'm not. I like to think I am a realist, though. Having been a member of four different unions on four different jobs in my younger days, I am a firm believer that companies get the kind of labor relations they deserve. Those that treat their employees with respect generally have good labor relations even if a union represents their workers.

"Others, obviously have poor labor relations and ultimately invite unionization by their own behavior and treatment of their workers. The Class 1 railroads, as you so well know, Roy, are effectively 100% unionized and bear the curse of having to deal with many unions, too. They actually have pretty good labor relations, as Frank Wilner points out in his soon to be released revised edition of his book on the Railway Labor Act.

"Nothing in this screed argues against a short line executive looking to pick up properties that are in economically growing areas as opposed to buying them in declining areas. Obviously, NS is trying to get out of much of its involvement in Michigan, but it is increasing its activities in New England, which is considered hospitable to unions. All in all, I guess I just demur that red-state, blue-state is anything more than a short-hand for economic growth vs. economic decline." I can always depend on Larry to add insight, and this trip out is no different. We are all the better for it.

Rob Himoto of California's Santa Maria Valley Railroad (WIR 11/14/2008) adds this tidbit on the care and feeding of customers. "Another thing is our engineer has a good rapport with all of the dock people. When the guys loading and unloading rail cars like the railroad, they are more motivated to load and unload railcars a lot quicker. His hunch with Pictsweet is that the guys loading the cars like the 50' cars, they can load them nice and tight and not have to worry about shifting loads. If a load shifts, it is blamed on the person loading the car, not the railroad. I invited the dock manager to one of our open houses and he really appreciated it.

"Happy dock people gets things done more efficiently and will push for rail cars over trucks. We have a drywall customer, the only drywall customer on the Central Coast served by rail. I cold-called them a year ago and the response was that they were shipping 10% by rail and 90% by truck. It was too much effort for them to unload a center-beam flat car, they would rather unload a truck. When they did receive a railcar, they took several days to unload the car and it was a chore to get them to tie up the cables afterwards. The manager did note that there was considerable savings by rail and after my visit he brought more rail cars in, he said that he would try to shoot for a 50-50 mix.

"The housing slowdown really hit the Central Coast here and the drywall customer was bought out by U.S. Gypsum and brought a new manager in. The new manager came in to our offices about 6 months ago and said that he is putting everything on rail and cleaned house. Carloads started to come in and they are promptly unloaded and cables up. By utilizing rail and buying in bulk, they have been able to dominate the Central Coast for drywall. This year has been their biggest year in terms of rail cars received since opening in 2001." Like the man says, "It begins with the customer."

Closing chuckle. Charles Schwab Chief Investment Strategist Liz Ann Sonders writes, The Treasury Department [wants to] modify how it will use the remaining $700 billion Troubled Asset Relief Plan (TARP) funds… prompting some to coin TARP the 'Try Anything Relief Plan.'" Sounds about right.