The Railroad Week in Review,
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"While orders will begin to pick up next year, extremely low backlogs will serve to keep assemblies at 16,500 units in 2010." – Peter Toja, EPA

Art Cashin offers more shortline-applicable insights from his recent session with Mohamed El-Erian of Pimco. Art writes then cites thus: "Mohamed shares my concern about the risks of [the present environment in Washington] turning into an 'us versus them' argument. No democracy will tolerate a system that privatizes massive gains and then socializes massive losses... We have a risk that things are going south quickly in the real economy. Unemployment is at 8.9%; we wouldn't be surprised if it gets to 10.0% within three months and it's not clear if it stabilizes there. It's going to be a real test for the American system that has checks and balances to stop the mob taking over there.

"I went on to expand on the societal risks of an 'us versus them' crisis. Regular readers know of my often-expressed concern about an ugly summer. A shortage of jobs and goods could explode into civil unrest in an 'us vs. them' environment. Our friend, Kevin Ferry, of Cronus Futures wrote this week of his concerns about a troubled summer. 'Washington needs to unite not divide.'"

In this regard I have reason to believe the ASLRRA, the FRA and even some Members of Congress are seeing the light of how some of the proposals for new regulations could do real harm to the short line community. I'm talking about things like hours of service, where a freight guy might not be allowed to go out and run a weekend steam excursion after five weekdays in freight service. Or having to put PTC equipment on a short line loco that ventures out onto a Class I line only to make interchange. This is definitely a work in progress; keep a weather eye on the ASLRRA's *Views & News.* I'm encouraged that the divisions that may be occurring elsewhere are less virulent in the short line arena.

A May 13 note from Jeffries & Co ought to be good news for short lines in the grain belt and in the farm machinery business -- think Iowa Northern, e.g., in both Deere and ethanol. "We continue to believe that farm markets are weathering the economic storm better than many other industrial sub-sectors. As we progress through the Spring season, planting is off to a slow start, which supports high crop prices. Recent proposals to increase ethanol blending could also provide longer term support." This could relieve some of the pressure on grain haulers from slowing export grain markets.

In a parallel note the same day, UBS analyst David Silver is bullish on ag products next year: "We believe grower profitability is rising for 2010 due to attractive crop prices and moderating costs for fertilizer, fuel, and land rents following a 2009 crop year that could mark the second down year of US and global fertilizer use. Grain prices could strengthen further as global stocks tighten from a smaller harvest, rising US biofuels demand, and economic recovery."

Morgan Stanley rail analysts Bill Greene and Adam Logsden see this development as a "modest positive for all rails -- UP and CN in particular. We view the forecast as a modest positive for rails with heavy grain exposure (Canadian and US Western rails). However, poor wheat exports are an incremental, offsetting negative for BNSF, as export wheat volumes are some of the highest margin moves on the railroad. Overweight-rated UP (and CN to a lesser degree) may benefit most should USDA forecasts prove true due to relatively larger corn exposure, albeit slightly lower overall grain exposure"

Genesee & Wyoming April 2009 carloads dropped 6.3 percent from April 2008 and 11.9 percent from March 2009; year-to-date loads through April are off 8.1 percent. Same-railroad business sank 21.8 percent with losses spread more or less evenly among coal & ores, pulp & paper, metals, and other (which includes haulage fees). Acquisition volumes made up made up for 70 percent of the same-railroad losses. The widest year-to-year commodity swings occurred in pulp & paper (-29.9 percent), lumber & forest products (-18.7 percent), metals (-29.7 percent), automotive (-42.2 percent) and other (+154.8 percent).

Peter Toja, President of Economic Planning Associates, writes regularly for *Railway Age* on the state of and outlooks for the railcar building industry. His most recent missive, posted on that magazines “Newswire” feature, concludes, “Railcar orders in the first quarter amounted to only 2,374 cars, the lowest quarterly level since the recession-impacted period of 1982-83. And, with assemblies amounting to 7,657 units, first-quarter backlogs dropped to 26,171 cars, the lowest level since the first quarter of 2003.

“At the same time, we are leery of the Greenbrier portion of the backlogs, which is destined for GE as part of a multi-year agreement. Much has appeared in the media regarding GE’s desire to delay, postpone, or change existing orders for covered hoppers and *tank cars* [emphasis added, especially in the ethanol context -- rhb]. And, given the weak economy, extremely low traffic levels, and the financial hardships suffered by GE Capital, we are doubtful that any meaningful number of these cars will be assembled in the near term.

“Based on first quarter assemblies and the solid backlogs in coal cars, tank cars, and covered hoppers, we anticipate deliveries of 25,600 railcars in 2009. While orders will begin to pick up next year, extremely low backlogs will serve to keep assemblies at 16,500 units in 2010. After two dismal years, we look for railcar deliveries to rebound moderately to 29,000 cars in 2011 and then expand annually to the level of 58,000 units in 2014.”

The Modoc Northern Railroad, a short line on the California-Oregon border, appears to have run afoul of its operating contracts with the UP and with the county that owns some of the railroad right-of-way and track. An item on the AP news feed cites one Ken Kester, Lake County (OR) Commissioner as telling the local newspaper that problems with Modoc Northern included poor maintenance and financial mismanagement. Moreover, it is reported that Modoc Northern wrote the county a $45,000 check that bounced last fall.

According to my database Modoc operates on some 160 miles of railroad and has only 2000 revenue loads per year. Can’t be more than $500,000 or so in revenue, tops. My “Rule of 100” tool suggests you need at least a million dollars a year just to staff, fuel and maintain (ex-track) even the smallest of short lines. The website, www.modocnothern.com, shows what appears to be a first-generation GP-something on some light rail track that has clearly seen better days. I called the number on the home page only to find it disconnected.

This being the kind of ugliness that gives short lines a bad name, I cranked up my Rolodex of California contacts to see what’s what. A sample response: “I can pretty much confirm the MNRR is dead. Last week the UP got finally got fed up with MNRR’s creditors hounding UP (not to mention the very sizeable sum MNRR owes UP) and terminated their [agreement]. Basically, it doesn’t appear as if MNRR was paying anybody, including their employees. Lake County has also terminated the operating agreement MNRR had to run the Lake County Railway. The lesson is to pay your bills, ESPECIALLY to the guy who holds your lease.”

By way of background, Andy Cummings writes in the *TRAINS* Newswire, “UP plans to conduct a safety inspection of Modoc Northern’s track, and will assume service as soon as practicable. The decision to terminate came as UP received increasing information on Modoc Northern’s failing financial condition. Modoc Northern operates the remains of the ex-Southern Pacific Modoc Line, plus the Lakeview branch, also of SP origin. It began leasing the McArthur, Calif.-Klamath Falls portion of the Modoc from UP in 2005, and added the Lake County Railroad to Lakeview in 2006.” Traffic is wood chips, perlite, lumber and agricultural products.

“Choo Choo Surge Capacity” is how UBS rail analyst Rick Paterson introduces his recent notes on Class I equipment stored and people furloughed. “While difficult to imagine at present, there will come a day when railroads grow again and begin to reabsorb critical surplus resources.” As for locos, “Too few on hand badly inhibits growth and efficiency into an upturn; too many hurts ROA a little (so much better long than short).

“KCS and UP have more power than they’re likely to need, even in an upturn, as recent surges in productivity have exacerbated equipment surpluses. CP is also probably too long. BN has it about right but will be forced to take delivery of more under a contract. CSX, NS, and CN have a 10% cushion - adequate in anything less than a strong recovery. Average road fleet ages hover around 15 years, so not a differentiator, but the oldest most fuel inefficient units are the first to be sold and stored, hence a recent increase in efficiency per unit.”

Memo to short lines: Get your financial house in order and take some of that free cash flow after track repair to update your own loco fleet. It’s a fact that too many short lines have too many units on the books, some not even in service, occupying valuable track space. Time to clean house. If Rick is right, and I were a UP, CP or KCS short line, I’d be parked on their doorsteps, checkbook in hand.

Re furloughed T&E employees, Rick writes, “These are critical employees whose numbers most closely fluctuate with volumes, and typically account for about 40% of total railroad headcount. While some furloughed employees don’t return to the railroad when called, the vast majority do, given the relatively high pay vs. non-rail employment alternatives.

“Most railroads have comfortable T&E availability of between 9-15%, with only two materially above that: CP and UP at 30% and 26%, respectively. Clearly it’s unlikely all these employees will be called back, however from a corporate point of view health and welfare benefits cease after a few months and costs go to zero (good for the company, unfortunately painful for the individuals). CP, CSX, and UP are taking the most aggressive action into the downturn.”

Short line owners tell me they can often attract furloughed Class I T&E guys with shorter hours, no taking their rest in a distant hotel and regular out-and-back jobs. To be sure, the pay envelope may be smaller, but going to work in the same place every day and finishing work where you started has its own rewards. Moreover, the guy brings his own CLE ticket that you didn’t have to buy. That ought to be worth a *few* bucks.

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