THE RAILROAD WEEK IN REVIEW
SEPTEMBER 25, 2009

"The destruction of money balances is madness". -- Art Cashin

Money, it seems, remains in tight supply for some short lines. And they're not the only ones. UBS' Art Cashin wrote on Monday, "U.S. bank loans continue to contract at an alarming level. That does not bode well for the so-called recovery. Some very bright minds in the business have expressed grave concern about this problem." He cites three very bright people talking about the "scope and rapidity" of the contraction. "US bank loans have fallen at an annual pace not seen in the US since the 1930s.

Cashin concludes, "The rapid destruction of money balances is madness." As for the effect on short lines, a reader in Chicago who gets paid to watch these things reports that lenders are not going out further than one-time EBITDA. In the past covenants limiting outstanding debt to three or four times EBITDA were not uncommon. But ONE time?

Putting this in context, a typical short line with revenues of $2 million could conceivably be blessed with an EBITDA margin of 50 percent, or a million dollars. Now comes the FRA bridge man who opines that the 800-foot timber trestle needs $350,000 in repairs. The new Hours of Service law mandates that the line in question must hire another T&E employee if they are to continue offering service six days a week. Compounding matters, the two cars of chlorine that go to the local water purification plant every week puts the short line in the TIH business and thus must install PTC.

I wonder when we'll hear of the first short line filing for bankruptcy because it can't meet what UP's Jack Koraleski calls "unfunded mandates." Take our poor guy above. Putting the bridge out of service could shut him down so the local grain elevator has to truck to a different place to get on he railroad. Not running a sixth day makes him non-competitive for a customer running a lean inventory and a tight supply chain. The TIH requirements put the chlorine on neighborhood roads.

Any one of these would be enough to sink a marginal railroad. But all three at once is a surefire way to kill a marginal short line, of which I estimate there are a couple hundred. I wish Congress would think through these unintended consequences before they start passing new laws that actually degrade the quality of life for their voters.

And in the vein of unintended consequences, a friend writes, "China can only do so much to drive exports -- especially since we are not importing. Cash for clunkers has emptied the showrooms. The government now finds, a la Chrysler, that they are in the rebate business, not the car business. Several steel mills re-started, sensing a firming in prices. They are now wearing that inventory around their ankles. It is quite possible that this is the middle of a "W" recovery. In any event, unemployment will grow for a quarter or three. Unit trains of Pepto and Maalox may be needed.

How does a single-carload railroad franchise survive in a high-speed, high-density world? I put that question to WIR readers last week and the response was encouraging. The main theme revolves around doing the basics well. First, "pay attention to your online customers, make their day to day experience with the RR easy and helpful, do what you can to anticipate their needs and try to bring them business development opportunities" That's easy enough and only takes listening.

Part two is tougher: cost control. “Be very reluctant to add cost and pay attention to items that could conspire to sink the day to day cost of operation,” says a relatively new entry to the field. Sound advice and it works. A short line in Canada saw revenues drop by three percent yet grew EBITDA 25 percent by getting rid of those money sinks that were killing operating results. A new operation in the midwest is on plan for a 76 operating ratio in its first year of operation.

Third, readers say one must take advantage of federal and state money wherever it makes sense and is available. Fourth, and sometimes hardest, be a professional business partner with your connections -- be reasonable but don’t get walked on. Which means hold them to their word when it comes to revenue divisions and interchange agreements. One chap who operates several short lines says that the understandings he reached with the Class I short line marketing groups was ignored – or at least not taken seriously -- by the ops guys.

Yet across the board the re-reg threat looms large. The owner of a 20,000 car a year short line writes, “As for rereg, my bigger concern is additional burdens the FRA and Congress are placing on the railroads. It is important to remember that at the time [the Staggers Act was under consideration it was assumed] the market would regulate the industry and that there would be lots of Class Is around to compete with each other. I’m not sure anyone anticipated that there would be basically two east and two west Class Is [following] deregulation.” He adds that eliminating the deregulation provisions of the Staggers Act would not be good for the industry.

Railex LLC has added a fourth weekly refrigerated unit train departure from the West Coast to eastern markets via UP and CSX. The new service departs Wallula, WA on Fridays at 11 PM and arrives at the Rotterdam, NY, distribution center the following Wednesday afternoon. The other three departures are from Wallula on Wednesdays at 11 PM arriving Monday afternoon, and from Delano, CA on Wednesdays and Fridays at 7 PM and arriving in Rotterdam Monday and Wednesday mornings respectively. Transit times are guaranteed, running with intermodal priorities and speeds on both railroads. It’s a 3,186 mile trip from Delano; Wallula is 2,877 miles from Rotterdam.

This is truly a success story, Railex having run its first perishables unit train in October, 2006. Each train is comprised exclusively of 64-foot, Plate F mechanical refrigerator cars capable of carrying nearly 100 tons of merchandise in a temperature-controlled environment set to the customer’s requirement, from below freezing to “ambient” or 55 degrees Fahrenheit. Railex has designed all three facilities around this specific car type to facilitate loading and unloading a train a day. Each equipment set goes back to its own origin and averages two turns a month.

Shippers include fruit and vegetable growers running the length of California’s San Joaquin Valley plus potatoes, onions and wine from Washington state. Receivers include New England’s Price Chopper grocery chain as well as distributors literally from as far north as Montreal to Washington DC and beyond.

The light at the end of the recession tunnel is growing brighter and it may even be a train. JPM’s Tom Wadewitz sees “significant upside (20% or greater) over the next 15 months (through year-end 2010) for most of the asset-based names that we cover, including the railroads.” He continues, “With 10 weeks of the quarter behind us, we are updating our volume assumptions” for the full third quarter. He’s also taking up earnings estimates for all rails but CP, unchanged; mix appears to be a major factor thanks to higher volumes of higher-rated commodities. That’s the good news.

But the legislative picture may yet dim that light. In a separate note Tom writes, “Senator Jay Rockefeller (Chairman of the Commerce Committee) is likely to introduce new rail legislation within the next several weeks. In aggregate, we believe that the bill will include several favorable changes for the shippers in terms of access (bottleneck, terminal access, paper barriers), and it is unlikely to include potential material wins for the railroads (replacement cost, hazmat risk sharing)."

Cherilyn Radbourne, writing for Scotia Capital in Toronto, adds, "The U.S. House Judiciary Committee has passed a bill that would revoke the railroads' antitrust exemption. We assign limited significance to this development, given that the Senate appears to have taken the lead in drafting railroad legislation. The Senate cancelled a vote on a similar bill in June after Senators Kohl and Rockefeller agreed to work together on legislation that would address a broader range of shipper-carrier competition issues.

"That bill is still pending from the Senate Commerce, Science and Transportation Committee, and could come at any time. The content remains very uncertain, but the railroads seem to feel comfortable that the Committee understands the issues involved, and is conscious that a "bad bill" would put union jobs at risk, and threaten the railroads' ability to fund needed investments in infrastructure.

Shortline carloads through Week 37 (ending September 19) were off 25.5 percent ex-intermodal against the Class I carloads ex-intermodal but including coal and grain. Short lines lagged 5.5 points in coal because – I think – most short line coal haulers are in the east and App coal lags PRB coal. Short lines' aggregates loads were 3.7 points less worse than the class Is. Other places where the short lines were down less than the Class Is – though not by much – include aggregates, the STCC 24 (wood) group, chemicals and scrap (see RMI RailConnect Index, attached.).

It figures. The trend in the Class I single-carload business, as mentioned above and as exemplified by the Railex unit train, runs to bigger blocks moving longer distances between nodes. Terminal dwell times and system average train speeds are improving. In preparing for my recent UP cab ride, for example, I learned UP can take 80 locomotives out of its daily requirement by assigning power by tons per axle rather than horsepower per trailing ton. Both western roads are using distributed power to increase train size and are running greater distances between terminals.

With two thirds of shortline volumes in bulk, forest, waste and scrap, it's getting tougher to make a buck in this business. I'm looking forward to seeing how the UP short lines are faring when we gather in Omaha this weekend.

RailTrends 2009 returns to New York City October 6 and will run for two days. My friend Tony Hatch tells me it will have "the best lineup ever," starring CN's Hunter Harrison, winner of the new "Railroad Innovator" award from *Progressive Railroading* magazine, Norfolk Southern's EVP Debbie Butler on capex, and other principal players from labor to the AAR plus speakers from Watco and Wal-Mart. Check it out on line at www.railtrends.com) and reserve your seat today. It's bound to be an SRO crowd.

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RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 9/19/2009

Week Number: 37

Carloads Handled	Current Week 2009	Current Week 2008	Current Week % Change	Year-To-Date 2009	Year-To-Date 2008	Year-To-Date % Change
Coal	10,863	15,964	-31.95%	480,633	567,925	-15.37%
Grain	13,791	15,208	-9.32%	467,254	559,027	-16.42%
Farm & Food (Exc. Grain)	5,500	5,437	1.16%	192,112	210,756	-8.85%
Ores	2,189	2,928	-25.24%	63,178	105,845	-40.31%
Stone, Clay, Aggregates	10,885	13,452	-19.08%	382,309	473,531	-19.26%
Lumber & Forest products	3,802	5,244	-27.50%	129,548	180,567	-28.25%
Paper products	5,718	7,100	-19.46%	209,348	276,675	-24.33%
Waste & Scrap materials	5,572	6,359	-12.38%	164,952	243,014	-32.12%
Chemicals	15,653	16,113	-2.85%	561,339	644,221	-12.87%
Petroleum & Coke	3,402	5,042	-32.53%	130,798	214,959	-39.15%
Metals & Products	6,310	10,982	-42.54%	210,418	415,407	-49.35%
Motor vehicles & equip.	1,163	1,875	-37.97%	36,914	72,261	-48.92%
Intermodal	5,691	12,306	-53.75%	237,159	463,889	-48.88%
All Other	1,569	3,373	-53.48%	52,253	114,980	-54.55%
Total	**92,108**	**121,383**	**-24.12%**	**3,318,215**	**4,543,057**	**-26.96%**

RailConnect Index

Year-To-Date