THE RAILROAD WEEK IN REVIEW

October 15, 2010

"The Staggers Rail Act can be credited with saving consumers billions of dollars, making our nation's economy more competitive, and supporting 1.2 million jobs throughout the economy."
-- Ed Hamberger, President, AAR

The monthly gains in year-over-year revenue-unit counts continues. Setting the scene, theAAR report for Week 39 (ending Oct 2), shows total year-to-date units up 12 percent for 2010 thus far. Total carload moves were up10 percent; ex-coal loads increased 16 percent. Intermodal boxes -- no surprises here -- gained 16 percent year-to-date.

For the month, Jason Seidl at Dahlman Rose uses a rolling four-week total putting revenue units up 12 percent, intermodal alone up 18 percent and coal up six percent. Merchandise carloads ex-coal and intermodal grew nine percent over the 2009 count. Shifting to the RMI RailConnect Index for Week 39, short lines were up nine percent year-to-date all-in. Intermodal has dropped to just seven percent of the total and, as it shows up on relatively few of the 343 road names in the RailConnect Index, isn't particularly helpful as we try to measure strength of the short lines' core merchandise and coal franchise.

Ex-intermodal, short lines gained ten percent -- 13 percent if you exclude coal as well as intermodal. Another word on coal: short lines touched eight percent of the total AAR North American total, down from nine percent in 2009. AAR year-to-date coal loads were essentially unchanged year-over-year, up less than one percent. Yet the short lines were down ten percent in the same period, once again supporting my thesis that shortline coal is the first to go when the chips are down.

Moreover, just this week I learned of four short line-served coal-fired generating plants that have either already closed or are slated to close near-term. Total volume loss to the short lines? Something in low five figures of units and significantly high double-digit percentages of total volumes. Effect on the connecting Class Is and the AAR car counts? Minuscule.

That said, there is one place natural gas or western coal can't push out the coal so many short lines depend on: met coal, particularly anthracite -- where it's the carbon content that counts, not the BTU content. AAR carloads of metallic ores and metals are up 64 and 49 percent respectively. Shortline ores and metals are up 78 and 36 percent respectively.

The top four shortline commodities according to RMI are, in order, chemicals (16 percent), grain (13 percent), coal (12 percent) and aggregates (11 percent) and together these commodities account for 52 percent of total revenue units on short lines. Take out coal and and the number four commodity becomes metals at nine percent. The new top four (absent coal) are all up double-digits but chemicals, only six percent. Still, not a bad story.

Continuing the thread of short lines and commodity car-counts, RailAmerica year-over-year September loads increased eight percent with gains in all four of its top commodity groups -- coal, agricultural products, chemicals and aggregates -- that together account for 61 percent of total carloads. Of the 12 total categories, the only decreases were in the STCC 24 segment of forest products, petroleum, auto and "other," together making up 15 percent of loads. The September count was was only marginally higher than August's but the quarter-to-date was up six percent and year-to-date came in with a seven percent gain.

Genesee & Wyoming's September 2010 carloads increased 13 percent year-over year. The four top commodities -- coal, aggregates, farm products and paper-related -- all gained, though GWR says most of the 3,000+ unit gain in farm products came from Australia. The next largest commodity is -- you guessed it -- metals and it too was up. Total loads were off two percent from August -- 1,600 units on a base of 73,000 is not a big concern. The quarter-to-date was up 11 percent, and that *is* a significant number. Year-to-date loads through September are up seven percent, on a par with RA, with both lagging AAR ex-IM by nine points.

CSX was once again the lead-off batter for the Class I earnings season and what a start it is. Operating income jumped 39 percent to $825 million on 17 percent more revenue, $2.7 billion, against a modest nine percent ops expense gain. CSX handled 1.6 million revenue units, up ten percent. Merchandise carload volume gained seven percent even though the forest products and food-and-consumer groups were unchanged. Automotive units leapt 44 percent, a fact which, when compared with the paltry auto gains for short lines, reinforces the theme that most shipments are finished vehicles that do not see short lines and not auto parts that at one time did.

The operating ratio was 69.1, the first sub-70 number ever. Ops expense ex-fuel increased six percent even though GTMs were up eight percent. "Equipment and other rents," largely net car hire, dipped two percent -- even though on-time originations and departures slipped a bit as dwell time crept up slightly. The personal injury ratio came down eight percent to a respectable 1.06 per 200,000 hours worked. The bottom line? Net income increased 43 percent to $414 million and earnings per share went up 48 percent thanks to a $1.1 million share buy-back program that reduced diluted shares three percent. The free cash flow before dividends of $1.2 million helped.

Of particular interest to short lines making interchange with CSX, Chief Operating Officer David Brown said during the call, "Road, local and yard crew starts increased six percent in the quarter but at a rate below the ten percent volume increase. When feasible, incremental volume was added to existing trains using available capacity and avoiding additional crew starts." Thus it behooves short lines to keep interchanges fluid, perhaps even exploring pre-blocking outbounds to help cut CSX yard dwell times.

The President's Message in the latest *Pan Am Clippe*r, the employee magazine for Pan Am Railways, has some very good news for shippers employees and investors. David Fink writes, "We broke below the 1.0 injuries per 200,000 hours worked threshold year-to-date through August, 0.94. [*By comparison, industry-leading Genesee & Wyoming is in the zero-point-70s. --rhb*] We've purchased 20 new locomotive units to augment the existing fleet. These SD40-2s will allow us to retire some older, lower-rated units that were not up to handling properly the substantial business increase we've seen since April.

“As of mid-September we have brought on more than 40 new train and engine employees and we expect that within six months they’ll all be qualified to hold down our growing number of T&E assignments. Finally, our main line track improvement program continues as we get more track and bridges up to spec for 286,000 lb freight cars. Our continuing progress on the safety front combined with our new investments in personnel, track and locomotives will go a long way toward improving service from Mattawamkeag, Maine to Mechanicville, New York. Our loyal customer base is looking forward to the new service initiatives these changes will facilitate.”

I spent some time with PAR President David Fink, VP Transportation Ed Motte and VP Sales Mike Bostwick at NEARS last week and I heard a lot of positive things. What’s clear is there is a plan to run the railroad to fit the traffic base and they are ready to commit resources to realize significant new revenue streams. And that’s as it should be.

Reader Feedback Department: Re New Jersey DOT’s investment in short lines, I’m told it’s the usual story: “We go ahead with the submissions as usual, the state processes the proposals, and hopes that it has the funds. Our sources say the funds will be there. Maybe so. But rest assured we won’t start a state rail plan project until the contract is signed with the state. And, they won’t approve it unless they have the funds.”

Re a nation of accountants: “What all those motor carrier regs mean is that one of the few job areas where semi-literate males can work will be squeezed. Hell of a way to boost employment. All of that grand intermodal technology, which I applaud, will consign a lot of folks to the dustbin on employee ranks.

“We are against congestion on the roads and suburban sprawl and we have managed to stop both in their tracks. I admit that the greens ought to be happy, and I am as well. But there are consequences. We live in interesting times.”

How true. More short lines are weighing on on the health care mandate and the uncertainty and expense of new regulations. The stay-below-50-employees mantra is gathering steam. There is heightened interest in capturing all the grants and low-interest loans you can because of the cost of compliance with the new laws, written and threatened. One chap even told me he’s had to hire a compliance officer just to stay ahead of the curve.

Let’s say you pay somebody $50,000 a year to do this and have a 50 percent burden -- that’s $75 grand right off the top, enough to keep 15 miles of track up to FRA class 2 spec for 25 mph operation. If you can get $1,750 a mile in tax credits, it eases the pain of hiring a Compliance Officer somewhat. Like the man says, “We live in interesting times.”