THE RAILROAD WEEK IN REVIEW

February 18, 2011

"The difference between the U.S. corporate tax rate and the lower rates abroad encourages U.S. firms to locate production in foreign countries and discourages foreign firms from producing in the U.S. unless absolutely necessary." -- Martin Feldstein in the Wall Street Journal, Feb 15

Intermodal is looking up, reports Wolfe Trahan in a February 11 note. "We spoke with a third-party logistics provider who expects to begin using intermodal service for the first time this year. While many large shippers have already moved large amounts of freight to intermodal, our contact believes his smaller customers are now considering intermodal for the first time.

"Given the rails' fuel efficiency edge over trucking carriers and improving rail service levels, our contact believes intermodal is increasingly compelling for shippers at lengths of haul north of 550 miles. For example, this third-party logistics provider currently estimates about $300-$400 of savings on a long-haul intermodal move from Atlanta to Los Angeles, or about a 15 to 20 percent discount relative to current truckload rates.

"Our contact expects this spread to widen going forward given his expectations for rising fuel costs and truckload capacity constraints. Further, our contact generally estimates only about one day of additional transit time currently for intermodal moves relative to truckload, much improved from about two to three extra days on intermodal moves about five years ago." And if you're shipping relatively high-value manufactured widgets, transit time is crucial.

Which segues nicely to the Wolfe Trahan "Monthly Macro Watch" slide set from Feb 14 warning that the "strong transport stock outperformance in 2010" may have been a function of faster inventory turns and accelerated restocking. "Freight data is now trending modestly worse on a seasonally adjusted basis;" restocking will likely continue in 2011 at a much reduced pace, potentially "turning into a negative for freight at some point in 2011" barring a further uptick in the economy.

Monthly Macro Watch says freight cars in storage were sequentially up in early Jan for the first time since June 2009 though cars stored as a percent of the fleet stands at 21 percent compared with the peak 32 percent in May, 2009. Wolfe believes the center-beam is the largest car type still in storage with most grain cars and intermodal platforms now back in service. But let's not hold our breath for any more cars to come out quickly.

RMI's RailConnect Index shows a shift in shortline carloads toward more bulk and less manufactured goods. The nearby table compares January loads for 2011 and 2007. I picked 2007 because the AAR's *RailTrends* letter for this month clearly labels that year as the peak for most commodities. I've noted the change in basis points so you can quickly sort the winners from the losers. Omitted are RailConnect commodity groups that show minimal changes or that represent a small portion of shortline volumes - automotive, for example. Intermodal remains, however, because it is a large percentage of the whole even though only a handful of properties handle it.

Rows are sorted by basis point change. The big gains occur mainly in bulk commodities that are highly fungible: one kernel of corn is no different from the next. Farm & Food is everything but grain and so includes items from canned goods to DDGs and soybean meal. Chemicals include ethanol; aggregates are, well, aggregates; grain includes all the STCC oh-one commods.

Week 5			
Commodity	**2007**	**2011**	**Basis Pt Change**
Farm & Food	11.20%	14.60%	340
Chemicals	13.60%	16.80%	320
Aggregates	7.00%	9.50%	250
Grain	3.80%	5.00%	120
Coal	12.40%	12.00%	-40
Paper etc	7.40%	6.50%	-90
Lumber etc	4.90%	3.50%	-140
Ores	6.60%	2.70%	-390
Intermodal	11.70%	7.70%	-400
YTD units	591,220	504,580	-1,465

It is important to note that year-to-date carloads over five weeks are still 15 percent behind where they were in 2007. As noted in this space before, it's going to take another two or three years to get back to the volumes we saw in 2006 and 2007. Marginal short lines will find themselves increasingly marginalized while their compatriots with strong business cases will fare well, especially where they can build their revenue bases in the top commodities above.

In that regard, recall that last week I took umbrage at short lines dependent on hand-outs for survival. However, a short line operator in the northeast takes exception to my remarks, and with good cause, too. He writes, "Since these public funding sources do exist, one would be foolish not to take advantage of them. If you look at the public cost-benefit, and the amount of money committed by the state(s) to these programs compared to highway and other grant programs, eliminating assistance to shortline railroads would not make an appreciable dent in the larger problems of state finances.

"Would Conrail have done a double-stack program across the Commonwealth without assistance? Probably not? How about more modern infrastructure improvement programs like Norfolk Southern's Heartland or Crescent Corridors? Tough questions and even more difficult to answer. Government regs and environmental requirements have pushed up the costs of everything. Try building anything, anywhere nowadays compared to days of old. Our recent one-mile track extension to a key customer took 13 years, for example."

And from Kentucky comes word that the state and the R. J. Corman Railroad Group have begun the company's Appalachian Regional Short Line Project. The 246 route-mile right-of-way rehab is partly funded with $17.5 million in federal stimulus money and includes improvements to highway crossings, railroad bridges and tunnels.

Reason vs. Regulation Department. From the AAR's Insider newsletter comes this tidbit: "Last week, Senator Kay Bailey Hutchison (R-TX), ranking member on the Senate Commerce, Science, and Transportation Committee, introduced legislation that would amend the Positive Train Control (PTC) regulatory mandate to reduce compliance costs, while maintaining a safe rail system. Says she, 'This is an example of regulatory excess that is costing America's businesses billions of dollars with no obvious benefits.'

“The proposed bill would clarify the congressional intent -- that PTC must only be installed on rail lines that are carrying toxic inhalation hazard commodities in 2015, not 2008 as FRA has proposed in their rule-making. PTC is expected to cost more than $5 billion to install and hundreds of millions more to maintain. By FRA’s own estimate, its rule to implement PTC would result in a cost-benefit ratio of approximately 20 to 1. The bill was initially co-sponsored by Senators John Thune (R-SD), Roger Wicker (R-MS) and Tom Coburn (R-OK).”

And the STB, at the urging of the ASLRRA, is postponing its public hearing on “The Current State of Competition in the Railroad Industry,” moving it out to June 22 from the original May 3 date. A February 24 STB hearing to consider whether to lift existing exemptions for various cargo will go on as planned. As one might expect, CURE (Consumers United for Rail Equity) said it opposed any extension and urged no more than a 30-day delay if the agency was so inclined. Under the new schedule, the STB now requires initial comments on competition issues to be submitted by April 12, with replies due May 27 and the hearing less than a month later.

“The high corporate tax rate in the United States causes a misuse of our capital stock,” writes economist Martin Feldstein in Tuesday’s *Wall Street Journal*. “More specifically, the high rate drives capital within the U.S. economy away from the corporate sector and into housing and other uses that do not increase productivity or raise real wages.

“Because interest payments by companies are deductible in calculating taxable profits, the high tax rate induces firms to use too much debt to finance their operations, increasing risks for them and the U.S. economy. Moreover, the difference between the U.S. corporate tax rate and the lower rates abroad encourages U.S. firms to locate production in foreign countries and discourages foreign firms from producing in the U.S. unless absolutely necessary.”

In other words, make every thing you can someplace else. If this be the case, the only thing we’ll make here is fuel (coal, oil, natural gas), food (grains, fresh vegetables, meat) metallic ores for export and aggregates. These are the very commodity groups where short lines shine, and we’re seeing a shift to more of these and less of everything else in the shortline commodity reports.

Closing tidbit. The NY Fed’s summary of household credit described continued declines in overall consumer indebtedness but the first rise in non-mortgage household debt since 2008. This suggests both balance sheet improvement and strengthening consumer demand. -- UBS Daily Economic Comment, Feb 15

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