THE RAILROAD WEEK IN REVIEW

May 13, 2011

"The top fifth of Americans by income represent two-fifths of consumer spending and fully half of discretionary spending." -- Wall Street Journal, May 13, 2011

Dennis Gartman, he of the Gartman Letter out of Suffolk, Virginia, offers some insights as to the employment situation and what it bodes for manufacturing activity and consumer behavior. In his May 9 letter he writes, "We admit that by historical terms we are creating far fewer jobs than we have created this far from the depths of recessions past, and we further state that the process is almost certainly going to continue. The ranks of the ill-educated unemployed will not fall materially henceforth, while the ranks of the well-educated, well-trained employed shall continue to rise. This is the harsh reality of the current economic trend and it will not change any time soon.

"To this end, anecdotally, we have seen signs recently in shops and around town of Skilled Help Wanted. These signs have only just begun to appear. More shall. Several years ago US businesses complained bitterly of the lack of well trained, well educated, skilled help available. The recession cleared that problem for a while but It is returning and will get worse." And if you want proof, look at the railroad situation: try and find anybody sober and not on drugs willing to work *hard* and get paid extremely well for their efforts.

As for the consumer, the NY Fed's May, 2011 *Quarterly Report on Household Debt and Credit* says aggregate consumer debt "held essentially steady in the first quarter, ending a string of nine consecutive declining quarters." At the end of March total consumer indebtedness had dropped eight percent from its peak level at the close of third quarter, 2008.

As company magazines go, the *Pan Am Clipper*, a quarterly number from New England's Pan Am Railways, is among the best. Moreover, coming as it does from a regional property of roughly 500 main-line route-miles, it is exceptional. The First Quarter, 2011 issue is particularly welcome because it gives readers an update on the new run-through train service between New Brunswick, Canada and the US over the New Brunswick Southern (NBSR) and Pan Am Railways (PAR) to/from CSX and NS for beyond.

The thrice-weekly service starts in St John, gathers up local traffic in the Canadian Maritime provinces and heads west over the ex-CP main to Matawamkeag, Maine. There the train is turned over to PAR, already pre-blocked for NS at Mechanicville, NY and CSX at Worcester, Mass. The article tells us the elapsed time for the 700 miles St John to Ayer is four days, including pickups and set-outs at Portland and Waterville. At Ayer, CSX cars continue on to Worcester and NS cars run west to Mechanicville.

That four-day schedule was the original operating plan, and, as so often happens, once you start running trains you find places to tighten the plan. That's exactly what we have here. In an e-mail exchange this week with Jim Patterson, EVP and Chief Operating officer for Pan Am, I learned the transit time to Barbers (the official CSX interchange north of Worcester) is now less than 60 hours. Three trains are involved: the SJWA from the NBSR hand-off to Waterville, the WAPO from there to Portland, and the NMSE (Northern Maine-Selkirk) from Portland to the CSX connection. The NS cars run in the NMED (Northern Maine-East Deerfield) from Waterville to East Deerfield, Mass, and then in the EDMO (ED to the CP connection at Mohawk Yard). Crews are now making EDMO/MOED turn in ten hours thanks in large measure to the infrastructure enhancements that are the core of the Pan Am Southern joint venture with NS, so we know that segment does not dally.

Does it work? Evidently so. A recurring theme among shippers at last month's NEARS conference was the desire for consistency and reliability in rail service. As money gets tighter and inventories shrink from weeks' supplies to days' supplies, smaller, more frequent shipments are the rule. Taking days out of transit times can only help bring more loads back to the rails.

My comments about short lines and NS pricing (WIR May 5) drew some critical comments, mainly from aggregates haulers in short-haul lanes with NS on one end or the other or as a bridge carrier. The general complaint is that NS is raising rates faster than the short line's customers can absorb them. To understand what may be happening, one needs to look at NS pricing trends and where the market is for tonnage in the specific commodity origin-destination lanes.

Using the same commodity groupings NS does in its Quarterly Financial Report, I found that system average sequential quarter-to-quarter price increases were greater in the 2011 first quarter than in previous quarter-to-quarter metrics. First quarter 2011 rates for all carload commodities but automotive were up double digits over what they were at the end of the 2010 fourth quarter. Interestingly, sequential quarterly changes were relatively small in the middle quarters of 2010.

Both CEO Wick Moorman and Chief Commercial Officer Don Seale reiterated once again on the Q1 conference call that they intend to price aggressively to the market, and, as we've seen truck rates rise and truck capacity get short, we're seeing increased demand for rail service. But with a near-term fixed amount of cars, equipment, crews and track space one has to make choices, and the shipper who can't make the market rate will get left. More demand for the same assets equals higher prices. It's that simple.

This can be hard on some short lines. Many of them, particularly in the northeast, got started as subsidized entities, either through direct government purchases of rights of way or where Conrail or other predecessors simply needed to get off the property. The downside comes when the entrepreneur's due diligence is not sufficiently diligent. I personally know of branches that were lousy lines but somebody convinced the owner they could make a go of it. A friend who was involved with Class I line sales in the 1990s says that when things did not turn out, he would remind prospective buyers that they had received the equivalent of Miranda rights.

He continues, "The inherent conflict is that so many of the shortlines are truly marginal from the perspective of the big railroad. The volumes just do not make any difference to the big railroad; one significant intermodal contract is many times more lucrative than trying to convert traffic to rail a carload at a time." To make it worthwhile for the Class I there has to be volume, a lot of it, and often. A dozen hoppers of rock running 50 miles once a week won't do it.

I continually come up against short lines that propose "boutique solutions" to transportation markets that simply don't exist. The beauty of the truck is the ability to customize each element of the batch. Arrival and departure times are robust enough to minimize inventories and one-size only has to fit the one move, not all (like a train). Trucks simply do small, complex things involving special services better than trains. And it's why the rails -- all of 'em -- are moving more traffic at higher rates and lower cost: they go where the non-custom batch process works.

Genesee & Wyoming reported April carloads this week. Total volumes here and in Australia increased 12 percent to 82,190 units, a delta of 8,982 loads. Nearly 6,000 units were on the FreightLink acquisition that came on line in December, 2010 for a same-store increase of 3,057 units. Of these, 85 percent were in the US: 1,769 carloads for the coal and coke group mainly in the Illinois Region while 817 more cars of pulp and paper moved in the southern region.

From here on my remarks deal exclusively with GWR's North American carloads because, for WIR at least, the object of this exercise is to see how short lines and Class Is stack up in terms of commodity gains and losses and overall trends. GWR's Australian numbers are the outliers for our purposes and are accordingly set aside for this discussion.

GWR North American loads were up three percent to 65,612 units for the month and seven percent year-to-date but off seven percent from March. Coal and coke, together making up 27 percent of GWR vols (up from 25 percent a year ago), increased 11 percent year-over-year. Pulp and paper, 12 percent of total units, jumped 12 percent, a nice surprise and I suspect the "brown paper" trends we've seen other railroads' results have something to do with it.

The biggest monthly decline was in farm & food (STCC 01 and 20), down 11 percent and representing six percent of total units. Lumber and forest products (all STCC 24, nine percent of all loads) drifted south by eight percent. "Other," mostly overhead NS coal on the Ohio main line, was off four percent.

By way of comparison, the AAR's May, 2011 ***Rail Time Indicators***, reports April North American traffic volumes (carload and intermodal, US and Canada) increased four percent to 2.6 million revenue units, of which commodity carloads represented 57 percent of the total. Coal remains the largest single commodity with 21 percent of the total units including intermodal. It was off two percent year-over-year. Ag products (both STCCs) comprise the next biggest commodity group at nine percent of vols, up three percent year-over-year. The chemical commodity group is third at eight percent of total units, up three percent over April, 2010.

Week in Review takes a breather next week. We have three days in Harrisburg for the annual Rail Freight Seminar followed immediately by our granddaughter's HS graduation in deepest Georgia. Look for us back at our usual vegetable stand the week ending May 27.