THE RAILROAD WEEK IN REVIEW

June 3, 2011

“The goal of the Staggers Rail Act of 1980 was not to insure competitive rail options for customers but to ensure there would continue to be private railroads to provide essential transportation.” -- Luther Miller, Railway Age, May, 2011

TD Newcrest’s Cherilyn Radbourne writes, “Total Big Six Class I carloads were up two percent year-over-year in Week 21 (May 28) and are tracking up three percent quarter-to-date and up four percent year-to-date. Absolute carload volumes at CN and CP were impacted by Victoria Day, but the holiday fell in Week 21 in both years, such that the year-over-year comparisons were not impacted.” Week 21 US carloads hardly moved, up 0.7 percent; intermodal units increased 4.2 percent, per the AAR.

Radbourne adds, “The ISM manufacturing index came in at 53.5 in May, down sharply from 60.4 in April, but still well above the 50 level. We see this pullback in the ISM as consistent with the performance of other indicators, including the rail carloads, and the American Trucking Association’s For-Hire Truck Tonnage Index, which suggest some deceleration of activity. TD Newcrest Equity Strategist John Aitkens continues to believe that the US and global economies have been in a soft landing since momentum peaked in Q2/10, and expects that a re-acceleration will most likely begin in early 2012.”

That’s a theme I’m hearing more and more. In an e-mail exchange about railroad pricing, a short line contact writes, “The growth rate of the economy has slowed and I read an article this morning about the possibility of a double dip recession.” A June 2 Bloomberg item adds, “Economists predicted a gain of 185,000 before yesterday’s ADP Employer Services report showed companies added 38,000 jobs last month, less than a quarter of the median estimate in a survey of economists.”

And a page-one *Wall Street Journal* feature the day before notes that home prices nationwide “fell 4.2 percent in the first quarter after declining 3.6 percent in the fourth quarter of 2010. The index had seen increases in 2009 and early 2010.” The *Journal* concludes, “That doesn't bode well for the economy, which historically has depended on home buying and other consumer spending to rebound.”

There are some bright spots, however. A note from Credit-Suisse this week documents the likely sector and sub-sector weight shifts in the upcoming Russell 3000 index recalibration. The most important sectors for the carload business are consumer staples (grain, beverages, boxcar foodstuffs), industrial (the usual suspects), and materials (chemicals and paper-related). Sub-sectors with significant increased weightings include beverages (wine and beer in boxcars, corn sweeteners), machinery, building products (!!), paper and forest products (particularly packaging) and utilities. But it’s still the “heat and eat” groups that are saving the day.

The Florida East Coast Railway is the newest AAR member. This 351-mile, AAR Class II rail racetrack runs between parallel to I-95 for the length of Florida, from Jacksonville to Miami and interchanges with NS and CSX in Jacksonville. FEC joins AAR as a full member, which includes holding a seat on the AAR Board of Directors and a seat on AAR's two governing committees, the Safety and Operations Management Committee and the Policy and Advocacy Management Committee.

Here I have to plug my good friend Fred Frailey's excellent FEC update on page 14 of the July, 2011 issue of *Trains*. He frames the piece in his signature present-tense style, giving a sense of urgency as he takes us from a view of Bowden Yard in Jax down the main to Miami, with stops along the way about the RailAmerica relationship, how the traffic base has changed (now 81 percent intermodal) and how they restructured the debt load. The FEC is a worthy addition to the AAR family and I salute them for making the commitment.

My invitation to readers to join in a discussion of rail vs. truck intercity market share garnered some very meaningful insight. A former Class I auto exec now closely allied with the intermodal field writes, "Good article on rail-truck market share. I think your thesis of focusing on market share 'for just traffic that might be rail-truck competitive' is good one but might also miss some of the big shifts that have resulted because the rail industry has realized its 'network potential' by allowing the American and world economies to restructure into supply chains where traffic may NOT be truck competitive.

"The oldest example is the long haul bridging of shiploads of containers from Asia to interior U.S. markets. This market could never have existed if it were not for the fact that shiploads of containers were transferred to trainloads of containers. So that the apparent 'growth' of rail market share comes about from a 'created' market that could never have been truck competitive due to concentrated volumes, the frequency of ship arrivals and commonality of ocean/rail containers, among other things.

"Other 'created' markets that use the rail network for non-truck competitive movements include the long-haul transportation of finished automobiles where the shift to rail market share was significant. That was because the economics of wider geographic distribution from assembly plants which were exploiting the network potential of the rail industry but technically maybe were not 'truck competitive.' The concentration of new assembly plants in the east/southeast was in response to rail network economies, not just a shift in a static transportation market.

"I agree the issue for the rail industry (to make your point directly) is whether the rail industry can create a domestic truck competitive intermodal transportation system whose growth exceeds the growth of the direct trucking industry. Then we can conclude that a rail/truck intermodal system has gained longer term market share from a direct trucking system. While much progress has been made, this is still a work in progress."

A midwest regional rail operator with a significant coal franchise adds, "I'm puzzled by your efforts to pull coal car loadings out of inter-city market share for rail. Coal has always, from the industry's very earliest days, been a major commodity for railroads, first in England , then in the US and beyond. Railways opened up new markets for coal and other bulk commodities before any significant other traffic gravitated to rail. And so my response to your question is, 'So what?'Coal is a staple of America's and Canada 's railways.

"In addition, you intimate that all coal is captive to rail and cannot be moved by truck. We move several million tons of coal per year that moved by truck before our railroad was formed. In some cases we influenced market shift of coal sourcing between mines to allow for rail participation. In each case we've helped reduce the utilities' delivered cost on a BTU-basis so the utility and its ratepayers got a better deal.

"You make the mistake of assuming because railroads serve coal fields that railroads have no influence over how coal moves. It just isn't true, Roy, and we operate in a highly competitive market. We have to compete for every ton of coal we move. One last point in response to your effort to remove coal from rail market share. Perhaps a better indicator of the industry's success is to track how well railroads continue to compete for domestic intermodal which continues to be impressive."

And of course Larry Kaufman weighed in, only with a little different spin. "I like your idea of starting a discussion with WIR readers. As for rail vs. truck shares, I'm sending along my recent note to Bill Cassidy at *The Journal of Commerce* after he ran a story from an ATA 'study' showing the truckers doing much better competitively than I or other rational people believe.

"Bill [writes Larry], the American Trucking Association 'study' that you write about today is an example that figures don't lie, but liars can figure. ATA claims truckers will gain market share by 2022 and railroads will lose share. Perhaps, but read on. ATA also claims it will handle a majority of all freight and the largest portion of predicted growth. Perhaps, but read on.

"ATA also says intermodal will be the fastest growing part of the freight transportation business. The last time I checked, intermodal involves movement by more than one mode - the reason it is called intermodal in the first place. So, let's assume, for the sake of argument, that ATA's forecasts are correct. That means railroads will 'touch' as much of the growth in freight movement as do truckers, draymen, or any other participant in an intermodal movement.

"Going back to my long-ago days at the AAR, I recall that the ATA always has preferred to measure the freight market in terms of tonnage, while the railroads prefer to do so in terms of ton-miles. The ATA method distorts things just a bit. Short haul trucking piles up tonnage, but doesn't do a thing for ton-miles."

"A railroad may have moved a container some 2,300 miles (the BNSF distance between Los Angeles and Chicago) and a drayage driver takes it the final 10 miles, or whatever. Do the math, Bill. The rail movement was 2,300 miles times 20 tons, or 46,000 ton-miles - assuming a legal load. The drayage accounts, in this example, for 200 ton-miles. Add in drayage from shipper to intermodal facility at the origin end, and you have another 200 ton-miles of trucking. Does trucking dominate the market? Not in this example."

Another reader sent along a spreadshseet of "modal share of non-coal ton-miles via rail and truck." The 2006 rail share of 4.6 trillion total freight ton miles was 38 percent to truck's 28 percent. Coal accounted for 480 billion rail ton-miles, 13 percent of rail ton-miles vs. 4 billion truck ton-miles, 0.3 percent of truck ton-miles. Back out 2006 coal ton-miles for both modes and get a 26-35 rail-truck share of total ton-miles moved by all modes including barge and air.

Finally, some thoughts on the market for freight cars, which appears to be rather robust, in spite of the doom and gloom at the opening of this Letter. "The railcar operating lease market is heating up," writes Railroad Financial Corporation's Tony Kruglinski in the May, 2011 *Railway Age* (page 9). He writes that the market has turned for many car types, from grain hoppers to mill gons to small-cube covered hoppers for sand, plastic pellets, and grain, tank cars and even -- get this! -- 100-ton, Plate F, 286 boxcars.

There is a definite correlation between the car types "heating up" and the year-to-date commodity carload volumes out of the AAR. But boxcars? I did some digging to reconfirm what's likely to be in 'em and the usual suspects popped up: STCC 20 foods, metals, forest products (both paper and wood) and auto parts. Yet not one one of these groups is growing at a rate more than modest YTD single-digit percentages. So where's it coming from?

Kruglinski says one doesn't always find a correlation between commodity demand and operating-lease cars out on the road (and not in storage). Sometimes there are "collateral effects." Take coal hoppers under lease to utilities: when the rails are full of traffic, transit times are slower so it takes more cars to move the same tonnage. Things ease up, transit time improve and cars get parked, tonnage remains the same and car-counts go down.

The boxcar shippers are seeing the opposite effect. As the older, smaller Plate C 70-tonners are phased out, some paper shippers are leasing the bigger cars and putting them in faster lanes, meaning fewer carloads reported to the AAR because bigger cars moving faster can turn the same amount of goods in fewer trips. However, the paper-maker keeps his customers' supply chains full with more economical volumes and better transit times even as carload volumes reported to the AAR don't seem to be increasing at a double-digit rate. Like Tony says: collateral effects."

I'm writing a *Trains* feature on short-haul, single-commodity shuttle trains for early 2012 and need your suggestions. Two that come immediately to mind are the coal shuttles on RJ Corman/ Pennsylvania and the Nittany & Bald Eagle limestone shuttle. I know of another one that is set to start soon on CSX. Another three would round out the story nicely. Any suggestions?