# THE RAILROAD WEEK IN REVIEW

## December 23, 2011

*"Tight truckload capacity should have favorable implications for intermodal, which has had another year of strong growth." -- Todd Fowler, Vice President and Equity Research Analyst, KeyBanc Capital Markets as quoted in the on-line WSJ Transcript*

**Norfolk Southern continues** its intermodal expansion at the Rutherford Intermodal Facility near Harrisburg, Pa., following a $15 million TIGER III grant from the federal Department of Transportation. The $60.5 million Rutherford project, slated for completion in 2014, will help NS meet growing demand for intermodal freight transportation in the Harrisburg region.

Harrisburg lies a the north end of Norfolk Southern's 2,500-mile Crescent Corridor, stretching from Louisiana to New Jersey and along which NS has identified infrastructure improvement projects worth some $2.5 billion. The Rutherford expansion is just one of three significant property enhancements NS has on tap for central Pennsylvania. The other two are a new $96.9 million intermodal facility under construction near Greencastle in Franklin County, and a $28 million expansion at the Harrisburg intermodal terminal on Industrial Road.

Once again, I have to reiterate what CEO Wick Moorman says at every shortline meeting in Roanoke: Yes, these Corridor projects are adding capacity so our intermodal product can gain a significant competitive advantage. But not at the expense of our merchandise franchise. As we speed up intermodal, we speed up everything. And the merch franchise gains its own competitive advantage in the process.

**Over at Jefferies & Co**, lead rail analyst Peter Nesvold sums up rail revenue units for Week 50 saying that autos were up 20 percent year-over-year (short lines benefit mostly on the raw materials side from plastics to metals) and non-met minerals jumped 25 percent (up from a 16 percent gain in Week 49). On the down side, ag products slid five percent, same as Week 49.

> Total Week 50 revenue units were up year-over-year for each of the five rails we cover. CSX posted the largest increase of the group, as total volumes jumped 17.7 percent, its fastest pace since early February. NS gained 15.6 percent and CP experienced an 11.7 percent increase. Union Pacific total volumes increased 4.7 percent over the 2010 period, its twelfth year-over-year gain in the past thirteen weeks, while CN volumes were up 6.4 percent
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> Train speeds were up across the board except at UP, where velocity has decreased on a year-over-year basis for 30 consecutive weeks. Conversely, CP's average train speed jumped 19.7% in Week 50, besting Week 49's 11.0 percent and the 11.6 improvement on a six-week moving average basis -- CP's ninth straight year-earlier gain.

Putting it all together. In Week 50, industry-wide volumes jumped 9.1 percent on an easy weather comp, although that shouldn't mask the fact that rail volumes have steadily improved since late 3Q. While many indicators clearly remain mixed and rebounds are never linear, we recommend adding additional risk capital to the transports generally even after the recent market rally. Please see our October 11 out-of-consensus note, *The Freight Debate: Three Developments that Appear to Support this Rally* — in which we briefly outlined a handful of reasons why we have just started to turn more optimistic for the first time this year. [*I have a copy if you need to drill down further. -- rhb*]

**The good folks at RW Baird** advise us of "greater demand risk given a maturing economic cycle, "where goods buyers have reacted to potential demand uncertainty through lean inventory strategies." However, lean picking today can mean more fat tomorrow as end-market sales increases can have "an outsized benefit to carriers given current industry capacity dynamics." Meanwhile,

Railroad volume growth continues, improved yoy trend 4QTD against eased comparisons. Volume +3% yoy 4QTD, an improvement from 3Q's +1%. Recovering automotive demand and continued strength in industrial related carloads offset weakness in ag; Intermodal growth +4% 4QTD better than overall growth trend, improved from +2% 3Q11.

Diesel fuel prices remain elevated as price per gallon hit $4/gal in late November, up from roughly $3.80 during mid-October. Fuel prices have moderated to $3.90 in mid-December but remain +21% yoy. WTI crude oil prices are near $100/barrel after beginning 4Q at $77. Domestic freight trends moderating into December, consistent with seasonality; underlying demand remains stable. Domestic intermodal volumes slowing following build through mid-November; broader industrial rail activity moderating but growth remains positive.

Spot truck demand also slowing in recent weeks, with industry supply/demand at equilibrium. Truckload demand growth is stable, with our November Baird Freight Index +3% yoy (vs. +2% in 3Q). Weak consumer sentiment and macroeconomic concerns cloud demand expectations, though retail sales trends have held up well through mid-December.

I mention all this because carload shippers -- the raw material guys -- are at the beginning of the food chain and if there's no downstream demand there is little need for raw materials. Maybe you don't need that extra crew-start or new locomotive just yet. See how the next two months play out.

**The truckers may have dodged** the Hours-of-Service bullet, but the short lines are still under the federal thumb. An note from the ALSRRA's David Wharton reminds us that limiting a T&E employee to six consecutive service days without 48 consecutive hours without duty -- no more than 276 hours a month -- can wreak havoc on smaller roads.

In many cases, a railroad employee must wear many hats. For example, Joe Short Line may work 9 A.M. to 2 P.M. in the office (a non-covered service job), and 2 P.M. to 6 P.M. as an engineer (a covered service job). Even though Joe has only worked four hours at a job that falls under hours of service, the regulation commingles the hours worked. That is to say, Joe's total covered hours for any 24-hour period is the sum of his covered *and non-covered* hours. Thus Joe has logged nine hours (0900-1400 and 1400-1600) of covered service in the same duty-day.

For a railroad that works only five days a week, this is not an issue. However, many of these railroads run six days in order to provide Saturday or Sunday service. The regulation would thus force such short lines either to shut down one of those days (and lose revenue), or to hire more personnel even if the normal workload doesn't require that level of staffing.

ASLRRA, on behalf of its members, has obtained a waiver that allows railroad employees to work six consecutive days on, with one day off, without falling afoul of the regulations. Recently, we also negotiated a waiver allowing a railroad employee who works an occasional sixth day to return to work after one day off.

Once again, the Law of Unintended Consequences is at work. Limiting the days a short line can switch a customer limits the customer's ability to do what he does to make a living -- and provide jobs in the community. Property, plant and equipment are full-time assets and down time degrades the owner's competitive advantage, hardly a favorable environment for adding staff.

**RailAmerica's Chief Commercial Officer** Charlie Patterson retires at the end of this month. Patterson served in key roles at CSX Transportation, Great Lakes Transportation and CN before joining RailAmerica when the company was taken private in early 2007. During his nearly five years at the commercial helm, Patterson effectively boosted RailAmerica's revenues, strengthened the marketing and sales teams and brought focus and direction to both non-freight revenues and industrial development.

I've known Charlie since his CSX days and have always found him to be open to new ideas and willing to follow the money. I know all WIR readers will join me in a round of thanks for his service and will raise a glass in best wishes for a well-earned retirement.

**This is it for WIR 2011.** Thanks again for your continuing interest and contributions. See you next year.

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