THE RAILROAD WEEK IN REVIEW

March 9, 2012

"A strong service product is the foundation for achieving price, productivity and growth targets." -- Fred Eliasson, Chief Financial Officer, CSX

The 23d Annual CSX Short Line Workshop was yet another standard-setter in terms of content, delivery and overall message. The content was the right balance between and among the 30,000-foot view from senior management, the facts and tools for helping short lines improve their results, and, above all, a welcoming atmosphere. I was particularly pleased to see the way they opened up the trade show (see photo) with more room to move about and interact with both booth staffers and other shortliners.

To begin, the rules. The CSX shortline car-count includes only those moves to and from short lines and regionals that use a junction settlement or ISS for their revenue streams; flat-fee switch carriers are not included. Moreover, where CSX is a bridge carrier between a shortline origin and a shortline destination, only the origin counts in the CSX shortline car-count. I have not heard any other Class I be as explicit.

Interline carloads on/off shortline partners during 2011 increased by 22,600 carloads (2.8 percent) and switch carrier vols grew by 17,900 carloads (6.0 percent). Putting this in context, CSX system carloads (non-intermodal) increased by 48,000 units in 2011, so if the short line plus switch carriers added 40,500 cars we can safely say these properties in essence contributed 84 percent of CSX's organic growth. Further, 2011 annual interline volume with short lines came to some 835,000 units (CSX did 4,214,000 units ex-intermodal) worth revenues of $1.8 billion out of total CSX carload revs of $10.0 billion.

As good as these results look, CSX lags the other Class Is in absolute shortline vols each year 2009-2011 and in year-over-year increases 2010-2011. Comparing CSX to its nearest peer, NS, the CSX 2010-2011 car-count delta is plus 2.7 percent to plus 11.2 percent for NS. If you add up all four Class I shortline cars for 2010 and 2011, the delta is a plus 7.0 percent. Yes, I know there may be variances between the way CSX counts shortline carloads and what the other Class Is do, but -- orders or magnitude -- CSX still lags.

Clearly, there's still work to be done. In his opening presentation, CSX Director of Regional & Shortline Development Len Kellermann laid out several discrete challenges "to improve the intensity of our commercial efforts." In addition to sustaining 2011's momentum, he said, short lines would do well capturing more modal conversions, getting more business from existing customers and growing the customer base, making more joint sales calls with their CSX reps and arriving at the right price for the given commodity lane.

This last implies -- in my opinion -- a shortline requirement to have a price range in mind beforehand: the highest price that will work and still win the move and the lowest that will cover all shortline direct avoidable costs associated with that move. Unfortunately, based on my conversations during the meeting, the number of shortline operators who have a handle on customer-specific revenue per revenue ton-mile and operating costs is *de minimis*. This must change for the Class I-short line partnership to reach its full potential.

CSX delivering to First Coast Railroad Interchange at Yulee, Florida, Feb 2012 (c) Roy Blanchard

The expanded CSX trade show added the very tools that can help. Among the record 44 total booths were CSX desks supporting interchange enhancement for all nine CSX operating divisions, a TSI booth for getting the ISAs right, and a desk for bringing shortlines into the Carload Total Service Integration initiative. I spent time with each and came away with the sense that CSX wants to identify those short lines that Get It and can help bring the shortline portion of CSX vols and revs higher still.

I attended the breakout sessions for Emerging Markets (aggregates and minerals ex-frack sand), Chemicals & Fertilizers, Wood Products (both STCCs), Metals and Ag products. Each was highly informative and professionally presented with an excellent overview of the commodities in each group, the trailing results and outlook, an equipment survey and how short lines can grow in the group. That's the upside.

The downside was two-fold. First, the subject of frack sand was assiduously avoided in both the Emerging Markets and Chemicals breakout sessions, yet this is one of the fastest-growing commodities in shortlinedom. Second, I was surprised to see the high number of freight cars reaching their sell-by date in each commodity group. Here's what I've learned since.

Frack sand, though managed within the Chemicals group at CSX, remains in what the AAR calls "Group 5," Crushed Stone, Sand & Gravel, and it's up 11.2 percent YTD in Week 9 (March 3) for all US Class Is. Waybill sample data show CSX ranking dead last in frack sand vols through the first nine months of 2011 -- 20,000 loads to 35,000 for NS, to name one comp. One reason may be that CSX has no presence in the North Central area of Pennsylvania, the most active portion of the Marcellus Shale formation with its "gassy gas" drilling and where NS dominates.

However, a recent Raymond James study shows drilling shifting to western Penna and eastern Ohio where "oily gas" dominates and where CSX has a much stronger franchise. Thus it seems odd the topic was skipped in both breakout sessions, especially given Kellermann's opening charge "to improve the intensity of our commercial efforts."

As for car replacements, the CSX 10-K for 2011 shows the railroad capex for locos and freight cars to average 13 percent of total capital expenditures 2009-2011 and two percent of revenues over the same period. The 2011 NS 10-K says the company was spending 26 percent of capex -- five percent of revenues -- on locos and cars 2009-2011. In 2011 CSX put 22 percent of capex dollars into rolling stock, up from 10 percent in 2010, which explains high car-replacement numbers we saw in the breakouts.

That small quibble aside, one comes away with the sense that CSX has once again set the gold standard for shortline workshops in terms of a welcoming environment and a collaborative atmosphere. This Workshop led many shortline horses to water; let's hope they drink deeply.

The question of how can carload volumes be up at all with coal taking such a beating has come up a number of times of late. Though I have my own ideas, I always like to turn to The Experts to confirm -- or refute -- my positions. Here I turned the AAR's Clyde Crimmel, who, as the Association's Director of Statistical Information, generally has the right stuff.

He writes, "Coal originations were down for all five of the US Class I railroads for Week 7 – down 13.9 percent for the five railroads combined... Other commodities are, for now, making up for the coal and grain declines – meaning cumulative overall carload traffic is somewhat flat exclusive of coal." He attaches a bar chart showing coal down drastically in Week 7, not so dire over the trailing four weeks, and least bad year-to-date.

Similarly, total Week 7 trailing four-week carloads look bad and YTD a tick above flat. Ex-coal, automotive, aggregates and ores (thank you, frack sand and US Steel) are the winners. Reinforcing the thesis still further, Clarence Goode, Chief Commercial Officer at CSX, told the assembled shortline reps that 71 percent of CSX commodity groups see upticks YTD and the pace is expected to continue.

It isn't happening in Week 9. The AAR says total YTD carloads for US rails are down one percent, some 59,000 units. Of this, coal is down seven percent, 33,000 loads. Grain is down by

23,000 cars or 11 percent. Happily, met ores, aggregates including frack sand, automotive, metals & metal products and petroleum are all up double digits, adding 74,000 carloads.

Canadian Pacific will be starting a crude oil by rail service out of the Bakken oil fields via US Development's new hub at Van Hook, ND. Initial capacity design is for 35,000 barrels-per-day throughput across eight automated truck-unloading positions. Plans are for the Van Hook hub to launch 104-car unit trains at a rate of up to 17 a month to start, expanding to 30 trains.

Says Jane O'Hagan, CP's Chief Commercial Officer, "This partnership with USD strengthens our network and advances our strategy to drive volume growth, expand network capacity and achieve targeted improvements in our operating efficiency. By taking advantage of the CP network to the Northeast U.S. and through its Kansas City gateway to the U.S. Gulf Coast, Canadian Pacific is able to partner with the energy industry to facilitate further growth in moving oil and energy-related materials."

I'm glad to see CP capitalizing on its unique position as the only North American Class I railroad to serve the Bakken Formation, the Alberta Industrial Heartland, and the Marcellus Shale. Short lines in north central and western Pennsylvania have experienced rapid carload volume growth thanks to the natural gas business and eastern refineries are gearing up to take the Bakken crude. The sheer economic leverage of CP's single-line haul offers a powerful competitive advantage.

The North East Association of Rail Shippers (NEARS) will host its Spring 2012 conference May 8-10 at the Downtown Marriott in Providence RI. The theme is "Shippers: A Different Perspective," in response to member requests for more shipper involvement. Program highlights include an All-Star shippers panel with representatives from the paper, consumer discretionary and consumer staples industries; a shippers' multi-modal panel with speakers from the paper, port and steamship businesses; two Wall Street analysts on how shippers can use railroad financials in vendor selection; and a field trip to the Providence & Worcester Railroad's ethanol receiving facility.

You can register on-line at www.nears.org as well as renew/sign up for membership and -- if you'd like to contribute to the cause (I do it very year) -- you can add that at the same time. Of course, there's golf. NEARS has arranged for "golf on-your-own" on Tuesday at Triggs Memorial Golf Course in Providence, only 10 minutes from the hotel. If you are interested, please call or email Karl Augustine at Triggs: 401-521-8460, email is karlws@cox.net.