THE RAILROAD WEEK IN REVIEW

September 21, 2012

"Home prices during the first half of 2012 posted their strongest gains in six years, the clearest sign that more U.S. housing markets have hit bottom." -- WSJ, September 14, 2012

Housing prices may be going up, but it's not demand-driven according to the *Wall Street Journal*. "Today's rising prices have less to do with surging demand than with declines in the number of properties for sale. Inventories of existing homes are at eight-year lows. New-home inventories are lower than at any time since the U.S. census began tracking them in 1963. In some cities, there are one-third fewer homes listed for sale than a year ago. And low inventory is benefiting home builders, as buyers grow frustrated by bidding wars sparked by a shortage of move-in-ready housing."

We've all noticed that lumber loadings are up for both short lines and Class Is. To find out what's behind the numbers, I checked the QCS tables at usraildesktop.com and found that the forest products carloads are still short of their pre-recession peaks. In terms of revenue units, the two biggest lumber STCCs are 242xx and 249xx, cut lumber and OSB/Panel board respectively. Looking just at NS and CSX because they serve the most US population centers, I searched the QCS files for the quarterly carload lows and highs from the first quarter of 2008 through fourth quarter 2011 so I'd have full-year comps.

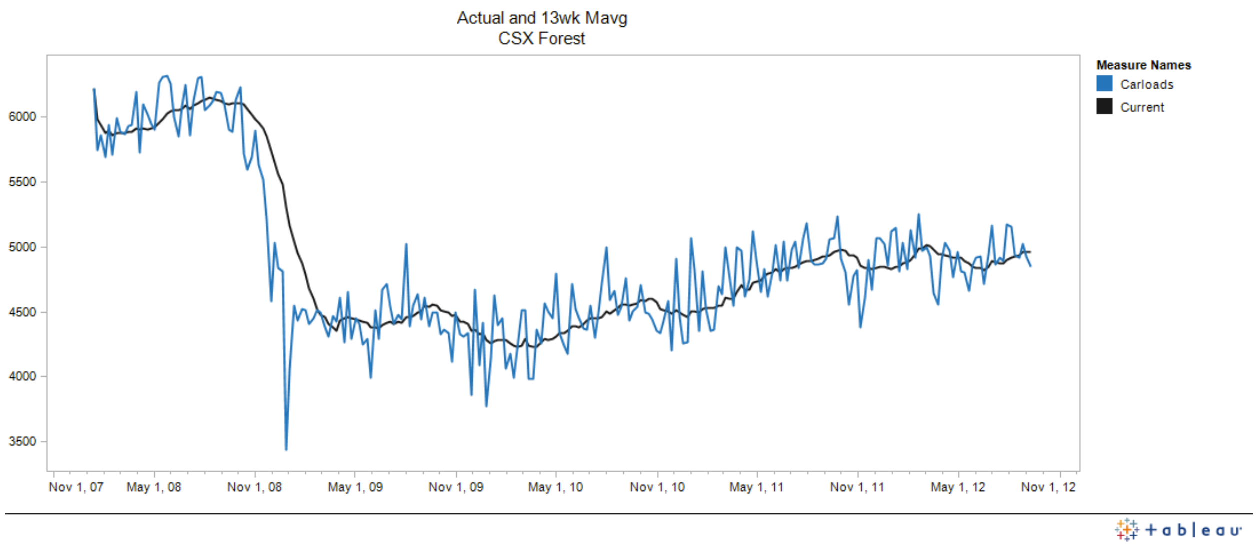
Both roads hit their peak lumber loadings in the 2008 third quarter at roughly 5,000 units each; the lows came in 1Q2009 with volumes about half the peak. Panel and OSB peaked for both roads in 3Q2008 at some 5,000 revenue units. The lows, like cut lumber, were about half the peak numbers, though CSX hit the low in 1Q2010 and NS a year later. As of the present, loads are roughly half way between the lows and highs for both roads.

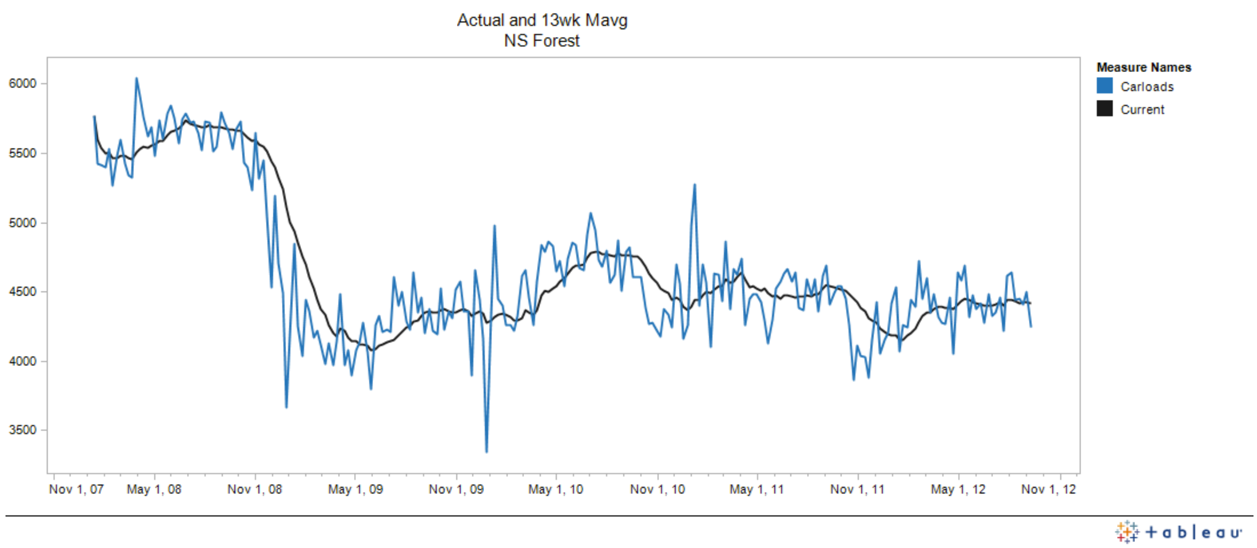
The *Journal* concludes, "An important test comes later this year. In each of the past three years, prices rose in the summer but gave up all those gains and more in the winter, when sales traditionally slow. This year could be different because the supply of homes isn't piling up. Absent a shock to the economy, housing is on the mend. But it will be a long time before it returns to normal."

Paper carloads appear to be following roughly the same patterns as lumber. The two biggest groups of paper products in terms of annual loadings are STCC 262xx, printing paper, and STCC 263xx, pulp-board -- such as you find encasing your Amazon order. The two groups account for nearly half a million railroad carloads a year, with pulp-board representing about 56 percent of the total. Here again I looked only at CSX and NS due to their presence in the largest population centers and for the period 1Q2008 through 4Q2011.

CSX printing paper hit its high in the 2010 fourth quarter and its low a year before that; NS reached its highest printing paper loadings in the 2008 third quarter, its low in 2Q2009. In both instances the lows were about two-thirds of the highest carloading reached, with both roads hitting their highs in the low 20-thousands range. Pulp-board highs were in the high 20-thousands, and the lows, like paper, were down about a third. Both roads has their peak loadings in third quarter 2008; the CSX low came in 2Q2010 and NS a year before.

These two charts for CSX and NS combine lumber and paper into one "forest products" line. The former appears to be doing a little better at recovering some degree of its former forest products self while NS has flat-lined.





Charts courtesy of ASI-Transmatch in NYC, Drew Robertson, Prop.

The fact of the matter is these forest products charts data points can be either good news or bad, depending on how you look it. In the macro picture of housing starts housing or paper trends, it can be a cautionary tale. On the other hand, the trends also imply opportunity. Yes, industry production may be slowing and supply chains are being tightened, but that implies market share growth potential for the superior service provider. Horses to water, and all that.

RMI's *RailConnect Index* of shortline traffic for Week 36 (ending Sep 8) has Class II and III roads total revenue units up 6.3 percent for the week and 1.5 percent year-to date, based on 422 roads reporting (attached). However, you'll note that intermodal accounts for ten percent of the revenue units reported. Knowing that intermodal isn't of much interest to many short lines -- other than perhaps a means for siphoning off their precious boxcar business -- I asked RMI about where it's coming from and how many roads are included in the number.

RMI's Jane Edgar was able to say just 21 road names (she did not name them specifically) report any intermodal activity (a "carload" in this case is a container, just as it is on the Class Is). Furthermore, these 21 roads account for just five percent of the RMI sample and fewer than one percent of all roads in the RMI sample depend on intermodal for 80-100 percent of their loads. Less than three percent have intermodal volumes ranging from less than one percent of loads to nine percent.

As regular WIR readers may have noticed, I regularly exclude the intermodal numbers from my shortline traffic analysis based on my *opinion* that they are not representative of the shortline community as a whole. Now, thanks the good folks at RMI, I can skip past the intermodal counts based on the *fact* that they do not represent the larger shortline community.

Now, then. Week 36 year-to-date total loads across all commodity groups increased 1.5 percent against the 2011 period, with intermodal up the most -- 26 percent. Back that out and the 90 percent of commodity loads that make up 100 percent of 95 percent of short lines' commodity base are actually down a percent. Moreover, three of the four commodity groups that account for half of all shortline cars were down: coal, grain and chems; forest products registered a plus.

I track share prices of 28 companies for my "Railroad Commodities" check on investor attitudes about commodities from coal to grain to auto to forest and fertilizers. In forest, a one-year chart has Louisiana Pacific share prices in the lead, up 150 percent, Weyerhaeuser's 50 percent gain in second place, IP at 25 percent in third and Meade Westvaco last at ten percent (the Dow did 20 percent). Which leads me to believe production is there, so any rail gains must be gains *on the origin side* in share and/or volume for the specific franchise.