THE RAILROAD WEEK IN REVIEW

July11, 2014

"CSX shortline merchandise volumes are strong in agricultural products, minerals, paper, and metals; coal has improved dramatically." — Len Kellermann, CSX

***CSX Interchange*, the quarterly regional railroad newsletter,** is a bearer of good tidings in the Spring-Summer, 2014 number. As you saw here last week, I estimate CSX merch carloads finished Week 26, for all intents a YTD number, up seven percent to 1.2 million units. If I remember correctly, feeder lines touch about a quarter of all CSX carload units, putting the quarter at some 300,000 feeder rail units.

The YTD through May 23 (Week 21) total in Len's chart (below), supports my thesis and then some as it's five months, not six. In order of importance to feeder lines:

CSX 2014 YTD SL Vols thru May 23

	2014	2013	pct chg	Pct 2014 Total
Coal, Coke, Iron Ore	88,250	89,364	-1.2%	26.6%
Chems	56,852	55,526	2.4%	17.1%
Ag Prods	56,191	50,994	10.2%	16.9%
Forest Prods	37,807	35,694	5.9%	11.4%
Metals	34,499	33,388	3.3%	10.4%
Minerals	26,526	24,097	10.1%	8.0%
Waste & Equipment	14,589	15,372	-5.1%	4.4%
Phosphates	11,794	12,062	-2.2%	3.6%
Food & Cons	3,335	3,425	-2.6%	1.0%
Auto	2,002	3,474	-42.4%	0.6%
All-In	331,845	323,396	2.6%	

Coal is surprising. I tend to think of it as Class I mine to Class I power plant or export facility — Mobile, Baltimore, Newport News, e.g. — none a shortline play. Chems is about right. The Class I pure STCC chems are up 1-2 points. The short lines don't really play in the crude-oil game, and I suspect STCC 29 petroleum products at CSX are like they are at other class Is: steady vols, a point or two one way or another quarter-to-quarter, year to year.

Here at quarter's end the pundits are saying we ought to expect 2-3 percent volume growth in the second half. Wall Street seers see little earnings growth for the quarter vs last year and only crumbs for the full 2014 year. That being the case, seeing shortline YTD carloads up nearly three percent with a fifth of the quarter still to go is a positive sign.

(Reminder: The 26th Annual CSX Short Line Workshop will be March 1-3, returning to the Ritz Carlton on Amelia Island. To which I say, "Hallelujah!" World Golf Village is nice, but if you're a non-golfing city-slicker like me, there's no there there. At least folks can live and shop for groceries at Amelia. And it's on the same side of Jax as Amtrak and the airlines.)

To make money in any business, especially in the feeder railroad business, takes money. Pennsylvania's Reading & Northern is a case in point. One of the first Conrail Express short lines, the officially-named Reading Blue Mountain & Northern opened for business in September, 1983 on a 13-mile piece of the former PRR that the State had acquired from Conrail, running north out of Reading.

Fast-forward to today and it's a 320-mile heavy-haul railroad with a well-balanced mixture of commodities from anthracite coal, consumer products, and frack sand, to forest products and wine. Here's what the 2013 maintenance year looked like:

What	How Much	Remarks
Own Money	$ 8,700,000	
Miles	320	
Capex/mi	$ 27,188	
Ties	35,000	incl T&S; "Smoothie Gang"
Joints elim	175	
Grade X-ing	12	Rehabbed
bridges	210	
Tunnels	6	
slow-orders	0	All removed in 24 hrs
lubricators	$ 90,000	Trackside, 15 each
Hwy x-ings	241	total
tons scrap rail	1,000	created by re-rail program
Source: R&N Magazine, Summer 2014		

Oppenheimer's technical guru, Ari Wald, looks at the market through sectors and spiders; both are worthwhile from a feeder railroad operator's perspective. Sector views — industrials, materials, consumer discretionary — tell us how the various players in each sectors are faring economically, and spiders — the ETFs comprised of shares of the sector leaders — tell how investors see the respective stories. Most recently,

> The Materials SPDR (XLB) and the Industrials SPDR (XLI) swapped spots in our SPDR rankings this week to the No. 3 and No. 4 positions. Within the XLB, we like Metals & Mining and in that sub-industry we like Freeport-McMoran [FCX; copper mining, e.g.] Within the XLI, we continue to like Transports and Machinery: Fed Ex and Joy Global [the latter a good fit with the Freeport theme]."
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> The materials industry has seriously underperformed in recent years, and this decline is now reversing. We believe it is encouraging to see the sector making a new price low in March while maintaining share-volume momentum, suggesting less of a downside and a meaningful turning point. We expect FCX to exhibit leadership within the Metals & Mining Industry in the coming months.
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> Transports and Machinery remain two of our favorite groups within the Industrials Sector. Relative to the sector, Transports are breaking above multi-year resistance and are in position to continue to outperform, in our view. [The Big Five Class Is have all outperformed the S&P by ten points or better YTD]. Machinery is also a rotation idea based on signs of a relative base following several years of underperformance. [All the car builders are here; each of the four has beaten the S&P handily YTD.]

John Stoltzfus, Chief Market Strategist at Oppenheimer, thinks there's renewed investor interest in the Consumer Discretionary sector (entertainment, eating out, cars, furniture). Could be. The July 3 *McClellan Report* (no kin to our NS friends that I know of) says the percentage of the work force not looking for work is shrinking. Again, good for feeder rails:

> It may be worth noting that the extended unemployment benefits which Congress kept extending further and further, due to the economic emergency, finally ran out in December 2013. And now, we are seeing more of the population going back to work, now that the federal government is not paying them for staying unemployed. There is a lesson in this story. If you don't want people to do something, don't pay them for continuing to do it for a really long time.