

RAILROAD WEEK IN REVIEW

JUNE 22, 2007

“The ability to differentiate between different levels of service is one of the benefits of deregulation.”
– Larry Kaufman in Argus Rail Business

Larry’s argument is shippers have more choices as to both mode and levels of service than ever before. Pre-Staggers, there were no rail service contracts and tariffs had to go through an ICC review before they could be published. Rail service was rail service with no Unique Selling Points between and among vendors. Fast forward and today shippers are, says Kaufman, “putting their money where their mouth is and are opting for low-price services for price-sensitive goods and premium service for service-sensitive products.”

There remains, however, a certain cadre of shippers who are behind the times and whose “utterances at industry meetings and government hearings appear silly the instant they leave the speaker’s mouth.” Kaufman nails it right there. We both talk with a lot of shippers and rail sales folks and too much of what we hear comes right from the YCMTSU (you can’t make this stuff up) file.

He cites a few prototypes we’ve all seen. There’s the guy who says that “trucking is more expensive than rail and that makes his company rail-captive” even as the ICC long ago said that “a shipper does not achieve captive status just because a competing mode was more expensive.” Or the guy who complained that “rail service was unreliable and trucks cost too much.” Kaufman responds by pointing out that “there are no constitutional rights to low-price transportation.”

Of course, the rails are not without fault, either. Like the seasoned and about-to-rotate rep who tells a good customer “we don’t want your business because of congestion” and six months later a new rep comes by and says “we want your business.” Meanwhile, the shipper had reorganized his supply chain by changing to truck-friendly and even offshore vendors. Or the shortline rep that sends a rate request to a Class I partner without clear OD pairs, a five-digit STCC, requested car type, anticipated annual volume and market price data.

A good friend in sales with a Big Six Class I writes, “I get short line e-mails that are so poorly written I can’t figure out what’s being asked or IN ALL CAPITAL LETTERS as if the writer were shouting at me. Moreover,” he continues, “there seems to be no understanding of car supply or asset management.” Like the guy who wanted a dozen cars to be at the short line customer’s disposal for loading when there were no trucks available.

It boils down to the transportation provider’s economics vs. what works for the beneficial owner of the goods in transit. At the extremes, the railroad offers a batch service where production units (freight cars, containers and trailers) are all handled in a batch, or trainload. Trucking is a custom service, where goods move in trucks that operate without reference to any other load.

Any rail customer is likely to have supply chain requirements that vary from time of day to commodities to OD pairs. Our job is to offer a price-service package that fits the needs, and the only way to do that is to call on the customers and design services that fit within your railroad’s economic model. That said, the ASLRRRA could do the short line community a great service by being as proactive on the commercial and financial sides as it is on the operating and lobbying sides.

The DM&E pot continues to boil. Dan Daily, a reporter for the *Rapid City Journal*, writes, “DM&E president Kevin Schieffer said the *Trains* story [WIR 6/15] had ‘an awful lot of speculation.’ But he also said the company is looking at many options to obtain private financing for the coal line. (June 16). And one of those options could clearly be finding new owners with deep pockets. Which is exactly Kevin Dodd of the Sioux Falls *Argus leader* picked up in his June 15 feature: “A patient investment group that believed in the long-term profitability of hauling coal could jump-start a larger investment campaign and persuade federal officials to reconsider the loan.”

As for Schieffer, Dodd quotes him as saying, “Sioux Falls is our headquarters, and South Dakota is our home base. I have no desire or intention of going anywhere else, on a personal level.” As for selling to another railroad, Dodd says, “A competing railroad would want to bring in its own management team and assess all its options before committing to the expansion.” In other words, selling to a PE group gives Shieffer better odds of keeping his job than would selling to another railroad, especially a Big Six Class I.

Rail Freight Traffic in Week 23 (June 9) declined nearly 4% for the week with merch carloads (ex coal, IM, grain) off 2%; coal was down 6%, ag off 5% and IM slid 3%. The only good signs on the merch side were chems +6% and mets incl ores +4%. For the YTD, total revenue units are still running 3% behind 2006 with merch down 5% as forest prods and non-met minerals (mostly aggregates) skidded a combined 22%. Intermodal lags by less than 3% YTD and coal’s down 2%. For the full story, see the excellent summary table from Jason Seidl at Credit Suisse, attached.

Shortline traffic as reported in RMI’s RailConnect (also attached) with 296 names reporting (out of a total universe of 550 or so, depending on who’s counting) is still in decline, off 5% for the week and 7% YTD. But coal and grain were both up vs. down in the Class Is, with these two representing 23% of total short line loads. But like their larger brethren, shortlines also saw continued declines in forest products and aggies, down 22% and 3% respectively with these groups comprising 21% of shortline revenue loads.

Meanwhile, the re-regulation threat rears its ugly head in Canada. Seidel writes, “Not only do the US railroads face the possibility of re-regulation, but the Canadian railroads are also facing regulatory pressure in the form of proposed amendments to the Canada Transportation Act (CTA). Much of the potential for change surrounds the rate and service dispute process. The proposal would see the option of final offer arbitration extended to groups of shippers rather than individual shippers, which is the current practice.

“The current requirement that the CTA must be satisfied that a shipper would suffer ‘substantial commercial harm’ before imposing a remedy relating to levels of service, inter-switching rates and competitive line rates is removed, thus providing much faster resolution to complaints that arise. Finally, the CTA will be permitted to investigate, upon complaint by a shipper, incidental charges such as demurrage fees contained in a tariff, and to impose new terms or conditions if the existing ones are found to be unreasonable, for a time period to be determined by the CTA.

“It is our view that should these amendments be enacted, they would be a negative for the Canadian rails as they would provide shippers with additional leverage in rate disputes, and possibly limit future price increases.” And it is my view that such “remedies” are more for political reasons than for economic reasons and as such discourage investment, hinder the rails’ ability to add capacity and can lead to the very service degradation that programs like the Investment Tax Credit and RRIF loans are designed to prevent. At some point, Atlas will shrug, and then where are we?

The Pennsylvania Railroad Technical & Historical Society has placed a bronze plaque commemorating the beginning of high speed rail transportation in North America in the Princeton Jct (NJ) station of New Jersey Transit. The plaque was unveiled June 14, a little more than 40 years after the first record speed was set. The plaque recognizes the technical achievements of the program as well as those individuals whose work and dedication made it happen.

Three speed records for rail passenger equipment were established at Princeton Junction in the late 1960s by the four US Department of Transportation Test Cars, a United Aircraft Corporation Turbo Train, and all of the original Budd built Westinghouse Electric and General Electric Metroliner cars as they operated on the test track between New Brunswick and Trenton. The organizations that have contributed towards making this plaque possible are The Pennsylvania Railroad Technical & Historical Society, the Penn Central Historical Society, LTK Engineering, Bombardier (representing Budd, Westinghouse and Pullman Standard) and NJ Transit.

Iowa Interstate ran a double-headed steam freight behind its pair of 2-10-2s. A note on the *TRAINS* Newswire reports that the trips were intended to set a record for a steam-hauled freight train in the United States in the 21st Century. On Saturday June 9, they pulled regular IAIS freight train BICB-07 (Blue Island, Ill.-Council Bluffs, Iowa) with 66 cars weighing over 4,000 tons from Booneville to Council Bluffs, a line that has many grades and curves. On June 10, the 2-10-2s left Council Bluffs early in the morning (for the best light for photogs) with train CBBI, which included some cars of double-stacked containers. The steam power took the train all the way from Council Bluffs east to Newton, where they will be placed back into storage.

Meanwhile, in eastern Washington State the 2100, an ex-Reading 4-8-4 Class T-1, has moved from Tacoma where it was converted to oil from coal to Randy Peterson's Tri-Cities and Olympia Railroad in Richland. The locomotive arrived from Tacoma after crossing the Cascade Mountains on the former NP line now part of the BNSF system. TCRY officials said the 2100 will be in the Tri-Cities for an extended period of time and will see service on both passenger and freight trains run during special events.

Rick Paterson, one of the more astute observers of the railroad scene, asks whether the market is "switching valuation metrics" for the Big Four US Class I roads. In a UBS note dated June 14 Rick writes, "Cash-flow metrics are gaining importance in rail valuations. One possible factor is the recent shift in the predominant driver of rail valuations from an earnings to a cash-flow multiple is the LBO speculation that emerged in the past few quarters."

It can't happen soon enough for me. The creative accounting that one sometimes sees between operating income and net income can too often hide what's really going on in the core business. Depreciation is a non-cash item and can be anything you like, so take it out of the expense total. Taxes and interest are below the line anyway, so they're moot. Now you can compare Enterprise Value to ebitda on any set of railroads and see how well the core business is doing. I'll take that.

The Railroad Week in Review, a weekly compendium of railroad industry news, analysis and comment, is sent via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than \$12 mm annual revenues \$125. Corporate subscriptions are \$500 per year. A publication of the Blanchard Company, © 2007. Subscriptions are available by writing rblanchard@rblanchard.com. Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned.

Exhibit 1: Weekly Railroad Traffic Data

Week 23, 2006

Week Ending June 09, 2007

WEEKLY RAILROAD TRAFFIC

Carloads by Commodity Type	This Week	One Year Ago	Y/Y % Change	Cumulative			Quarter to Date 2007	Quarter to Date 2006	Y/Y % Change	Year to Date 2007	Year to Date 2006	Y/Y % Change
				Four Week Total	One Year Ago	Y/Y % Change						
Agricultural Products	53,178	56,208	-5.4%	209,828	217,319	-3.4%	535,333	553,972	-3.4%	1,235,242	1,294,474	-4.6%
Grain	27,533	31,634	-13.0%	111,781	119,292	-6.3%	291,430	308,194	-5.4%	689,382	729,541	-5.5%
Farm Products, Ex. Grain	3,873	3,381	14.6%	13,030	13,803	-5.6%	32,353	35,595	-9.1%	70,228	79,670	-11.9%
Grain Mill Products	10,945	10,746	1.9%	42,123	42,544	-1.0%	104,801	105,234	-0.4%	235,331	244,734	-3.8%
Food and Kindred Products	10,827	10,447	3.6%	42,894	41,680	2.9%	106,749	104,949	1.7%	240,301	240,529	-0.1%
Chemicals	51,223	48,377	5.9%	208,872	196,702	6.2%	529,745	499,113	6.1%	1,202,085	1,144,683	5.0%
Chemicals	43,914	41,115	6.8%	179,496	168,432	6.6%	456,764	430,468	6.1%	1,042,178	993,389	4.9%
Petroleum Products	7,309	7,262	0.6%	29,376	28,270	3.9%	72,981	68,645	6.3%	159,907	151,294	5.7%
Coal	142,437	151,524	-6.0%	585,279	599,190	-2.3%	1,455,862	1,484,340	-1.9%	3,328,824	3,384,053	-1.6%
Forest Products	24,590	28,268	-13.0%	99,899	113,363	-11.9%	254,907	288,331	-11.6%	587,838	680,795	-13.7%
Primary Forest Products	4,141	4,974	-16.7%	16,242	19,026	-14.6%	41,865	49,891	-16.1%	100,019	123,288	-18.9%
Lumber and Wood Products	8,679	10,595	-18.1%	35,345	42,167	-16.2%	90,659	109,306	-17.1%	199,334	250,904	-20.6%
Pulp, Paper, and Allied Products	11,770	12,699	-7.3%	48,312	52,170	-7.4%	122,383	129,134	-5.2%	288,485	306,603	-5.9%
Metallic Ores and Minerals	44,573	42,989	3.7%	175,059	179,635	-2.5%	426,596	447,292	-4.6%	2,056,810	2,223,077	-7.5%
Metallic Ores	23,173	20,814	11.3%	88,475	90,038	-1.7%	205,890	219,809	-6.3%	917,255	968,782	-5.3%
Coke	6,183	6,036	2.4%	24,167	22,779	6.1%	62,209	60,684	2.5%	630,760	686,766	-8.2%
Metals and Products	15,217	16,139	-5.7%	62,417	66,818	-6.6%	158,497	166,799	-5.0%	508,795	567,529	-10.3%
Motor Vehicles and Equipment	30,618	30,896	-0.9%	114,572	118,105	-3.0%	286,717	296,535	-3.3%	630,760	686,766	-8.2%
Non-metallic Minerals	44,740	50,981	-12.2%	263,614	289,014	-8.8%	436,582	476,224	-8.3%	1,402,806	1,527,181	-8.1%
Crushed Stone, Sand, and Gravel	26,112	29,062	-10.2%	43,591	47,608	-8.4%	246,306	271,071	-9.1%	231,367	258,573	-10.5%
Nonmetallic Minerals	7,338	9,565	-23.3%	175,481	195,312	-10.2%	81,610	86,680	-5.8%	914,430	1,007,429	-9.2%
Stone, Clay, and Glass Products	11,290	12,354	-8.6%	44,542	46,094	-3.4%	108,666	118,473	-8.3%	257,009	261,179	-1.6%
Other	17,369	18,043	-3.7%	67,905	68,202	-0.4%	172,930	173,232	-0.2%	389,903	398,493	-2.2%
Waste and Scrap Materials	11,415	12,005	-4.9%	44,542	46,094	-3.4%	115,410	115,990	-0.5%	257,009	261,179	-1.6%
All Other	5,954	6,038	-1.4%	23,363	22,108	5.7%	57,520	57,242	0.5%	132,894	137,314	-3.2%
Intermodal	284,607	294,121	-3.2%	1,097,070	1,119,249	-2.0%	2,757,957	2,823,899	-2.3%	6,265,002	6,319,363	-0.9%
Trailers	52,056	58,967	-11.7%	197,739	223,596	-11.6%	501,891	570,682	-12.1%	1,174,511	1,326,572	-11.5%
Containers	232,551	235,154	-1.1%	899,331	895,653	0.4%	2,256,066	2,253,217	0.1%	5,090,491	4,992,791	2.0%
Total w/o Grain, Coal & Intermodal	238,758	244,128	-2.2%	939,835	969,346	-3.0%	2,351,380	2,426,505	-3.1%	5,188,131	5,451,881	-4.8%
Total Carloads	693,335	721,407	-3.9%	2,733,965	2,807,077	-2.6%	6,856,629	7,042,938	-2.6%	15,471,339	15,884,838	-2.6%

Source: RailShare Data

RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 6/9/2007

Week Number: 23

Carloads Handled	Current Week			Year-To-Date		
	2007	2006	% Change	2007	2006	% Change
Coal	14,702	14,092	4.33%	319,297	337,927	-5.51%
Grain	13,684	12,542	9.11%	293,066	307,855	-4.80%
Farm & Food (Exc. Grain)	4,123	4,645	-11.24%	101,414	107,622	-5.77%
Ores	2,844	3,219	-11.65%	59,666	66,745	-10.61%
Stone, Clay, Aggregates	12,712	13,150	-3.33%	236,835	252,382	-6.16%
Lumber & Forest products	6,325	7,396	-14.48%	142,997	177,902	-19.62%
Paper products	7,915	8,628	-8.26%	187,892	202,274	-7.11%
Waste & Scrap materials	5,648	6,415	-11.96%	136,705	139,697	-2.14%
Chemicals	16,615	15,828	4.97%	381,690	353,337	8.02%
Petroleum & Coke	5,767	6,403	-9.93%	126,182	133,214	-5.28%
Metals & Products	11,710	12,473	-6.12%	255,591	278,881	-8.35%
Motor vehicles & equip.	2,331	2,425	-3.88%	50,942	53,934	-5.55%
Intermodal	15,386	18,012	-14.58%	321,149	409,197	-21.52%
All Other	3,102	3,525	-12.00%	67,308	76,953	-12.53%
Total	122,864	128,753	-4.57%	2,680,734	2,897,920	-7.49%

