THE RAILROAD WEEK IN REVIEW
FEBRUARY 22, 2008

"Legislation gets passed when [special] interests can persuade Congress that there is a crisis." – Larry Kaufman in Rail Business*.*

To hear the tales being told in DC, one can only conclude the robber barons still run the railroads and must be brought to legislative heel lest the poor fellows that must use the rails for chems, coal and other bulk commodities be put out of business. That, says Kaufman, may be the tenor of the news from the Capitol though in actuality "the relationships between railroads and their customers are pretty good; it is their respective public policy advocates who are engaging in combat."

The reality is that shippers and the rails actually get along pretty well on the operating level. "There is a collegiality between carriers and shippers who understand that they have to do business with each other and it is better to do so in a civil manner." But in Washington there are no commercial relationships and there is no incentive for gentlemanly conduct. It takes a degree of hyperbole to "try to persuade convince Congress and the STB that railroads are abusing their market power" and that regulatory or legislative relief is in order. Therein lies the rub.

At the end of the day the lobbyists earn their keep by getting Congress to see things the way their clients want Congress to see things. The poor schlepps with product to move just want dependable, reliable transportation providers who provide value at a reasonable cost.

Railcar manufacturing and demand are excellent leading indicators of where the rail business is headed. Bear Stearns' rail equipment analyst Peter Nesvold writes, "While the outlook for demand generally remains muted, many of our contacts suggested they are seeing signs of life in some car types though overall demand will remain muted in 2008." There are a lot of cars of all types stored (you should have heard the multiple mentions of the center-beam dilemma at the CSX short line meeting). Lessors are feeling the downturn as well though "tank car pricing was down as well, it continues to hold up modestly better than other railcar types." Rebuilders are doing well also as "the backlog for getting a car refurbished remains very long."

Moreover, in a later note, Peter adds, "While the leasing arms of the railcar OEMs are able to place these cars in service (at competitive prices) they are adding excess capacity to the industry-wide number of railcars in service which will likely pressure future demand. [Some say] that increased leasing competition is not the only thing pressuring the industry: there is an oversupply of railcars in the marketplace because of speculation in certain car types." Drilling down to specifics, Nesvold opines that specialty covered hoppers (PDs, hi-cubes for DDGs, e.g.) may be approaching the overbuilt stage. Various coal OTH users aren't exactly jumping up and down looking for more equipment (there are always pockets, but…).

Car cycle time was a recurring theme among the Class I fourth quarter earnings presentations and again at this week's CSX short line conference (see below). We've noted before that greater transit time consistency not only means you can charge higher rates for an improved product, but also that you can move the same amount of material with fewer cars. If there is less tonnage to move due to a downturn in business, then you need even fewer cars.

Last week I had the chance to spend a couple of hours at the train-watching platform the good folks in Folkston, GA have set up beside the CSX main into Jacksonville. There were six trains while I was there and covered hoppers, tank cars, box cars and intermodal platforms predominated. There were a few newer covered hoppers with many carrying second-hand marks (class I name painted out and an "x" lease number slapped on). The tank cars were the newest of the lot and the boxcars were a pretty beat-up lot. The IM platforms were – well, IM platforms – where TTX dominates and the loads were a mixed bag of international and domestic containers plus a LOT of trailers (too many voids among the double-stack platforms IMHO).

Short form from one day's small sample? I would not want to be in the new car business for anything but tank cars and perhaps aluminum or composite coal hoppers to replace what's wearing out. Moreover, short line mechanical forces with time on their hands might do well to get into the rebuild or refurbish business.

The 2008 CSX Short Line Conference once again carried a growth theme: "United for Growth." This year's conference was the 19th for CSX and is the longest-running short line conference in the business and – like the CSX quarterly earnings calls – shows a consistency in format and delivery that makes the trends easy to follow and the highlights easy to spot. To put things in context, short line connections handled close to a million units worth $1.4 bn in total CSX revenue for calendar 2007. Each of ten short lines brought in 1000+ carloads of new business in products ranging from oriented strand board (OSB) for the construction market to scrap in, coils out in the metals group.

Transit time consistency remains critical and to that end, CSX has added a geographic focus to its traditional commodities-based business development efforts. Partly as a result off this, the short line share of new CSX freight volume has grown to 36% from 3% in just five years. In 2007 alone, there were 38,000 carloads of new business coming out of 37 new projects on 29 different short lines. Being off the core routes is important, too, as traffic density (see Folkston, above) prohibits holding the main while the crew works an industry.

That said, ISA adherence is essential. I came away with the sense that CSX and short lines are not communicating well on what ISAs are and how to measure performance against them. They are, like the Pirates' Code in *Pirates of the Caribbean*, more like guidelines than actual rules. They exist to a promote service consistency and to take out transit time variability. The "One Plan" is the system operating plan that starts with the core system and works out to the branches, where events are timed to support the core operating plan. Like it or not, short lines are part of the One Plan and interchanges have to take place as scheduled.

The unit train picture at CSX is most encouraging from a short line point of view. Recall last week I mentioned the "Ray L. Rhodes" column in the Feb *Railway Age* Short Line/Regional Perspective space on the last page. In it, the authors hold that Class Is "insist" that corn and coal be handled in blocks of 65-115 cars. Yet when I specifically asked CSX market managers whether this be the case the answer was universally NO.

Transit times are key, but they are not the only consideration. If a short line can break a unit train, unload it and return it to the interchange in one piece, no problem. However, it has to be done in the timeframe that works within windows based on commodity O-D pairs and movement histories in those lanes. The fact is that the railroad is a batch process – a term used repeatedly in the CSX presentations – and is priced accordingly.

Prices will rise as one moves from the batch to custom side of the service spectrum. However, a huge shortline selling strength is being able to offer power-unloads and frequent switching at the customer to let a Class I batch process unit train become closer to a custom carload offering on the short line.

My CSX contacts said they really don't care what the short line does with the cars between load in and empty out as long as they comply with the operating plan for the lane.

Finally, the two shipper presentations on Friday morning were instructive. Both speakers – one in building products, the other in steel pipe – gave specific examples of the ways being located on a short line provides unique inventory-management benefits that in turn become competitive advantages vis a vis their customers. Moreover, the pipe guy gets his slab steel raw material from a supplier that is on another CSX short line a thousand miles away and he gave examples of the way the origin short line adds value for his vendor.

Which brings us full circle. From the opening remarks on the economic impact that short lines have on CSX revenues, car counts, and operating earnings to specific examples of how it all comes together. It was clear to me that all the presenters carried the same message: we're in this together and we are truly "united for growth." Thanks to all at CSX for the hospitality, the keen interest in moving the ball forward, and for providing some valuable insights as to why CSX does what it does.

The attached chart shows short line car counts down less than 1% through Week 6 (2/9/2008). As expected, the less cyclical STCCs are doing best with grain up 10%, other STCC 20s up 5%, metals and ores up 9% and 20% respectively, with petroleum and coke up 10%. Forest products and paper continue to be a drag, down another 22% yoy. Taken as a whole, and considering what it *might* be, that's not too bad. STCCs 24 and 26 are but 4% of short lines' car-count whereas the gaining groups represent 32% of short lines' revenue units.

Jason Seidl of Credit Suisse does a top-notch job reporting the AAR data, providing a superb by-railroad breakout. For Week 6 he writes, "Total carloads fell a mere 0.2%, driven by continued weakness in Forest Products (-17%), Motor Vehicles & Equipment (-12%), and Intermodal (-2.2%). BNSF had the worst showing for the week as overall traffic fell 2.8% year-over-year on the heels of sharp declines in Forest Products (-25.3%) and Intermodal (-7.3%).

"Union Pacific outperformed its Western counterpart, posting a 1% decline with weakness in Forest Products (-12%) and Motor Vehicles & Equipment (-8%). In the East, traffic at CSX increased 4% with a strong showing in Intermodal (+5%) and Coal (+21%). Meanwhile, Norfolk Southern posted a 0.5% decline in traffic due to losses in Metallic Ores & Minerals (-6%), Forest Products (-5%), and Intermodal (-3%). In contrast, the Canadian rails reported a collective gain of 2.4% in traffic — 3.7% growth at CP and 1.6% at CN."

Bear Stearns has just released its new 100+ page report detailing their recent rail sector upgrade. Here Bear provides further explanation of their rail thesis for 2008 plus the longer-term outlook. Moreover, there is a fine explanation of why rail stock PE ratios may be increasing along with CY 2008 estimates. This is timely as CSX CFO Oscar Munoz touched on this very theme in his remarks on Thursday. Here's how Bear puts it: "We have increasing confidence rail earnings growth will accelerate, there is an improving regulatory outlook in DC and a more aggressive Fed easing cycle." For specifics, or for a copy of the full report, drop me a note. It's a fascinating read.

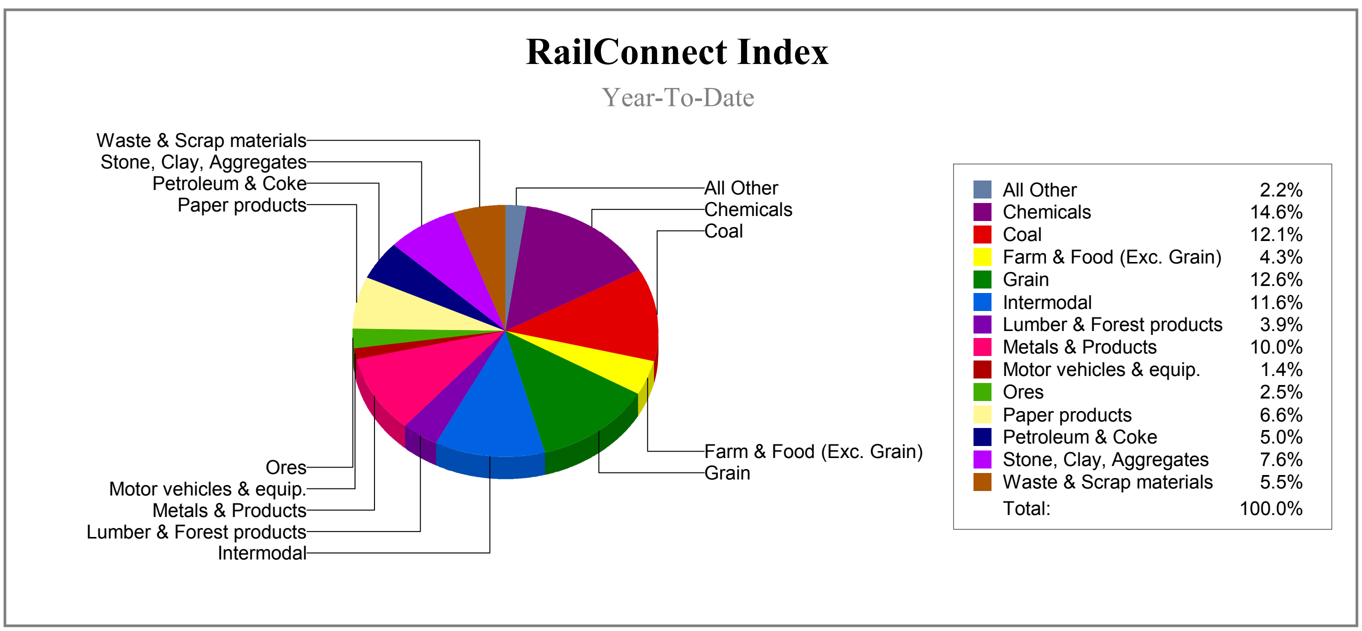
RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 2/9/2008

Week Number: 6

Carloads Handled	Current Week			Year-To-Date		
	2008	2007	% Change	2008	2007	% Change
Coal	14,199	14,519	-2.20%	84,766	85,125	-0.42%
Grain	15,079	12,287	22.72%	88,039	79,709	10.45%
Farm & Food (Exc. Grain)	5,214	4,801	8.60%	30,273	28,918	4.69%
Ores	2,849	2,218	28.45%	17,431	14,587	19.50%
Stone, Clay, Aggregates	9,640	8,889	8.45%	53,020	51,542	2.87%
Lumber & Forest products	4,642	6,208	-25.23%	27,454	35,217	-22.04%
Paper products	7,451	8,275	-9.96%	46,284	52,479	-11.80%
Waste & Scrap materials	6,444	6,199	3.95%	38,231	35,933	6.40%
Chemicals	17,204	16,437	4.67%	102,465	98,175	4.37%
Petroleum & Coke	6,093	5,254	15.97%	35,221	32,045	9.91%
Metals & Products	12,085	11,155	8.34%	70,300	64,238	9.44%
Motor vehicles & equip.	2,183	2,375	-8.08%	9,947	11,343	-12.31%
Intermodal	14,804	15,552	-4.81%	81,372	89,970	-9.56%
All Other	3,121	2,899	7.66%	15,402	16,146	-4.61%
Total	**121,008**	**117,068**	**3.37%**	**700,205**	**695,427**	**0.69%**



This report is comprised from 313 roads.

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