THE RAILROAD WEEK IN REVIEW
AUGUST 22, 2008

"It's tough to make predictions, especially about the future." – Yogi Berra

Every year about this time I like to remind my faithful readers what *Week in Review* is all about. This note first appeared in October 2005 and it stays in my weekly New Material file to help keep the focus. *Week in Review* is written mainly for short line owners and operators, railroad customers in what I call the merchandise carload commodities – essentially everything but intermodal and coal – and their Class I counterparts. Though *Week in Review* touches on the investment aspects of railroading to show what's driving the Class Is, this is not an investment letter.

Accordingly, you may expect four things from WIR going forward. First, we will continue to emphasize what works best for the shortline-Class I-customer relationship. It is increasingly clear that the most valuable shortline relationships are the ones that maximize the efficient use of the assets of both. We will push that idea.

Second, the Class Is are paying close attention to customer supply chains because the fortunes of the railroads and their customers are inextricably linked. WIR will thus increase coverage of supply chain trends in the usual merch groups from chems to forest products to aggregates and agriculture.

Third, I am continually struck by the short lines' heavy emphasis on government regulation and the mechanics of running trains almost to the exclusion of the care and feeding of customers. With no customers you've got no reason to play trains. WIR will follow the money and talk ops only when it means making more money.

Fourth, WIR's quarterly earnings reports will focus more on cause and effect in the carload business and less on what's happening bellow the line. I'm a firm believer that yoy revenue changes tell one more about a company than earnings per share ever will. Moreover, seeing what the Class Is are getting for each merch carload (price plus fuel surcharge), helps short lines and their customers establish a range of prices by commodity O-D pars in their own negotiations.

One last thing: the economy. Here again the stock market is useful because stock performance reflects people's bets on where companies are headed. To be sure, one can create a Watch List from various companies representing their sectors, say ADM for agriculture, BTU for coal, GM for auto, etc. Alternatively, one can track exchange-traded funds (ETFs), baskets of companies grouped by sector – industrials, consumer staples, financials, energy, etc. My preference is the X-series of "Standard & Poors Depositary [sic] Receipts" or SPDRs where XLI is industrial (MMM, BA, UNP, GE, etc.) and so on through nine separate funds.

Year-to-date every single one of the nine is down, some in double-digits; no surprises there. However, the ones that are down the least matter most to railroads – materials (XLB), energy (XLE) and consumer staples (XLP). *Week in Review* tracks these ETFs so railroad readers can see which sectors are leading and lagging and direct their business development activities accordingly.

For example, your Fallen Flag & Eastern has a chicken feed plant and an rock quarry. Run a three-month chart comparing the XLP and XLB. You will see the former is up a tad while the latter is down 15%. Now check your yoy comps for carloads to these customers. Are there fits or anomalies? If the latter, perhaps a customer visit is in order to stay ahead of the curve. WIR can help.

Short line carloads for Week 31 ending Aug 2 actually increased 3.2% yoy with double-digit gains in grain, ores, and waste materials (see RMI RailConnect Index, attached). Intermodal was down 16.4% but since those 14,000 platforms are limited to a handful of port carriers, I don't consider what's happening there as indicative of the larger short line community. Similarly, ores are less than 3% of short line loadings, so even though it's is up big, it is not a big player in the larger scene.

Carloads and commodities YTD provide a much clearer picture of the health of the short line industry. The volume leaders ex-coal and intermodal are chemicals, grain, metals and aggregates. All but aggregates are in the positive YTD column. Moreover, the three leaders were all in the positive column when the Class Is reported 2Q earnings two weeks ago. Moreover, all four US Class Is averaged double-digit RPU increases for over the first six months (the Canadian roads hardly budged). We also know fuel surcharges played a major role and would suggest that handling lines ask their Class I "partners" about sharing in some of this increase.

Norfolk Southern got some good ink from Seekingalpha.com in the context of second quarter results exceeding expectations, and everybody knows earnings "surprises" are good for stock price momentum. "Rail shippers continue to be in favor as many companies have struggled with the higher costs associated with traditional trucking. This dynamic was evident when Norfolk reported strong second-quarter results on July 22. Revenue was up 16% from last year to $2.77 billion. Income totaled $453 million, a 15% increase from last year, producing earnings of $1.18 per share, ahead of analyst expectations of $1.05 per share.

"Norfolk noted that its costs were up 16% in the quarter due to higher energy prices. But the company's strong pricing power enabled it to pass these expenses on to its customers. [Revenue unit] volumes were down marginally, by about 2%, but Norfolk did experience strong demand from a number of sectors, including the coal, agriculture and metals markets." NS short lines take note.

"This is the fourth time in the last four quarters that the company has surprised and beaten analyst estimates, having done so by an average of 7 cents, or 6.64%. In this economic environment it is a testament to the company's ability to drive its growth and produce gains. Analyst estimates have been creeping higher for the last 3 months. The current-year estimate now stands at $4.31 per share, up from $4.04 per share 30 days ago and $4.28 per share just 7 days ago. The next-year estimate is projecting 14% earnings growth, with the consensus estimate pegged at $4.91 per share." Remember the trader's adage: "The trend is your friend."

Ed Wolfe, as most of you know by now, has opened his own shop and continues to build the transportation brand he developed at Bear Stearns. He publishes a monthly summary of activity that provides a good look at trends for carriers and customers alike. Excerpts:

"RAIL VOLUMES IMPROVE TO BEGIN 3Q. Total rail vols are tracking down only 0.1% y/y through the first 3 weeks of 3Q, improved from -2.4% in 2Q and -2.3% in C07. Comps are getting easier and the rails are making up some lost vols from the Midwest floods. Export/commodity demand remains solid, offset by weak auto, lumber and intermodal import trends.

"GRADUAL SIGNS OF INCREASING TRUCK BUILDS, ORDERS AND TRUCK BANKRUPTCIES**.** June over-the-road Class 8 Truck builds and orders were up 25% and 50% y/y off a small base. Meanwhile, our preliminary Truck Bankruptcy index declined modestly in June, holding steady around 100. TL capacity seems more in balance than in some time, while LTL capacity remains more robust.

“WEST COAST PORT VOLS AND GLOBAL OCEAN PRICING TURN DOWN IN JUNE**.** West Coast port vols decelerated materially in June, down 5.3% y/y vs. +1.8% and +1.2% in May and April. Imports took another step down and export growth decelerated from high to low double digit growth. Clarksons’ Ocean Pricing Index declined 3.4% y/y in June, its first y/y decline since Jul 07.

“SIGNS THAT JULY FREIGHT IS SLOWER. While rail vols have been less worse to begin July (likely some make-up vols from Midwest floods), several trucking companies noted during their 2Q:08 earnings calls that July has been seasonally slower. Expectations for peak season from ocean and rail carriers remains muted and global freight vols have began to slow in June.” Let me know how you can use this and I’ll forward your remarks to Ed.

Providence & Worcester’s second quarter results are encouraging on one level and business as usual on another level. They had a nice 17% bump in freight revenues, to $7.8 mm. Merch carloads increased 17% to more than 10,000 units and RPU was up 6%, in line with what the Class Is have posted. Ethanol, automotive, steel and imported coal drove the increases – new commodity lanes begun in 2H07, chiefly out of Providence and Davisville. P&W held the ops expense delta to 13%, nearly quadrupling ops income to $292,000. (The 10-Q says ops income was $320,000 because P&W puts real estate and property sales above the line whereas everybody else puts ‘em below.)

The operating ratio remains stubbornly in the high 90s and I blame payroll at 55% of sales, some 25 points above what we see in roads of similar size – the “business as usual” cited above. Fuel expense doubled, but then MOE and T&S dropped 33% and 55% respectively, consequently capitalized cost recoveries were cut in half. Still, P&W did manage to take the OR down 2.5 points in the bargain. Last and least, the intermodal business took hits of 49% in units and 46% in sales which P&W blames on more all-water boxes. Maybe so, but replacing $63 boxes with $740 carloads is good.

The meetings season kicks off in NYC Sep 10-11 with the Dahlman Rose First Annual Transportation at the Sofitel on 44th just west of Fifth. Presented in association with *Railway Age*, Day One is dedicated to ocean transporters with Chairmen and CFOs from such names as Britannia Bulk PLC, Excel Maritime Carriers and Seaspan. The railroaders hold forth on Day Two with CFOs from all the Class Is (CP alone took a bye) plus GWR President Jack Hellman.

Since this will be the first public outing for the Class Is *en masse* since the second quarter conference calls, the economy and capacity will doubtless take center stage. Keynote speaker Jeff Shane, former USDOT Undersecretary for Policy, will open Thursday’s proceedings with some observations on the infrastructure needs and what’s being done to meet them. The recent drop in the price of crude is bound to bear on the rail CFOs’ remarks, especially since it’s below the planning number they were using just two months ago.

For further information and to register, go to www.railwayage.com/conference1.html and click Register On-Line in the top left corner. Looking forward to seeing you then. (There’s a great little French restaurant I’ve been going to for forty years at 51st and Eighth. Do I have any takers?)

There will be no Week in Review for August 29. Enjoy the long weekend.

RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 8/2/2008

Week Number: 31

Carloads Handled	Current Week			Year-To-Date		
	2008	2007	% Change	2008	2007	% Change
Coal	15,922	15,525	2.56%	465,561	446,998	4.15%
Grain	16,304	14,687	11.01%	450,147	421,863	6.70%
Farm & Food (Exc. Grain)	5,181	4,868	6.43%	163,078	150,355	8.46%
Ores	2,963	2,500	18.52%	95,048	80,462	18.13%
Stone, Clay, Aggregates	12,942	13,365	-3.16%	342,272	342,553	-0.08%
Lumber & Forest products	5,363	5,727	-6.36%	155,614	192,223	-19.05%
Paper products	7,989	8,192	-2.48%	240,857	260,872	-7.67%
Waste & Scrap materials	7,278	5,883	23.71%	206,640	195,170	5.88%
Chemicals	17,614	16,538	6.51%	535,457	519,961	2.98%
Petroleum & Coke	5,649	5,676	-0.48%	185,997	172,681	7.71%
Metals & Products	12,580	10,712	17.44%	372,528	346,425	7.53%
Motor vehicles & equip.	2,034	1,805	12.69%	62,503	59,764	4.58%
Intermodal	12,039	14,406	-16.43%	393,827	457,049	-13.83%
All Other	3,175	3,197	-0.69%	93,608	97,612	-4.10%
Total	**127,033**	**123,081**	**3.21%**	**3,763,137**	**3,743,988**	**0.51%**