The Railroad Week in Review
September 12, 2008

"Grow, succeed, innovate - and do it faster than the guys down the street." – From Core Value, Apache Corp.

Liz Ann Sounders, Chief Investment Strategist at Charles Schwab & Company, is to my mind one of the sharper commentators on the economic scene. In a recent Schwab client webcast Liz Ann said she does not see the economy getting better any time soon and that a large portion of the recent spike in home sales was in reality builders unloading condos built on spec. The July Producer Price Index spiked to 9.7%, the largest gain in twenty-seven years, even as commodity prices continue their southerly drift. [Anybody looked at steel producer stock prices latterly?] And lending standards are "getting strict," which is going to impact short lines and their ability to tap OPM (Other People's Money) for rehab grants.

Making matters worse, the Secretary of transportation said fuel tax receipts were so far down the Highway Trust Fund would need a congressional bailout or it would be out of cash "in the next few weeks." It says here that DOT Secretary Mary Peters had opposed such a bailout in the past but on reconsidering said, "States should not have to bear the burden of Congressional overspending." Moreover, the American Road and Transportation Builders Association said that FY 2009 federal highway subsidies to the states would drop 31% to $24 billion from this year's $35 billion.

Accordingly, The House passed the measure on a 376-29 vote Thursday, a day after the Senate overcame objections from conservative senators and passed it on a voice vote. The legislation transfers $8 billion from the Treasury's general fund to the highway fund, ensuring that ongoing construction projects won't be interrupted. With nearly 400,000 jobs at stake, or so says the ARTBA, the Members didn't really have a choice, The Associated Press notes that the current highway program is larded with some 6,300 earmarks — lawmakers' pet projects — worth some $24 billion still on the books.

Canadian National's request that the STB expedite its request that the Board "expedite action" on its bid for the J was denied. The Board said no because, according to the *Railway Age Newswire*, "any accelerated decision-making would violate its environmental review process." In its request CN had cited he Board's giving its blessing to the CP's acquisition of the DM&E without the usual environmental threshold determinations.

In its decision the Board holds that "the DM&E had not yet decided to actually build the line into the PRB, so there was no time table for construction of the line, and the information needed to prepare an EIS or EA related to new traffic from the PRB — such as likely shippers, routings for PRB coal, destinations and frequencies — did not exist. Therefore, it was reasonable in both cases for the Board to defer consideration of the impact of moving PRB coal over the newly combined lines until the construction of the new line became probable and to attach a condition to preserve the environmental *status quo* in the meantime with respect to the movement of PRB coal.

"Here, by contrast, there is nothing speculative or remote about the traffic increases that are projected with this transaction. CN has provided detailed information on the frequencies and the routings of the increased EJ&E traffic. Moreover, CN seeks to take control of EJ&E for the very purpose of integrating the EJ&E into CN's system and rerouting significant amounts of rail traffic over the EJ&E's lines. Approval of the application is a condition precedent to implementation of CN's

Operating Plan. They are two links in the same chain that must be studied together under 40 CFR 1502.4."

The plot now thickens as Congress considers an Oberstar-sponsored measure requiring the STB to reject a merger if any adverse impacts on safety and on affected communities are found to outweigh transportation benefits, and to make the bill retroactive to cover the J. CN President Hunter Harrison said in his House Transportation Committee testimony that the bill could kill the deal entirely. I wouldn't blame him at all if he were to take the transaction off the table.

Ownership of the J would provide direct connections between the north and south segments of CN, linking the former Wisconsin Central and Illinois Central and helping justify the proposed intermodal terminal at Memphis. By killing the deal, Congress and the STB force the CN to find another way to link up its system, and two bits says it won't be via Chicago. Care to guess the job loss?

Rail traffic for Week 35 ending August 30 was another downer, if only slightly. Total revenue units were off seven-tenths of one percent year-over-year, making it three down weeks in a row. Intermodal was down a bit, forest products down a lot and auto even more (mainly finished vehicles as the parts segment is essentially toast). Coal jumped five percent, metals went up ten percent and chemicals was up a point.

Looking at the individual Class Is, we see BNSF essentially unchanged as coal and agricultural products gains offset intermodal losses. UP dropped six percent as losses in agriculture and intermodal overwhelmed gains in coal, chemicals and metals, again all shortline favorites. In the east CSX loads decreased four percent and NS lost three percent. The former's losers were intermodal and coal while a surge in chemicals shipments was insufficient to move the needle into positive territory. At NS, intermodal, automotive and chemicals were off; strength in metals and coal wasn't enough to make the week positive for Norfolk.

It wasn't much better for CN and CP, either. CN revenue units came down two-tenths of one percent while CP was off one-point-two percent. Chemicals, agriculture and forest products were CN's downers with intermodal and metals nearly offsetting the losses. CP unit counts were down a point driven by -- you guessed it -- intermodal and agriculture; coal was up lots (is Elk River finally behaving?) and chemicals up a crumb.

Shortline Week 35 car counts from RMI's RailConnect Index showed strength in metals, petroleum/coke, ores and both food STCCs, 01 and 20. Year-to-date short line revenue units are off only half a point: paper and lumber/panels continue to be major drags while waste and scrap is up twenty-two percent over last year. Intermodal is down twenty-five percent, a big number, and though it's ten percent of total revenue units, the segment is concentrated on a few port roads like Anacostia's Pacific Harbor Line and the Georgia port roads.

A source close to the short line picture nationally tells me the larger operations are generally better off than the mom-and-pops for two reasons. One, the larger road has a more diverse commodity mix, and is big enough that if, say , STCC 24% is off 10%, there are still enough lumber and panel loads to sustain the railroad. Two, my contact thinks the aggressive marketers who know what it costs them to do business are faring quite well, thank you, in spite of the soft economy.

Knowing your own costs and margins is essential in grantsmanship, as well. Two eastern Genesee & Wyoming properties garnered more than a million dollars in FRA grants for ties, new rail connections, and new rail. The Buffalo & Pittsburgh, operating in New York and Pennsylvania gets $100,000 to replace approximately 1,625 ties along a 25-mile segment of track between Cloe and

Creekside, Pa. These funds will supplement a larger ongoing rehabilitation project to upgrade the line that will permit trains that deliver coal to the Edison Mission Homer City Power Plant to operate at higher speeds. The railroad is providing $25,000 in matching funds.

And in New England the St. Lawrence & Atlantic is receiving a $924,510 grant to supplement an ongoing project to upgrade about 18 miles of track between North Stratford and Norton, Vt. The grant funds will be used to install approximately three miles of continuous welded rail. The railroad is providing $231,128 in matching funds. So, including matching funds, these two G&W properties will be able to add about $1.25 mm in capacity improvements that will permit faster track speeds and will save on fuel, loco and crew hours.

Washington State DOT picked up $882,000 in grant money for rail improvements at the Big Pasco Industrial Center. This intermodal facility is owned by the Port of Pasco and is located along the Columbia River in southeastern Washington. The grant funds will be used to construct a new track connection with BNSF Railway, a new grade crossing, and adding one and a half miles of new track within the industrial center to be used for switching operations.

In California, Richmond Terminal's John Cockle writes, "Unlike Oakland and other container-based ports where volumes are off, the cheaper dollar and foreign appetites for commodities has pushed our business up dramatically. Driven primarily by significant increases in export petroleum coke, scrap steel, and DDG's we are on pace to break 2007's carload record as May, June, and July proved to be consecutive record-breaking months for revenue units. August has slacked off some, but we are still doing well. This is a good time to be in the West Coast bulk trades."

I've been a fan of Cockle's for years and he runs a sharp little railroad. With only eleven miles of track, he is able to generate some truly remarkable traffic density in terms of carloads per mile, locomotive hours, crew-starts and fuel burn. The key, of course is business concentration, and, as his website (www.levingterminal.com) puts it, "Levin-Richmond Terminal Corporation (LRTC) is a dry bulk marine terminal located 10 miles East of the Golden Gate Bridge and is significantly closer to major markets of the Pacific Rim than other ports." Check it out and see why he gets high marks.

Kathryn McQuade moves to CFO from Chief Operating Officer at Canadian Pacific, replacing Mike Lambert. Brock Winter, off on TDY for a productivity and efficiency study, steps back in as SVP Operations. As CFO, McQuade will assume responsibility for the comptroller and treasury functions, investor relations, internal audit, and corporate planning. She will also retain responsibility for Business Information Services and Strategic Sourcing Group.

"Kathryn's extensive finance skills and experience, deep knowledge of the North American railway system, and recent experience with CP's operations, are a wonderful combination for CP," said CP President and CEO Fred Green. I'll have to second that. What she bought to CP from her years at NS, added to her year-plus actually running the railroad, strengthens the team considerably.

RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 8/30/2008

Week Number: 35

Carloads Handled	Current Week			Year-To-Date		
	2008	2007	% Change	2008	2007	% Change
Coal	17,208	16,775	2.58%	532,818	512,986	3.87%
Grain	16,477	16,692	-1.29%	517,027	484,982	6.61%
Farm & Food (Exc. Grain)	5,537	5,357	3.36%	184,678	171,113	7.93%
Ores	2,928	3,231	-9.38%	107,844	91,763	17.52%
Stone, Clay, Aggregates	12,501	12,737	-1.85%	392,534	393,715	-0.30%
Lumber & Forest products	5,604	6,129	-8.57%	177,707	216,254	-17.82%
Paper products	7,819	8,736	-10.50%	272,171	294,612	-7.62%
Waste & Scrap materials	7,769	6,348	22.39%	235,324	218,841	7.53%
Chemicals	17,935	17,246	4.00%	606,265	587,899	3.12%
Petroleum & Coke	6,081	5,550	9.57%	209,502	193,545	8.24%
Metals & Products	13,236	11,377	16.34%	415,036	381,307	8.85%
Motor vehicles & equip.	1,834	1,943	-5.61%	69,393	67,641	2.59%
Intermodal	11,794	15,677	-24.77%	441,603	516,312	-14.47%
All Other	3,576	3,122	14.54%	107,154	110,179	-2.75%
Total	**130,299**	**130,920**	**-0.47%**	**4,269,056**	**4,241,149**	**0.66%**