THE RAILROAD WEEK IN REVIEW
OCTOBER 10, 2008

"We're at an emotional point where chart points can be breached by breathing on them." Phil Roth, chief technical analyst at Miller Tabak, in Art Cashin's October 8 UBS letter.

It's been another turbulent week on Wall Street with share prices for the rails and their suppliers are pretty much in the toilet insofar as technical indicators go. Among carriers, BNSF is the only Market Edge "long" though it's slipping toward "neutral" or "avoid." Norfolk Southern and Union show "mild improvement." As for the rest, the tech advice is to sell the shares if long but don't short.

As for the fundamentals, all the carriers and suppliers from American Railcar (ARII) to Wabtec (WAB) are selling at fifty to seventy-five percent of intrinsic value. But I'm no bottom fisher and firmly believe the trend is my friend. So if I can pick up a company that's selling at half its intrinsic value *and* where the price is moving upwards I might give it a look. That ain't happening. I shall for one remain on the sidelines until it does.

Taking the wider view, MarketEdge says, "Despite the Fed's new effort to inject confidence in the credit market by purchasing commercial paper, a bleak economic picture for the next several quarters painted by Mr. Bernanke in his speech this week only sent investors to the exits. All market internals were once again ugly as the market got more oversold." Best idea is to turn off the intraday charts and look for the two signs of a potential turn: Lows have to hold and closes have to be higher on higher volumes.

Art Cashin's Tuesday take was that "Monday's internals showed many extremes usually found on capitulation days. New lows crushed new highs. Declines overwhelmed advances. There were scores of other extremes. The oddest part of trading, however, was that we had the same kind of extremes yesterday. Nearly sixty percent of stocks listed on the NYSE made new fifty-two week lows. That's outright incredible."

Charles Schwab Chief Investment Strategist Liz Ann Sonders said in a webcast this week that since the end of World War Two the market has anticipated recessions by starting a decline from highs about seven months before a recession is "officially" declared. The peak-to-trough decline averaged twenty-five percent and trough-to-recession end saw average run-ups of twenty-four percent, with the median recession duration about ten months. Odds are this one will be longer and deeper thanks to the global aspects and a "lack of confidence" in the banking community. Cheers.

More bad news from the states. Year-to-date sales tax revenues in California are down five percent, the state faces a fifteen-billion dollar budget shortfall for the current fiscal year, and it's cutting aid to municipalities. New Jersey's cash will fall short of budget by about a billion-point-seven dollars. Across the Hudson, Wall Street contributes about twenty percent of all New York State tax revenues yet bonuses are off forty-five percent and capital gains taxes are down thirty-five percent causing a one-point-two billion dollar budget deficit. Continue east to Connecticut and the budgeteers in Hartford saw the budget hole double in just one month to more than three hundred million dollars.

But I've not said all. Diesel fuel has dropped below the magic four-dollar threshold, a point where Pan Am Rail's Mike Bostwick says owner-operators start to park their vehicles. Oil has dropped below ninety dollars a barrel and oil demand over the past month is eight-point-six percent below where it was a year ago.

In his *RailTrends* presentation last week, UBS rail analyst Rick Paterson said that oil between eighty and a hundred bucks a barrel favors trucks, north of a hundred and a quarter rail gets the nod and in the middle it's a toss-up. Now put that in the context of consumer spending, which the credit card companies predict will drop by ten percent. Shoppers pulling back means smaller inventories and smaller shipments from vendors to stores. That favors truck.

On the other hand, as we've noted before in these pages, shippers are looking to cut transportation costs above all, and that can mean railroad carloads to distribution centers and local truckload beyond. BNSF among all class I rails is the strongest supporter of this notion and is, most important, the most out-spoken advocate for putting its "Premier" distribution centers on short lines. The combination of shortline distribution centers and local owner-operators firing up their rigs again bodes well for all.

Week 38 rail traffic dropped another eight percent with a small up tick in metals and coal (both up one percent) doing little to offset the double-digit losses in chemicals, agriculture, autos and building materials (yawn). Paper and forest dipped another eight percent and intermodal dropped six percent. Shortlines (attached) got hammered to the tune of down nearly fourteen percent as a result of double-digit losses in (top to bottom on the chart) coal, grain, aggregates, paper, petroleum and coke and intermodal.

Regarding this last, I asked RMI's Paul Pascutti how they counted intermodal and who's handling it. He says the RailConnect load-count is a mix of trailers and platforms, depending on how the short line reports. The short line switching ports make up eighty percent of the revenue units, and, no, Florida East Coast is not in the RailConnect Index even though it's part of RailAmerica. Intermodal is ten percent of the RailConnect Index year-to-date car count so to have it down to seventy-five percent of last year's count through September 20 is not a good sign.

There may be a glimmer of hope, however. Rail stock prices turned positive Thursday afternoon even after the DJIA had briefly dipped below 9100 earlier in the day. As you know, transports are considered a leading indicator of the health of the economy. Might this brief up tick be a foretaste of the feast to come?

This credit crunch can hobble the best intentions. A New Jersey accountant and tax advisor who specializes in small businesses tells me that his clients who have long-established credit lines with their banks have little to fear. Even where there are balloon rates in place they are being renegotiated favorably. He says "The larger credit question is how tighter credit will hit my clients' customers. If they start running payables out beyond sixty days or so it could affect cash flow."

On the other hand, says the accountant, start-ups are finding it difficult sourcing initial funding. Unless they have their own bank rolls – or a cash stash with rich relatives – banks are taking a gimlet eye at loan requests. In a similar vein, an accountant who knows the short line business intimately tells me he sees three threats. The first is where a short line borrows money to buy track materials for a grant-funded rehab program and the grant money gets pulled after the fact. (See New York, above, for one example of where this could happen.)

The second threat is a function of Class I cash flow. What happens if a big Class I customer is slow in paying its freight bills and there's an allowance-based short line in the route? Will they get paid on time? The third and potentially most damaging event is where the ISS short line's customers stretch out payments beyond the settlement date, meaning the paying short line has to settle out of cash flow.

I've started asking around to see what shoes fit where and initial short line responses have been cautious but encouraging. An operator of several Midwest short lines writes, "We are not having any bank issues currently as we have a strong bank group with which we enjoy a long-term relationship. Early this year we were able to realign our credit agreement to get us through this slowing economy."

This mirrors what I've heard from both coasts as well. Moreover, the common thread among all respondents is a broad-based commodity mix and stellar relationships with their connecting Class I railroads. In fact, the only caveat comes from a long-term shortline practitioner who writes, "I strongly suspect that some of the more aggressive holding companies with tiered debt structures may encounter servicing pressure and a much less receptive market for refinancing." He goes on to name names and they're all among the usual suspects. I intend to ask suppliers I see at the upcoming Eastern Region ASLRRA meeting what they see as well. Tax credits good; grants dropping bad?

To end this screed on a happy note, just this week I've heard from a number of shortline operators who are looking for tuck-ins from extant short lines to contract-switching opportunities. One, Ed Ellis' Iowa Pacific group, has closed five such deals year-to-date, most recently a new venture in the United Kingdom, British American Railway Services, Ltd. The entity has assumed control of RMS Locotec, the Dartmoor Railway, and the Weardale Railway.

Locotec offers contract-shunting (switching to us Yanks) services plus track and equipment repair. Dartmoor Railway operates a seventeen-mile freight and passenger line in the South-West of England, serving Okehampton and Meldon Quarry. Weardale Railway owns an eighteen-mile line in County Durham between Bishop Auckland and Eastgate, with heritage passenger services presently operating between Wolsingham and Stanhope.

This is a nice addition to the six railroads Iowa Pacific has in the United States that handle some thirty-five thousand revenue units a year on seven hundred route-miles of track and generating revenues in excess of forty million dollars a year. Moreover, and germane to the present theme, Ellis tells me they completed a refinancing in August. Which tells me his "agriculture and extraction" rule is alive and well at Iowa Pacific. Nice work, Ed.

Class I tidbits: Union Pacific and CSX have begun a new fifty-five car weekly perishables train from Delano (thirty-five miles north of Bakersfield) to Schenectady over Chicago in a truck-competitive hundred and twenty-eight hours…Morgan Stanley's William Green writes that the market is "under-estimating the resiliency of rail stocks" and that he sees up/down ratios from fifteen percent up and two down to fifty-five percent up against fifteen percent down… Wolfe Research upgrades Kansas City Southern to Outperform: "This is a terrific growth story that we have wanted to more aggressively recommend for years, but have chased upwards into consistent relatively lofty valuations. However, we believe that [the] eighteen-percent pullback provides a very attractive entry point."

The* Railroad Week in Review*, a compendium of railroad industry news, analysis and comment, is sent as a PDF via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 mm annual revenues $150. Corporate subscriptions $550 per year. To subscribe click on the* Week in Review *tab at www.rblanchard.com. A publication of the Blanchard Company, © 2008. Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned in WIR. Specifics available on e-mail request.

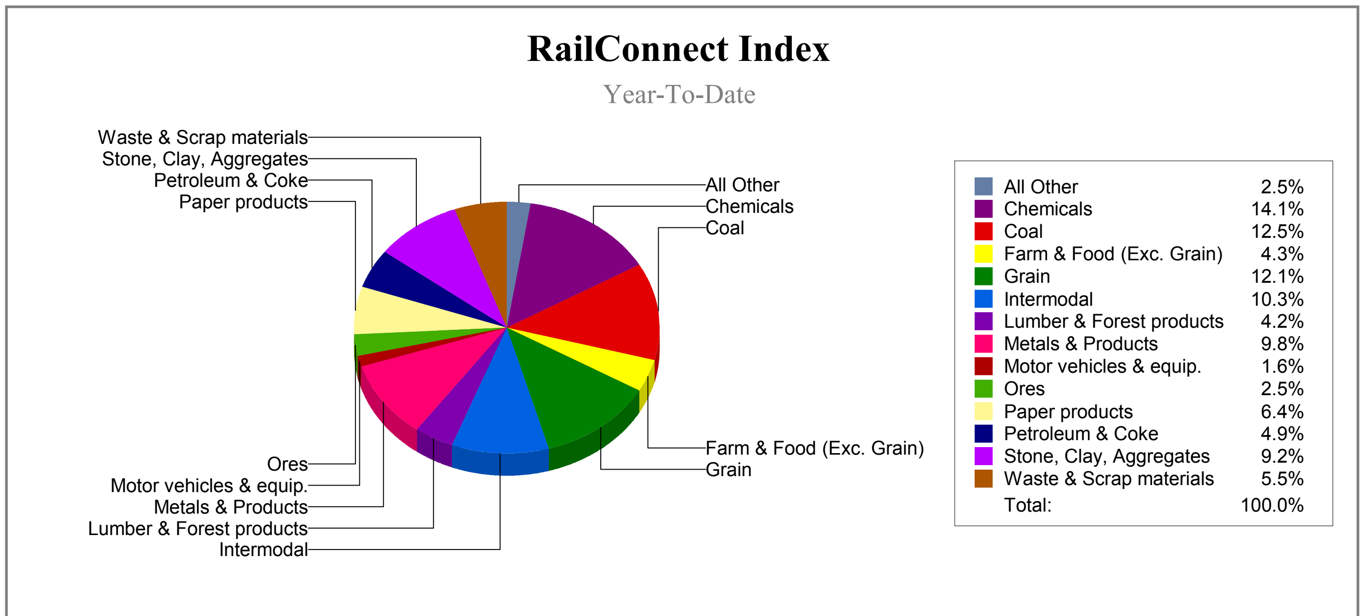
RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 9/20/2008

Week Number: 38

Carloads Handled	Current Week			Year-To-Date		
	2008	2007	% Change	2008	2007	% Change
Coal	14,519	16,748	-13.31%	578,241	563,570	2.60%
Grain	13,714	16,825	-18.49%	561,186	533,227	5.24%
Farm & Food (Exc. Grain)	5,180	5,593	-7.38%	199,814	187,228	6.72%
Ores	2,639	2,803	-5.85%	116,698	100,236	16.42%
Stone, Clay, Aggregates	11,096	12,566	-11.70%	426,230	430,491	-0.99%
Lumber & Forest products	5,397	5,794	-6.85%	193,388	232,979	-16.99%
Paper products	7,127	7,938	-10.22%	294,676	318,453	-7.47%
Waste & Scrap materials	6,820	7,272	-6.22%	255,320	239,060	6.80%
Chemicals	14,576	17,598	-17.17%	653,415	639,081	2.24%
Petroleum & Coke	4,834	5,643	-14.34%	226,177	212,194	6.59%
Metals & Products	10,810	11,435	-5.47%	455,502	418,700	8.79%
Motor vehicles & equip.	2,142	2,219	-3.47%	74,691	73,647	1.42%
Intermodal	12,207	16,462	-25.85%	477,720	563,018	-15.15%
All Other	3,143	3,205	-1.93%	116,808	119,534	-2.28%
Total	**114,204**	**132,101**	**-13.55%**	**4,629,866**	**4,631,418**	**-0.03%**



This report is comprised from 337 roads.

10/2/2008 9:51:08AM