THE RAILROAD WEEK IN REVIEW,
MAY 8, 2009

"We have a million and a half too many houses." – Warren Buffet, CNBC March 9, 2008

"**For a while we were building** a million and three-quarters or something like that and household formation was a million three, and two-thirds of the people that form houses want to live in their own house so maybe you had demand for a million, and guess what happened? We had too many houses. Now we've got the housing construction down to 500,000 new permits or something like that. We're using up the million and a half units. But we have to work our way out of it."

"And we have to work our way out of the car situation. We have 250 million cars and light trucks on the road. Year after year we produce maybe 15 million or something like that because there's a lifetime to the 250 million, sort of a normal cycle. But we got down last month, you know, a little over nine million… If they modify the business model to adapt to the reality of a [making] 13 million cars a year and have a business model that works with that [number it] would get them through this. We are going to sell 13, 14, 15 million units a year sometime in the future."

That's what's happening in the housing and auto industries according to Warren's World. Rail traffic numbers continue to support that thesis: too many houses and too many cars. Just this week Credit Suisse rail analyst Chris Ceraso wrote in a client note, "Railroad volumes declined 20.4percent last week – coming in slightly better than the prior week's 21.9percent shortfall.

"There is little to be excited about as Week 16 represented the third consecutive week where volumes were down more than 20 percent year-over-year. In our view, this confirms that the industry has experienced yet another leg down in carloads. The average year-over-year carload decline so far in the second quarter is 22.1 percent, versus the 16.4 percent decline posted in the first quarter."

Short lines are in very much the same boat (see RMI RailConnect for Week 16, attached). Year-over-year data show Lumber & Forest products down 31.83 percent for the week vs. 30.40 percent in Week 15. The Stone, Clay & Aggregates group was down 30.47 percent from Week 16 in 2008 vs. down 28.55 percent in week 15 year-over-year.

Though the automotive group represents but one percent of short line revenue units, Chemicals (mostly plastics) and metals are good proxies for how the ills of the auto industry can affect short lines. Chemical loadings in Week 16 were down 18.94 percent year-over year while Week 15 results were down 14.28 percent, a four-point drop over seven days. Metals loadings were off 55.16 percent for Week 16 year-over-year while Week 15 loadings were down 52.73 percent year-over-year. Total short line revenue units for Week 16 were off 33.70 percent year-over-year; week 15 was off 32.46 percent vs. the same period in 2008 so there is a definite worsening trend.

Ceraso has also created a "service score" that is an amalgam of changes in average velocity, yard dwell and cars on line. For the 2009 second quarter through April Ceraso ranks CN Number One. He writes, "Canadian National has led its peer group in terms of its QTD service score for the better part of 2009. For the first three weeks of the second quarter, CN has generated a service score of +15.4. Indeed, the Canadian Class I has seen a 19.2 percent rise in train speed, a 7.2 percent improvement in terminal dwell and a 19.9 percent drop in cars on line."

From here down, second place went to BNSF with UP third, and so on followed by NS, CP and CSX in order. What we see in this Credit Suisse note is pretty much what we'd expect from the recent spate of earnings calls. It's also a clear indication for short lines connecting with these roads as to where things are working and where there is room for improvement.

Clearly, we're still far from being out of the woods, though UBS rail analyst Rick Paterson sees the beginnings of a recovery in the second half of this year. "Following a somewhat more than expected 6.1 percent annualized decline in real GDP in the first quarter of 2009, we still foresee a less negative minus two percent pace in the second quarter before a return to positive annualized growth of two percent in the third quarter, two and a half percent in the fourth and 2.2 percent in calendar 2010.

"The weaker than anticipated start of the year reduces our 2009 calendar average real GDP forecast by 40 basis points to minus 2.6 percent, but the financial markets will be more focused on quarterly sequential growth. Improved manufacturing and consumer confidence indexes in April are encouraging."

And Scotia Capital rail gooroo Cherilyn Radbourne writes, "We held our Transportation & Infrastructure conference earlier this week, and the general message from our speakers seemed to be that business conditions have stabilized, but are showing few signs of improvement. Most companies have adjusted their cost structures to match current activity levels." Kinda supports what Rick is saying about 2Q being a bit of a turnaround.

On the other hand, there's the unemployment factor that could dampen or slow down any recovery. Art Cashin, UBS director of NYSE floor operations and a regular CNBC commentator, cites a rather pithy recent commentary by Jim Welsh of Welsh Money Management. "The economy needs to create 125,000 jobs each month, just to absorb the number of new entrants into the labor market. If job growth were to average 325,000 per month in coming years, it would still take four years to replace all the jobs lost in this recession.

"With so much excess labor capacity, wage growth will be weak for the next few years, which will make it harder for consumers to increase savings and spending. The combination of less credit availability, weaker business investment and consumer spending will be headwinds whenever the economy emerges from this recession." Thus the operative question to short line owners is this: What will you do if your carload volumes remain unchanged for the next three years?

Think of the impact on your ability to qualify for RRIF loans to repair and replace what wears out and to hire new people to offset the inevitable attrition. And what abut the ten-percent rule? It's something I attribute to Charlie Marshall: You lose ten percent of your customer base every year and if you're not out there replenishing the losses you'll be out of business in ten years.

Long-time WIR reader and shortliner Brian Holtz has been paying attention to my screed about making more fixed costs variable. He writes, "Your comments about making railroads more variable cost hit a home run with me. I have felt for many years railroads needed to become a more variable-cost business as they spend a far greater percent of their income on fixed costs than any other business.

"When studying truck competition many years ago, it readily became apparent that trucks adapt much more quickly to changing conditions to find more profitable freight. Drivers and fuel make up most of their costs and equipment is depreciated over five to seven years. One trucking operation I am familiar with is currently running at a 74 percent variable cost rate.

"There is a big disadvantage in providing customers rail equipment over half way through its 30 year depreciation cycle. Most Short Lines have already outsourced expensive derailment/rerailment equipment and the related specialized work. Many also outsource customer siding construction and repair and should do so with some track/bridge rehabilitation and maintenance.

But I also know of one short line that leases a line and sends its own track crews to do the work. This causes lost time for driving, away from home meals, motels, delays for equipment repair and increased benefit costs for injuries and railroad retirement. They could outsource cheaper with better equipment and faster completion, saving derailment costs in the meantime. Replacing jointed rail with CWR requires much different equipment and skills best found by outsourcing and saves considerable future maintenance cost.

"Leasing locomotives and equipment can help as well as encouraging customers to own or lease their own equipment which forces customers to take a real interest in cycle times and steady shipment levels. Many locomotive and equipment repairs can be outsourced reducing management of these functions and can be cost justified by the difference between railroad retirement and social security costs. Electric braking should enable rail equipment to be built to withstand less strenuous abuse resulting in less expensive equipment with faster depreciation." Excellent points, all. Thanks.

Some "stimulus" money appears to be trickling down to short lines, at least in New Jersey. A grant of nearly a million smackers goes to the Southern Railroad of New Jersey to rehabilitate a portion of its 18-mile ex-PRSL Salem branch between Swedesboro and Salem (SPV "Northesast" book, page 19, top left corner). This poor line, originally put down with light rail, little ballast and little grading, exists mainly to serve a shrinking industrial base in and around Salem. The money will go to rehabilitate the twelve miles in Salem County to allow 25 mph vs. the current 5 mph. The grant money came as part of the fiscal year 2009 omnibus spending bill.

And for dessert: If you happen to be in Ogden today through Sunday, get thee to Union Station to gawp at the UP 844, the last steam loco built for the UP and delivered in 1944. A high-speed 4-8-4 passenger engine, it pulled such famous trains as the Overland Limited, Los Angeles Limited, Portland Rose and Challenger. When diesels took over all passenger train duties, No. 844 was placed in freight service in Nebraska between 1957 and 1959, much like my old friend the N&W 611 in eastern Virginia, 1957-1959. The 844 was saved from being scrapped in 1960 and held for special service. Unlike the N&W 611, the UP 844 never left the active roster.

Photos, a complete schedule, a link to GPS tracking of where the locomotive is operating (that is now connected to a Twitter page) or information about No. 844 are postetd at:
http://www.uprr.com/newsinfo/media_kit/steam/844/index.shtml

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RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 4/25/2009

Week Number: 16

Carloads Handled	Current Week 2009	Current Week 2008	Current Week % Change	Year-To-Date 2009	Year-To-Date 2008	Year-To-Date % Change
Coal	10,830	13,696	-20.93%	221,123	241,968	-8.61%
Grain	11,155	16,416	-32.05%	203,658	250,411	-18.67%
Farm & Food (Exc. Grain)	5,000	5,808	-13.91%	84,023	93,128	-9.78%
Ores	1,792	3,284	-45.43%	23,901	46,056	-48.10%
Stone, Clay, Aggregates	10,051	14,456	-30.47%	155,543	186,063	-16.40%
Lumber & Forest products	3,632	5,328	-31.83%	55,469	75,722	-26.75%
Paper products	5,532	7,874	-29.74%	95,028	124,438	-23.63%
Waste & Scrap materials	4,051	6,770	-40.16%	71,197	100,869	-29.42%
Chemicals	14,414	17,782	-18.94%	249,064	282,885	-11.96%
Petroleum & Coke	3,393	5,779	-41.29%	61,811	92,649	-33.28%
Metals & Products	5,437	12,125	-55.16%	97,466	176,923	-44.91%
Motor vehicles & equip.	1,001	2,347	-57.35%	15,624	30,770	-49.22%
Intermodal	5,915	11,422	-48.21%	107,952	215,253	-49.85%
All Other	1,593	3,302	-51.76%	24,896	48,277	-48.43%
Total	**83,796**	**126,389**	**-33.70%**	**1,466,755**	**1,965,412**	**-25.37%**