THE RAILROAD WEEK IN REVIEW

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"Shorter haul export volume through the Port of Baltimore increased 94 percent driven by Pennsylvania coals, offsetting a 14 percent decline in export coal to Lambert's Point." -- Don Seale, Chief Marketing Officer, Norfolk Southern

There's a definite upside to having most of the earnings calls all jammed together in one week: it lets one compare and contrast the results side by side. Some important themes emerge early on. Margins are expanding, incremental margins are out of sight, and -- even with the economy not in the best of health -- the 90 percent of folks still with jobs have to heat and eat and replace what they wear out. Perpend.

Across the board, revenues among the companies reporting to date increased by solid double-digits with revenue units increasing in the 9-18 percent range. Operating expenses increased more slowly, and in all cases at a lower rate than the revenue-unit increase. Consequently operating incomes rose by 20 percent or more, with UP taking the honors -- up 46 percent.

BNSF, on the other hand, has not yet released its third quarter 10-Q so we don't have revenue and expense data. What we *do* have is commodity carloads through October 3 for the quarter and year-to-date. Total units were up 13 percent, in line with what we see elsewhere. Merchandise carloads, where the BNSF short lines live, were up 15 percent, once again in line with the others. Within the merchandise group industrial products -- everything from aggregates to forest products and scrap -- increased 37 percent. We ought to get more color at the upcoming BNSF shortline meeting scheduled for Monday and Tuesday next week.

RailAmerica was a special case, showing how depending on the kindness of strangers can get you in trouble. Counting last year's 45G tax credit, year-over-year quarterly ops expense rose 18 percent, ops income increased a mere 11 percent and the operating ratio degraded to 77.8 from 76.8. Take out the $4.5 million tax credit and ops expense was up only 12 percent, ops income was up a whopping 35 percent and the OR came down three points to 77.8 from 80.9.

For the Class Is, intermodal was the star with solid double-digit gains in both units and revenue; coal was a bit of a laggard. Taking NS intermodal because they have the best breakout, we see domestic up 30 percent and "premium" up 23 percent, indicating there is a quality measure people will pay for. Moreover what I'm calling "domestic" -- what NS breaks out as "domestic" plus Triple Crown plus Premium -- now accounts for 64 percent of the total boxes.

There are two coal stories at work. First, tonnage. Through the third quarter of 2007, NS hauled 138 million tons of coal -- 78 percent utility, eight percent export, 10 percent domestic metallurgical, and four percent industrial. Through Q3 of this year, tonnage was down eight percent to 127 million tons of which utility coal was 70 percent. Export jumped six points to 14 percent, domestic met coal increased to 11 percent and industrial stayed the same at four percent.

The second coal story is year-over-year carloads. Comparing the current quarter with 2009's third quarter, loads are up 15 percent. However the mix has changed. Utility coal is up eight percent and accounts for 64 percent of the total, down from 72 percent. Export is up 11 percent and remains at 13 percent of the total. Domestic met coal is now 15 percent of the total, up from ten percent a year ago, and is up 73 percent in volume vs. a year ago. Industrial coal is flat at five percent of total loads with vols about where they were a year ago.

During the call, Chief Marketing Officer Don Seale added this tidbit, sure to gladden the hearts of the folks at Pennsylvania's Reading & Northern: "Shorter haul export volume through the Port of Baltimore increased 94 percent driven by Pennsylvania coals. The increase in Baltimore traffic effectively offset a 14 percent decline in export coal to Lambert's Point which was impacted by higher finished steel inventories in Europe." [For more on the R&N/Norfolk Southern anthracite story see my news item on page 12, October, 2010 *Trains* magazine. -- rhb]

There were two more significant threads running through the quarter's calls: major bites out of the operating ratio as -- among other things -- crew-starts never increased as fast as car-counts and incremental margins were running 50 percent or better with KCS hitting 62 percent. Everybody is hiring, too. Though Train & Engine crews are getting the biggest play, others are needed as well. RailAmerica's John Giles, for one, said on the call they've gone about as far as they can outsourcing trackwork, communication & signal and car repair; look for head-counts to rise maybe three percent in these crafts.

But before the hundreds of openings on the Class Is and regionals can make a dent in unemployment numbers, the unemployed have got to get serious about getting themselves employed. Everywhere I go it's the same thing: to get five or ten Certified Locomotive Engineers who will stick around, you have to look at 100 applicants. Drugs are the biggest problem. One chap said if he got 100 people in the door, the minute he said, "Drug test," half would leave and never return. Half of the remaining 50 would fail the drug test. A third of whoever was left would wash out in training, and half of that would quit in six months. See what you have to put up with to make $50-80,000 a year with benefits? (All agree the military provides the best candidates.)

Reading the press releases and financials will only get you so far if you're looking to divine the direction of your favorite Class I connection. Better you tune in on the calls. Take the CP call, for one. CEO Fred Green has long stressed the need for railroads to be supply chain partners as opposed to mere providers of empties on demand. How he responded to a Tek Coal question from Scott Group (Wolfe-Trahan) brings into sharp relief the reason one listens to the calls: the why's behind what's being reported. The new Tek coal agreement stands to add significantly to CP's coal franchise, so, in response to Scott's question about infrastructure and pricing, Green said, "We need to motivate and incent [sic] each other to make the supply chain more efficient."

That reinforces Green's earlier comment that Tek pricing will be a function of volumes: as long as the quantities shipped hold up, unit prices will go down; if volumes falter, pricing may be adjusted upward accordingly. Asked about CP's infrastructure additions in support of increased Tek business, Green said they're making a "gated set of investments" that will go with increased unit volume commitments, thus avoiding any huge front-loaded capex commitment on the come. You wouldn't know this if you didn't listen to the call, and the shortline takeaway is that CP

commits resources where the commercial partner is making similar commitments. There is no free lunch.

Keeth Creel, CN's Chief Operating officer on getting closer to the customer: "Our daily operating metrics are being rounded out with suite of customer centric metrics designed to assess performance from our customer's perspective. These measures include switching performance, car supply, traffic left behind and terminal-to-terminal transit times." This is a theme first broached by CEO Claude Mongeau at last May's CN shortline conference and more recently by CN's VP Marketing Dough MacDonald on my NEARS panel a few weeks ago. It's particularly applicable to short lines where it's mostly a first-mile, last-mile business. "Train time is any time" doesn't work any more.

The AAR's *Railroad Facts* booklet is chock full of industry data that -- once again -- can help the short line do some strategic thinking. I have before me the 2009 version and on page 33 is a very telling chart on train-mile trends. Go back to 1955 and see that the 476 million US train miles split about evenly between east and west. By 1960 the west has pulled ahead and the gap grows every year. By 2009 the west was running 65 percent of US train-miles.

It can be argued that the longer distances between nodes in the west leads to more train miles for a given tonnage. I'll give you that. Now look at tons originated (page 28). The east originated 63 percent of the tonnage in 1955 but only 43 percent by 2009. Moreover, originated tons in the east peaked in 2006 and have declined three percent since then.

Now shift your mind to Q3 year-to-date revenue units over five years and consider:

	BNSF	UP	West	NSC	CSX	East	All
3Q2010	6,801	6,578	13,379	5,055	4,693	9,748	23,127
3Q2005	7,443	7,123	14,566	5,803	5,532	11,335	25,901
Growth	-642	-545	-1,187	-748	-839	-1,587	-2,774
Pct Gain	-9.44%	-8.29%	-8.87%	-14.80%	-17.88%	-16.28%	-11.99%

As you can see, 90 percent is the new normal and the west is bearing up better than the east. Not to put to fine a point on it, the western roads serve mostly "red" states while the eastern roads have to cope with the "blue" northeast where business climates can be downright hostile. Most of the red states are also right-to-work states -- five of which are in the top-ten best business tax climate states as ranked by *Harvard Business Review* (see also WIR 11/14/2008). Expect more on this theme anon as we look at where the healthiest short lines are and why.

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