THE RAILROAD WEEK IN REVIEW

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"Betting on the lottery is not a business plan." -- Anon.

The election results have really hammered the pro-passenger people and there will no doubt be fallout on short lines looking for quick resolution of the "45G" tax credit matter. Jim McClellan, now-retired former SVP for Strategic Planning at Norfolk Southern, put it this way in his October 25 "State of the Industry" address at the University of Kentucky: "The government is mostly broke at all levels. There are huge conflicts coming -- meds for grandma *vs*. fixing roads. We are a society that has lived on convenience facing a time when we must learn to be efficient."

Given this state of affairs, says Jim, with "meds for grandma" trumping transit, all kinds of convenience goods and services will find funding not so readily at hand. The Class I network, on the other hand, "took a lickin' and kept on tickin,'" meaning that they have the resources to keep doing what they do best without being dependent on the kindness of strangers. Critical were the "big, robust networks that could make changes in a hurry and do the computer modeling needed to know where and how to cut costs." This is where the big push to make fixed costs variable came into play.

But the railroads make their money moving "stuff," and with consumers hunkered down and manufacturers keeping smallish basic loads of inventory, there's less stuff to move. McClellan again: "More spending for health care, higher taxes, debt reduction, keeping kids in college and protecting the nest egg means less spending on consumer discretionary goods" from refrigerators to furniture to SUVs.

So to survive in this lower-volume world, the successful railroad will have to follow the money: domestic intermodal and key heat-and-eat carload commodities. The Class Is prepared themselves for this "leaner, greener environment by running faster, smarter and more efficient." More unit trains, more domestic intermodal, more distributed power, more volume with fewer crew starts, and more revenue-ton-miles with fewer individual carloads.

For an inking of where the short lines are headed, recall that at the BNSF shortline conference last week we talked about short lines "blocking for the distant node." It's where domestic intermodal is going -- you don't build a train in Birmingham and expect it to go all the way to Harrisburg non-stop. You do block swaps along the way, just like the passenger trains used to set out and pick up sleepers and head-end traffic en route. and since short lines are the drayers of carload traffic from the hustings to the terminals, they have to set up the blocks to be swapped at Atlanta, Charlottesville, and on up the line to Harrisburg.

The new reality puts the short lines in the same predicament as the passenger planners. Sure, every foamer wants passenger service restored to Possum Hollow, but unless there is a mass of people who can fill 16-car trains of double-decker equipment with power on both ends, it's not going to work. Locals stopping everywhere are a poor substitute for the convenience of one's

own auto, just as local freights and manifests taking days to go 500 miles are no match for a truck. As for "high-speed rail," forget it. What we need is dependable rail service in high-density corridors that runs according to the time-tables. Better we spend any available funds on making what we already have work the way it's supposed to.

In short, short lines betting on continued government funding from tax credits to FRA loans to state grants may be out of luck. In the words of one railroad professional, "I disagree with your statement 'betting on the lottery is not a business plan.' It *is* a business plan. It is one with grand objectives but only a very modest opportunity for success. However, it should not be taken lightly since it is the fundamental business approach of too many public agencies and when it is not realized, they need a private entity to blame. Thus, the dilemma." Say amen to that.

Monthly carloads for October are out for Genesee & Wyoming. The good news is units are up 16 percent year-over-year and up eight percent year-to-date over the first ten months of 2009. The bad news -- well, less robust news, anyway -- is that, taken month to month, GWR seems stuck in a bit of a rut. October's 72,246 units were about the same -- 0.2 percent up -- as September, 2010. In fact, if you go back to April total revenue units hover right around 72,000 carloads.

By commodity group, coal - GWR's #1 commodity -- was up 30 percent thanks to gains in the Illinois and NY/Penna/Ohio regions. Aggregates, the #2 commodity by volume, slipped 12 percent. Farm & Food, the next largest group was up 74 percent though it must be recalled that this commodity group is affected by the strength of the Australian grain harvest and is not reflective of the core North American carload franchise. The Pulp & Paper group, 11 percent of carloads, was up 14 percent on general strength in this sector.

RailAmerica's October carloads -- including the Ottawa Valley Railroad -- were up 3.8 percent to 72,826 *vs*. 70,159 in October 2009. Six out of 12 commodity groups posted gains. Two of the four largest commodity groups, comprising 56 percent of RA's traffic, increased handsomely: chemicals up 19 percent and non-metallic minerals (aggregates) up 22 percent. Chemical volumes were up primarily due to increased shipments in the Midwest, Northeast and West regions. Non-Metallic Minerals and Products carloads increased primarily due to higher shipments in the Midwest and Central regions.

As to the other two commodity leaders, coal skidded eight percent percent primarily due to lower shipments in the Central region, and Motor Vehicles were down primarily due to decreased shipments in the Midwest region. And surprisingly, given the strong stories from UP and BNSF, ag products slipped half a percent from October 2009. Like GWR, RA seems mired in the 70K-plus carloads per month range. October 2010 loads are about equal to September's. Year-to-date comps remain in the six-to-seven percent range.

Norfolk Southern's corridor car counts are scoring some impressive gains. Speaking at the *Baird 2010 Industrial Conference* on Monday, CFO Jim Squires cited the success of the "intermodal corridor strategy" (you can see his presentation on the Investors page at www.nscorp.com). Squires provides both quarter-to-quarter and year-to-date comps and I believe the latter is the more telling. And though these are intermodal unit counts, recall what

CEO Wick Moorman said at last summer's shortline gathering in Roanoke: though designed mainly for intermodal, these corridors speed up the whole railroad -- "a rising tide lifts all boats."

The "Premier Route" between Chicago and the NY market is up 20 percent, the Crescent Corridor linking New Orleans/Memphis with New Jersey and New England is up 31 percent and the Titusville Corridor between Chicago and its namesake Florida terminal is up a whopping 167 percent. The two joint ventures -- the Meridian Speedway with KCS and the PanAm Southern with Pan Am Rail -- are up 40 percent and 36 percent respectively. These numbers are proof indeed that the domestic intermodal corridor strategy really works, block swaps and all. The carload guys better get on board.

Union Pacific held its annual Investors Day in Chicago last week. Setting the scene, UP economists forecast GDP growth at roughly 3.5 percent per year 2011 through 2015. In the same time frame UP says unemployment will drift down to 8.5 percent, enabling housing starts to hit 1.3 million units, light vehicle sales gains to the 15.5 million unit level and imports to rise 7.6 percent year-over-year. That said, UP volumes, while recovering nicely from the pits of 2009, are still not where they were at their peaks. Best performers are ag products and intermodal, each less than 2,000 units off; industrial products lags the most, off 9,000 units.

I think the message to short lines is to do everything in your power to capitalize on what EVP Marketing & Sales Jack Koraleski calls "the franchise potential." The commercial strategy is simplicity personified: leverage UP's Value Proposition, build on UP's network of core routes and its connections to grow revenue-unit counts and revenues, and become the "Carrier of Choice" for every customer in the franchise area. A close look at his slide set on the Investors Page at www.uprr.com is highly recommended.

Lance Fritz, EVP Operations, shows how they're going to do what's needed in terms of product and service design for UP to become Carrier of Choice. Here again, the ability of short lines to dovetail with UP will be critical. Turn to Fritz' slide 4 and see how UP has increased revenue units 15 percent on only four percent more crew starts. How can a short line with only one crew start a day build on this? By precise event recording in real time so UP always knows what to expect at your interchange. If they come out under-powered it's a second crew start to pick up your cars and that makes for unhappy customers.

Ditto through freight starts up eight percent to yard and local starts unchanged. Short lines can help by pre-blocking groups of 15-20 cars heading in the same direction for the distant node, especially when the serving local ties up in a flat-switch yard. Bottom line is UP in September, 2010, got back to its 2008 volume level of 180,000 cars a week and then some. Looks like a lot of shippers are indeed making UP their Carrier of Choice.

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