THE RAILROAD WEEK IN REVIEW
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"When government guarantees are involved, the profit-and-loss system that determines the behavior of private actors gets fatally distorted." -- Gene Epstein, Barrons, May 23

Daniel Machalaba's pair of pieces in Monday's *Wall Street Journal* represents as good a summary of the State of the Railroad industry as you're likely to find in a daily newspaper. Machalaba has been pounding the railroad beat for many years and knows where to go for answers.

The lead piece, "The Little Engine Really Could," shows how and why technology "is on the verge of transforming freight rail." He shows how tech toys from GPS to ECP brakes and new types of trackside defect detectors have been able to transform "one of the earliest network businesses, the railroad, into an integrated, digital network."

Says Machalaba, one result has been amazing strides in operating efficiency and, as a result, profitability. The second article, "The Future of Rail," features highlights from a series of interviews with industry leaders that shed some light on the sustainability of what my friend Tony Hatch calls the "railroad renaissance."

On the question of what's ahead for railroads, I found STB Commissioner Francis Mulvey's remarks encouraging but also a little puzzling. He says, according to Machalaba, "Since Staggers, the rail share of intercity ton-miles has grown to more than 43 percent from just 30 percent." That's nice, but...

Here one must ask what does that share look like if you back out the one commodity where trucks can't really compete: coal. The AAR data sheets show that for the full-year 2010, combined US and Canadian railroads moved some 32.3 million revenue units, of which 7.1 million units -- 22 percent -- were coal. (Putting that number in perspective, 13.7 million units -- 42 percent -- were intermodal containers, leaving merch carload traffic including ag products at 46 percent of total revenue units).

Now these are revenue units, not Mulvey's ton-miles. So I asked the AAR for a ton-mile breakout of the 2010 numbers. Not so fast. It turns out that "good commodity-specific ton-mile data by region is very difficult to get," my contact writes. Ah, but we can sort of back into it, I think.

Coal accounted for 45 percent of tons originated (ex-intermodal) and 24 percent of revenues in the peak year of 2008 according to the 2009 AAR "Railroad Facts" book. Intermodal goes into the "miscellaneous mixed shipments" category, six percent of the total 2008 tonnage but 14 percent of revenues. A 2005 Bureau of Transportation Statistics study shows railroads with 38 percent of the total ton-miles, truck with 29 percent, pipeline 20 percent and "domestic water"

with 13 percent. The railroad ton-miles are given as 1,774 billion and the AAR's 2008 number is 1,777 billion so we know we're in the ballpark.

Now to make the jump. North American 2008 loadings came to 30.6 million revenue units, including intermodal. Coal was 7.7 million units, 25 percent of the total. Thus coal accounted for 45 percent of tonnage with only 25 percent of the carloads. Another way, railroads put 879 million tons of coal in 7.7 million carloads, averaging of 114 tons per car.

Thus a 100-car unit train of coal generates 11,400 ton-miles for every mile it moves. Intermodal on the other hand took 8.1 million units to move 120.3 million tons of freight -- 15 tons per unit. If this is right, a solid train of 100 platforms moving 200 double-stack containers is carrying 3,000 tons of freight and generates 3,000 ton-miles for every mile it moves -- a quarter of what a unit coal train does.

With coal trains generating four times the ton-mile density of intermodal trains, I think it's safe to say that Commissioner Mulvey's "43 percent share" of inter-city ton-miles is heavily influenced by coal. Now back out long-haul unit trains of grain in markets where trucks can't compete and the picture begins to change even more. I submit that to have any meaningful discussion of market share splits between trucks and trains it has to be in terms of commodity O-D pairs that are open to truck-rail competition.

Rail traffic numbers continued to improve in Week 20. Peter Nesvold at Jeffries & Co. writes, "U.S. total rail volumes jumped five percent year-over-year for the week ending May 21, 2011, the strongest weekly gain since early April." Automotive (parts and finished vehicles) and coal were up; forest products slipped slightly. "Industry-wide volume growth remained in the mid-single digit range in Week 20, against tough year-over-year comps. We believe that volumes will continue to grow in the mid-single digits during the first half of the year, and that the trend should continue as the year progresses."

Short lines, as measured by RMI's excellent RailConnect Index, were up eight percent in Week 20 and nine percent year-to-date. The year-to-date commodity leaders ex-intermodal include grain (10 percent), aggregates (13 percent) and chemicals (12 percent). These three commodity groups represent 42 percent of shortline volumes. Coal, the largest commodity by total carload volume at 17 percent, was up just three percent.

The oil and gas exploration and production (E&P) industry is a major player in shortline aggregates and chemicals and is likely to remain so. The May 25 "UBS Morning Meeting Highlights" notes that "E&Ps focus on liquids-rich growth plans while natural-gas weighted E&P [share prices] remain over-valued. The E&Ps are discounting the $5.10/mm cu ft and $76 per barrel gas and oil price."

At last week's well-attended and highly informative Pennsylvania Rail Freight Seminar, we saw how sand, pipe, cement and heavy equipment are adding to shortline carloads, and I'm hearing the same from western carriers. Suffice to say support materials by rail figure in both oil and gas plays. In fact, BNSF carload data for Week 21 shows double-digit carload increases in metals (21 percent), sand/gravel (20 percent) and petroleum products (nine percent).

And though the Week 20 data show the forest products group in a continuing funk, shortline paper and lumber are up four and seven percent respectively year-to-date. The UBS morning note for May 23 highlights stability in containerboard, favors packaging over paper (fits what we hear at both NEARS and the CSX Shortline Workshop), and lowers housing forecasts.

On the trucking front, Ed Wolfe and Scott Group at Wolfe Trahan write, "A food & beverage shipper we spoke with isn't having any major truck-load capacity issues with his group of core carriers and several regional, private carriers. He ships most of his freight through the Northeast, California and Kentucky and noted that Kentucky is relatively the tightest of these three regions currently. On the pricing side, our contact expects low single-digit truckload rate increases this year, and much higher seven to eight percent intermodal rate increases.

"He believes the railroads have become much more aggressive raising intermodal rates this year given tight truckload capacity generally and expectations for strong intermodal volume growth. Lastly, our contact noted that he has hired a third-party consultant to help him monitor each of [truckload] carrier's CSA scores. Our contact has not moved freight away from any carriers yet, but seems unlikely to enter into contracts with new carriers that have a CSA 'alert.'"

Toronto's Cherilyn Radbourne reports, "The American Trucking Association (ATA)'s advance seasonally-adjusted For-Hire Truck Tonnage index declined 0.7 percent in April compared with March, but was up 4.8 percent compared with April 2010." On the subject of driver availability, Jeffries' Nesvold reports that a for-hire truck operator is "only able to hire about 4 percent of the driver applicants since most of them are unqualified. He suspects that some people (including drivers) aren't really looking for work, noting that in some states people can make more money by staying at home and receiving unemployment than if they were employed."

To which Nesvold adds, "According to the U.S. Energy Information Administration, the national average of retail on-highway diesel currently stands at a seven-week low of $3.997 per gallon. That's 32 percent, or 97.6 cents, more than during the corresponding week last year." One of my own channel check sources in New England told me that truckers in his neck of the woods tend to park their rigs once diesel fuel gets north of four bucks. So even if Maine and others opt for higher truck weight limits on the interstates, it won't do much good if the OOs can't afford to fill up their rigs.

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