THE RAILROAD WEEK IN REVIEW

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"Capital investment is always more valuable five years out. All businesses have to earn the right to grow." Matt Rose, CEO BNSF Railway, in Railway Age, March, 2012

BNSF will invest some $3.9 billion in its core network and related assets this year. That's an increase of $400 million or 11 percent. Larry Kaufman sat down with Matt Rose at the railroad's Fort Worth campus recently for another installment of the *Railway Age* "Architects of Change" series and came away with some solid guidance for BNSF's short line partners.

Says Kaufman, "Investing in capital is Rose's principal focus." He has built on what his predecessor Rob Krebs called his "three bucket" approach to capex: the "catch-up bucket," happily now well in the past, the "maintenance bucket" to support the current franchise, and the "expansion bucket" for adding products and services. In his wrap, Kaufman quotes Rose thus: "We need capacity and that's a good situation to be in."

From this I see a two-part message for short lines. One, know where you are in terms of buckets. The good news is most of the short lines I've visited of late are beyond playing catch-up. They've negotiated some pretty handsome handling fees and divisions and they're putting what they can back into track and locomotives to run a consistent, clean and *safe* operation. But I worry about the remaining short lines that have yet to get the message.

Two, use BNSF tools like the Velocity tool (by way of review, see attached PowerPoint) and the AIM initiative to add capacity to the BNSF network. But to do either effectively you have to know what each customer costs you to do business with them. Customers that can take a car, load or unload it and release it back to you in a day and without extra handling are the ones you want to keep. Others? Well, you make the call.

Demurrage, intermediate switch charges or other ancillary fees may look good as "other income" on the income statement, but they don't help you turn cars. BNSF wants its cars back ASAP because every empty is another potential load. If BNSF is plunking down nearly $4 billion to add capacity, the least short lines can do is turn the cars to add capacity to the first-mile, last-mile.

Crude Oil by Rail is getting a lot of ink these days and my good friend John Larkin -- perhaps the only Wall Street analyst out there who ever actually worked for a railroad -- has a few caveats. He writes, "Rail will play a growing and permanent role in the Bakken, but risks lie ahead." Even though rail will play a key role getting oil out of the Bakken this year -- and as long as significant WTI/Brent spreads exist -- rail share will fall off "as spreads narrow and pipe takeaway catches up."

Such a tapering off is still five or so years out, however, and "given the strong drilling economics and the increased comfort in rail economics" rails will play an important part and Bakken volume growth should remain strong.

BNSF and CP are the only two Class Is with any presence there and neither RailAmerica nor Genesee & Wyoming have any properties there. You can't buy shares directly in BNSF and Stifel concludes, "The North American energy development projects represent exciting opportunities for CP, but we believe that dynamic alone is not a compelling enough reason to take a position in the shares."

Out railfanning in the Horseshoe Curve area a month ago I heard the enthusiasts talking about the NS SD40E (E for enhanced) Juniata rebuilds in helper service. Turn out NS has 48 of them numbered 6300 to 6347. Here's the 6307 shoving on an eastbound coal train at Lilly, Penna.

Chris Toth, an enthusiast who runs a website devoted to NS power, NSDash9.com, tells us the 6307 began life in July, 1984 as the NS 6506, an SD50, and was rebuilt to the present 3,000 horsepower configuration in April, 2009. All SD40E units are air conditioned with dynamic braking, and single control stands. Units 6300-6329 are equipped with a "Helperlink" device that allows the helper unit to disconnect from the train on the fly. A post on trainorders.com puts it this way:

> Helperlink is a device that is chained to the crosswalk and handrails and hooked into M-U cables, the main air reservoir, and independent actuator hoses. Through telemetry via the EOT the device gives pressure readings in the cab of the helper unit, then when the helper is ready to cut off after the shove, the engineer bails off the independent brake and the device uncouples the locomotives from the train on the fly.

The SD40E program, along with the SD60E and others, is recycling at its best, adding another 15 or 20 years of useful life to locomotives that might otherwise be scrapped. Writing in the March, 2012 *Railway Age*, Editor Bill Vantuono notes that NS "reconditions and reuses the original steel

frames, wheel assemblies, traction motor frames and engine blocks. These rebuilds come in at about half the cost of new DC power and include enhancements that put them in the same league as newer power in terms of fuel efficiency and reduced emissions."

I'm not at all surprised. Look at the heritage of these units. The PRR designed and built much of its most famous steam and electric power at Juniata. N&W kept its fleet of built-in-Roanoke Js, As and Ys running longer than any other Class I kept their steam locos hot. And Southern was always an innovator for everything from remote-controlled units to automatic tampers.

Bakken aside, the flip side of the oil coin is the high price of gasoline, the shrinking number of motoring miles undertaken in the family car, and the unemployment picture. And even as Our Leaders proclaim the rate of unemployment is coming down, the real numbers of unemployed are enough to give one pause. As if to underline this observation, Baker Hughes said in their 4Q2011 slide set that oil consumption has been trending down since 1980.

Art Cashin, Director of NYSE Floor Operations at UBS, holds forth in a daily letter that provides some pretty good isights as to the numbers. In a little screed under "Getting By With A Little Help From Some Friends," he writes,

> In Monday's Comments, I lamented that I still hadn't had a chance to flesh out the fact that 2012 has seen a loss of 1.8 million jobs on a non-seasonally adjusted basis. Several readers, most notably John Shipman of Dow Jones and Bruce Barker at Bennett Jones, rushed to my rescue. Mr. Shipman even sent along the BLS table of the data. The raw (unadjusted) number for December of 2011 was 132,965,000, which represents all employees. The number for February (last available) was 131,164,000 or down 1,801,000 jobs for 2012. So, the raw data says the jobs picture is stinko to use a technical term.

Finally, a note from Stern Agee in Birmingham says truckers are beginning to see the negative effects of the new CSA regs. Two fleet operators are seeing driver supply tightening up and another says he was "forced to sell" a profitable recent acquisition "because of rising costs related to poor CSA scores. Insurance costs are rising based on CSA scores and the increases have cause "some underperforming fleets" to shut down. And now for the first time "CSA scores are being written into some customer contracts, as well as remedies available to customers for failing to maintain CSA standing." I could go on, but you get the idea. Fewer trucks competing for your customers' loads could put money in your pocket.

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