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**To say short lines had a tough 2009 is an understatement**

**Freight rail pricing is expected to strengthen gradually this year, staying ahead of cost inflation, as the economy recovers**

**Railroad Updates****Short-line Carloads Tumble 25 Percent in 2009, RMI says**

To say short lines had a tough 2009 is an understatement. Their carloads dropped 25 percent vs. 2008's total, with volume falling by double digits in 13 of 14 commodities, according to RMI's "RailConnect Index of Short Line Traffic" for the 52-week period ending Jan. 2.

Based on carloads handled by 336 U.S. and Canadian regionals and short lines, 2009 volume totaled 4.4 million units vs. 2008's 5.8 million units. The biggest year-over-year decline was registered by intermodal traffic, which plummeted 47.3 percent to 326,218 units. The sole single-digit drop: farm and food product carloads (excluding grain), which decreased 9.6 percent to 245,629 units.

Other large year-over-year declines were tallied in "all other traffic" (down 46.4 percent to 75,223 units), metals and products (down 44.7 percent to 288,231 units), motor vehicles and equipment (down 44.5 percent to 52,358 units), and petroleum and coke (down 36.9 percent to 180,596 units).

Meanwhile, ores traffic plummeted 28 percent to 95,722 units; lumber and forest products traffic tumbled 27.4 percent to 178,999 units; waste and scrap metals traffic decreased 24.7 percent to 225,353 units; paper products traffic dipped 23 percent to 288,628 units; coal traffic declined 21.1 percent to 599,703 units; stone, clay and aggregates traffic fell 17.1 percent to 490,452 units; chemicals traffic decreased 12.3 percent to 735,047 units; and grain traffic dropped 10 percent to 601,088 units.

Read the entire article:

<http://www.progressiverailroading.com/prdailynews/news.asp?id=22335>

**Dahlman Rose Looks Beyond 2010**

Freight rail pricing is expected to strengthen gradually this year, staying ahead of cost inflation, as the economy recovers, according to revised predictions issued this morning by Dahlman Rose & Co.

"While we admit to looking at the glass half full for the railroad industry in 2010, we are modestly trimming some of our 4Q09 and 2010 estimates as we look ahead to 2011," said Dahlman Rose Director Equity Research and *Railway Age* Contributing Editor Jason Seidl. "Although rail volumes have made a notable recovery in the second half of 2009 from the historically low levels seen earlier that year, the improvement was largely attributable to the easiest year-over-year comparisons in decades. Demand for many commodities has strengthened as of late, and further improvement in market

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**AAR announces Car Repair Facility Labor Rate increase of 4.9 percent for January 2010**

**AAR reports 2009 carload traffic at**

fundamentals likely lies ahead. However, such improvement will occur slowly and gradually in 2010 and rail traffic growth may fall short of some investors’ expectations.”

Though 2010 pricing will fall short of the numbers recorded in 2008 and 2009, the railroads “should be able to generate pricing levels above the level of cost inflation,” said Seidl (see *Railway Age’s* story from January 18). “Indeed, respondents to our proprietary Dahlman Rose 4Q 2009 Railroad Shipper Survey noted that they expected rail pricing to grow 3.8% over the next 6-12 months. Looking into 2011, we might see rail pricing strengthen given that current truckload rates are likely unsustainable over the long run. This should raise the price ceiling on truck competitive traffic for the railroads.”

2010 is “unlikely to be the banner year needed to erase memories of the late 2008/early 2009 nightmare,” Seidl concluded. “We believe investors will start to value the companies on earnings generated in 2011 or beyond. Accordingly, we have initiated EPS estimates for 2011 to go along with our revisions for 2009 and 2010. We have also chosen to value the stocks on 2011 numbers, which has led to the price target of our four Buy rated railroad stocks.” Those price targets are US\$58 for CN (exchange rate assumption of \$0.95 US/Canadian), \$51 for CSX, \$56 for Norfolk Southern, and \$68 for Union Pacific—an average increase of 6%.

Read the Entire Article At:

<http://www.railwayage.com/breaking-news/dahlman-rose-looks-beyond-2010.html>

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### **AAR Updates**

The AAR released Circular C-11164 on December 22, 2009 advising its readers that effective January 1, 2010, the Car Repair Facility Labor Rate would increase to \$102.80. The announcement comes as a result of an increase of 4.9 percent from the October 1, 2009 rate of \$98.04.

The major causes of the increase are new health and welfare rates (which are considerably higher than those for 2009) and the new overhead study results in a higher overhead rate because the individual year 2008 rate that became part of the three-year average is higher than the year 2005 that was replaced.

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### **Railroad Traffic**

The Association of American Railroads (AAR) reported on January 13, 2010 that 2009 saw total carload traffic on U.S. railroads at its lowest levels since at least 1988, when the AAR’s data series began. AAR’s January Rail Time Indicators report includes both monthly numbers for December and 2009 annual totals for freight railroad traffic.

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**Cement industry  
poised for  
unprecedented  
period of growth**

January’s Rail Time Indicators report notes 2009 carload traffic was down 16.1 percent compared with 2008, and down 18.2 percent when compared with 2007. For the month of December, rail carloads were down 4.1 percent compared with December of 2008 and down 17.6 percent compared with December of 2007, due mainly to declines in coal carloadings. However, had coal been excluded, rail carloads would have been 6.9 percent higher in December 2009 than in December 2008. While the report notes that traffic for every commodity category was down in 2009 compared with both 2008 and 2007, 12 of the 19 major commodity categories tracked by the AAR saw higher carloads in December 2009 than in December 2008.

U.S. rail intermodal traffic, which covers the movement of truck trailers and shipping containers by rail, posted slightly better year-end numbers with traffic down 14.1 percent compared with 2008, and down 17.7 percent compared to 2007. Last year saw the lowest intermodal traffic levels since 2002. U.S. intermodal traffic was up 2.5 percent from December 2008, though down 11.5 percent from December 2007. Unusually heavy early-season snow in much of the heavily-populated Northeastern U.S. negatively impacted consumer focused intermodal traffic in December 2009.

“Railroads are happy to have 2009 behind them,” said AAR Senior Vice President of Policy and Economics John Gray. “Last year saw declines, most of them quite steep, in every major category of rail carload traffic as well as intermodal. However, we’re seeing signs that the economy is improving. We’re hopeful that 2010 will be a much better year for the economy and for railroads.”

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<http://www.aar.org>

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### **Industrial Inside**

As the cement industry emerges from the recession, it’s expects to embark on a period of sustained growth fueled by infrastructure investment, sustainable construction and a shift in market dynamics in paving.

The expected turnaround in demand and consumption of cement is coming at a time when the industry can really use a jump-start. Since reaching its peak in 2005, cement consumption has declined by about 45 percent, and the actual decline in usage represents the worst volume decline in the industry’s history.

However, according to PCA, cement consumption is projected to increase by 5.2 percent in 2010, the first year-to-year rise since the middle of the decade. Beyond that, demographics and pent-up demand is expected to grow consumption to a greater degree in 2011 and 2012 and beyond.

In 2011, PCA is projecting an overall increase of 16.5 percent in

**A perfect storm of factors are increasing demand for concrete as a highly sustainable, cost-effective building material for a wide variety of uses including roads, bridges, and both residential and commercial buildings.**

**U.S. Federal Reserve says interest rates will remain near zero "for an extended period," but acknowledged recent signs that the economy is gaining momentum after its worst slump in decades**

cement consumption in the U.S. versus 2010 levels, with another incremental 14.5 percent increase in 2012.

A perfect storm of factors are increasing demand for concrete as a highly sustainable, cost-effective building material for a wide variety of uses including roads, bridges, and both residential and commercial buildings.

Among the factors is a paradigm shift in the cost of building concrete roads versus asphalt roads. In the past, the short-term investment to build an asphalt road was less than the cost of building a concrete road – even though concrete enjoyed a significant cost advantage over the life of the road. However, in 2009, that short-term advantage disappeared completely – accelerated by an increase in the cost of asphalt – and concrete is now not only a more durable solution for building roads, it is also a less costly solution both for the long term as well as for the initial investment.

Read the entire article:

[http://www.cement.org/newsroom/Brian\\_Webcast\\_Dec09.asp](http://www.cement.org/newsroom/Brian_Webcast_Dec09.asp)

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### **Financial Focus**

The U.S. Federal Reserve said in December 2009 that interest rates will remain near zero "for an extended period," but acknowledged recent signs that the economy is gaining momentum after its worst slump in decades.

Following a two-day policy-setting meeting, the central bank reiterated its stance that interest rates should stay in their current range as long as unemployment and other forms of economic slack are very high and inflation is low.

But the Fed's assessment of the economic landscape was more upbeat than a month prior, suggesting it is edging closer to withdrawing some of its support for the economy after a stronger-than-expected November jobs report and other positive data. Fed officials also emphasized that many of the emergency lending programs devised in the heat of the financial crisis--such as special lending in commercial paper markets and to investment banks--are in the process of being scaled back.

"Information received since the Federal Open Market Committee met in November suggests that economic activity has continued to pick up and that the deterioration in the labor market is abating," the central bank said in a statement.

The FOMC voted 10-0 to maintain the target federal-funds rate for interbank lending at a record-low range of zero to 0.25%.

The panel's decision isn't a surprise to financial markets, which don't expect the Fed to begin raising interest rates until the recovery is entrenched in 2010. Fed Chairman Ben Bernanke cemented those

**"Though we have begun to see some improvement in economic activity, we still have some way to go before we can be assured that the recovery will be self-sustaining,"**

**The FOMC said it will "maintain the target range for the federal funds rate at zero to 0.25%"**

**"Our call is that they start raising rates in**

expectations when he said slack in the economy and subdued inflation would keep the central bank from lifting interest rates soon.

"Though we have begun to see some improvement in economic activity, we still have some way to go before we can be assured that the recovery will be self-sustaining," Bernanke said.

Recent data hint that the recovery is taking hold. The U.S. unemployment rate declined to 10% in November, an unexpected drop that bolstered hopes the labor market has turned the corner. Robust retail sales and rising consumer confidence, meanwhile, raised expectations for strong economic growth in the fourth quarter.

At the same time, inflation has been tame, giving policy makers room to wait before beginning to push up interest rates. Core consumer prices were unchanged last month.

Michael Feroli, an economist at JPMorgan Chase, said there was nothing in the FOMC's statement to prompt analysts to reassess their expectations for monetary policy.

"There were no major surprises," Feroli said. "The way they described the economy remained consistent with the tone of recent speeches." The federal-funds rate has been near zero for a year, part of the Fed's response to the financial crisis, a strategy that also includes emergency measures to buoy credit markets and lending.

The FOMC said it will "maintain the target range for the federal funds rate at zero to 0.25% and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

"When the time comes for the Fed to adjust policy, they will almost assuredly implement an 'open mouth' policy of tightening, preparing the markets for adjustments to their language and, perhaps in January, the discount rate," Dan Greenhaus, chief economic strategist at Miller Tabak & Co. said in a note to clients. "Our outlook for Fed policy remains entirely unchanged after the statement."

While the timing of future rate hikes remains uncertain, some of the stimulus the central bank has pumped into the economy is scheduled to end next year, and short-term borrowing from its discount window has eased over the past year.

Citing "ongoing improvements in the functioning of financial markets," the FOMC reiterated that most of its special liquidity facilities will expire on Feb. 1. It also said it is working to close temporary liquidity swap arrangements by Feb. 1, and expects that amounts provided under its Term Auction Facility will continue to be scaled back in early 2010.

But in a nod to lingering uncertainty, the Fed said it is prepared to

**September," said Harm Bandholz, a UniCredit economist. "Subdued inflation allows the Fed to sit back and watch how the recovery and financial market stabilization unfolds."**

modify the plans if necessary to support financial stability and economic growth.

"Even though the interest rate won't be raised anytime soon, the central bank probably has begun to shrink the balance sheet in order to deflate long-term inflation expectations," said Sung Won Sohn, an economist at California State University.

"Our call is that they start raising rates in September," said Harm Bandholz, a UniCredit economist. "Subdued inflation allows the Fed to sit back and watch how the recovery and financial market stabilization unfolds."

Learn more at:

<http://online.wsj.com/article/BT-CO-20091216-712083.html>

## **The Edge**

A few years ago I broke my collar bone. It was a quick snap (yes I heard it) and numbness... no pain, just numbness. About 100 steps later enroute to my pickup the pain hit and I almost passed out. After making the trek to my house in a stick shift pickup driving and shifting with my left hand, the pain became a teeth gritting ordeal. That continued as my wife drove me to the hospital a very long fifty miles away.

Sounds analogous to our economy, doesn't it?

Some twenty-four plus months ago the US' collar bone snapped (I'm not sure we heard it at that time though). We've made the 100 steps and as an economy come very close to passing out and have been saddled with programs that make driving left handed while gritting our teeth seem easy. We're still looking for someone to drive us to the hospital though!

The Wall Street Journal (WSJ) reported a GDP gain of 5.7% (4<sup>th</sup> quarter 2009). Sounds like great news; however, WSJ also reported that most of the gain (3.39%) was comprised of a slower draw down in business inventories than an actual GDP gain.

### **When you look across industry you see much the same story.**

A recent report by Aggregates Manager recapping 2009 statistics shows quarries operating on shorter hours with fewer workers and larger stockpiles. Across all commodity types (crushed stone, sand & gravel) one sees annual production decreases from 67.4% to 84.4% with selective company increases of 3.1% and 13.5%, the decreases far outweighing the increases. Yet when one looks at the infrastructure needs across the country comprised mostly of new and refurbished highway construction, there is significant demand. In some states the fifty year demand for aggregates, sand and gravel are projected to exceed production capabilities by 50%, yet the U.S Census Bureau notes that stimulus dollars committed to the construction industry in 2009 trickled in at an estimated 16% of the \$26.7 billion committed having been paid to contractors and construction materials providers by December 2009. Considering that it often takes five to seven years to permit new supply, we certainly see upside for suppliers....if they can

make for the next few years. Meanwhile, stone, sand and gravel rail carload shipments are down 22.1% for the year 2009 compared to 2008.

Recycling Today reports recovered fiber inventories are depleted and as a result driving a little bit of optimism simply because supply is so low that a very basic demand has bumped prices up. Nearer to my home in Montana, the optimism is usurped by closing of a Smurfit-Stone plant in Montana and farther away in Michigan. In the long term these facilities didn't make the "drive to the hospital" although you'd think the recycling industry certainly would be a key growth area given the political push to recycle, do good green and support Al Gore's lifestyle.

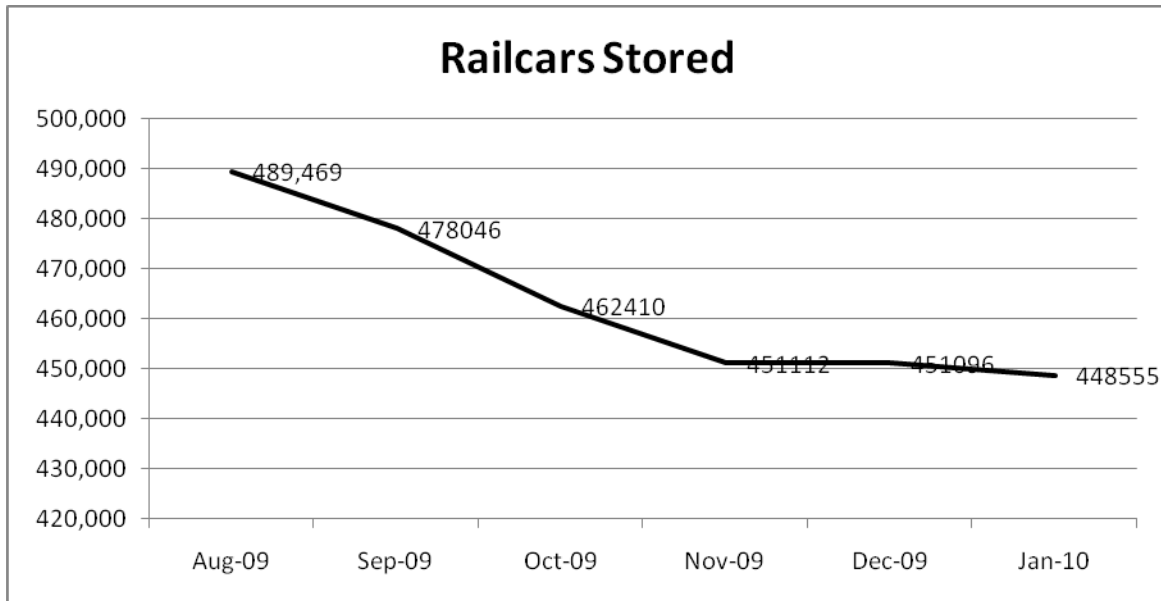
Copper as a commodity seems to be on the upswing primarily due to Andean flooding in South America temporarily shutting down many of the mines. Hopefully this will help bolster some of our North American operations. Expect other mineral prices to follow suit as they often come from the same mine complex.

Scrap metal prices seem to be following the general commodity trends of let supply run out and base demand catch up hence we see an uptick in pricing and movement of product (in many cases railcars) to the scrapper thru the process to the finished product. The first uptick we can expect is the proverbial price growth from China. Looking across many printed articles one can ascertain that many specialists say that after the Chinese New Year holidays (near the end of February) the demand and prices for steel products will boost. Corresponding to this Chinese expectation, stockpiles in US mills should be low. Domestically there certainly isn't any near term light driving scrap demand support as the predominant finished product user in the US is the auto industry being wrought with its own challenges.

Energy is another interesting area. In 2008 coal accounted for 45.4% of the total tonnage shipped by the rail industry. Those shipments were down by 10.1% comparing 2009 to 2008 yet general electricity rate increases of 1 to 10% to the consumer are occurring across the country to consumers who face 10% (probably closer to 16%) unemployment, loss of house and income. Wind energy has filled in some gaps, hydro has remained flat and we're reconsidering nuclear power plants. We need a national energy policy but I digress. Consider that your number one carload and revenue generator takes a 10% hit. Being publicly traded you're in the same boat as any other company. To meet your Wall Street goals you've got to naturally increase margins thru price increases ironically to an industry that is being pummeled by political Cap and Trade pressure.... Did I mention we need an energy policy?

Grain continues to be a push business. It's the only industry I know of where the factory continues to make advancements not to drive out higher margins but just to survive from year to year. The US farmer is the most efficient producer in the world. The 2009 corn crop is projected to be in excess of 13.1 billion bushels. That's another record despite poor harvest conditions in the corn-belt. Agriculture exports were off \$16 billion dollars in 2009 compared to 2008. That's a significant amount of covered hopper railcars not in use hauling commodities to the integrated port systems at our coasts. Domestic food grain processing is the only area that seems to be holding to reasonable decreases, e.g. flour, rice, etc. People still have to eat but maybe not quite as much variety.

Closer to home we watch railcars in storage (see graph below). If you consider it a measure of goodness we're seeing fewer cars in storage. Sometimes though it's similar to housing sales improvements, a slight improvement is touted as an improvement but generally meaningless. I guess the trend is going the right way. Consider the impact though that there are approximately 1.6 million US freight cars and of that 28% of them are stored. The trend is going the right way...



Despite the fact that we're "driving our stick shift left handed with a broken right collar bone" there's some glimmer of light. If we can help "drive you to the hospital" through equipment sales, better planning, operations efficiencies or exploring creative alternatives don't hesitate to give us a call.

*We look forward to earning your business!*