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Railroad and Policy Updates

A rail strike was averted as agreement with 12 of 13 unions was reached late December 1, 2011. Represented by the National Carriers' Conference Committee, the major U.S. railroads reached tentative agreements with the Brotherhood of Locomotive Engineers and Trainmen and the American Train Dispatchers Association, which together represent about 26,500 employees in collective bargaining. The last remaining union without a settlement, the Brotherhood of Maintenance of Way Employees (BMWE), agreed with the railroads to extend the "cooling off" period until Feb. 8, 2012, eliminating the immediate threat of a national rail strike, which could have occurred as soon as Dec. 6.

"We're pleased that we have now settled with 12 of the 13 unions in this bargaining round. Everyone wins when we reach voluntary agreements," said NCCC Chairman A. Kenneth Gradia. "In a tough economy, these agreements offer a terrific deal for rail employees. They lock in well-above-market wage increases of more than 20% over six years, far exceeding recent union settlements in other industries."

"The goal of the nation's freight railroads, from the start of bargaining almost two years ago, has been to reach voluntary settlements with all of its rail unions," said Association of American Railroads President and CEO Edward R. Hamberger. "These agreements bring the industry closer to achieving that goal. Freight rail touches nearly every sector of our economy, and we are committed to finalizing the remaining agreement so that we can continue to deliver for the tens of thousands of American businesses that rely on rail, and the hundreds of thousands of Americans who use passenger rail to commute to work every day."

Economic Planning Associates: Freight Car Backlog "Formidable"

In spite of a struggling economy, "the railcar market continues to astonish on the upside," Economic Planning Associates says in its latest quarterly report. "Third quarter orders of 20,165 units far outpaced deliveries of 12,519 cars, bringing end of September backlogs to 65,044, significantly higher than opening year backlogs of 22,658 cars. Thus, even with the acceleration in third quarter production, existing backlogs still represent 5.2 quarters of deliveries. As a result, car builders will begin the fourth quarter with a formidable level of cars in their backlogs."

Based on current backlogs and anticipated further gains in demand for a variety of railcars, EPA is projecting assemblies of 40,400 cars in 2011, followed by an increase to 51,300 units in 2012. Longer term, EPA is projecting an acceleration in railcar demand that will take deliveries from 54,300 units in 2013 to 63,500 units in 2016.

"A closer inspection of the third-quarter orders indicates that railcar demand was broad based, with significant strength in tank cars and small cube covered hoppers," EPA said. "Mid-sized covered hoppers, coal cars,

was broad based, with significant strength in tank cars and small cube covered hoppers...Mid-sized covered hoppers, coal cars, and intermodal platforms also recorded good levels of orders

and intermodal platforms also recorded good levels of orders. Mill gons are beginning to respond to growth in industrial production and steel mill shipments. Third-quarter orders for 460 mill gons brought end-of-September backlogs to 2,050 cars.

"And, we believe that orders during the next year or so will continue to advance, albeit at a more moderate pace. Replacement pressures have intensified among a number of car types such as boxcars and various covered hoppers. At the same time, the shift to aluminum bodied coal cars will stimulate demand while strict regulation of hazardous materials being transported on tank cars will boost demand for newer pressurized tank cars. The generous depreciation provisions of the tax code in place this year will also facilitate the decision to purchase new equipment. In addition, the railroads will also provide support to new equipment demand during the foreseeable future.

"In spite of a weakening economy which has softened both commodity and intermodal hauling... railroads continued to score impressive financial gains"

"In spite of a weakening economy which has softened both commodity and intermodal haulings in the third quarter, railroads continued to score impressive financial gains. The roads are attributing record quarterly levels of revenues and profits based on some modest volume growth, increased revenue per unit, and operating efficiencies. UP reported that third quarter operating revenues climbed 1.6% to an all-time quarterly record $5.1 billion and operating income rose 13% to a record $1.6 billion. Each of UP's six business groups registered freight revenue growth and four of them posted volume gains. Likewise, CSX saw operating income rise 6% to an all-time high $878 million while net earnings rose 12% to a record $464 million. Due to price increases, KCS also reported strong third quarter financial results.

Read the entire article at: **http://www.railwayage.com/breaking-news/economic-planning-associates-freight-car-backlog-formidable-3667.html/**

Mechanical Brief with Steve Christian

Mechanical engineering versus the real world

I have had the good fortune to have worked in the mechanical department of Class I railroads at many levels. I worked as a laborer, as a helper and as a carman through college and after college, I interviewed for salaried mechanical positions at a few railroads. I remember a series of interviews with a variety of mechanical department officials at one particular railroad.

The most memorable interview was with the Chief of Mechanical Engineering. The first thing he asked me was "have you ever wondered who the guy was that dreamed up some of the special tools and procedures that made your job totally miserable?"

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I thought about some of the things that I cussed about daily that seemed counterproductive and just plain dumb and then, without hesitation, I confessed that I had. He paused and told me "well I am that guy!"

Oops, I thought I was in trouble.

He went on to tell me that there is a difference between an "engineered solution to a problem" and a "real world solution to a problem". His point

A close examination and analysis of real world results might just make these tools, equipment and processes more effective

was that engineering is only the beginning. The engineering solution has to be tested in the real world over an extended period of time and after the real world testing process, adjustments should be made to make the engineering solution a practical solution. His response was amazing and stays with me. I see it fitting to remind myself, my colleagues and my readers that the real world is a different playing field than the engineering paper our tools, railcars and processes are drawn on. A close examination and analysis of real world results might just make these tools, equipment and processes more effective.

By the way, in case you're curious, I was offered and accepted that job!

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Railroad Traffic

October 2011 U.S. freight railroad traffic up 1.7 percent over October 2010 - the biggest year-over-year percentage increase since March 2011

The Association of American Railroads (AAR) reports carload traffic in October 2011 increased 1.7 percent compared with the same month last year and intermodal traffic (using intermodal or shipping containers) increased 3.6 percent compared with October 2010. On a seasonally adjusted basis, carloads in October were up 0.5% from last month, and intermodal in October was up 0.8% from September.

U.S. freight railroad originated 1,215,627 carload in October 2011, an average of 303,907 per week, up 1.7 percent over October 2010, and the highest average of any month since October 2008. It's also the biggest year-over-year percentage increase since March 2011.

On a non-seasonally adjusted basis, U.S. rail intermodal originations averaged 243,892 trailers and containers per week in October 2011, up 3.6% over October 2010. That's the highest weekly average for any month since October 2006 and the sixth highest weekly average of any month in history.

October is almost always the top month for intermodal traffic because it's when retailers do the bulk of their stocking up for the holidays.

Learn more at : **http://www.calculatedriskblog.com/2011/11/aar-rail-traffic-increases-in-october.html**

Industrial Inside

2011 coal market trends: the highs and the lows

With its dark and sooty constitution, coal is continually praised for having a future as bright as its burning embers. While 2011 was not as radiant as its long term projections—stymied by natural disasters, political melees and a flagging global economic reality—both thermal and coking coal markets saw consistent production and consumption growth.

However, three important dynamics have been, arguably, important features of 2011 thus far. The rising role of developing markets (predominantly China) in reshaping coal consumption and shipping trends, the predominance of soft or "above ground" issues related to political, social and environmental challenges, and the continued confusion surrounding the fate of the global economy have all guided the broad developments for coal markets in 2011.

Extensive flooding in the Australian province of Queensland led to record breaking coking coal prices as monsoon rains washed away some AUS $2.1 billion in sales by coking coal majors operating in the region

2011 coal market events

As the year began, extensive flooding in the Australian province of Queensland led to record breaking coking coal prices as monsoon rains washed away some AUS $2.1 billion in sales by coking coal majors operating in the region. On the whole, the natural disaster caused losses in the Australian coal mining region of some US $473 million a week in exports during the month of January.

While production in the Australian coking and thermal coal heartland eventually returned, bringing in export earnings growth for thermal coal up AUS $641 million, the country's coal industry was faced with important political and legislative changes. In November, Australia's Senate passed a carbon tax which will impose an AUS $23/MT of greenhouse gas (GHG) emissions cost for heavy polluters (like coal miners) starting in mid-2012. In the same month, the lower level of parliament pushed ahead its mining industry "super" profits tax legislation after more than a year of debate settling on a 30 percent tax levied on coal and iron ore producers with profits above AUS $75 million/year beginning next July.

… The natural disaster caused by the Japanese earthquake, tsunami and ensuing nuclear meltdown disaster also briefly deformed thermal coal markets [as] the world's number one thermal coal importer was destroyed

Further north, the natural disaster caused by the Japanese earthquake, tsunami and ensuing nuclear meltdown disaster also briefly deformed thermal coal markets as a large portion of Japanese electricity grid capacity—the world's number one thermal coal importer—was destroyed. Analyst expectations of significantly reduced thermal demand and prices followed with resulting impacts on thermal prices. While the disaster claimed more than 20,000 lives and destroyed huge swaths of steel refining capacity, a quicker than expected Japanese recovery was able to buoy thermal prices more quickly than expected.

Some of Japan's demand recovery was aided by China's continued meteoric growth of thermal and coking coal demand, one of the most important current dynamics in coal markets in 2011. Chinese thermal imports were so strong this year that Platt's report suggested Chinese thermal coal prices could supplant the Australian Newcastle 6,000 kcal/kg price benchmark due to the declining volume on the Newcastle index. China, which only became a thermal coal importer in 2008, has exploded as a thermal importer with 150 million tonnes projected for this year and has even been said to have sparked to life the declining American coal producers who see

Last quarter of 2011 has not been kind to coal markets on the whole

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If 2011 was any indication of the years to come, coal

the Asian market as a godsend to their bottom line.

Coal prices drag on economic concerns

But, the last quarter of 2011 has not been kind to coal markets on the whole. With an economic malaise plaguing American and European industrial and job growth, and more importantly the recent evidence of retrenching Chinese and developing market growth, coking and thermal prices have slid over the past three months.

Coking coal contracts, which started the year around the US $200/mt mark, have sunk back from their US $300 range after the Australian floods and logistical bottlenecks reduced supply. Currently, coking coal contracts are trading around US $110.85 for 6,700 kcal/kg at the Newcastle port, while China's benchmark thermal coal price at Qinhuangdao port also dropped for the first time in three months by 0.6 percent to a range of 845 to 855 yuan (US $133-134.5) for 5,500 kcal/kg.

Thermal prices also hit a high water mark around US $140/metric ton mark early in the year, the highest level since September 2008, with prices on the global COAL Newcastle index at the end of November sliding between the $110 and 113 per tonne range.

With China alone representing nearly 50 percent of global market volume, it is clear their impact will be important in the continued short term profitability of coal producers and traders. While the closing days of 2011 and first quarter of 2012 look to remain rather pessimistic, analysts at UOB-Kay Hian Ltd recently suggested in a recent Bloomberg article that China's "strong demand and supply tightness should continue to support coal price uptrend in 2012."

It has been this same continued faith in Asian developing market growth that have kept numerous large-scale producers and traders in merger and acquisition mode to be ready to meet the coming change from emerging markets.

But as governments worldwide seek to manage the continued growth of their economies, political action in coal markets—seen in 2011 in countries as diverse as Australia, Mongolia, China and South Africa—will continue to be important dynamics to watch. Consulting firm Deloitte released a report warning that a "perfect storm" is converging around mining companies in 2012 as price inflation, commodity price volatility and aching labor shortages are set to through a wrench into numerous mining operations worldwide.

The coal industry is ripe for this very consternation as an industry caught up in the crossroads of global economic growth and rising environmental concerns. If 2011 was any indication of the years to come, coal will be an important commodity to watch.

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Learn more at: **http://www.thestreet.com/story/11337196/3/2011-coal-market-trends.html**

Financial Focus

Accelerating U.S. economy may put Federal Reserve asset purchases on hold

The U.S. economy may have achieved a sustainable pace of growth that eases pressure on the Federal Reserve to buy more bonds while giving it time to fine tune how it informs the public about the outlook for interest rates.

"Recent economic data takes away some of the urgency for the need to engage in a new round of quantitative easing," said Michael Feroli, a former Fed economist who is now chief U.S. economist at JPMorgan Chase & Co. in New York. The Federal Open Market Committee "can say, 'Let's wait and see if this is going to build on itself.'"

Since the Fed's last meeting early in November, reports on employment, manufacturing and retail sales have dispelled concerns the world's largest economy may slide back into recession. Signs of economic strength, along with coordinated central bank action to alleviate the European debt crisis, last week helped drive the biggest rally in the Standard & Poor's 500 Index since March 2009.

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The FOMC will update its outlook on the economy in its Dec. 13 statement and maintain a pledge to leave the benchmark lending rate at zero until at least mid-2013, Feroli said. Policy makers at their two-day January meeting may announce a strategy for improving how they communicate their policy goals to the public, said Antulio Bomfim, senior managing director at Macroeconomic Advisers LLC in Washington.

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Fed officials plan next month to update their quarterly forecasts for growth, inflation and employment. That gives them an opportunity to explain their outlook for the federal funds rate in coming months, said Bomfim, a former senior economist at the Fed and former portfolio manager at Oppenheimer Funds.

Out of Step

Currently, the FOMC's 2013 interest rate pledge is out of step with both its own economic outlook and investor expectations.

Federal funds futures contracts indicate investors believe the Fed will increase the main rate after mid-2013. Central bank officials expect unemployment of about 8 percent in the fourth quarter of 2013. That's two percentage points above the high end of their longer-run estimate for full employment of 6 percent.

At the same time, policy makers forecast inflation to be around their 1.7

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percent to 2 percent goal by the end of 2013.

Chairman Ben S. Bernanke said at a Nov. 2 news conference that the FOMC statement that day bears "no implication" the Fed plans to raise interest rates in 2013. The committee hasn't specified any set date for a rate increase, he said.

"The statement says at least mid-2013," Bernanke said. "So clearly it could well be some point beyond that."

Global Poll

The U.S. receives its highest rating from international investors in more than two years on optimism the economy will weather the financial crisis in Europe and avoid a recession in 2012, according to the quarterly Bloomberg Global Poll.

Forty-one percent of those surveyed identify the U.S. as among the markets that will perform best over the next year. That's up from less than one in three who felt that way in September, according to the survey of 1,097 investors, analysts and traders who are Bloomberg subscribers conducted Dec. 5-6.

Bernanke asked an FOMC subcommittee in November to consider giving the public more information about policy makers' interest-rate outlook. That's one piece of information that's missing from officials' quarterly forecasts.

Publishing participants' interest rate forecasts would help clarify the mid-2013 conditional pledge because most FOMC members probably expect to tighten after that date, Bomfim said. Such a communications change would also tie their policy outlook more closely to their forecasts for growth, inflation, and unemployment.

Read the entire article at: **http://www.bloomberg.com/news/2011-12-08/accelerating-u-s-economy-may-ease-pressure-on-bernanke-to-buy-more-bonds.html**

The Edge

At this time of year we're all typically winding down the current year and are in the process of planning for the next year. 2011 sure seems different than most recent years in that it won't quit! Here at Tealinc we're certainly going to work our 365 days this year.

Speaking of planning I just read an article that you should immediately take to your finance department and ask that they get involved. The gist of the article is that the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have made a proposal to change how leases are accounted for on corporate balance sheets. Read the entire article at:
http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175821125393&blobheader=application%2Fpdf

The change that FASB and IASB are proposing is in how operating leases are reported in a company's financial statement. Currently operating leases are reported in the footnotes of a financial statement. The proposed change would require that companies report virtually all their leases (operating and capital) on their balance sheets. One would expect capital leases to be on the balance sheet as they are today as a capital lease could be construed as a different form of ownership of an asset. However operating leases are clearly derived as a riskier investment primarily by the Lessor and the benefits (mainly tax benefits) of that risk should flow to the Lessor. Conversely if a Lessee shows an operating lease on its balance sheet it must show as debt. If it shows as debt and really is an operating expense then the ability of the company to borrow against their balance sheet is reduced as the balance sheet is negatively impacted.

Extrapolating a SWAG on the impact to the railcar market in the United States one could assume that there are easily 600,000 railcars under operating leases with monthly lease values of $240 million dollars that would need to be transferred to various Lessee companies balance sheets. That's an annual impact of approximately $2.88 billion dollars. I'm not an accountant nor profess to have a lot of understanding of accounting guidelines but I do believe this is an item that deserves major Lessor and Lessee companies attention.

On another note if you're in the small business category, there's been no revision in Section 179 tax code for 2012. At the current time it remains at $125k with a phase out after $500k. In 2011 Section 179 is at $500k with a phase out after $2 million. It appears that without a change our governmental leaders redefine "small" in small business. Albeit most of us are in manufacturing of goods and or providers of services to the manufacturing industry this type of impact to small business restricts our overall growth as a country. "Small" business creates a lot of demand for the goods and services many of us provide or support.

Merry Christmas. Happy Hanukkah. May Peace Be With You!

We look forward to earning your business!