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**Western rails get ready to redraw intermodal map**

**UP, BNSF target millions of truckloads for conversion to rail**

**Challenges ranging from high fuel prices to fears of a driver shortage to highway congestion are forcing more truck shippers to consider domestic intermodal as an alternative, regardless of location**

## Railroad Updates

The two Western rail giants, BNSF and the UP, are positioning themselves to capitalize on a potential bonanza: The conversion of millions of truckloads mostly moving west of the Mississippi to domestic intermodal service.

The UP estimates that approximately 11 million truckloads shipped within its service territory are candidates for conversion to domestic intermodal service. About 3 million of those move in UP's 10 primary domestic corridors, according to the railroad. The BNSF projects that 7 million truckloads in its territory are candidates for conversion. In 2010, BNSF handled between 2.25 and 2.5 million domestic intermodal loads, while UP handles, on average, about 2 million a year.

The Western rails, which like their brethren in the East have been criticized in the past for overstating the reliability of their intermodal service, say they have brought their infrastructure, rolling stock, and terminal capacity up to levels where they can now compete with trucks on most traffic lanes and at lengths-of-haul as short as 700 miles, well under their traditional 1,500- to 2,000-mile movements.

For the rails' senior intermodal executives, the prospect of converting 18 million truckloads to intermodal is sufficient motivation to get it right.

"We have a unique opportunity, and the opportunity is huge," says Steve Branscum, BNSF's group vice president, consumer products marketing.

The efforts by the Western rails—along with similar strategies being employed by their two Eastern counterparts, CSX Corp. and Norfolk Southern Corp.—represent a fundamental change in how the industry has marketed and operated its intermodal business. For decades, domestic intermodal operations were viewed as a "bolt on" to international service that involved a prior or subsequent ocean freight movement. Over the last decade, domestic intermodal has grown as a stand-alone service, but mostly from east to west and over lengthy distances. Eastbound intermodal movements remained mostly an extension of ocean service linking West Coast ports with inland points.

Today, however, challenges ranging from high fuel prices to fears of a driver shortage to highway congestion are forcing more truck shippers to consider domestic intermodal as an alternative, regardless of location. The increasing demand is fast making domestic the tail that wags the intermodal dog. UP, for example, reported a 17-percent increase in 2010 domestic intermodal volumes over the prior year. BNSF's 2010 domestic intermodal traffic volume rose 4 percent over 2009 levels. However, first-quarter domestic traffic grew 13 percent over the same period in 2010.

In the first quarter of 2011, domestic service accounted for 46.7 percent of

total intermodal volume, slightly higher than full-year 2010 figures, according to the Intermodal Association of North America (IANA)

**Hurdles to clear**

But with the growth and opportunity come challenges, especially as the railroads become more aggressive in the 600- to 1,000-mile lane segments long dominated by over-the-road truckers. To be "truck-competitive"—which railroads define as competing with a solo driver on short and long hauls—railroads have to ensure their own networks, as well as those of the draymen responsible for bringing goods to the intermodal ramp, are synchronized to deliver fast, consistent service at lower price points than trucks can offer.

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Many of those short- to intermediate-distance segments are located in what are known as "secondary markets" that lie outside of the railroads' primary corridors. It is in these lanes that the rails' intermodal efforts have been hurt by a lack of significant traffic density and a less-robust infrastructure relative to their primary corridors.

David Howland, vice president of land transport services for third-party logistics giant APL Logistics, says the railroads have made significant speed and reliability improvements in their intermodal operations, and can now compete with trucks across the country better than ever before. However, Howland notes that intermodal service in the secondary markets—he cites the Ohio Valley–Kansas City corridor as an example—still needs work and will require significant investment by industry, government, and private sources to get up to speed.

Matt Gloeb, UP's assistant vice president of domestic intermodal, says the railroad is committed to the secondary markets and is addressing the concerns over service inconsistency. "The 11 million highway conversion truckload opportunities [for] Union Pacific include secondary markets that we are targeting," he says.

Gloeb says of UP's 10 primary corridors, only the Los Angeles–Seattle and Los Angeles–Houston lanes are not yet at service levels where they can regularly compete with trucks. The rail is expected to reach service parity on the two lanes by the end of the year, Gloeb says.

Another challenge for the railroads is convincing truck shippers that domestic intermodal can work for them and, perhaps more importantly, that the rails can deliver on their service commitments. UP and BNSF say with their physical networks in place, it now becomes a matter of persuading prospective intermodal customers to come on board, getting existing intermodal users to use more of it, and assuring both new and current customers that they can rely on it to do the job.

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Branscum of BNSF says most of his company's customer base relies on intermodal for only about one-quarter of their total transport needs.

"A lot of customers keep freight on the highway because they don't think there's an intermodal solution," Branscum says. Gloeb of UP adds that the

**that they can rely on it to do the job**

reluctance of shippers to convert to intermodal is largely due to "an issue of confidence" in the quality of rail service.

As part of its marketing effort, BNSF earlier this year stepped up its "Next Generation" program, launched in 2010, in which it works closely with intermodal providers to educate shippers on the benefits of the service, Branscum says.

Read the entire article at:
http://www.dcvelocity.com/articles/20110607western_rails_to_redraw_intermodal_map/

**Workers Wanted: Railroads on Target to Hire 15,000 This Year**

North American freight railroads plan to hire 15,000 people in 2011, according to the Association of American Railroads' (AAR) top executive.

During a press teleconference organized June 15 by the BlueGreen Alliance, AAR President and Chief Executive Officer Edward Hamberger said his informal survey of AAR members indicated the industry will hire closer to 15,000 employees this year — 5,000 more than the figure of 10,000 he cited in a March 9 teleconference.

**The hiring trend also reflects the industry's response to increasing carload traffic as the economy continues to recover**

"I have been advised by my members that the number of 10,000 is on the low side," he said during the June 15 teleconference, which the BlueGreen Alliance called to highlight a new report that shows the relationship between investment in freight rail infrastructure and job creation.

The railroads' 15,000 new hires in 2011 will include replacing employees who retire. However, the hiring trend also reflects the industry's response to increasing carload traffic as the economy continues to recover, Hamberger said. Anecdotally, AAR members have told him many of those hires will be in train and engineering crews to accommodate traffic growth, he said.

"We are seeing growth in about every commodity sector except for housing," said Hamberger, adding that slow and steady traffic growth likely will continue for the rest of 2011.

Freight-rail hiring and job creation was the subject of the BlueGreen Alliance's new report, "Gauging Growth: The Freight Rail Supply Chain and Job-Creation Potential."

**"We are seeing growth in about every commodity sector except for housing," said Hamberger**

It is essential that the United States build a 21st Century infrastructure that supports the more efficient movement of goods" and creates jobs, BlueGreen Alliance Executive Director David Foster said during the teleconference.

The report, citing various case studies, underscores the freight rail industry's "ability to sustain private investments in the national rail network that will create quality jobs while reducing pollution and breaking our dependence on foreign oil," he said.

For every $1 billion in freight rail capital investment, 7,800 "green" jobs are created or sustained, the report said. In 2011 alone, freight railroads will

invest more than $12 billion in capital expenditures, Hamberger noted.

In addition, freight rail is a more efficient mode of transporting bulk goods, especially over long distances. Railroads can move a ton of freight 484 miles on one gallon of fuel. Trucking uses four times the energy to move freight on a per-ton basis, the report stated.

**As the U.S. economy gets back on track, freight movement will expand, requiring corresponding infrastructure investment**

"As the U.S. economy gets back on track, freight movement will expand, requiring corresponding infrastructure investment," the report stated. "By growing capacity, the freight rail industry can seize significant opportunities to meet projected demand for shipping cargo, save energy, reduce pollution and create tens of thousands of new jobs throughout the economy."

Read the article at:
**http://www.progressiverailroading.com/class_is/article/Workers-Wanted-Railroads-on-target-to-hire-15000-this-year--27028**

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**AAR Updates**

The Association of American Railroads (AAR) told the Surface Transportation Board (STB) on June 22, 2011 that the current rail economic regulatory framework allows freight railroads to sustain billions of dollars in private capital investments in the nation's rail network each year and support more than 1.2 million jobs around the country.

**"Freight railroads today spend more than $20 billion in private funds each year to keep our nation's rail network the envy of the world"**

Testifying at a hearing on freight rail competition regulations, AAR President and CEO Edward R. Hamberger told the STB that today's rail regulations have engendered a competitive freight marketplace that encourages private investment in railroads, rather than relying on the federal government to fund the nation's rail infrastructure.

"Freight railroads today spend more than $20 billion in private funds each year to keep our nation's rail network the envy of the world and American businesses competitive in the global marketplace," said Hamberger. "These are private investments made by railroads so that taxpayers don't have to."

Hamberger told the STB that they should maintain and preserve today's balanced regulatory framework because it has benefitted rail customers and the public alike. "Rail rates are down by 51 percent since 1981, which means the average shipper can move twice as much freight for the same price as 30 years ago," he pointed out.

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At the STB hearing, Hamberger also explained that changing the current regulations on rail competition and forcing the railroads to provide other carriers with access to their networks and property would make the rail network less efficient and affect service to customers. "Railroads know best how to operate their networks efficiently to best serve their customers," he told the Board.

"Proposed changes to how this country's interconnected rail network operates threaten to disrupt a system that serves customers in the most efficient and cost effective way possible," Hamberger said. "Today's

balanced regulations enable freight railroads to serve all their customers while continuing to invest in the country's 140,000 mile rail network.

You can learn more at: **http://www.aar.org/NewsAndEvents/Press-Releases/2011/06/22-STB.aspx**

### Mechanical Brief with Steve Christian

**CEPM program is scheduled for implementation in January 2012**

The AAR and Railinc have announced a Town Hall Meeting scheduled for July 12, 2011 for the rollout of the Comprehensive Equipment Performance Monitoring (CEPM) program which is scheduled for implementation in January 2012. The program is a multi-phase, multi-year ATSI program to create an industry process and related technology tools for capturing data around railcar equipment components. They are phasing it in by component. The first phase of the program is focused on wheelsets and includes centralizing the registration of wheelset component details and indentifying the application of wheelset components. Wheels have probably the most impact on railcar performance and already have a great deal of information gathered via AAR billing, wheel shop reporting, manufacturer' records and remanufacturers' records. Initially there will be quite a bit of work as with any program rollout.

**CEPM is geared towards the focus of original component manufacturers, wheel shops, repair shops, equipment owners and other interested parties**

While CEPM appears to be a novel idea, I would like to point out that some Midwest utility fleet managers went down this road over 30 years ago. As a railcar shop manager, I can remember the seemingly endless requests for detailed component information verification and measurements when unit trains were periodically inspected at our shop. This data was provided to the fleet managers who inputted it into their own computer programs. This information was then molded into reporting tools for component performance and maintenance budgeting. To my knowledge these systems continue to evolve. CEPM might make these programs irrelevant over time, but not in the near future.

CEPM is geared towards the focus of original component manufacturers, wheel shops, repair shops, equipment owners and other interested parties. This is a long term project for the collection of data on railcar components and links them to repairs, mileage and past history. This is a huge task which will require users' time and efforts for data entry; however, it offers long term benefits to railroads, car owners, component manufacturers, component remanufacturers, and repair shops by providing performance data by component will allow purchasers of those components to make informed decisions about which component to purchase. The manufacturers/remanufacturers can see the performance of their products versus other manufacturers/remanufacturers products. The AAR technical committees can see side by side comparisons of components and react quickly to problems with failures and underperformance. The CEPM information will also allow unit train operators to broaden their view of the available components to be able to choose better performing ones.

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**May freight rail traffic makes slight gains**

**May saw the 18th straight month of intermodal gains, the second highest May average on record**

**For the second month in a row, rail intermodal traffic was great, while carload traffic left something to be desired**

**US steel exports fell 9.3% in April while US Steel imports rose 5.6% in May**

## Railroad Traffic

The Association of American Railroads (AAR) reported June 7, 2011 that carloads in May 2011 increased 0.5 percent compared with the same month last year, for a total of 1,159,328 carloads. According to AAR's monthly Rail Time Indicators report, intermodal traffic in May increased 7.5 percent for a total of 932,956 trailers and containers compared with May 2010. On a seasonally adjusted basis, carloads were flat and intermodal was up 0.8 percent over April 2011.

May saw the 18th straight month of intermodal gains, and this month's weekly average of 233,239 is the second highest May average on record. The gains in intermodal can be attributed to several factors including growing international trade, better service, large investments in infrastructure and equipment by railroad companies, fuel costs, highway congestion and truck driver shortages, and the conversion of boxcar traffic. Looking further at the import and export commodities, "big box" retailers dominate intermodal container imports while recycled paper, scrap materials, and chemicals dominate container exports.

Railroads also continued to add jobs, with April seeing the addition of 935 freight rail employees, bringing the Class I freight railroad employee total to 156,777 employees nationwide.

"For the second month in a row, rail intermodal traffic was great, while carload traffic left something to be desired," said AAR Senior Vice President John T. Gray. "Like other national indicators, rail traffic reflects a degree of uncertainty regarding the direction of the economy. Railroads join everyone else in hoping current trends are just a bump in the road rather than a portent of things to come."

Overall, eight of 20 commodity categories saw carload gains on U.S. railroads in May 2011 compared with May 2010. Traffic gains were led by metallic ores, up 17.6 percent; grain, up 16.3 percent and chemicals, up 4.1 percent. Commodity groups with declines included: waste and non-ferrous scrap, down 16 percent; nonmetallic minerals, down 11.5 percent, and coal, down 1.8 percent.

Learn more at: **http://www.aar.org/NewsAndEvents/Press-Releases/2011/06/07-rti.aspx**

## Industrial Inside

U.S. steel imports increased by 5.6 percent in May 2011 from April 2011, according to preliminary government figures.

"The increase in imports in May reflected improved steel market conditions, principally in the flat rolled market, as semi-finished imports by domestic mills jumped by 38 percent in response," said David Phelps, president of the American Institute for Imported Steel. He said finished imports declined in May.

U.S. steel exports declined 9.3 percent in April 2011 from March 2011 and

**Exports through the first four months of 2011 totaled 4.12 million tons, a 1.2% increase from the corresponding period in 2010**

**Data through May clearly show the slow but steady improvement in the steel market so far in 2011**

**Year-to-date US steel imports total 11.667 million tons**

**Federal Reserve, acknowledging slowdown, reins in forecasts for economic growth**

8.8 percent year-to-year, the Commerce Department said.

"Softening shipments to the NAFTA region led the decline in April, although there was some good news as non-NAFTA Western Hemisphere shipments rose, mostly due to a jump in semi-finished exports to the Dominican Republic over March," said David Phelps, president of the American Institute for International Steel.

Steel exports in April totaled 1.026 million tons, compared to 1.132 million tons in March 2011. Exports through the first four months of 2011 totaled 4.12 million tons, a 1.2 percent increase from the corresponding period in 2010. (May and June 2011 data were not available for this month's newsletter publishing)

Phelps said year-to-date imports continue to reflect stronger demand and pricing, with nearly half of the increase coming from increases in imported semi-finished steel as domestic mills augment their hot end melting capacity in response to improved conditions. "While there is currently a pause in the marketplace, data through May clearly show the slow but steady improvement in the steel market so far in 2011, except of course for non-residential construction," he said.

Total steel imports in May 2011 were 2.691 million tons compared to 2.549 million tons in April 2011, a 5.6 percent increase, and a 17.3 percent increase compared to May 2010.

Year-to-date imports increased 20.6 percent compared to 2010 or from 9.671 million tons in 2010 to 11.667 million tons in 2011.

Imported semi-finished products increased by 69 percent in May compared with the same month last year. For the year-to-date period, semi-finished imports increased from 2.046 million tons in 2010 to 2.893 million tons in 2011, a 41.4 percent increase based on preliminary reporting.

Read the entire articles at: **http://www.joc.com/logistics-economy/us-steel-imports-rose-56-percent-may** and **http://www.joc.com/logistics-economy/steel-exports-fell-april**

## Financial Focus

The economic recovery is slowing and the outlook for next year has gotten worse, Federal Reserve Chairman Ben S. Bernanke said Wednesday, June 22, 2011, backing away from the view that the slowdown of the past few months was merely temporary.

The central bank released new economic projections that showed weaker growth in both 2011 and 2012 than had been forecast just two months ago. Despite the slowdown, the Fed said it will end a program of buying vast sums of Treasury bonds at the end of June as scheduled and gave no sign it is contemplating new action.

But Bernanke, whom markets turn to as a purveyor of economic wisdom, said the Fed had no solid answers as to why, two years into an economic

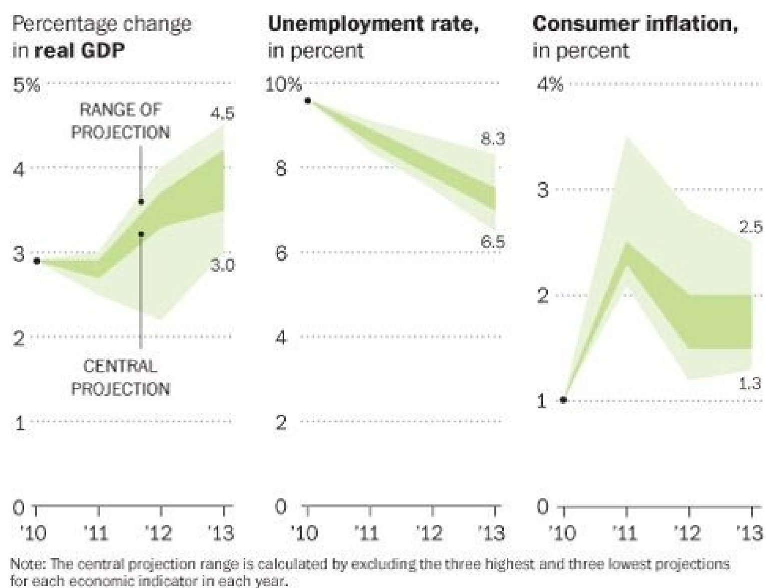
**Economic projections showed weaker growth in both 2011 and 2012**

recovery, growth keeps disappointing.

"We don't have a precise read on why this slower pace of growth is persisting," Bernanke said in a news conference Wednesday afternoon. He suggested that problems in the financial sector and the housing market, and with consumers trying to pay down their debt, had been underestimated. "Some of these head winds may be stronger or more persistent than we thought."

**Congressional Budget Office estimated that the rising cost of Medicare, Medicaid and Social Security would, if left unchecked, lead to a national debt twice as big as the economy**

Even as the central bank's leaders lowered their expectations for the days immediately ahead, a different set of government economists offered a dire long-term forecast for the federal government's fiscal health. The nonpartisan Congressional Budget Office estimated that the rising cost of Medicare, Medicaid and Social Security would, if left unchecked, lead to a national debt twice as big as the economy.




*Source: Federal Reserve. The Washington Post, "Federal Reserve, acknowledging slowdown, reins in forecast for economic growth" as published on June 22, 2011.*

The CBO report highlighted the quandary confronting the United States: a weak economy in the near term and huge deficits in the longer run. Bernanke cautioned against conflating the two problems.

**The Fed left its policy of ultra-low interest rates unchanged and will continue to hold massive amounts of securities in a bid to foster growth**

"Our budgetary problems are very long-run in nature," said the Fed chairman, noting that the CBO projections go to 2025 and beyond. "That doesn't mean we should wait to act. The sooner we can act the better. But the most efficient and effective way to address our fiscal problems . . . is to take a long-run perspective, not to focus the cuts heavily on the near term."

The Fed left its policy of ultra-low interest rates unchanged and will continue to hold massive amounts of securities in a bid to foster growth. But it confirmed Wednesday June 22, that it will let its policy of buying $600 billion in Treasury bonds expire at the end of this month, as has long been the plan. That brings to an end the controversial round of quantitative

**Inflation is higher and job growth is stronger, though employment weakened a bit in May 2011**

easing — or QE2, as it became known — enacted in November to boost the economy.

Extending the old metaphor that the role of a central bank is to take away the punch bowl just when the party gets good, economists at Bank of America Merrill Lynch wrote that “with so many parts of the economy like somber wallflowers, the Bernanke-led Fed is keeping the punchbowl filled but not spiking the drinks any further at this time.”

That’s because not all economic arrows are pointing in the wrong direction.

“The situation is different today than last August [2010],” when the Fed began considering what became the QE2 policy, Bernanke said, in that inflation is higher and job growth is stronger, though employment weakened a bit in May 2011.

Read the article at: **http://www.washingtonpost.com/business/economy/fed-says-economy-is-slowing-will-let-bond-program-expire/2011/06/22/AGPzYzfH_story.html**

## The Edge

On July 4, 1776 the United States commemorated the adoption of the Declaration of Independence. This document declared the United States Independence from the Kingdom of Great Britain.

It is a time of celebration and a way of life for those of us who still believe in the words upon which the foundation of this country was built, words such as “one Nation under God, indivisible” and “land of the free, home of the brave”.

Since the first declaration of independence some 235 years ago, brave men and women have defended our countries freedoms in numerous ways. Our many thanks and gratitude go out to those on the front line who served and who are currently serving in such a capacity. What a wonderful country in which we live!

Today, we seem to be in a different mode of defending our freedom - one in which the enemy of debt has infiltrated many lives, businesses and most importantly our government. The war is against debt.

My family and I spent a recent vacation in Europe. Of course as my family can attest not all of it was for fun. The consensus of concern from those persons I talked to in numerous European countries: What is America going to do about its staggering debt structure? Greece is broke, Italy is on the verge, France is not economically healthy and Germany is stable and all are waiting to see what America does next.

An article in June 27, 2011 “Wall Street Journal” entitled “Debt Hamstrings Recovery” seems to sum it up. Consumers debt and government debt is higher than expected even after the Federal Reserve pumped $2 trillion into financial markets since August 2008.

So what does this mean to those of us in the shipping and transportation community? Here’s a synopsis of thoughts and quotes from our network of shippers, receivers and transportation professionals.

- It seems as though we’ve lost a sense of the Industrial Nation we once were. Those of us who actually produce, make, modify, transport, or assemble goods are becoming the

minority. When we get back to producing goods and fewer services we'll have a healthier recovery.

- We focus on variable operating costs. The past three years have caused us to rethink our capital program and look hard at capital investments. We try to stay as variable and short term as possible on operating costs and capital expenditures are virtually non-existent.
- We're working on future growth and expansion. Now is the time to buy and consolidate where ever possible. Valuations haven't been this low in the past eight years.
- Railroads are moving from providing equipment to having the shipper provide equipment. The basis of their reasoning is they can't afford to reinvest in older types of railcars. I believe Railroad capital programs simply don't include all but basic commodity types of railcars.
- Railcar builder prices are up twelve to fifteen percent along with component pass-through increases off a base cost. There is little stability in this market. New car builds are out until 2012 for hot car-types. I wonder if we're overdoing it again on railcar supply.
- We have no choice but to roll with the times. If demand goes up for our product we make the best decisions possible to supply that product demand at a price that gives us an acceptable margin. The variables are the uncertainty of the times, in particular corporate and country debt levels.

Our opinion is:

- You have to operate in the environment in which you are participating. If you're a shrewd operator that continuously watches cost, margin and profits, odds are you haven't really changed your operating mode.
- Plan and re-plan. There are a host of operating and capital, strategic and tactical decisions to be made. When making one type of decision, keep the other in mind.

If we can assist you in these tumultuous times feel free to give us a call.

*We look forward to earning your business!*