

THE RAILROAD WEEK IN REVIEW

JANUARY 8, 2010

“I have thought it my duty to exhibit things as they are, not as they ought to be.” – Alexander Hamilton, August, 1782

The Week 52 car counts are in and with the data comes the usual flurry of year-over-year analyst reports. The real story, however, and the one most critical to short lines that live or die on the single-carload business, is how 2009 looks in comparison with 2007 and 2006. Happily, Cherilyn Radbourne of Scotia Capital in Toronto has come to the rescue with a series of charts that include the 2007 data.

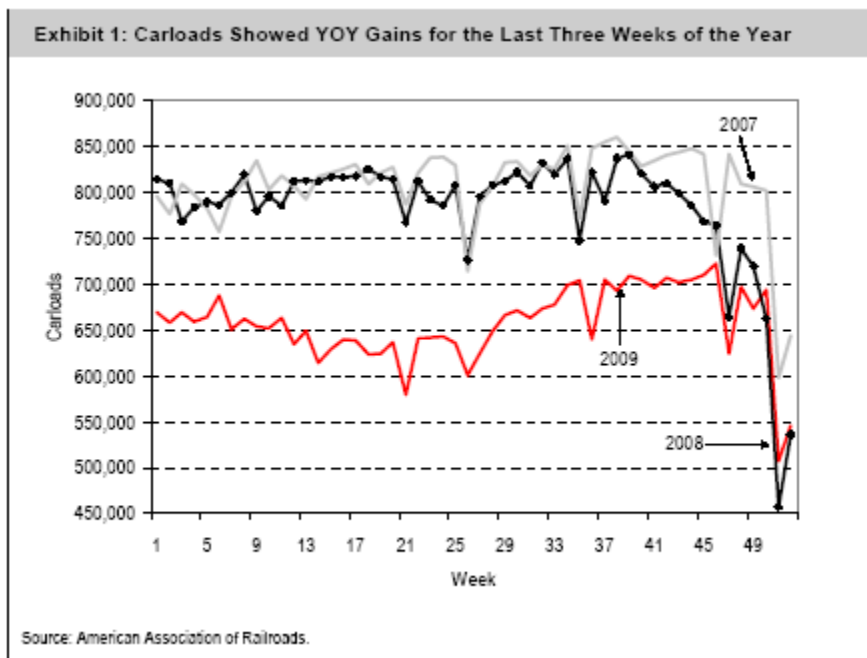


Chart Courtesy of Scotia Capital, Toronto

The charts show how 2008 tracked 2007 into October and then tanked, conforming what many short lines were saying at the time: We were OK year-over-year or even up a bit into Oct and then the fit hit the shan. The one positive we can glean is a glimmer of recovery starting mid-year 2009. Cherilyn’s individual railroad charts confirm this trend with the two Canadian roads showing the most marked improvements.

Still, even disregarding the usual December dips, getting back to 2007 levels is going to be a long pull what with the 16 percent drop in total revenue units 2007-2009. From a short line viewpoint it’s even scarier. The Week 52 RMI RailConnect Index of shortline carloads has the sector down a whopping 25 percent vs. 2008. Chemicals, coal, grain and aggregates account for 55 percent of shortline volumes and look where *they* are on Cherilyn’s Exhibit 5 bar chart.

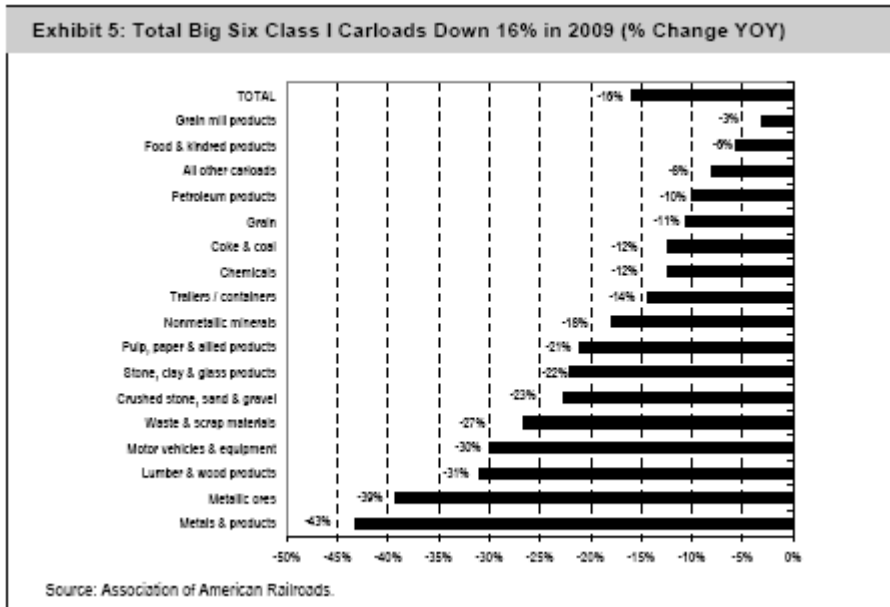


Chart courtesy of Scotia Capital, Toronto

It's a general fact of life for any business that ten percent of your customer base goes away every year through natural attrition and if you don't replace it you're out of business in ten years. One of the best examples I've seen of how a railroad reinvents itself comes from the Lycoming Valley Railroad, a member of Pennsylvania's North Shore Railroad Group.

Years ago, Newberry Yard in Williamsport (see attached aerial photo) was the interchange point for the Reading and the NYC for a Philadelphia-Chicago/St Louis freight service in competition with the Pennsy. The Final System Plan, Penn Central and Conrail put an end to all of that and in the process the former Reading and NYC lines serving Williamsport became dotted lines on the SPV maps. With the exception of the former PRR Buffalo-Harrisburg line everything else in the area went to SEDA-COG, the local quasi-governmental agency featured in my June 2006 *Trains* cover story on the short lines of Pennsylvania. North Shore runs these lines for SEDA-COG.

Today, it is said Williamsport is one of the largest concentrations of industry in the state. You better believe it. There is so much frack sand flowing through the place that the transload site in Newberry Yard (red dot in the exact center of the photo) is locally known as "the beach." Ten of these customers didn't exist when Conrail sold the lines in 1996. The common thread has been "know thy customer and how his business works." This is the result.

There's no reason it can't continue even in this less-than-robust economy. Just the other day I heard about a shortline-served paper plant taking in chemicals by barge yet the shortline marketing manager didn't even know the product was moving, yet a sister plant 100 miles way was taking all that commodity by rail. Another short line complains about the low handling allowances it gets while its customers are running all kinds of commodities around them on trucks. Both are missing new business opportunities. Ten per cent a year, guys.

The BNSF short lines are going to have to take the lead in replacing volumes lost in intermodal and coal. In the Winter *Short Line Connection* newsletter from BNSF the company notes that short lines have identified more than 150 new business opportunities worth a quarter of a million new loads a year. Short Line AVP Short Lines Mark Schmidt writes, "Another major goal for 2010 will be to

improve our interchange effectiveness with short lines. Based on feedback from many of you, you have made it clear that this is an area where improvement is needed. To improve our performance, we will establish additional interline service agreements (ISAs) on a prioritized basis. ISAs will give us a basis to measure against and to identify where improvement is required.”

I’m surprised there are still questions re ISAs. Failure to meet ISA guidelines is a service performance failure issue, something not worthy of a scheduled railroad like BNSF. But failures there must be and Schmidt has determined to get to the bottom of it. I’d appreciate a note from any BNSF short line out there seeing consistent interchange failures including advance consist reports.

Chop Hardenbergh’s Atlantic Northeast Rails & Ports letter brings this delight: A handful of Maine Legislators have decided to penalize the railroads if they do not move a car to interchange within 48 hours of loaded release, saying “There’s a collective feeling that [rail service is] an issue here, and it’s time to start putting our foot down.” Lovely.

A railroad is a volume business and if the customer lacks the volume to make his business profitable for the railroad, maybe he ought not to be using carload service. Too often we see customers using just enough rail to keep their truck rates down. They know the minute the siding is pulled those truck rates will go up and stay up. So the question is not how to force the railroad to do something that is economically absurd but rather how to use more rail to strengthen the supply chain process and lower inventory cost including transportation.

Not that long ago I sat down with some of the folks at Maine DOT to seek out ways to match public policy with supply chain requirements of Maine industries. One of their major themes emerging was exactly that: how to encourage increased use of rail by looking at the railroad as a supply chain management tool. Looks like these legislators never heard what the DOT guys were promoting.

In response to Chop’s inquiry on the subject, MMA President Bob Grindrod writes, “On lines where service is provided less than five days per week (out of economic necessity) the impact would weaken these lines even further. This would only serve to make rail less competitive with truck, and probably drive some volume of traffic from rail to truck.

“I think such a result would be contrary to good public policy [which was what DOT was trying to codify -- rhb], and would certainly not have a beneficial impact on the railroads. Railroading is a volume business that has a very difficult time reducing expenses (to bring them in line with revenues) without a reduction in service. “ And running counter to the policy DOT was seeking to promote.

In my WIR cover letter for December 24 I took a pass on the Washington morass. Larry Kaufman takes umbrage. “Here, I’m inclined to disagree with you, Roy. I think the lobbying that is going on now is even more ferocious than before the Senate Commerce Committee voted out the marked up bill. And it will become even more ferocious going forward.

“In my next column, I discuss this and will even speculate that there’s no guarantee that a bill will be passed, something that won’t bother the railroads at all if it were to happen that way. Considering that railroads always have been regulated to one degree or another, the negotiations now are for a bill that they can live with and that will allow them to prosper.”

Maybe. Monday’s WSJ carried an Op Ed piece by three economists who are at the University of Chicago -- Gary Becker, Steven Davis and Kevin Murphy. Messrs. Becker and Murphy are also fellows of the Hoover Institution of Stanford University. Mr. Davis is also a visiting scholar at the

American Enterprise Institute. They write in part, “The separate [health] bills passed by the House and Senate worry small businesses, in particular. They fear their labor costs will increase because of mandates to spend much more on health insurance for their employees. The resulting reluctance of small businesses to invest, expand and hire harms households as well, because it slows the creation of new jobs and the growth of labor incomes.”

Worse, for short lines, at least, “Faced with a highly uncertain policy environment, the prudent course is to set aside or delay costly commitments that are hard to reverse. The result is reluctance ... by businesses to undertake new capital expenditures or expand work forces, and decisions by households to postpone major purchases.” All the tax credits in the world won’t help if there are no goods to move. I’d love to know what you short line guys are thinking.

If our own government is weakening the competitive advantage of our own businesses, who’s to step into the void? Dennis Gartman, he of *The Gartman Letter* and *trader extraordinaire*, suggests in his Jan 4 note that Canada (our largest trading partner at 1.5 times more export/import trade with the US than China) may have the brighter future as “the world will have to come to Canada to buy the things it needs: food, energy, raw materials and water.”

He’s predicting that the Loonie will move “to parity and beyond” against the US Dollar and approaching parity but not surpassing the Euro. It wasn’t that long ago that we heard the Canadian railroads talking about the shifts in traffic patterns -- less lumber south to Texas in support of the Texas building boom, more piping north from Texas to support the Athabasca oil sands expansion. Shorting the dollar against the Loonie might be an interesting trade.

RailAmerica subsidiary RaiLink Canada Ltd. has closed on a transaction with the Canadian Pacific to terminate its lease of the Ottawa Valley Railway (OVR) line between Smiths Falls and Camspur, ON, about 100 miles. Termination will be effective upon clearance of the remaining cars from the line. The RA subsidiary will continue to maintain and operate the CP-owned rail lines between Sudbury and Mattawa, ON, Mattawa and Temiscaming, PQ, and Mattawa and Camspur until dates in 2010 to be determined by CP. The OVR operation up to this point was comprised 342 mainline track-miles used mainly for bridge traffic, chemicals, and pulp and paper products.

For the nine months ended September 30, 2009, total revenue for OVR was C\$13.3 million, operating income was C\$4.6 million, depreciation/amortization expense was C\$0.4 million and capital expenditures were C\$0.7 million. Under the terms of the agreement, RA received C\$73 million in gross proceeds. RA estimates net cash proceeds after taxes and transaction related expenses of C\$69 to C\$70 million and will record the income or loss from these operations in discontinued operations beginning in the fourth quarter of 2009.

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Lundy Warehousing

Transload of gas fracing sand

Bell Pole

Communication pole distribution

Alcan

Manufacturer of aluminum cable

Frito-Lay

Snack foods manufacturer

Bell Pole

Communication pole distribution

Nor-Pac

Communication pole distribution

Transco

Rail car repair

Penn Recycling

Scrap metal processing

Speedy Heavy Hauling

Gas pipe transload

Staiman Recycling

Rail (metals) processing

Nittany Oil

Ethanol transload

Smurfit Stone Container

Manufacturer of corrugated materials

LVRR Engine House
In 1999, JRA builds new engine house to be occupied by LVRR. Later substantial improvements made to other buildings in yard.

Kennedy King Industrial Site
JRA is working with city to develop rail-served site using DCED \$1 million grant. Project will be done spring 2010.

DCED Infrastructure Grant
\$126,000 awarded to JRA to construct turnout and related track work to serve Moran Industries distribution center.

Lonza
JRA sold property to Lonza so that this company could make major site and security improvements.

High Steel
JRA sold property to High Steel in the late 1990's to accommodate their expansion. Project included improvements to High Steel's ability to use rail service

Sechler Property
JRA's acquisition of Sechler home and lot ensures better access for Newberry South.

Did you know this about the Newberry Yard?
▲ Has about 20 miles of track
▲ Contains 109 acres
▲ Extends for nearly 1.5 miles from end to end
▲ Largest railroad yard between Buffalo and Harrisburg

Railway Unloading Services Newberry South Bulk Transfer

Plastic and food grade transload

Moran Industries

Distribution center
Rail to truck transload

UGI

Propane transload and storage

High Steel

Manufacturer of steel bridge beams

Lonza

Chemical manufacturer

Shop-Vac

Plastic resin transload

Fisher Mining

Coal transload

Railway Unloading Services - Newberry North

Transload of gas fracing sand

**Newberry Railroad Yard
Williamsport, PA**

Owned by SEDA-COG Joint Rail Authority
Operated by Lycoming Valley Railroad