

THE RAILROAD WEEK IN REVIEW

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“Longer sidings, extra tracks at stations and other projects funded by HSR grants will contribute to more efficient freight operations.” – Larry Kaufman in Rail Business

US Rail Partners CEO John Howell writes, “Roy, the February 12 WIR piece quoting Art Cashin and the Bloomberg story about small businesses not hiring strikes a chord regarding the ‘hunkered down’ approach short lines continue to maintain when it comes to their own hiring. While it’s true the financial and political pundits on cable TV insist that the reason businesses large and small don’t hire is uncertainty -- uncertainty in tax rates, uncertainty in health care costs, uncertainty in whatever -- the real reason businesses aren’t hiring is lack of demand.

“Railroads, short lines included, can only make money when their customers have something that needs to be moved from suppliers to end users and where the railroad price for that service is sufficiently competitive with alternate transportation modes. New business opportunities aside (and I agree with you that beating the bushes for new business is key), until demand improves little is going to happen.

“Short line businesses, like any other small business, will be glad to bring back furloughed employees or even hire new ones once the current staff is working all the hours they can. But until then I don’t see where we can do much more than go after new business where we see it, continue beating on the doors of our Class Is to improve short line service and urging them to keep us in mind as they continue to exercise their pricing power.”

Thanks, John. As you so correctly point out, transportation services are a derived demand. As such, the rails won’t see carload numbers increasing until somebody senses an increased demand for whatever they’re selling, from whole grains to finished autos. That’s why transportation is seen as a leading indicator and it’s part and parcel of the Dow Jones Theory.

A tenet of that theory posits, “An investor looking for signs of health in manufacturing needs to look at the performance of the companies that carry their output to market -- the truckers and the railroads.” That’s the derived demand part. The “hunkering down” part comes from the fact that the citizens are not spending as they used to. That’s why the credit card balances are down and savings as a percent of disposable income are up. That’s why I wrote that uncertainty keeps firms from hiring and until they see a demand uptick they will fill the needed labor hours with overtime and temps.

Howell concludes, “As I recall, Warren Buffett once said on CNBC that if he were on a desert island and could have access to only one financial statistic as a sign of the economy’s health, he said it would be freight car loadings.”

Larry Kaufman asks in his *Rail Business* column whether the so-called High Speed Rail initiative is about transportation or putting shovels in the hands of the needy *a la* the infamous Civilian Conservation Corps of the 1930s. He does acknowledge, however, that “money spent on higher speed passenger rail service will benefit freight railroads simply by allowing passenger trains to move more rapidly over their systems, which in turn will allow their freight trains to operate without conflicting competition for capacity.

“Longer sidings, extra tracks at stations and other projects funded by HSR grants will contribute

to more efficient freight operations - even if the country doesn't experience true HSR." And therein lies the rub. Even as the feds are putting money into, say, the Buffalo-Albany (NY) corridor, one municipality along that route is threatening to put a short line out of business over less than \$200,000 in property tax arrears. The local newspaper reports that if the railroad goes, so does a new ethanol plant. Stupid.

Yet on the other end of the state the New York & Atlantic, an Anacostia & Pacific short line, stands to gain new business with the reactivation of the old Northrop-Grumman industrial track in Riverton. The town's board has ponied up \$3.5 million to have Railroad Construction Corp. put the line back in shape. (These are the right folks. I once hired them to rebuild an old Lackawanna freight yard in NJ and connect it to the NJ Transit's booming Boonton line.) The project is being paid largely through federal stimulus funding.

And, speaking of NJT, it looks like work may finally begin on restoring the portion of the Lackawanna Cutoff between Port Morris and Andover Township. This is part of the same Lackawanna main mentioned above and which Conrail abandoned in 1982. Pennsylvania has declined to extend the service to Scranton so Transit plans to put the tracks back half way to the Delaware River at a cost of cost \$36.6 million.

The freight benefit will be there in spades if and when they get the rails restored into Pennsylvania. NS has the former Lackawanna main from the Delaware River Bridge to just west of Stroudsburg and Genesee Valley Transportation has the line to Scranton where it connects with the former D&H to Binghamton and north to Albany and beyond. Could the D&H once again regain its fame as "The Bridge Railroad" linking New England and eastern Canada with the south and west?

And in southwestern Vermont the Omya calcium carbonate processing plant in Pittsford will finally get its three-mile spur to connect Vermont Railway's ex-Rutland Railroad main line to reach the Middlebury marble quarry supplying the raw material. At present the marble moves the 24 miles down US Route 7, a two-lane road that is the state's main highway for its west side. Omya's permit, issued in 1999, limits the company to 115 truck trips a day between the quarry and plant yet the need is for half again that many. Omya has been exploring building the spur for a decade.

The new spur will not be cheap, requiring for example a trestle nearly half a mile long. The state of Vermont plans to use an \$8 million federal earmark to pay for its share of the project, which mainly involves work related to highways. The next step will be for Vermont Railway and Omya to arrange financing to build the track.

Just last week Genesee & Wyoming CEO Jack Hellmann said on the fourth quarter call that listeners should soon expect an acquisition "in the natural resource area." Well, here it is: GWR has created a new subsidiary, Western Labrador Rail Services (WLRS), to "provide transportation services" for the yet-to-be-built 21-mile Bloom Lake Railway Company (BLRC), itself a subsidiary of Consolidated Thompson Iron Mines Limited (CLM), a development and exploration mining company traded on the Toronto Stock Exchange.

The Company is presently developing its Bloom Lake iron ore deposit that is expected to produce some eight million metric tonnes of ore to start. The mine, located in the province of Quebec on the south end of the "Labrador Trough," will use the new railroad to reach Wabush, Labrador, for interchange with the Quebec North Shore & Labrador for movement beyond to CLM's port facilities in Pointe-Noire on the St. Lawrence River for export primarily to Asian markets. The Bloom Lake rail is planned to be operational by the end of the first quarter of 2010 with iron ore shipments starting immediately thereafter. The new line will be operated as part of the GWR Canada Region.

Running the numbers, eight million metric tonnes (a tonne is 1000 kg, 2204.62 lbs) is roughly 8.8 million US tons or 88,000 annual 100-ton carloads. GWR averaged \$360 a car for “coal coke & ores” in 2009 in regular revenue service, though I’m willing to bet the nature of the transaction is such that a hook-and-haul arrangement such as GWR has in Australia is more likely – a hundred dollars a load? If that be the case it’s nine million dollars a year in new money

The actual revenue per car is less important than how fast they can turn the cars. Hellmann said on the call they are making a ten million dollar capital commitment for rolling stock and they’re not going to own or maintain the track. So if a block of 50 cars can make two trips a day with one set of power and one crew-start you can make a lot of money at a hundred bucks per turn. And if it takes three days and two crew starts to make \$360 a car in revenue service, this operation will clearly be the more profitable. This revenue stream will go into the “non-freight” line on the income statement and as such we will not see actual carload numbers.

A northern plains short line manager writes with regard to corn price trends (WIR Feb 12), “In our neighborhood the corn was harvested late into November after nearly a month of steady rain in October. We’ve seen some mold/vomitoxin issues, and rejected grain inspections, so while the quantity of corn was high, the quality is not. The carry in the market suggests a slow Feb-May, with increasing activity in June-August.” He adds that the two new ethanol plants opening in the second half of 2009 could affect the local mix as well as corn available for export.

Wheat is not a large part of this railroad’s commodity base. The writer says over the last years there has been a steady decline in wheat and barley acres as these fields are being converted to corn and soy beans. And yet, just this week the National Corn Growers Association said their members face a loss of ethanol-based sales if Congress does not renew the refiners’ 45-cent-a-gallon tax credit and the 54-cent-a-gallon tariff on imported ethanol. Reading between the lines, the fear is that Brazilian ethanol shipped to the US East Coast could displace Midwestern corn-based ethanol.

The NCGA says without the tax credit corn-based ethanol simply fails to compete with oil. But the tariff is perhaps even more important. With Royal Dutch Shell’s recent \$21 billion-a-year joint venture with Cosan, Brazil’s biggest ethanol maker will suddenly give sugarcane ethanol access to the oil company’s global fuel distribution and retail system. Without tariffs, the U.S. suddenly becomes an ideal home for all that Brazilian ethanol. And that of course threatens the railroads that have been making a nice buck moving all those tank cars east.

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