

THE RAILROAD WEEK IN REVIEW

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“Idiocy trumps wisdom almost every time when it comes to the US House of Representatives.” -- Dennis Gartman, The Gartman Letter, March 16, 2010

Gartman’s comments are in the context of Congress’ understanding the relationship between China’s currency management and the US economy. The same sentiment could be applied to the actions of state and provincial governments when it comes to economics and railroads. As Exhibit A we have the machinations of the Maine Legislature over the MMA where the market for the rail service offerings of the MMA has shrunken appreciably.

The Huron Central is Exhibit B. Genesee & Wyoming has said clearly it will shut down the line unless there is some relief forthcoming from the Ontario provincial government. GWR’s argument is the same as the MMA’s: there is insufficient cash flow to warrant the investment required to fix the tracks and run the trains. My friend Rick Webb, president of the Watco Companies, puts it simply and eloquently: “The railroad is a wasting asset and what wears out has to be replaced.”

You can’t legislate against this fact of life, that the railroad is an absolute and it either works or it doesn’t. I’m reminded of Ophelia (Jamie Lee Curtis) in *Trading Places* when she tells Winthrop (Dan Akroyd), “Clothes cost money, Louie. Food costs money.” You just can’t have opinions about this stuff: if the business isn’t there, no amount of wishing will make it work. Track, brake shoes, diesel fuel and paying the staff all costs money. If the operator can’t support the cost out of cash flow and the shippers still want service, there is a way out.

Consider the model used so well in Pennsylvania with its Susquehanna Economic Development Association - Council of Governments (SEDA-COG) Joint Rail Authority (JRA). Its first acquisitions were light-density lines that were surplus to Conrail and the JRA hired the North Shore Railroad Group to run them. In the succeeding 25 years the JRA acquired four more ex-Conrail branches, kept the operating assignments with the North Shore and now has a thriving rail network that is bringing new business to the area. See the Williamsport aerial view attached to the Jan 8, 2010 WIR for a sample of their handiwork.

New York short lines are asking what’s happened to \$106 million from a 2005 bond issue that was supposed to be invested in rail and port projects. The Albany *Times Union* reports that \$200 million in grant requests submitted before the October 1, 2008, deadline are still “under review” by state officials. Norman Schneider, Executive Director of the Railroad of New York (RONY) trade association, told the paper, “For the last two years not a dime has flowed.”

RONY membership includes short lines from the Arcade & Attica to the Western New York & Pennsylvania as well as the larger Pan Am Railways, Norfolk Southern, and CSX. Like other states’ railroad associations, RONY serves as an important liaison between business interests looking for new sites in the state and the railroads that would serve them. Yet, says Schneider, the number of NY DOT staffers devoted to rail issues is down to fewer than 50 from 200 in the 1970s even as the rail renaissance continues.

The short lines are the ones that really get it in the neck when the grant program shrivels up. Not having the cash flow and resources of the Class I they are dependent on state grants another financial assistance to maintain tracks and bridges. The WNYP’s key bridge route for coal into the Southern Tier and on into New England, the new Medina ethanol terminal on the Falls Road and the Barilla pasta plant on the LAL

are but three examples. If the state is serious about gainful employment for its residents, the adults in charge in Albany (if any are left) would be well served by turning these funds loose.

Short lines can heave a sigh of relief on Hours of Service, thanks in part to the efforts of the ASLRRRA staff. As reported in the Association's *Views & News* the FRA on March 5 gave "initial approval to parts of ASLRRRA's July 16, 2009 Petition for Waiver of Hours of Service." The petition noted, "Small railroad employees almost always sleep in their own beds at night, and are not subject to deadheading long distances from remote locations at the end of their shifts. Many train service employees at small railroads work more than five days per week just to garner a 40-hour work week. Seen in the light of this reality, small railroad train service employees who happen to work some hours six or even seven days a week do so as a lifestyle choice, and fatigue is not an issue."

The FRA waiver allows six days' consecutive work with one day off as long as "covered service [does] not extend into the early morning hours for six consecutive calendar days." If work schedules extend into those early morning hours, the FRA has indicated that it will examine those schedules on a case-by-case basis to determine if it will grant the waiver under those conditions. To view a copy of the waiver of relief granted by FRA on March 5, link to http://www.aslrra.org/images/news_file/ASLRRRA_HOS_Waiver_Petition_Initial_Decision.pdf

The 2010 winners of the *Railway Age* Short Line of the Year and Regional Railroad of the Year awards are South Carolina's Greenville & Western Railway LLC and North Dakota's Northern Plains Railroad, respectively. The former operates on 13 miles of ex-CSX track acquired in 2006 with a mere 100 revenue loads a year. Intensive work on the right-of-way and a strategic purchase of 38 acres to encourage storage facilities for oil and ethanol products helped propel the short line's volume to 1,872 revenue carloads in 2009—an increase of 130 percent over a two-year period. President Steve Hawkins was one of the shortline presenters at the breakout sessions in Jax and the ethanol story is to say the least impressive.

Northern Plains Railroad opened for business in 1997 and now leases 388 route-miles in No Dak and Minn from CP. Primarily a grain hauler, NPR has added wind energy component traffic through a joint business arrangement with Union Pacific Railroad. NPR also gets kudos for coping with extensive spring flooding in 2009 when the Red River overflowed its banks and forced the railroad to suspend service for 26 days. Yet the railroad ended the year nearly equaling its carload traffic record and anticipates resetting its record books in 2010.

Freight car builders' shares are trending nicely upward. However, reports from a recent carbuilders conference indicates the number of cars stored would indicate rather tougher times ahead. What's going on? MarketEdge, a stock watch service that issues Long, Neutral or Avoid ratings based on a combination of technical signs and fundamentals, lists 17 rail-related names from CSX and Union Pacific to Foster and Trinity to Wabtec. Of these names, 15 are Long and two are Neutral, however of the car-supplier Longs Trinity, GATX and Wabtec are "oversold" meaning prices are expected to come in a bit before resuming the upward trend. Being "overbought" indicates the prices are likely to come in but how far in is the question.

The chatter at an informal gathering of rail stock-watchers in NYC this week showed a degree of amazement at these trends given the number of railroad-marked cars stored on Class Is and the number of X-marked cars stored on short lines and regional railroads. Moreover, the feeling goes, the rails are turning cars faster and running smarter than ever and this bodes ill for the number of cars needed to haul a given amount of goods.

I've written before that UP President Jim Young, for example, says his railroad is "right sized" for 200,000 revenue units a week and at the moment they're running in the neighborhood of 160,000 units a week. Loco and car miles per day, crew starts and cars on line are flat to down, so it's hard to square the stock trends of the builders with rail traffic data. *Caveat emptor.*

The Wellsboro & Corning Railroad (WCOR), a piece of the old NYC coal route down into the central Pennsylvania coal fields, has struck gold in terms of its proximity to the Marcellus Shale bonanza. Clearly, the collection of older power would not do and so the WCOR has grown the fleet with the March 11 addition of four microprocessor-equipped SD40-2 units. The six-axle locomotives use 3,000 horsepower, turbo-charged V-16 engines.

WCOR is a wholly-owned subsidiary of Myles Group, LLC. Myles Group began operating the railroad in January of 2008 and purchased the locomotives to support their recent increase in business. Information on Wellsboro & Corning Railroad is available at www.WellsboroandCorningRailroad.com.



Class I Railroad revenue units for Week 10 saw a 9.9 percent year-over-year increase, slightly below last week's increase of 11.6 percent, but above the prior four-week average increase of 5.9 percent. Metals and automotive were strong, coal was "less worse," as Ed Wolfe likes to say. Grain increased 14 percent and there begin to be some signs of life in forest products (both 24 and 26) and aggregates.

RMI's RailConnect Index says shortline carloads increased 11 percent year-over year for the week with grain up 19 percent on 15 percent of shortline volumes plus double digit gains in both forest products STCCs and aggregates. Metals were strong at eight percent of shortline traffic and waste is staging a comeback as well, up 17 percent. Year-to-date numbers still lag, up less than two percent. But it's a start.

Is it time for Class I railroads to re-start their share buyback programs? UBS' Rick Paterson seems to think so and has the charts to prove it. According to his analysis, CP is best positioned with more than \$3 "excess cash per share" on its balance sheet, roughly six percent of market cap. He writes, "We were surprised none of the rails bought back stock in the back half of last year when it became apparent volumes had troughed in Q2, but at the time we put it down to re-reg fears -- i.e. hard for the rails to make the case that re-reg may constrain pricing and starve them of capital when buybacks are tangible evidence of excess capital.

"Whatever the merits of this theory, the re-reg threat has largely abated over the last few weeks and now the shackles should be well and truly off. CN has stepped up with a new 15m share authorization and CSX has opportunistically bought back at least \$229m in Q1, but that's all the activity we've seen so far." Rick estimates the rails "can repurchase between one and six percent of their market caps with current excess cash on hand, with UP, CSX, and NS best placed."

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