RAILROAD WEEK IN REVIEW
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"UTU would have had several weeks to review the Lease if it had acted in a cooperative and reasonable fashion with respect to discovery." WNYP Response to UTU Petition for Stay

The Western New York & Pennsylvania (WNYP), a relatively new shortline that was created in mid-2001 to operate 190 miles of the former Erie main between Hornell NY and Meadville PA, has leased the portion of the former Pennsylvania Railroad Buffalo line between North Driftwood PA and Machias NY plus two other smaller segments for a total of 98 miles. The transaction brings WNYP to approximately 340 route miles forming an "X"-shaped regional system centered at the former Conrail yard at Olean NY. The NS press release said simply that interchanges will be at North Driftwood and Meadville and that WNYP "is responsible for all rail operations on the leased lines, including track and signal maintenance, as well as customer service." WNYP started operating the lines Aug 3.

But there's a little more to it than that. On August 2, the day before the WNYP was scheduled to begin operations, the UTU filed a Petition for Stay of Effective Date (See FD 35019). In its filing the UTU took the position that certain employees had not been afforded the required 60-days notice, that the Machias-Driftwood lease will "cut off the traditional flow of traffic," that "the instant situation is another attempt to circumvent the required employee protection," and that UTU members will be "adversely affected" by the transaction. The attached Verified Statement from the local UTU rep was mostly concerned with employee dislocation.

WNYP's response to the UTU Petition for Stay notes that the UTU did not respond to the initial notice in a timely manner and waited literally until the last minute to file the Stay: "UTU would have had several weeks to review the Lease if it had acted in a cooperative and reasonable fashion with respect to discovery." Attorney Kevin Sheys spells out in great detail how the employee protection provisions were met and that the UTU had known about the Aug 3 date well in advance.

The language of the STB Decision is eloquent, to say the least, taking the UTU to task for not making a clear case for itself. "If UTU-NY suffered any harm from what it asserted on July 25 was a delay in its receipt from WNYP of confidential information, it made no mention of it in its August 2 request for stay." And so, "to the extent that the July 25 petition seeks different relief from that sought in its August 2 stay request, we find no basis for adopting UTU-NY's suggestion that the effective date of the exemption be extended in this proceeding." Thus "it is ordered that UTU-NY's August 2 petition for stay is denied." Life goes on.

Continuing the thread about GWR transparency (WIR 8/3/2007), I had a very helpful chat with CEO Jack Hellmann and CFO T.J. Gallagher. They agreed it was a difficult quarter to report and offered a number of corrections to my summary and some very instructive clarification. To begin, the 27-cent EPS figure in the press release was *after* the 11-cent Mexico charge. Excluding Mexico and the related restructuring charges, the real comp is 38 cents, up 7.6% over 2Q06 and consistent with their previous guidance.

Second, to call the "non-freight" revenues as a percentage of total revs "worrisome" is inaccurate. What I had missed was that the growth in this category includes expansion of Genesee and Wyoming Australia's business with a large Australian steel producer. This business includes both the delivery of iron ore to the steel mill as well as intra-plant switching. To that is added the revenue generated by GWR's North American port terminal railroads and the industrial switching operations (which operate under the Rail Link brand). The port railroads, which switch intermodal and bulk commodities, have benefited from both higher volumes and rates.

The "other" category in the commodity group report includes the Meridian & Bigbee overhead traffic. The unfortunate bridge failure took "other" revenue units down a third yoy and revenue down nearly as much. Looking ahead, GWR is faced with some challenges in terms of what to put where. The new Maersk terminal in Portsmouth will push up intermodal revenue units substantially for the company's Commonwealth Railway, which will provide service to the new terminal. Where to count it? In with the IM traffic on the SLR or in "non-freight" along with the other Rail Link port business?

The Commonwealth Railway doesn't only serve the port, in contrast to most of GWR's port railroads. Like the SLR, the Commonwealth has a legitimate over-the-road traffic base that shows in the car-counts along with the rest of the commodity groups. T.J. and Jack seem to think that the Maersk traffic will end up in the IM category, given the differences between the Commonwealth Railway and its port terminal railroads, but the jury is still out.

One more thing. The commodity listings reflect mostly North American traffic. The AUS biz shows up mainly in food products and minerals/aggregates. On the conference call Jack noted the grain RPU delta was sky-high because the combination of the drought and the high fixed portion of the contract caused the fee to be divided by a smaller number of units. On the mins/aggs side, there's a lot of short-haul movement in very small cars - say 40 tons lading max per car. Thanks,
Jack and T.J.

UBS Rail Analyst Rick Paterson writes, "Buffetted Again. The rail sector traded up 1.6% Wednesday, helped by a strong tape and news that Warren Buffett's Berkshire Hathaway had increased its stake in BNSF to 11.5% from 11% of the company. This continues a trend we've seen all year where the stocks are materially impacted by the names on the holdings lists, rather than fundamentals and the intrinsic earnings power of the companies.

"That was the good news for BN. The bad news is that we think it's likely to miss its $1.40 EPS guidance (and current consensus of $1.41) in Q3. We're at $1.37. It's obviously still early in the quarter, but with QTD volumes -4.8% vs. -3% guidance, and Q3 y/y velocity flat and terminal dwell off by 2%, the railroad will need a hot August (benefiting coal) and some sort of peak season (benefiting intermodal) to have a chance at hitting near-term financial targets."

Meanwhile, Morgan Staney's William Green sees transportation executives describing the US economy as uncertain however there remains cautious optimism about a late 2H07 pick up. "Most carriers were hopeful that any economic pickup would improve the industry outlook and pricing behavior, but saw no signs of a near term recovery. Railroads anticipate a slower recovery now than during previous quarters, but strong pricing will continue to drive earnings growth. Truckload and less-than-truckload carriers mentioned that the economy remained unpredictable and are still expecting softer volume and pricing growth in 2H07 offset by easier comparisons to last year."

Nobody disputes that the continuing mortgage debacle and housing slowdown is having an effect, but well all gotta eat and keep the lights on. Stocks like KO and PG are hitting new highs daily and the car builders backlogs are encouraging. Bigger cars getting better turns mean higher yields and more ton-miles per unit, so even as unit volumes drift down, GTMs don't necessarily follow. For 2H07 keep your eye on the RTM and GTM deltas rather than revenue units. It ought to be revealing.

The howls of some rail customers over rates continue to cause concern. A friend writes, "I've seen a number of screeds published in places like Wilmington, DE, and Mankato, MN, by CURE and the electric co-op people. They are not just shilling for their positions, but are actively disseminating misinformation about the railroads. [Then there's] Xcell Energy, which operates in Minnesota, Colorado and Texas.

"They recently testified before Congress and/or the STB, demanding that minimum service standards be established for railroad coal service, and that reparations be paid for failure to comply. Xcel just last year negotiated an agreement with the Colorado PUC in which it was relieved of minimum service standards and any obligation to pay reparations for failure to perform." Am I missing something or are there two sets of rules regarding service standards?

Perhaps not. AAR President Ed Hamberger wrote in an Aug 4 opinion piece for the KC *Star* that shippers and their representatives who blame railroads for increased costs are "flat wrong" on numerous counts. "Rail coal rates in 2005 were down 30% or more from where they were in 1981 while electric rates over than same period went up 38%. It's not just coal rates that have gone down either. So have rates for grain, automotive products, chemicals, lumber and just about everything else that moves by rail." Hamberger added that almost $400 bn in rail infrastructure improvements were made during the same time period, proving that railroad deregulation has succeeded, not failed as critics suggest.

We've been hearing a lot about "shareholder returns" of late however the fact of the matter is one can either return cash in dividends or buy-backs or put it back into the core business. And what you return to the shareholders can't go into track or locomotives. Perhaps CP's Fred Green put it best on past month's call saying safety and the infrastructure required for keeping train ops safe come first (WIR 7/27/2007).

I wanted to see who's giving back what and how the "shareholder returns" might affect infrastructure investment so I concocted the little table following the disclosure. Next I'm going to look at yoy changes in balance sheet debt. Yeah, I know. Some say the rails can support debt/ebitda north of five. I need further convincing, especially given some of the so-called main line track I've seen out there.

Worse, there seems to be an anecdotal ink between what I see out there and how well the operating ratio reflects the CEO's remarks on the calls. The more closely what's said on the call resembles what's really out there the lower the OR. I rest my case with CN.

Walter Rich passed away at home August 9 following a long illness. Walter had been a good friend and advocate to the short line industry and will be sadly missed by many. Please drink a toast to his memory and to absent friends tonight. Cards and notes of sympathy should be sent to the family at 1 Lake St., Cooperstown, NY 13326.

The Railroad Week in Review, a weekly compendium of railroad industry news, analysis and comment, is sent via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 mm annual revenues $125. Corporate subscriptions are $500 per year. A publication of the Blanchard Company, © 2007. Subscriptions are available by writing rblanchard@rblanchard.com . Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned.

Table 1.

		NSC	CSX	BNI	UNP	CP	CN
YTD Cash Flow Analysis							
Cash from operations		$ 1,137	$ 1,075	$ 1,576	$ 731	$ 592	$ 1,002
Net Income		$ 679	$ 564	$ 782	$ 832	$ 385	$ 840
Cash from ops/net income		167%	191%	202%	88%	154%	119%
Free Cash flow							
Cash from ops		$ 1,137	$ 1,075	$ 1,576	$ 731.00	$ 592.00	$ 1,002.00
Capex		$ (575)	$ (824)	$ (1,334)	$ (514.00)	$ (363.00)	$ 547.00)
FCF		$ 562	$ 251	$ 242	$ 217.00	$ 229.00	$ 455.00
FCF/Revenue		12.2%	5.1%	3.2%	2.7%	9.8%	22.4%
Payout							
Divs Pd		$ (174)	$ (106)	$ (179)	$ (83)	$ (64)	$ (212)
Divs as pct net income		25.6%	18.8%	22.9%	10.0%	16.6%	25.2%
Repurchase shares		$ (427)	$ (727)	$ (709)	$ (186)	$ (203)	$ (687)
FCF less divs, repurch		$ (39)	$ (582)	$ (646)	$ (52)	$ (38)	$ (444)