THE RAILROAD WEEK IN REVIEW
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"Some lessors are willing to lease railcars at rates that aren't profitable, as they view nearly any rate as an attractive alternative to paying to store a railcar."—Peter Nesvold, Bear Stearns

Barron's this week ran a Q&A on commodity pricing and the implications for Class Is and short lines are significant. Coal shortages in the Far East and India are drawing Appalachian coal for metallurgical use pushing prices toward the $150 a ton range. There is not much call for low-vol, low-sulfur PRB coal offshore so the US-source coal will have to come from mines on CSX and NS plus their short lines. Nobody's talking much about anthracite, though that is used as much as a commodity as a heat source in high-quality steel-making.

Barron's also reports that as fertilizer prices continue heading north. US wheat crop demand "replaces corn demand seasonally, and serves as a powerful reminder that world grain stocks remain exceptionally low." Barron's figures it'll take more than two years to replenish wheat supplies to "normal levels" the demand pull will continue to pressure supply and thus prices. Soybeans are also on the rise, up 20% since Nov. Yet farm returns remain higher for corn, good news for fertilizer suppliers, which is one reason share prices for companies like Terra Industries (TRA) and PotashCorp of Sask (POT) have been on a tear of late.

Greenbrier, with its unusual fiscal year for this industry, reported Q1 earnings (November close) that missed the estimates though special charges and foreign exchange seemed more the culprits. More important for WIR readers, however, is what Bear Stearns' Peter Nesvold concluded after the call. He writes, "GBX expects F2008 railcar deliveries of 7,500-8,000 of which some 80% is already booked." Leasing revenue may be soft as BSC's sources say, "some lessors are willing to lease railcars at rates that aren't profitable, as they view nearly any rate as an attractive alternative to paying to store a railcar."

Still, a short line operator in Penna located near a car manufacturing facility is spotting new cars on storage tracks as fast as they come off the line. Short line operators in NJ and Ontario say cars are still coming into storage in droves. On the other hand, a chemical manufacturer says inconsistent transit times are forcing him to increase his fleet size just to cover existing business. But, hey, if you have a short line and the freight biz is off make the money while you can by storing the excess cars.

Getting back to coal, Penna has a lot of anthracite still in the ground and short lines such as the Nittany & Bald Eagle, Corman's Penna Lines, GWR's Buffalo Rochester & Pittsburgh and the independent Reading & Northern are particularly well-positioned. Just this week the ASLRRA's *Views & News* reported that the Commonwealth of Penna has doled out some $20 mm in grants and the above-named lines are on the receiving end of roughly half of it.

Also this week comes news of several other shortline grants and loans around the country. In Washington State the Columbia Basin RR won a $3 mm RRIF loan to buy 73 miles of track it now leases from BNSF. The Crab Orchard & Egyptian Railroad in Illinois has been awarded $155,000 to rehab 13 miles of track to enhance its connections with the UP and BNSF. North of Denver OmniTrax' Great Western is picking up a $4 mm RRIF loan for industry tracks for an ethanol plant and an industrial park while adding mainline capacity for bigger trains.

The Carolina Coastal Railroad in NC ran its first revenue train into Raleigh following a 4,000-tie rehab of 13 miles of o/s track using a matching grant from NC DOT. This is the northern leg of the original Norfolk Southern Railway from Raleigh to the VA state line. It went to the Southern in 1974 and was in turn absorbed by today's NS eight years later. Most of the Virginia side is RailAmerica's Chesapeake & Albemarle; the southernmost 100 miles is leased to Bob Menzies' Aberdeen Carolina & Western.

On the other hand, Oregon's Port of Tillamook Bay Railroad (POTB), owned by the port of the same name, has given notice that it doesn't have the $27 mm needed to repair the damage done by storms last month (see slide show at www.potb.com). The railroad -- featured in the August 2005 *TRAINS* -- is a key lifeline to sawmills in the Tillamook Bay area. Its rugged line through the Salmonberry Canyon is largely inaccessible by road, making repairs difficult. The port still owes money on loans that fixed the line after a 1996 storm, but damage from that storm was half the damage here.

It's interesting to note that Oregon has four rail lines between coastal points and the I-5 corridor – this one, RailAmerica's CORP and two lines run by GWR's Oregon cluster, the northern-most of which has had its own share of difficulties keeping the last few miles to Astoria open for business. And we all know about the CORP's travails on the Coos Bay line.

These were all SP lines built around the end of the 19th century and were not designed for today's train sizes. Just as state DOTs chose new alignments for the Interstates (can you imagine the Penna Turnpike laid over top of US 30?), communities that rely on 100-year old RR infrastructure ought to look at applying the same engineering discipline to the rails as they do to their precious highways.

Happily, there are still entrepreneurs who care enough about the railroads to step when it's time for a change in ownership or operating entity. Such is the case with Pennsylvania's Wellsboro & Corning. The Growth Resources of Wellsboro (GROW) owns the underlying 38-mile railroad between its namesake city and a connection with the NS (former Erie) southern tier at Corning NY.

Effective Jan 1 former CR executive Tom Myles and his management team assumed operating authority and ownership of certain assets from Dick Robey, who had operated the line as a sub of his North Shore Rail Group based in Northumberland. In a press release Myles said they have no plans for any immediate operating changes and later told me in a phone interview the odds are quite good they will be able to grow the traffic base from the present 300 units a year.

The Virginia Department of Rail and Public Transportation (VDRPT) has finished its Economic Assessment report on the proposed regional intermodal facility near Roanoke. The report concludes that the intermodal facility, as part of the Heartland Corridor initiative, could provide significant economic benefits for the Roanoke region, including an increase in annual employment of up to 2,900 jobs and tax revenues of up to $71 million annually.

Additional public benefits identified in the report include 189 million gallons of fuel saved, 1.9 million trucks removed from Virginia's interstate highways and some 700,000 tons of carbon dioxide emissions avoided in the first 15 years of operation. The rate of return on the Commonwealth's investment in the Heartland Corridor project and this facility would be over 20 percent and the project would pay for itself within five years. It is estimated that the facility "has the potential to deliver seven dollars for every state dollar invested."

Credit Suisse rail analyst Jason Seidl writes, "2007 was nothing short of a volatile year for the transportation sector. While broad fears of an economic recession have driven notable market instability over the past few months, the transports group has been feeling the impact of an economic downturn for well over a year." According to the ATA 2007 is likely to come in as the worst year since 2000 when tonnage losses exceeded 5%. As for railroads, Jason sees rail demand is in a "freight recession" as the group reported four down quarters in a row though 3Q07.

And so it is that CS highlights "certain stocks in our space that stand out above the rest in terms of financial position, defensiveness, growth potential, and even risks to the stock. While many of our themes are long-term in nature, we believe that each could potentially play a significant role in the respective stock's price performance for 2008, in some cases irrespective of economic conditions."

Of course, stock prices don't rise if the underlying business is going to Hell in a hand-basket. The inference for short lines is then that these Best in Class are going to be the volume and profitability leaders. Your assignment is figuring out how to take part in the revenue and volume gains. The envelope, please…

The most pricing power – Union Pacific (and this is among all modes, not just rails) thanks to the most legacy contracts to be re-priced plus its PRB position. The most potential for acquisitions – Genesee & Wyoming based on its past performance in seamless integration of new properties, significant cash, and an appetite for smaller fry in the US, viz, Maryland Midland.

Conclusions: Make the most of your divisions with UP, taking cost out of your relationship and negotiating for a fair share of your traditional divisions. If system revenues are up 7%, so should yours; if UP is collecting a fuel surcharge for your mileage, ask for a piece of that too. As for GWR, look for opportunities to get some of that acquisition money if you're in a selling mood. If not, be ready to go up against one of the best in the business if you're on the acquisition trail yourself.

Watco has acquired the operations of Reload Inc., a transloading and warehousing firm that has built its business around railroad relationships over the past 25 years. Reload has facilities in the Phoenix, St Louis, Chicago and Mobile markets and its core business is in handling steel, lumber and bulk commodities. The acquisition is yet another piece of Watco's goal of producing one-stop shopping for all its shipping customers. As Watco President Rick Webb told me, "We'll place your carload, unload it, truck the load to your non-rail served customer, fix the car if need be, and take it away when made empty. All you're ever get from us is a smile, a handshake and a single bill."

Providence & Worcester and GATX announced on Thursday that they have teamed up with the latter buying shares in the former and the former signing up with the latter as its exclusive supplier of leased freight cars. To begin, GATX bought 239,523 newly-issued shares of PWX stock for $5.5 mm or $23 a share, a 44% premium over the PWX close of $16 on Wednesday. The diluted share count increased 5% to 4.8 mm shares, effectively doubling the 3Q07 loss to $0.35 from the reported $0.14. Over the next two years GATX will lease equipment worth about $35 mm. Clearly, there's more to this than meets the eye. Stay tuned.

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