THE RAILROAD WEEK IN REVIEW
NOVEMBER 13, 2009

"With respect to acquisitions, we are encouraged by what we see and will focus on situations where there is room for improvement." – RailAmerica President and CEO John Giles

Railamerica's first conference call since going public went very well, I think. After a brief introduction showing the diversification of the RA franchise -- highly industrial, little exposure to direct consumer products, geographically spread out -- CEO and President John Giles launched into a fluid account of their accomplishments not only year-over-year but also sequentially over the 2009 second quarter.

The common thread throughout was the great job the RA team has done seeking out places to cut costs, get more for the dollar, and improve yield. At first blush, seeing freight revenue down 24 percent year-over-year on a 23 percent decline in revenue units was about par for the course, given the economy and what we've seen in other third quarter calls.

Revenue carloads by commodity were up and down, a lot of it having to do with whether RA can control rates -- more than a quarter of the properties are ISS (in the route and are part of the rate-making process) while the rest are handling lines and they have to take what the Class Is give them. So coming out with a meager minus 1.3 percent in average revenue per unit ain't doing to bad. Ex fuel surcharge and foreign exchange, RPU was up four percent.

Total freight sales were down 17 percent. The total delta of some $23 million came from $24 million less freight revenue and $6 million less fuel surcharge while recouping $8 million in rate hikes, improved mix and non-freight revenues (ancillary charges, car storage, etc.). Car storage fees nearly doubled year over year and during the call Giles said he didn't see that changing because for very car that comes out there's another going in. Demurrage was down by 17 percent, meaning that customers are turning equipment faster and contributing to the 15 percent decrease in car hire expense.

Operating expenses came down 22 percent thanks to better control of fuel use, labor hours, purchased services and third-party maintenance agreements. Casualty and insurance came down13 percent as RA's safety initiatives have cut reportable injuries by nearly half since 2007 (though I would have liked to see the injury rate per 200,000 hours worked in addition to the raw numbers). Operating income was $24.6 million, up four percent over second quarter 2009. Below the line, net income jumped 21 percent to $3.5 million from 2.9 million. The operating ratio was 76.8, down five.

Giles also made the point during the call that they have a $130 million war chest for acquisitions, which is a good thing as that's where the growth will be going forward. He was somewhat pressured to give specifics during the Q&A but he dodged the bullet nicely, saying they're out there, we know who they are and we think reasonable men will respond to reasonable offers.

The market is presently pricing RA at slightly more than one time book value and even with an estimated PE in the 30s for the full year estimated eps of 39 cents, it would appear RA is on track to make some buys in the next few months. What's best, structured as they are, RA ought to be able to take on acquisitions in the $20-30 million range and have most of the new revenue go straight to the bottom line. Said NY analyst Ed Wolfe in his note, "We prefer fundamentals for the shortline rails with better long-term growth prospects through acquisitions." I agree.

It was encouraging to hear how many rail analysts tuned in to this first call. There was not as much questioning on the core business – commodity carload trends, operating expense trends, etc. – as I would have liked but instead questions went to below-the-line items and acquisitions. I'm hopeful RA will do an analysts day – maybe on the NECR because it's close to NY – to put these guys in a business car and show them how it works. They could even take Amtrak's Vermonter to get there.

Housekeeping: The presentation and supporting documentation were exceptionally clean and well prepared and ought to serve as a model for KCS and GWR. For KCS because it provides a balance sheet and a statement of cash flows plus an ebitda reconciliation, so important for the smaller roads. For both because the financials are offered in a PDF format with clean page breaks making printing out for leisurely perusal a snap. As is, printing either one on web-page format requires the user to make a page selection before printing and even then the right-most column does not always show. A PDF a la RA and the Class Is makes life a lot easier.

Genesee & Wyoming's third quarter came in with a 14 percent decrease in operating income to $107.9 million excluding the benefit of a $2.6 million gain from insurance recoveries relating to prior years' events. Revenue carloads declined only three percent to 197,087 units thanks in large measure to a strong Australian grain harvest that punched the farm and food number up by 12 percent. Minerals and stone, the other Austrian commodity group, declined by four percent. Absent the effects of foreign exchange, acquisitions and mix, average revenue per unit was up two percent.

Total freight revenues dipped 13 percent to $83.2 million and "non-freight," essentially Rail Link port and smaller shortline operations, dipped 17 percent, taking total revenue down 14 percent year-over year to $136.4 million from $159.4 million. The operating ratio ex-insurance recovery came in at 79.1, unchanged. The total revenue delta was a negative $23 million on a 36.9 million decrease in same-railroad sales offset by $12 million in sales from recent acquisitions. Same-railroad sales were also hurt by the $2.2 million decrease from foreign exchange rates and a $6.7 million shortfall in third-party fuel sales thanks to cheaper fuel and lower third party demand.

GWR finally sold off the last of its interests in Mexico and Bolivia, recognizing cash proceeds of some six million dollars. Net income from continuing operations was down two percent; net income including discontinued operations was $21.7 million vs. $21.2 million last year, a gain of two percent even though the diluted share number grew 13 percent, putting earnings per share at $0.53, down ten percent from last year's $0.58.

A quick perusal of commodity carload volumes everywhere but the foods and aggregates groups that are big in Australia shows a pattern similar to what we're seeing on all the railroads' third quarter results. As noted above, recent acquisitions reduced revenue declines without them by a third. The hazard here is that a company having difficulty growing its core revenue without acquisitions could be in trouble *sans* things to buy. See RailAmerica's first iteration as a public company.

Partly as a result of paying $113 million for CAGY and Rotterdam plus another $8 million for working capital adjustments on the Ohio Central and Maryland Midland acquisitions, GWR now has $360 million of debt on its books, about 54 percent of equity. Hardly highly leveraged but it's debt regardless. Happily, year-to-date free cash flow was a positive $53 million vs. a negative $55 million before acquisitions. The fact remains that GWR was profitable in an awful quarter and as the economy gets back on its feet we should expect great things from these folks.

Carmakers and leasing companies are not having an easy time of it. Economic Planning Associates, in its most recent analysis of the domestic freight car market, says builders and component suppliers will have to tough it out until 2011 or later before the market begins to improve. "In this environment, it is not surprising to note that there continues to be little, if any, interest in new equipment." Here are some indicators, courtesy of the *Railway Age NewsWire*:

American Railcar Industries (ARII) delivered 610 railcars in the third quarter of 2009, compared to 3,120 in the third quarter of 2008. In a statement ARII said, "The weak railcar market requires us to evaluate our production levels at all manufacturing locations and we plan to continue to adjust our workforce and production levels as needed. In addition, we have reduced overhead costs at all manufacturing locations as a result of reduced spending."

FreightCar America (RAIL), a Chicago-cased builder with a niche in coal hoppers, delivered 695 units in the quarter, down from 1,207 units in the second quarter and 3.082 in 2008's third quarter. Worse, there were NO new car orders in the third quarter vs. 694 new orders on the books in the second quarter and 2,329 booked a year ago. A press release says, "Total backlog of unfilled orders was 777 units at the end of the third quarter, compared with 1,472 units at the end of the second quarter of 2009 and 4,401 units at the end of the third quarter of 2008."

Not surprising. AAR data shows Class I coal volumes peaked in 2008 and are down ten percent through the third quarter this year compared to the same period last year. Even if volumes recover at an optimistic GDP growth rate of four percent in 2010 and 2011, they will not achieve the 2008 levels until 2009. An informal survey of Class Is' coal business with short lines shows that segment down even more than the individual Class I and RMI's RailConnect Index puts total shortline coal units down 16 percent for the first nine months of 2009.

The Rail Group of The Andersons Inc. had an operating loss of $8.9 million in the third quarter of 2008, down sharply from the $5.2 million it earned in the third quarter of 2008. In an earnings statement the company said, "The group continues to be impacted by the double-digit declines in rail traffic." It added, "Gross profit from the leasing business was significantly less due mainly to lower utilization rates and the corresponding increase in storage expense from idle assets. The group now has approximately 24,000 cars and locomotives. The average utilization rate in the quarter was 74.4 percent in comparison to 93.3 percent for the same period last year."

A tidbit from *Barron's*: "Insider sales are less informative than insider purchases. Insiders typically have undiversified portfolios because they get stock as compensation. As risk-averse investors, they don't want to concentrate their wealth in one stock. Buying more makes this problem worse. The only reason that they would buy more, even though it increases their non-diversification costs, is if they have positive information. They can sell to diversify, for liquidity reasons, or for other reasons. Sales are still informative but less informative than purchases."

The Motley Fool's Tom Gardner adds: "Insider ownership measures the percentage of a company's stock that key executives own. Generally speaking, the higher this figure, the better. Founders and managers with high levels of ownership have their own wealth riding on the company's performance. They are doing everything they can to increase the long-term value of their stock."

The Railroad Week in Review, a compendium of railroad industry news, analysis and comment, is sent as a PDF via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 mm annual revenues $150. Corporate subscriptions $550 per year. To subscribe click on the Week in Review tab at www.rblanchard.com. A publication of the Blanchard Company, © 2009. Disclosure" Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned in WIR. Specifics available on e-mail request.