THE RAILROAD WEEK IN REVIEW

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"Union Pacific's domestic intermodal business grew 8 percent last year during one of the worst recessions in decades as our record service performance attracted new business to our railroad." -- Jim Young, President, Union Pacific

Providence & Worcester once again turns in a quarterly performance that destroys shareholder value. Back at the end of 2006 P&W had on the books $37.6 million in Retained Earnings. That number had dropped 4.9 percent to $33.9 million at the close of 2009 and in the last three months dropped another 2.6 percent to $33.1 million. Total shareholder equity also dipped 1.0 percent in the first quarter of 2010.

The shift toward greater carload revenue as a percent of total revenue and revenue-units continues, and that's a good sign. First quarter 2010 carload revenues increased 28.3 percent to $5.6 million while intermodal revenues were slashed 41.2 percent to a mere $150,000. Carload units jumped 55.3 percent to 7,388 and intermodal boxes dropped 36.9 percent to 2,314 units. Carload revenue-per unit came down 17.4 percent, however the sizable jump in volume drove a positive system RPU gain of 11.4 percent to $582 per unit.

The 10-K blames the drop in container count on the shift to all-water container moves direct to the east coast from the Pacific Rim but there's more to it than that. CSX has moved its intermodal operations into Worcester from Boston and the advent of the Pan Am Southern relationship in Ayer, 32 interstate highway miles north, hasn't helped. Moreover, P&Ws penchant for spending more in operating expense than it has in railroad-related revenue continues with an operating ratio of 118.6, albeit a 26-point year-over-year improvement.

I still cite labor at 62.8 percent of railroad revenue as the big challenge. It's roughly double the labor percent of other short lines and regionals; cutting it in half could reduce the operating ratio to a more respectable 87, for example. I also suspect there is a relationship between the high labor line item and the 52.5 percent jump in casualty and insurance expense. Something has to give and it's coming out of maintenance: equipment repair expense, track materials and other materials came down 62.2 percent, 41.1 percent and 31.7 percent respectively. And the railroad had two derailments in the quarter whereas they usually have none.

The P&W is a terrific little property that has a great niche in southern New England. However, as shareholder value continues to degrade and labor continues to run the ranch, its days as an independent entity may be numbered.

The PTC argument is gaining momentum. Tony Hatch writes from the ASLRRA Annual Meeting in Orlando, "Positive Train Control is another area of concern (for the big boys). Matt Rose told the ASLRRA hordes that his railroad would make the 2015 deadline – but at what cost? Budgets are rising and it's not clear yet that the government will help out (despite its clear

and evident public safety benefits – though the FRA Administrator Szabo seemed to acknowledge that).

"The fast-approaching deadline has some wondering whether the technology will be ready, whether they aren't rushing to a less-vibrant model. Already one major defense tech leader with a system up and running in Australia has dropped out of the US story, saying the time-frame has forced the carriers to use Wabtec rather than promote a tech arms race. The cost-benefit seems stacked against them; it's even more so when you take out benefits from separate technologies such as GPS, precision dispatching, etc." That's part of it.

Another viewpoint comes from Larry Kaufman, writing in his May 17 *Argus Rail Business* column, "A 2005 study published by the Transportation Research Forum determined PTC internal rates of return" across a wide spectrum of operating conditions. "The peer-reviewed study, which was done for FRA, quantifies the benefits that might accrue to railroads and shippers. Line capacity would be increased, they say, because locomotive on-board computers would continuously calculate minimum safe stopping distances, enabling the system to determine minimum safe distances between on-coming and following trains. Precise knowledge of the required distances between trains also would allow trains to operate at higher speeds."

But short lines are a different story. Even if it can be argued that PTC may add capacity to Class I main lines where there are multiple train-starts per day and many trains over the same sets of tracks, on Class II and III roads such is not the case. On those rare occasions where there are multiple train starts per day they rarely traverse the same routes. The very fact that only one train pair a day operates over a given track segment is the most positive train control you can get. A single two-way crew start in no way can collide head-on with itself or even rear-end itself. The UP's Fresno Subdivision is one thing; the Aberdeen Carolina & Western is quite something else. Ergo, I say PTC on short lines is a waste and a plague on all their houses.

Union Pacific is adding to its domestic intermodal fleet, thanks to recent Board approval for a $100 million increase in growth capital spending in 2010. Says UP Chairman Jim Young, "UP's domestic intermodal business grew 8 percent last year during one of the worst recessions in decades, as our record service performance attracted new business to our railroad."

Meanwhile, UP still had 38,000 freight cars in storage as of the end of March. Even though cycle times are below nine days per turn, that's still a lot of car parked. And I doubt if UP would be investing $100 million in domestic intermodal boxes if they thought there was an immediate use for those parked cars. It's another sign of the times for merchandise traffic in the single-carload lanes. Short lines beware: what was there in 2006-7 may never come back.

During the afternoon CN sandhouse sessions May 13 the subject of car management and ordering came in for some heavy discussion. Paul Clarke, CN Senior Manager for eBusiness, said he'd set up webinars on the topics and so he has. He writes, "As discussed in our Shortline Conference, I have set up two Webinars to cover:

> Overview of CN's eBusiness Tools - Wednesday May 26 15:30-16:30 Eastern Time
> CN's New Car Order Process - Wednesday June 2, 14:30 - 15:30 Eastern Time

"The Overview will give you an idea of what tools CN Customers, including those located on your lines, have on the CN eBusiness site. The New Car Order Process will describe how we are changing our Car Order process in August, and the implications to you. Both sessions will be interactive, with a web link so you can see the presentation/system and a toll-free call in number for the discussion. You don't need to leave your office, but you will need to join 10-15 minutes in advance.

"I will send you an invite with the link and phone number a few days before the meeting. You are welcome to forward to your colleagues, or have them join you in a conference room where you can all see the web session. You do not need to confirm attendance, and if you are not available, I will send out the presentation material after the session." This in three business days from the event. Nice going. [*If you're not sure you're on the list or want to double check if you are, Paul can be reached at (514) 399-5686 or via e-mail at paul.clarke@cn.ca. -- rhb]*

Miscellaneous Intelligence Dept. Jeffries & Co initiates coverage of freight car builder Greenbrier "with a Buy rating and a $22 price target. Railcar loadings have started to pick up, an early sign the industry is moving past the trough of the cycle. New car orders and an increase in car refurbishment should follow, driving positive earnings momentum. Initiation of coverage follows the recently completed secondary offering of 4.0 million shares."

Domestic steel traffic may be in for an uptick, says UBS. "With shares punished on global concerns, we think some domestic plays -- in particular distributors and aggregates -- look relatively more attractive. The euro has now weakened to below 1.24/USD, levels last seen in the worst of the downturn, and some forecasts see it falling to parity; a stronger dollar could hurt a recent surge in US exports. We particularly like the recovery stories for specialty-metals producers Steel Dynamics and Allegheny Technologies."

Baird on CSX: Reiterate Outperform rating. Stronger-than-expected volumes, accelerating pricing growth, and effective cost management provide continued near-term momentum as well as longer-term opportunities for margin expansion. Raising estimates on stronger volumes, most notably within coal, CSX's largest franchise. Very tight truck capacity and rising truck freight rates support stronger intermodal. Domestic container capacity is largely sold out, unusual this early in year. Operational improvements and investments combined with a network advantage to potential drive peak ORs into the mid-60 percent range. NS has largely maintained the best-in-class US operating ratio over the past decade, but CSX's structural and cost attributes should support best-in-class status during this cycle.

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