THE RAILROAD WEEK IN REVIEW

February 25, 2011

"We had a strong finish to 2010 and are well-positioned for further progress as we move into 2011." -- John Giles, President and CEO, RailAmerica

RailAmerica's fourth quarter call was clean, transparent and positive. The level of detail went beyond what one usually sees and hears in these quarterly reports and conference calls and -- if one pays close attention -- shows how one can make a nice living in this business. In the presentation material I thought it instructive that Chief Commercial Officer Charlie Patterson elected to show commodity carload comps as opposed to the more usual revenue comps. This is where short lines live largely because they don't have the pricing power of the Class Is so carload comps give a clearer picture of the state of the shortline community as a whole.

Total revenue came in at $127.6 million, up 17 percent over the 2009 fourth quarter. Freight revenues increased 13 percent to $97.0 million while "non-freight" sales increased 34 percent, mostly on the Atlas Railroad Construction Company acquisition; absent that, non-freight gained 18 percent. A good thing, too, as the core freight-hauling business saw revenue units increase a mere four percent. Moreover, the non-freight sales from car storage are likely to decline in 2011 as cars go back into service.

The double-digit volume gains were in metallic ores and minerals, chemicals, non-metallic minerals and "other," Auto was the big loser, down 60 percent after a contract was not renewed. On the other hand, RA was able to replace the lost low-rated business with higher-priced moves so the automotive revenue per unit jumped 53 percent to $582 a car. In fact, RA was able to garner RPU gains in nine out of 12 commodity groups.

It gets a tad messy on the expense side. Because the final decision on 45G tax credits for 2010 came so late in the year, RA took the entire amount in Q4, generating a $17.6 million credit against expenses. Another $400,000 gain from asset sales further reduced the ops expense line. Going to the 2009 fourth quarter comps, RA had $3.9 million in 45G credits, $26.7 million in asset sales and an IPO charge of $6.3 million relating to the Atlas Purchase.

Put it all together and 2010 fourth quarter adjusted operating expense becomes $101.9 million, up 13 percent from last year's adjusted $90.1 million. The adjusted fourth quarter 2010 operating ratio becomes 79.9, an improvement of nearly 300 basis points. But I'm not concerned about the high-ish number; CEO John Giles has said in the past this company can comfortably operate in the mid-70s and to my mind that's in the cards.

RailAmerica still has a personal injury ratio north of two and that's got to be reflected in the 50 percent jump in casualty and insurance expense. But RA moved four percent more loads on just two percent more fuel, has won government grants to replace older power with more fuel-efficient power, took comp and benefits down seven percent and has positioned the railroad to

continue the pattern of increasing revenues at a faster rate than expenses, thus leveraging handsome operating income gains going forward.

Below the line, RA is paying back debt, has cut quarterly interest expense by 20 percent (that's a cool $5 million right there) and took the quarter's net income to a positive $17.9 million from a negative $6.9 million a year ago. The balance sheet's a lot healthier, too. Net debt at December 31, 2010 is down 11 percent to $573.7 million. Total debt now rests at a respectable 45 percent of capitalization, down from 45 percent in the prior year. And free cash flow after capex but before grants is a positive $54.5 million vs. negative $38.2 million a year ago.

RailAmerica figures 2011 carloads will be flat to down in the first quarter thanks to weather-related supply-chain shifts but most of that will be simply pushed out to the second quarter, yielding a full-year gain in the three to five percent range, about what we're hearing from the Class Is. Full-year non-freight revenue will come in at the $100 million level as Atlas gets cranking. And the 45Gs will be worth $17 million or so once again.

The state of Maine is beginning to get some nibbles on the Montreal Maine & Atlantic transaction, according to Chop Hardenbergh's *Atlantic Northeast Rails & Ports* letter. The responders to date are, in no particular order, the Myles Group of the 38-mile Wellsboro & Corning, RailAmerica, Patriot Rail, Pan Am Railway/Springfield Terminal and the Eastern Maine Railway.

Each brings something unique to the table. Tom Myles, a former Conrail executive, took over the Wellsboro & Corning from the North Shore Group just as the Marcellus Shale boom hit north-central Pennsylvania. Capitalizing on his transload experience, Tom set up a sand terminal at Wellsboro and has acquired four SD40s from the Quebec North Shore & Labrador to handle the traffic. Patriot Rail is Gary Marino's venture, building on his experience at RailAmerica and now the proud owner of 13 short lines with 500 route-miles in 12 states.

RailAmerica, Pan Am Rail and Eastern Maine are already in the area and know well the challenges of New England railroading. RailAmerica has turned the New England Central and its Connecticut Southern into regional powerhouses and, further north, has made the Cape Breton & Nova Scotia work better than ever. Eastern Maine Railway is under the Irving aegis, being a sister rail to that company's New Brunswick Southern, and runs the east end of the ex-CP route to St John across the top of Maine.

And Pan Am is the one constant of New England railroading. Its roots and routes go back to the Maine Central and Boston & Maine and has had a presence in New England for 30 years. If you look at the list of NEARS shipper members, many of the biggest names do business with Pan Am one way or another. I can guarantee an interesting story as the transaction evolves. Stay tuned.

Canadian Pacific CFO Kathryn McQuade provided some useful insights for CP's United States shortline connections as to what CP is up to and why at the BB&T Transportation Conference Feb 16. The slide set is available under the Investors tab at www.cpr.ca and I'd recommend your singing along.

I see three take-aways supporting my thesis about doing more with CP. Slide 5 breaks out the geographic distribution of CP's book of business. They handled 2.7 million revenue units in 2010, so -- doing the math -- 675,000 revenue units (25 percent 2.7 mm total rev units) are cross-border to/from the US. The eight border-crossing points are Huntington and Kingsgate, BC; North Portal, Sask; Emerson, MB, Coutts AB; Detroit/Windsor; Buffalo and Rouses Point. Spreading 675,000 units across eight border crossings averages out to 84,000 cars a year -- 1,600 cars a week, 16 trains, 2+ trains a day -- average per border crossing.

However, as CP points out in a note to me on this topic, there is a significant amount of "global" traffic that moves cross-border. This would in include grain from the Midwest that flows through the Portal interchange (where CP routinely sees 10-15 trains a day). Thus it's safe to say that (1) CP's cross-border traffic is not evenly distributed among interchanges and (2) my strict arithmetic averages understate the amount of traffic as cross- border traffic that is categorized as "global." For example, the global number takes in the intermodal traffic to and from the Port of Montreal destined to and from Chicago and Detroit.

I've also learned from CP that the two busiest corridors are Detroit and Portal. To which my CP source adds, "To the extent we can increase density over routes (like Rouses Point etc) we can not only drive better economics, but also a better service offering. With better service comes more opportunities – so it's a nice circle!" And that leads to Slide 7 showing that the energy sector leads in growth in the Industrial Products group.

Energy includes ethanol (much off the DME), frack sand (Wisc, W Canada) and pipe (Central and western Canada). Their marketing presentation at the June 2010 Investors Day in Calgary showed Marcellus as one of their US energy target markets. To this you can add ethanol to Providence and Albany off the DME. To increase density it would make sense sending it out of the US at Detroit/Windsor and back in at Rouses Point. And that leads to...

Slide 9: Long train strategy. NS keeps up its intermodal length by block-swapping along the way, just like passenger trains picked up and set out sleeper back in the day. Can CP do the same with merchandise train blocks? My sense is that short lines building business cases for increased CP participation in these key energy markets could result in new revenue streams for everybody.

End paper. Larry Kaufman's *Argus Rail Business* comment on the politics playing between Congress and the STB is worthy of particular note. "Despite pandering and posturing by all involved, there is no chance the STB will make significant changes this year. Rockefeller is not getting much support on Capitol Hill, either. Representative John Mica (R-Florida), chairman of the House Transportation and Infrastructure Committee, recently sent the STB a letter cautioning the agency not to fix what is not broken." Thanks, Larry.

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