THE RAILROAD WEEK IN REVIEW
March 30, 2012

"Our Multi-Year Plan, based on our in-depth knowledge of our franchise and endorsed by the Board, is the Right Plan to create the most shareholder value from its unique assets." -- Fred Green, President, Canadian Pacific

Canadian Pacific on Tuesday's Investors Day left no doubt about one fact of life in running any service business, be it a McDonald's franchise or a Class I railroad: customers value consistency and certainty and will withdraw their trade if their experience is otherwise. It is this Fact of Life that led CP to its Multi-Year Plan (MYP), first announced at the June, 2010 Investors Day in Calgary. Best of all, many of the technical aspects of the MYP were demonstrated on a train ride from Calgary over to Field, BC, through the famed spiral tunnels.

On that trip we got some good one-on-one time with senior ops folks and were able to see innovations like where and how to place distributed power in a train for maximum acceleration, braking and fuel efficiency effects. I remember in particular chatting with Ed Harris for an hour or so about where these operating initiatives would take the company in terms of service reliability and customer satisfaction. His observations and predictions were most encouraging.

Fast forward to Tuesday and it was clear from the presentations and accompanying remarks that the Green Team (Fred Green, Kathryn McQuade, Mike Franczak, Jane O'Hagan) is doing a terrific job of capitalizing on what Harris and I talked about two years ago. Every piece supports every other piece. Long trains with distributed power get out of town on time, use hot-box detectors to make running brake tests, run to plan make the meets as scheduled, and arrive at the receiving yards on time. Unit trains arrive at their destination terminals on time, get turned and are ready to make another run. All on schedule.

You can't run a railroad like this without a plan, and therein lies the rub. Green drove this point home most eloquently in his concluding remarks. He challenged four crucial Pershing Square assumptions -- pricing and service quality; unit operating expenses; car utilization; locomotive fleet size and utilization -- and demolished them one by one with the facts about CP's actual performance in these and other areas.

What Fred's saying (and I almost wish he'd said it in so many words -) is that the MYP now in place and run by the management team now in place is yielding the consistency and certainty that customers demand, as clearly shown in Drew Robinson's charts. As I see it, CP shareholders can continue with what's working now under the present leadership or opt for a management change in the hope of more better faster, to coin a phrase. It's going to be a tough call.

The ASLRRA Annual Convention is in Indianapolis April 21-24, and once again education is a continuing theme. Under the “RailroadU” heading, attendees can opt for any combination of topics grouped into seven “educational tracks” covering Engineering & Maintenance of Way; Finance & Administration; Legal; Legislative & Regulatory; Marketing; Operations & Safety; and Technology. All told, the Association has scheduled more than 40 individual sessions across these seven Tracks.

I may be accused of having a One Track Mind, and in the case of Railroad U, that’s a fair cop. I’m particularly heartened to see the breadth and depth of Track 5, Marketing. Four out of the five individual break-out sessions deal with wooing, winning and keeping customers, communities and the good opinion of connecting Class Is. Of the four, two are particularly timely: (1) What Class Is look for in a shortline partner and (2) How to know how much your service is worth. UP’s John Newman and NS’s Chris Spiceland will cover the first, Jerry Johnson, formerly of the BNSF shortline group and now in private practice, and Rich Kostler from FTR Associates cover the second.

As to the Johnson/Kostler segment, you can do some of your homework at the ***USRail.desktop*** booth in the Exhibit Hall. Ike Roberts, former Conrail Food Group marketing guru and ***USRDT*** founder, will be your host and I’d be delighted to make introductions. I regularly use their service to identify market trends, what the traffic will bear in any commodity lane, or how much of what STCC a Class I is moving, so you can get a sense of where your short line’s commodities fit in their food chains. Visit the booth and then walk into the pricing session with some ball park figures in mind. You’ll be glad you did.

Commenting on the trucking sector, RW Baird’s Benjamin Hartford writes that their proprietary Baird Freight Index has March demand “firming” and tighter truck supply is helping hold rates steady or even a little ahead. “Slow, steady growth is expected to continue through 2012 as upside is limited by increasingly popular lean inventory strategies.”

He concludes, “Our expectation for March volumes are solid given the five Fridays in the month and 2012’s earlier Easter positively benefiting year-over-year comparisons.” Moreover, “Current supply/demand dynamics are tightening as demand trends seasonally improve, sustaining pricing growth expectations of +2-4 percent year-over-year in 2012.” He concludes the rails may benefit as truckload rates increase and “the secular shift from road to rail should continue; rising fuel prices could encourage even more shippers to move freight to the railroads.”

It’s not getting any better in the world of coal. On Thursday a UBS note on mining equipment maker Joy Global says they are lowering US coal production forecasts for this year and next by some four percent while cutting Central and Northern Appalachian coal prices through 2014. UBS is also lowering thermal coal production and price forecasts -- a negative for Joy as US coal producers account for quarter to a third of its annual sales.

Moreover, UBS does not think met and steam coal exports will make up for the loss of tonnage going to coal-fired electric generating stations. And,

> UBS estimates plant retirements over the next six years will lower Eastern thermal production by 22.9 million tons and PRB production by 14.1 million tons. While increased exports may mitigate the loss, it will take another three years to gain an additional 30 million tons of eastern export capacity. Unfortunately, that will only partially offset the 40 million tons likely lost from that market due to shut downs."

Clearly NS and CSX will have to scramble to sustain current volumes. However, anecdotal evidence suggests one saving grace as eastern short lines appear to be more into export coal than domestic steam whereas western short lines handle mostly domestic steam coal on either overhead or terminating hauls.

Providence & Worcester eked out a net profit of $932,000 for 2011 vs a $267,000 loss a year ago. Credit for the gain belongs entirely to "certain legal proceedings" worth $1.2 million. Revenues increased 7.7 percent to $28.7 million on virtually no change in total revenue units and a 7.7 percent revenue-per-unit gain. Operating expenses increased by $2.1 million, 6.7 percent -- even after $1.2 million in 45G tax credits and state grants -- on increases in fuel, car hire and trackage rights expense.

Comp and benefits came down to 51 percent of sales from 54 percent a year ago. Casualty fees jumped by a third mainly as a result of an automobile accident involving a Company-owned vehicle. All told, the railroad saw an operating loss of $197,000 and an operating ratio of 100.6 -- better than the $1.2 million ops loss and 104.0 operating ratio a year ago.

The good news is that P&W remains a 97-percent carload railroad and posted a respectable 7.2 percent increase -- to $800 -- in revenue-per-unit divisions. However, intermodal at only $70 a box is pretty slim pickings and generates less than a $million a year in revenue. I'd like to see a P&L statement on the intermodal business. Then we'd know whether it's a product worth keeping or whether the assets deployed here might not be better used elsewhere.