THE RAILROAD WEEK IN REVIEW

May 25, 2012

"Governments may change the legislative and/or regulatory framework within which BNSF operates without providing any recourse for any adverse effects." Berkshire-Hathaway 10-K

Short lines and regional railroad carloads year-to-date through May 12 (Week 19) increased a mere 0.51 percent; back out intermodal and they're down 0.58 percent. Take out auto and coal and they're actually up a smidge, some 30,000 units or 0.51 percent with 410 roads reporting, per RMI's RailConnect Index.

Short Lines			
Commodity	YTD 2012	YTD 2011	Delta
Total	2,376,922	2,355,426	0.91%
intermodal	216,982	182,854	18.66%
Net	2,159,940	2,172,572	(0.58%)
auto	57,548	48,627	18.35%
Net	2,102,392	2,123,945	(1.01%)
coal	238,633	269,572	(11.48%)
Carload	1,863,759	1,854,373	0.51%
Class Is	NA Rails		
Commodity	YTD 2012	YTD 2011	Delta
Carloads	7,072,343	7,198,437	(1.75%)
intermodal	5,473,828	5,254,885	4.17%
Total	12,546,171	12,453,322	0.75%
auto	473,208	405,336	16.74%
Net	12,072,963	12,047,986	0.21%
coal	2,361,786	2,636,741	(10.43%)
Carload	9,711,177	9,411,245	3.19%

The largest non-coal commodities in terms of percentage of the whole remain chemicals, grain, aggregates (frack sand here). Chems and aggregates increased; grain dropped another 14 percent on the week, putting it down 16 percent year-to-date.

The North American Class Is aren't doing much better per AAR numbers, right. Total revenue units increased less than one percent; total carloads ex-intermodal units were off 1.75 percent. Backing out coal and auto leaves the Class I merchandise car count up 3.19 percent. I'm not convinced it's going to get much better (see below) and, as the Class Is go, so go the Class II and III railroads.

Share price trends for what I call "stuff stocks" are very predictive. If prices are going up, the outlook is good for more carloads; if not, well, not, and that's what I'm seeing now. I use a service called Market Edge to keep tabs. Each name is given an "Opinion" -- Long, Neutral, Avoid -- based on how share prices have been behaving.

I've been a subscriber for years ($15 a month for Schwab customers) and have found the Market Edge predictive powers quite remarkable. You can set up any watch list you like, but for now let's consider the 30 names in the Dow Jones Industrial Average and the stuff stocks therein -- Alcoa, Boeing, Caterpillar, Chevron, DuPont, GE, Coke, 3-M, Merck, P&G, United

Technologies and Exxon. Each of these dozen companies uses the rails as part of its supply chain and how much they ship of anything is a function of the business cycle. (I omit Walmart because its rail use is mainly intermodal and thus not a key merchandise carload player.)

At this writing, only Coke among our rail users is Long, though "mildly deteriorating." GE and Merck are on the cusp of Neutral from Avoid, and all the rest are Avoid. It's not surprising then that the rails themselves aren't looking all that good. UP, CSX, RA and NS are Long but "deteriorating." GWR and CP are Neutral from Avoid while KCS and CN are in the Avoid column. Among car-builders and lessors, American Railcar, Greenbrier, GATX, Freightcar America, Trinity and Wabtec are Avoids.

Drew Robertson's ASI Transmatch data base confirms the loss of interest in railroad shares among institutional owners. He charted the change in shares among 13-f filers for the third and fourth quarters of 2011 plus the 2012 first quarter. These are no small names, either -- T. Rowe Price, Vanguard, TIAA-CREF, Wells Fargo, to name a few. Total railroad share change across this universe was down a percent or two for each road in each quarter, ex-CP, up 7, 6 and 10 percent in successive quarters with Pershing's 20.06 percent CP stake as of Mar 31 the big outlier.

Given the cheery outlook above, it's a wonder anybody would want to be in the railroad business, to say nothing of the shortline business. Consider the risks beyond fluctuations in customer orders. From the Berkshire-Hathaway 10-K re BNSF:

> Our railroad business conducted through BNSF is subject to a significant number of governmental laws and regulations with respect to rates and practices, railroad operations and a variety of health, safety, labor, environmental and other matters... Governments may change the legislative and/or regulatory framework within which BNSF operates without providing any recourse for any adverse effects that the change may have on the business. Federal legislation... mandates the implementation of positive train control... Increased economic regulation of the rail industry could negatively impact BNSF's ability to determine prices for rail services and to make capital improvements to its rail network, resulting in an adverse effect on our results of operations, financial condition or liquidity.

Makes one wonder why any sane person would want to play.

Two Northeastern short lines have won the STB's blessing in their efforts to re-open lines that haven't seen any trains in years. The *Railway Age Newswire* reports that the Board, after initially rejecting an application by Iowa Pacific Holding's Saratoga & North Creek Railroad to reopen a private line in upstate New York, has asked the railroad to refile its application. The board said that it now has enough information to let the request go through.

Saratoga & North Creek wants to operate approximately the 30 miles of private track previously owned by NL Industries and known as the Tahawus Line. The U.S. government constructed the line during World War II, using its eminent domain power. After construction it leased the trackage to NL, which contracted with Delaware & Hudson to move ilmenite ore from a mine owned by the company. Following the end of the war, NL continued to ship ore from its mine until the 1980s, when it switched to trucks. In 1989, the General Services Administration auctioned off the line, and NL acquired it as private track.

Saratoga & North Creek plans to begin hauling ore by rail again, and anticipates hauling 100 million tons of material and tailings from the Tahawus mine. It was opposed by Protect the Adirondacks, a group that wanted the unused line to revert to private landowners since it traverses the scenic Adirondack State Forest Preserve, and argues the government violated the law when it used eminent domain to build the line.

And in north-central Pennsylvania the *Trains Newswire* reports that the STB has given R.J. Corman Railroad Co./Pennsylvania Lines Inc. (RJCP) authority to build and operate a new rail line using right-of-way previously rail-banked as well as new right-of-way, near Wallaceton. This is the first time the Board has ruled on a new rail line construction proposal combined with restoration of rail service over a rail-banked right-of-way.

The right-of-way, formerly part of the NYC line into the Clearfield coal fields from Beech Creek, is being considered for reactivation to serve a proposed new waste-to-ethanol facility, a quarry, an industrial park now under development near Gorton, Pa. plus other local business.

Now it's official. In a press release Tuesday,

> RailAmerica, in response to market rumors, stated that its Board of Directors is considering strategic alternatives, which may include a sale of the Company. In connection with its evaluation, the Company is engaged in preliminary discussions with third parties regarding a potential sale of the Company.
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> There can be no assurances that any agreement will be reached with respect to a transaction or that a transaction will be consummated. The Company has retained Deutsche Bank Securities Inc. as its financial advisor and to assist in its evaluation. The Company further stated that it does not intend to make any additional comments on this matter unless and until a definitive agreement has been reached.

And now we know. Film at eleven.