# THE RAILROAD WEEK IN REVIEW
## September 14, 2012

*"Hunter's been out turning over rocks. Some of them twice." Janet Weiss, VP Investor Relations, Canadian Pacific*

**Janet Weiss, head of Investor Relations** for Canadian Pacific, gave an update at this week's Credit Suisse Transport conference. I found her talk to be by all measures an excellent account of her company's progress of late. Her tone was positive, her delivery strong and her mood relaxed. And for good reason. From her opening slide -- year-to-date double-digit positive deltas in velocity, cars-on-line, dwell time and car-miles per day -- to her summary of new business initiatives in the energy sector, we could see clearly a company doing many things right.

Yes, there's a drought in the US affecting ag products, but less so in the CP service areas in the northern plains and Saskatchewan, where yields are expected to be up by half again above what they were last year. Growing stuff in the kind of volumes CP is talking takes fertilizer, and CP is exceptionally well-positioned there. Coal is 90 percent for met use, most of that is export, and the second half of 2012 will be see "modest" (Janet's word) growth.

The Industrial Products commodity group makes up two-thirds of CP's "merchandise" group, and the big story here is energy. CP is budgeting for "crude-by-rail" out of the Bakken fields in No Dak and Sask to increase five-fold to some 70,000 units a year in two years before leveling off, citing rail advantages in speed to market, capacity, flexibility and scalability over pipe lines. And CP's new frac sand origins in Wisconsin are expected to grow geometrically from today's small base of 3.5 million tons a year.

As for Hunter Harrison, he's been out touring the property for the last six weeks, tweaking yard operations, train starts and sizes, connections and how system performance is measured. I gathered, listening between the lines, as it were, that CP has an abundance of talent that wants to Get It Right, and that, like so many properties in transition, the Old China Hands who want to preserve the old ways, will simply be outnumbered. Thanks, Janet.

**RailAmerica's August carloads** increased 2.9 percent year-over-year to 74,813 units; same-store units -- absent the WCOR and Marquette acquisitions -- increased 0.6 percent. Coal and ag, together comprising nearly half RA's volume, were essentially flat against August, 2011. Paper was down 10.6 percent and lumber/panel goods increased 14.9 percent on more loads in the west and mid-west. Energy had a good play with petroleum products ex-crude up 29.5 percent and "other," where crude oil lives for RA, jumped a like amount.

Year-to-date revenue units are up 3.7 percent showing a better-than-average gain thanks largely to lumber and oils, both crude and refined (this last is of interest because one of my PNWARS panelists next week is in the refining business). Month-to-month changes this year seem to swing in a range from plus three percent to minus three percent.

**Genesee & Wyoming has filed** an 8K noting that the STB has accepted GWR's August 6, 2012 control application seeking STB approval to control RailAmerica and its railroads, and has deemed the transaction to be "Minor". This being the case, GWR anticipates an STB decision on its control application by February 6, 2013. If favorable, GWR control of RA will become effective by March 6 and will allow the operations of the two properties to be consolidated. The filing concludes, "It remains possible that the STB will adopt an expedited procedural schedule, and issue a decision on GWI's application to control RailAmerica and its railroads by the end of this year."

GWR's August North American carloads dipped 4.4 percent year-over-year to 66,882 units. Once again, the "other category" which includes NS overhead coal in Ohio was the big hit, down 41.7 percent to 3,537 units, a mere shadow of its former self. The minerals & stone group dropped 19.2 percent and chemicals slipped 7.3 percent. Happily, local coal has trimmed its loss to less than two percent even though same-railroad traffic was off 8.7 percent year-over-year.

North American month-to-month carload volumes are on the mend. August was seven percent ahead of July, July was nearly that much ahead of June, and so on back to Feb, when GWR loads hit 56,149 -- the year's low. Year-to-date North American revenue units are down by more than 20 percent from last year's 526,268 units. As it happens, monthly revenue units hit their peak at some 71,000 units in March, 2011 and have never recovered.

The 8K cited above warns that the midwest drought could cause pro forma RailAmerica results to slip slightly in the second half of 2012 and into 2013. Moreover, GWR non-freight revenues (smaller short lines and contract switching) could take an ag-related hit at the Gulf ports where GWR does the honors, notably on the Texas Gulf and around New Orleans.

**Monday's note from Barclays** says that -- while the August employment report was weaker than anticipated -- "We look for payroll growth to pick up in Q3 and believe that sustained employment growth above 100k per month should be sufficient to bring down the unemployment rate." I should hope so. Barclays also says July consumer credit outstanding came down by more than $3 billion and marked the first monthly decline since August 2011. In other words consumers continue to de-leverage, and reports of lower retail inventories reinforce that.

RW Baird's Benjamin Hartford has prepared a chart of sequential changes by commodity group for the four US publicly traded Class Is. For the third quarter to date CSX and NS remain in the negative column, down 0.5 and 0.8 percent respectively. Both still see double-digit year-over-year declines in coal and smaller downdrafts and positive auto deltas. Industrial products are off for both roads, though NS is up in grain where CSX is down. Intermodal remains in the plus column for both.

Union Pacific and KCS are down in ag, up in autos, up in chems, up in intermodal. UP shows gains in industrial products while KCS is down. As for BNSF, you have to go to their website and do a little number-crunching. Merch carloads -- all ex-auto, coal and intermodal -- are up 9.7 percent year-to-date through September 3. The chems group including ferts and ethanol is down 4.3 percent and has slipped to 22.4 percent from 25.7 percent as share of total merch loads.

Sand/gravel including frac sand was up 6.7 percent but dipped to 11.4 percent of total merch loads from 11.7 percent. But petroleum loads jumped 64.7 percent and now represent 16.9 percent of total merch vols, up from 11.2 percent a year ago. And last week BNSF issued a press release saying they have increased Bakken take-out capacity to a million cars a year. YTD crude-oil carloads already stand at 211,142 so at this rate they could do 314,000 loads.

**California's Santa Maria Valley Railroad** is a hundred year-old, 14-mile short line that connects with the UP's ex-Espee Coast Line at Guadaloupe. It was essentially a family-owned operation until 2006 when my good friend Rob Himoto, an investment banker following railroads at the time, acquired the control. Rob keeps me posted with regular updates and he has kindly given me permission to quote his latest here:

The year 2011 was our best year since taking over the railroad, and this year is going even better. June, and then July were record months, the best in six years. And August topped July just half-way through the month. For the first quarter, our carloads were up 23 percent, freight revenue was up 36 percent and revenue per car jumped 10 percent over first quarter last year. Second quarter total carloads increased 26 percent, revenues grew up 30 percent and revenue per car was up 3.7 percent over second quarter last year.

By commodity, frozen vegetables, petroleum, and farm machinery all doubled in carloads over last year, offsetting lumber, building products, chemicals and metals having down years. Chemicals dipped because of a lack of product being produced and the shortage of tank cars and metals came down because of a lack of product. The economy is barely perking up and right away there are shortages. Our increases, generally speaking, are from customers putting more product on rail and taking it off of trucks.

Several of our customers tell us that our service is better than trucks. They are telling us that they are ordering long-distance trucks two weeks in advance, and either they are 6 or more hours late to the dock or don't even show up more than half the time. They like how we try to give them a time that we show up and stick to it and if there is a problem we let them know. Also since last year we have offered 6 days a week switching, and we were surprised how many of our customers work on the weekends.

We estimate at least 35 percent of the increase in frozen vegetables is attributed to offering weekend service. (The former SMVRR management did not provide weekend service so customers would just order trucks.) These operations run 24 hours a day especially during harvest season, which is about 10 months out of the year here in the Central Coast of California.

The product has to move whether or the railroad rail is moving or not, so with weekend switching, we get carloads on a Saturday and sometimes Sunday, and the dock has empty cars ready to load Monday morning.  In the past, cars are loaded on Friday, not pulled until Monday morning, re-spotted with empties and loaded on Tuesday.

Over the past twelve months we've not seem much change in out customer base and most of the volume gains are with current customers. And I am continually finding new opportunities we are actually competing against other railroads. Unit train moves in particular come to mind, where we are obviously not competing against trucks as these projects have already determined to be shipped by rail and where we have a location advantage. Thanks, Rob.

**A friend from northern New England** writes apropos of my Vermont vignette last week: "I have always enjoyed Phil Hastings' b&w photos, esp. from his home territory. B&M-CP (no CPRS at that time!) ran a Boston-Montreal daytime passenger service via White River Junction and Saint Johnsbury, Vermont --  at least into the summer of 1964. I recall a CP Budd car (protected one side of the schedule) at North Station 8/1/64 when my Father & I arrived on a train from the Gloucester Branch to make an Mass Bay RRE passenger excursion special to Lincoln, NH.

**This just in**: From the University of Pennsylvania Press, a review copy of *The Pennsylvania Railroad, Volume 1: Building an Empire, 1846-1917,* by Albert J. Churella, release date October 15, 2012. This is no small undertaking. Weighing in at nearly pages, it traces the growth and expansion of the PRR from its pre-Civil war founding to the point where it had become the largest privately owned business corporation in the world. In 1914, for example, the PRR employed more than two hundred thousand people—more than double the number of soldiers in the United States Army.

The press material accompanying the book tells us, "Albert J. Churella's masterful account, certain to become the authoritative history of the Pennsylvania Railroad, illuminates broad themes in American history, from the development of managerial practices and labor relations to the relationship between business and government to advances in technology and transportation." I'm looking forward to dipping in and sharing my impressions.

**Off to PNWARS** in Eugene next week to hold forth with some friends on the question, "What Do You Want Your Railroad to Look Like in Five Years?" There will be no PowerPoint presentations and we will do a town-hall type discussion that will be more audience participation than pontification from the platform. We're at the Valley River Inn Sep 19-20.

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