THE RAILROAD WEEK IN REVIEW
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"*Moats ebb and flow. Tough periods allow the strong and capable to strengthen as they build business value."—Warren Buffett, Berkshire Hathaway 2009 Annual Meeting*.

Warren Buffet and Charlie Munger held a brief press conference at the close of the Berkshire Hathaway Annual Meeting in Omaha. The following is an instructive exchange about creating what marketers call "Unique Selling Propositions" or "moats" to use Buffett's analogy. A reporter from Montreal asked whether moats were becoming "filled with sand" or whether Buffett sees the opposite, "with a deeper moat filled with alligators and sharks."

Answer: "Google has a huge new moat filled with sharks, alligators and piranhas. Google's keywords generate huge money all electronically with little to no human effort. Some companies pay as much as $70 per click to be the first up in a search for certain key words. Geico (Berkshire's car insurance company) pays $10 per click to be on the top when you search for auto insurance - so please don't click just go to geico.com you'll save us $10!

"It doesn't matter how much money you throw at it you can't take the business away from Google. Generally moats are really hard to build and by definition there can't be many of them. A good example is Sees Candies. If I gave you $500 million to take away the California retail chocolate market share, you couldn't do it. That's how to recognize and define a moat.

"Moats ebb and flow. For example, trucking used to have a moat and it is now shifting back to railroads as the cost of fuel rises. If you are running your business right these are the times that you lay the foundations for future success. Tough periods allow the strong and capable to strengthen as they build business value."

In SCV's case (WIR May 29), their moat is being the only low-cost high efficiency service transportation provider for Horizon. By my reckoning, using my "Rule of 100" screen, SCV's EBITDA margin is perhaps 40 percent of revenues or something on the order of half a million dollars a year. Looks like a good bet from here, though given the tightness of credit and local bankers' general lack of understanding of the short line business, finding $600K in sort-term paper may be tough. But having a shark-filled moat sure helps make the case compelling.

In a note from Jeffries & Co, the analyst makes an important link between General Motors and DuPont (ticker symbol DD, or "Double-D" in the jargon). "Each cycle, DuPont presents two opportunities to investors. As an early cyclical bellwether, it should rally before the economy turns. As a diversified conglomerate, it has the perennial promise of transformation and revival. In response to inquiries as to DD's potential exposure to GM's bankruptcy filing, we find direct exposure to GM North America accounts receivables is roughly $7m, and we view this as a manageable risk."

I believe it was Norfolk Southern's Don Seale who said the chemicals business has significant ties to the auto industry and as GM goes so go the chemicals guys. Almost on cue, a short line operator who handles a lot of plastic resins for an auto parts maker said the same thing. Seven million dollars may be pocket-change to double-D but to a short line customer that is a niche supplier, a big GM receivable could be a killer.

Apropos of the GM Bankruptcy, the ASLRRA website's shortline commodity-connection search tool yields up 39 short line names in the auto business from parts to finished vehicles. Of these, 23 have NS connections. NS is key because 15 of 25 plants it serves belong to the Big Three: Ford, GM, Chrysler. With the future of the latter two in flux, Ford no doubt is hoping to pick up new buyers and, as owners of Dodges, Jeeps, Chryslers, Pontiacs, Saturns, Saabs and Hummers look for replacement wheels, the market share games are sure to hit short lines that play in this league.

Take auto parts, for example. Running a commodity trends report on usraildesktop shows NS revenue units for STCC 37147 dropped a low of 18,000 units in 3Q08 from a high of 33,000 units in 2Q05. Tellingly, units dropped 46 percent while revenues dipped but 22 percent. By comparison, CSX in 2Q05 moved fewer than 1,000 units for a little more than a million dollars and by 3Q08 loads had shrunk to less than 100 and revenues to a mere $73,000, both down more than 90 percent. Which says short lines working auto parts for NS have a lot more to lose than those linked to CSX.

Short Lines in the News Dept. Michigan's **Coopersville & Marne Railway** (CPMY), heretofore strictly a tourist operation, will assume responsibility for providing freight service over roughly 15 miles of railroad between the Grand Rapids City Line and Coopersville. Up to now RailAmerica had provided freight service on the line through its Grand Rapids & Eastern (GRE) however that agreement has come to an end. For the time being, GRE will continue to forward CPMY cars from its connections with CSX in Grand Rapids and NS via Watco's brand new Grand Elk Railroad. At some point in the future CMRY may establish its own connections with the outside, but that's still a work in progress according to sources familiar with the transaction.

In Cleveland the **Cleveland Commercial Railroad** has applied for permission to lease and operate Norfolk Southern's ex-Erie route between Cleveland and Aurora, Ohio. The branch will add 25 miles to the railroad's current 10-mile system, which connects Bedford and Falls Junction, Ohio, where it connects to the Wheeling & Lake Erie Railway. The spur proposed for lease is what's left of Erie's connection to Cleveland, which separated from its New York-Chicago main line at Leavittsburg. Cleveland Commercial currently operates a spur that dates to the original W&LE, and interchanges with NS at Von Willer Yard in Cleveland. Interchange for both lines will be Von Willer.

RailAmerica's **Kyle Railroad** took ownership of the ex-Rock Island track is had been leasing in Kansas and Colorado effective June 1 from the Mid-States Port Authority. The coalition bought the tracks from Rock Island's real estate arm for $19 million on April 30, 1984 and on the same day transferred operating rights to the Kyle with a 25-year option "to buy the line for little money," according to the AP. That turned out to be one dollar.

The 14-county coalition in those two states plus Nebraska (Kyle's original east end was within a couple of miles of the Nebraska border at Mahaska, KS) borrowed $18 million from the FRA to purchase the 460-mile line and collected enough rent from the Kyle to retire the loan. The current RA system map shows Kyle cut back 14 miles on the east end to Belleville, where the Rock's KC branch came in and which RA now operates as far south as Clay Center, 47 miles.

The counties affected formed the MSPA because they feared the track would be abandoned and they would lose rail service. According to the Kansas DOT website, 255 miles was leased from MSPA while Kyle also operates on another 176 miles leased from the UP, mostly ex-MP track in east central Kansas, extending south into the Salina area. Kyle currently handles more than 20,000 cars a year of which 90% are agricultural products. Class I connections are BNSF and UP. A note in *Forbes* says the railroad has an infrastructure spend of two million dollars a year and the KDOT website shows loans and grants of some $2.6 million, of which 79 percent or $2 million was in direct grants over the last 25 years.

TRAINS magazine contributor Steve Glischinski writes that Smurfit-Stone has reopened its Ontonagon, Mich., paper mill that makes corrugated packaging material ands is the biggest customer on the 112-year old **Escanaba & Lake Superior Railroad**. The mill had shut down in November 2008 citing weakening market conditions.

The E&LS has the 208-mile ex-Milwaukee main between Green Bay and Ontgonagon on the southern shore of Lake Superior in addition to four other branches from five to 63 miles in length. Traffic levels "have dropped preciptously" over the last six months, writes Glischeski.

He continues, "To serve Smurfit-Stone, E&LS normally operated a turn to Ontonagon out of Channing, Mich., to supply the mill with empty boxcars for finished paper products. The railroad also moved inbound scrap paper and chemicals used in the paper-producing process. From Channing, trains operated south to Crivitz to meet another turn from the CN interchange at Green Bay.

"During the shutdown, E&LS had to rely on other business to keep it going, such as hauling pulpwood, and rebuilding and repainting freight cars under contract at its shop in Wells, Mich., just outside Escanaba. E&LS also derives revenue from freight car storage" on its inactive branch lines the railroad has a number of lines that are inactive or partly so and are used for car storage.

Natchez Short Line redux. The *Railway Track & Structures* newswire reports, "Mississippi state lawmakers are urging the Surface Transportation Board not to approve the transfer of 252 miles of rail lines from Canadian National to newly-formed companies **Natchez Railway** LLC and **Grenada Railway** LLC unless the operation of the lines can be guaranteed past the two-year maintenance period outlined in the original deal.

"According to a report in the *Daily Leader*, officials are worried the new owners, which are affiliated with Salt Lake City's A&K Railroad Materials Inc., will scrap the lines after a two-year maintenance period ends. The transaction was filed in mid-May and requires a 30-day waiting period before finalization. Officials are trying to come to an agreement before that period ends."

Well, CN offered up the line fair and square and several operating short lines took a look. None wanted it so the A&K Materials railway operating subsidiary, V&S Railway (WIR 5/22/2009) stepped in. If it is too big for the state to want to risk losing it, then let it step up and buy it from A&K. If at the end of the two-years it's worth more in a scrap pile then let it be so.

Last time I looked A&K Materials was not a 501(c)(3) organization, and there is precedent for governments taking over what they see as key industries, viz., the Feds and GM. Let Mississippi issue bonds, buy the railroad from A&K and give it to the employees. (See also the apocryphal story of the NY Congresswoman threatening to take away the CSX ex-NYC main line between Albany and Buffalo if the carrier did not accommodate the state HSR needs in WIR dated 4/10/2009.)