THE RAILROAD WEEK IN REVIEW

February 11, 2011

"I am pleased to report that Genesee & Wyoming completed 2010 with an industry-leading reportable injury ratio of 0.51." GWR President and CEO Jack Hellman

Genesee & Wyoming's fourth quarter operating income rose 38.9 percent year-over year to $37 million, excluding one-time charges relating primarily to the FreightLink transaction in Australia and not indicative of the core railroad operating performance. Total revenues increased 21 percent to $170 million, of which 37 percent was "non-freight" or switching and terminal operations not included in GWR's conventional commodity-based railroad reporting. That's down from 41 percent a year ago.

But...non-freight revenue by itself was up nine percent; however, it decreased as a percent of the total because just one month of FreightLink traffic boosted the intermodal line to nearly five percentof total revenues from just crumbs a year ago. It's easy to see why. CFO TJ Gallagher says FreightLink will do 90,000 units a year, of which two thirds will be intermodal containers, a third metallic ores with the tiniest amount of other commodities showing up at times.

Total revenue units were up 19 percent to 224,970 loads. Carload (ex-coal and intermodal) was up 16 percent thanks mainly to a doubling of metallic ores (thank Labrador and FreightLink); coal and coke gained 20 percent and intermodal -- FreightLink again -- was five times what it was a year ago. Even if we back out the recent additions, same-railroad units were up 15 percent or 29,000 loads (see presentation excerpt, attached).You can see the deltas in metallic ores and intermodal were minuscule, which tells you something of the power of the FreightLink acquisition. [*I also like the comment column; other presenters please take note. -- rhb*]

Average revenue per revenue-unit gained nine percent, though the $1,000+ per-unit rates for the intermodal and metallic ores franchises do skew the numbers; same-railroad per-unit revenue actually dipped 2.5 percent, ex-foreign exchange, fuel surcharge and mix. Perhaps Allison Landry at Credit Suisse says it best: "At the end of the day, this decrease is not reflective of the underlying rate environment – and that on a customer by customer basis, core pricing was consistent with the company's expectations of about three percent."

Operating expense less the one-time items was up 17 percent year-over-year thanks in part to a 122 basis point drop in compensation as a percent of revenue. The adjusted operating ratio (before items) was 78.2, down 277 basis points year-over-year. The incremental operating ratio (expense delta over revenue delta) was 65.1, a tad higher than one likes to see. However, if you adjust for the puts and takes from one-time items, foreign exchange, FreightLink, etc., the incremental OR is closer to 55.

Something else Jack and TJ did exceptionally well on the call was the way they handled the 2011 outlook. Whereas most are kind of cagey and hedge their bets, *alluding* to this and that, our presenters were quite specific. Start with 2010's revenue of $630 million, add $100 million for

FreightLink, a quarter to half that for same-railroad sales, season with foreign exchange and $5 million from a better Australian grain harvest and -- voila -- revenues of $780 to $800 million for 2011, figuring more than a million revenue units and $90 oil.

In sum, what GWR is doing is following the principles for success in the railroad business as laid down by Jay Gould a hundred years ago: Long-haul traffic is nice but you earn your living serving lots of local customers. Of course, that's what being a short line is all about and Bill Greene's wrap to his Morgan Stanley note on the GWR call gets it right.

"Short-lines broadly share favorable rail industry characteristics with the Class Iss, but have an added bonus in their potential for acquisition-led earnings growth. In addition, short-line rails benefit from lower capex requirements, lower labor costs, less regulatory risk, and favorable tax attributes vis-à-vis their Class I peers. As a result, consistent with our preference for US Class I Rails within our Attractive View on Freight Transportation, we also view the short-line rails as attractive." And so should we all.

Small business optimism rose slightly in January, says The National Federation of Independent Business (NFIB) in its monthly report. Small business owners are skeptical about the future and are hesitant to spend and hire. Weak sales remain the most frequently cited top business problem. "On Main Street, there are too many firms competing for low (but improving) consumer spending, not a recipe for strong employment growth." As a result, more firms are cutting inventories than are adding goods.

"Manufacturing and exporting are leading the recovery—industries and activities that are not labor intensive—while construction, an industry historically dominated by small firms, remains depressed," said NFIB chief economist Bill Dunkelberg. "While the economy is moving forward, albeit at a snail's pace, it is not nearly fast enough to dramatically improve the unemployment situation, which continues to languish." And with small businesses dominating the short lines' customer lists, it could be a long slog for short lines.

It is in this arena that all short lines are not created equal. As GWR has shown in its fourth quarter report above, the guys with "stuff" to move -- heat, eat and mine, mainly -- will persevere. Read also what the clever Dennis Gartman has to say about stuff and railroads in his Feb 8 letter: "We understand the counting of containers moving into and out of the ports as evidence of economic growth. We understand coal barge shipments; we understand steel tonnage production and auto sales. We know that the world needs more and better food and that we think makes the case for fertilizer, or railroads that transport grain. We understand infrastructure needs and that means the need for steel production, or iron-ore mining. These things we understand, we can count them and they are things that if dropped on your foot will hurt. Our thesis thus far has served us reasonably well."

Notes From All Over department.

Wolfe-Trahan on the impact of Electronic On-Board Recorders (EOBRs) for over-the-road commercial trucks: "EOBRs are used to electronically monitor truck miles and enforce rules for Hours of Service and the proposed rule would apply to nearly all commercial motor vehicles --

about 90 percent of US motor carriers. The final rule on these devices is expected to come down June 2012."

Since we're looking at about $800 per vehicle, larger carriers will benefit the most. "Several larger truckload carriers have voluntarily begun to switch to EOBRs in recent months with little seemingly materially negative impact to utilization or ops, while most smaller fleets still use paper-based logs, which are subject to manipulation. We believe this broader mandate of EOBRs could eventually help level the playing field for larger carriers."

Jason Seidl, Dahlman & Rose on intermodal: "A key takeaway from the ongoing transportation earning season is that the intermodal traffic strength seen in 2010 is likely to continue into 2011. Intermodal was one of the highest growth groups on the Class I railroads in 2010, increasing 15.4 percent. Thus far in 2011, intermodal traffic continues to post weekly sequential increases.

"We believe this strength should continue in 2011 due to a number of favorable macro factors including robust growth in international trade and the ongoing North American economic recovery. For example, KCS expects its intermodal business to be one of its two highest growing carloading groups in 2011 along with automotive. On the trucking side, JB Hunt's intermodal segment had a strong 4Q10 performance and was an important reason behind the company's earnings beat."

Kathryn McQuade, CFO, Canadian Pacific, on PRB coal: "We have our four requirements for moving forward: access to the right of way, having coal contracts, having permits and mine access. It's constantly being looked at. The coal market is what's really been driving the overall business case, and that is still a work in progress, as we see coal now becoming more -- even being vocalized by Obama last night in terms of the clean coal initiatives. So it's one that we keep on the radar. It's one we're constantly working, and it's one that we have also said that would probably require us to be partnered with someone in order to move forward with it." [*transcript excerpt courtesy of seekingalpha.com*]

Iowa Governor Terry Bransted on passenger trains: "There are two questions: One is the state's initial requirement and then there is an ongoing subsidy. I am most troubled by the ongoing subsidy. I don't think we should be in the business of subsidizing passenger train service." The *Des Moines Register* article adds, "Iowa lawmakers have previously committed $10 million to the train project and another $10 million is needed. In addition, state officials have estimated the train would need about $3 million annually in Iowa taxpayer operating subsidies."

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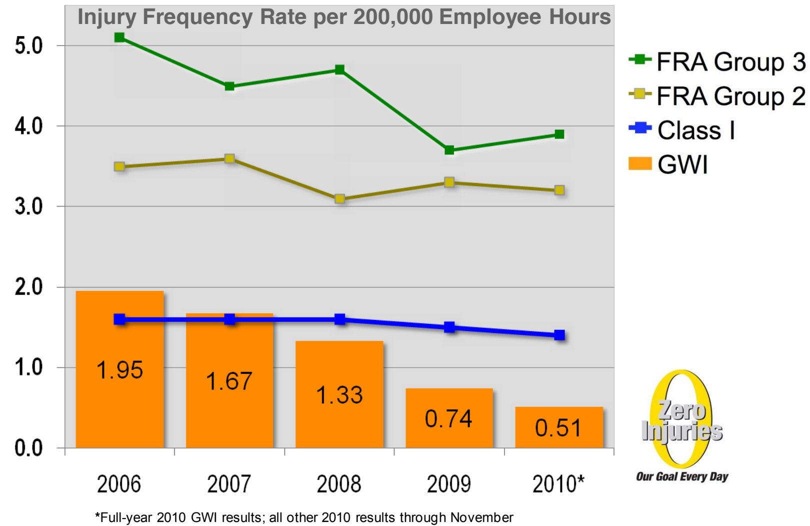
GWI Injury Frequency Rate vs. U.S. Rail Industry Averages



*Full-year 2010 GWI results; all other 2010 results through November

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GWI Same Railroad Carloads Q4 2010 vs. Q4 2009

Commodity	Change	%	Comment
Coal & Coke	9,260	19.8%	Export metallurgical and Steam
Pulp & Paper	2,284	10.9%	Pulp
Minerals & Stone	365	1.2%	
Farm & Food	9,509	53.9%	Australia
Chemicals & Plastics	2,564	21.2%	Economic Recovery
Metals	852	5.9%	Pipe
Lumber & Forest Products	486	3.3%	
Petroleum Products	432	6.0%	
Auto & Auto Parts	79	3.4%	
Metallic Ores	741	35.9%	Canada
Intermodal Units	(472)	(37.7%)	
Other	2,945	16.2%	Coal Haulage, MSW
Total Carloads	29,045	15.4%	

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