THE RAILROAD WEEK IN REVIEW

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"Revenue per load jumped 9.3 percent sequentially from Q42010 —by far the biggest sequential change in at least 15 years." UBS Rail Analyst Rick Paterson on NS results

Canadian National's first quarter call was, in a word, powerful. Jean-Jacques Ruest, EVP and Chief Marketing Officer said the quarter saw record winter GTMs and the "best intermodal service in years." Keith Creel, EVP and Chief Operating Officer, showed not only year-over-year operating comps but also two-year comps going back to the 2009 first quarter. The bar charts are impressive: record GTMs per train-mile, lowest terminal dwell (an industry-best 17.4 hours), second-best cars per yard switching hour and trailing GTMs per available horsepower.

Said Creel in his opening, CN knew winter was coming and did many things to get ready -- being teed up to triple the number of train-starts using distributed power, e.g. It was, said CEO Claude Mongeau, a "level of preparation and focus on execution" that generated a nine percent revenue increase (constant dollars) to C$2.1 billion on just three percent more revenue units; operating income was likewise up nine percent to C$645 million, and the operating ratio came down 30 basis points to an industry-leading 69.0 for the quarter.

I need to point out that equipment rents dropped 15 percent even as the revenue unit count increased three percent and that the fuel burn increased only two percent; gross ton-miles increased three percent and revenue ton-miles were up five percent. Operating expense ex-fuel (that line was up 36 percent in constant dollars) was essentially unchanged at three-tenths of one percent.

Of particular interest to short lines, grain and fertilizers make up 84 percent of bulk revenues and 72 percent of bulk carloads (coal is the other 28 percent). The new "scheduled grain plan" supports growth and high commodity prices in fertilzers and potash. Lumber, wood pulp and wood pellets for export are trending up as are carloads of steel and other metallic commodities. Average revenue per carload in the manifest sector grew five percent.

Net income increased 31 percent to C$668 and earnings per share was up 34 percent to C$1.45 on a three percent decrease in share count. Looking ahead, Mongeau said they are building on the dual themes of "the Next Level of Precision Railroading" and "smart stakeholder engagement." As for the balance of the year, CN expects 4-5 percent increases for industrial products, about 650,000 housing starts, auto sales of about 13 million, and a weaker 2010/2011 Canadian grain crop partly offset by larger stock carry-over. Fuel price increases will not abate. And given the winter just past, this was a very positive call.

Norfolk Southern wowed Wall Street Wednesday, so much so that share prices jumped ten percent in late trading, gapping up nine percent to $73 for Thursday's open. Revenues increased 17 percent year-over-year to $26 billion on eight percent more revenue units at eight percent more revenue per unit. And even though operating expense increased 20 percent (14 percent ex-

fuel), NS posted an eight percent operating income gain to $600 million. Below the line, net income gained 27 percent to $325 million and earnings per share increased 32 percent to 90 cents (it would have been a dollar but for the $58 million non-cash charge relating to the Graniteville accident -- imagine what a $58 million charge would do to a short line with a similar mishap.)

On the surface, these numbers may not look exceptional. But viewed in context, they are surely that. Merchandise revenue -- all but coal and intermodal -- was up ten percent on a three percent volume count propelling a seven percent merch RPU jump. During the call Chief Commercial Officer Don Seale cited record agriculture revenue, up eight percent (even though vols came down two percent, it's still the biggest volume producer in the merch group), metals and construction vols were up seven percent (much of the Marcellus support commodities go here), and even forest products went volume positive, up two percent up on -- you guessed it -- paperboard.

Out on the railroad you can tell they hustled. COO Mark Manion told how they handled the eight percent volume delta with five percent fewer crew starts, producing three percent more GTMs per train hour. My good friend Tim Heilig, Chief Mechanical Officer, must be smiling as his units hauled nine percent more gross ton-miles on less than two percent more fuel, increasing GTMs per gallon by seven percent.

The Wall Street crowd isn't usually given to superlatives; however, this quarter's crop of NS reports is most enlightening. Quoth JPM's Tom Wadewitz, "Norfolk's report was significantly better than we expected; the details of the report were encouraging as yields improved significantly." Jon Langenfeld at RW Baird writes. "NSC's strong performance relative to the other US Class I rails is a notable change from NSC's performance in recent years." And Peter Nesvold at Jeffries & Co, advises, "Few would've guessed that NSC would put up the group's biggest upside to 1Q consensus expectations with the strongest sequential improvement in pricing across all the Class Is."

Domestic intermodal continues to take share from the highways. It now represents 65 percent of total intermodal boxes and has three segments: Triple Crown (up two percent), Premium (up 19 percent) and other domestic (up 18 percent). Seale said the gains came from tightening truck capacity in a recovering economy plus new traffic lanes in parcel and LTL markets. Still, international boxes increased two percent thanks to "improving global demand."

The Street makes much of export coal and rightly so. Coal represents 31 percent of NS revenue and 24 percent of total revenue units. Two years ago export coal was ten percent of coal tonnage; in the present quarter it had grown to 17 percent. Meanwhile, utility coal tonnage has dropped to 71 percent of coal tonnage from 79 percent. I recall some years ago then-Vice-Chair for Marketing Ike Prillaman saying they make more money on export than on utility and I can see why: one destination with a handful of origins on the west end of the old N&W with most of it in railroad-owned equipment. It's a conveyor belt.

I take the winter's operational hiccups as aberrations, and not indicative of systemic troubles, even though a few pockets of congestion remain, according to some of my contacts. As for the rest of the year, NS sees volume gains in all commodity groups save paper and forest products,

with highway conversions the main domestic intermodal growth engine. The carload outlook is solid, and that bodes well for NS short lines as long as rates and service can create a product that is sufficiently competitive to take still more trucks off the highways.

The RailAmerica team, as JPM's Tom Wadewitz so aptly puts it, "communicated a clear transition in management focus from cost side initiatives to growth strategies. RA is adding sales resources and management identified 300 potential new business opportunities across their 43 shortline railroad properties... We believe that the potential new business from RA's increased sales focus is significant and RA indicated they expect to realize new business over the next two years amounting to some 100,000 carloads at an annual run rate. This would equate to 12 percent volume growth off of RA's total volume in 2010."

The company is certainly laying a solid foundation. First quarter 2011 revenues increased nine percent to $125 million, of which 36 percent or $27 million came from non-freight revenues. The carload business was up three percent to $98 million even though the number of revenue units came down one percent; revenue-per-unit increased four percent all-in, three percent if you strip out fuel surcharge collections. Operating income grew six percent before deducting the $4 million in 45G tax credits from operating expenses; the operating ratio before 45G credits came down half a point to 83.8 and the personal injury ratio dropped to a highly commendable 0.6 reportables per 200,000 hours worked.

RailAmerica, like CSX, goes into great detail in its commodity groupings with 12 separate lines from agricultural products to waste and scrap, further sorted into industrial, agriculture and construction products plus coal. Coal and Ag products took hits with pulp and paper (mainly out of the southeast) the winner (up 11 percent) in the industrial products group. RPU increases in metallic ores and minerals, chemicals, and ag products were all above average. RA expects to see core price increases in the three percent range going forward.

Non-freight revenue saw positive numbers in all areas except equipment rental fees on RA-owned cars. If you back out $3 million in revenues from the Atlas acquisition, non-freight revenue still increased 22 percent, mainly from car storage, cart repair and lease income. Demurrage is another $2 million-plus contributor, though happily that is down as customers must be turning their cars more quickly.

There were no outrageous swings in any of the expense line items except for fuel, as one might expect. Actual expense was up 30 percent or $3 million (of which $1 million was recaptured in fuel surcharge fees). But if you dig a little deeper, you'll see RA is gaining on fuel consumption. As noted above, revenue units were off one percent, yet fuel burn came down four percent. They burned 21 gallons per carload, down three percent, and operating expense ex-fuel rose less than three percent. Not bad when you're spending north of three bucks a gallon.

Genesee & Wyoming's first quarter results shows what the right acquisitions can do for revenue, operating income and shareholder returns. Consolidated freight revenues for North America, Europe and Australia jumped 48 percent to $133 million on a 21 percent hike in volume to 244,556 units and yielding a 23 percent gain in revenue-per unit. North American and European operations contributed 68 percent of the total freight revenue on 79 percent of the

revenue units. Non-freight sales increased five percent to $55 million, 76 percent of which came from North American and European operations.

Total revenues were $192 million, up 32 percent, with North America and Europe racking up 69 percent of the total. Operating expenses increased 32 percent and operating income grew 30 percent, again with North America and Europe accounting for 69 percent of ops expense. Net income was up 39 percent to $22 million with earnings per share up 35 percent.

The commodity carload traffic split between North America/Europe is instructive because it shows GWR's commitment to expansion in the "natural resource" sector. The 100 percent non-Australia commodities are coal and coke, pulp and paper, metals, chemicals, lumber and STCC 24 forest products, automotive and other. Australia dominates in intermodal and metallic ores, with a 60-40 advantage in "farm and food." The double-digit volume gainers in the predominantly North American freight business were pulp and paper, metals, chemicals, and other -- chiefly overhead NS coal on its Ohio Central Division.

Safety deserves special notice at GWR. Each year since 2006 and continuing through the present quarter the personal injury ratio has been lower than the year before. Calendar 2010 finished with an admirable 0.51 injuries per 200,000 hours worked and GWR then took it down to 0.30 at the end of March, 2011. This is a mark of true leadership: running a far-flung railroad operation on four continents with this kind of safety-awareness throughout the organization.

And there's more to come. Hellman in the first quarter earnings press release: "Our business development efforts in 2011 have thus far yielded three significant new projects. In Australia, we have signed a major new agreement to ship export iron ore from a new mine that we expect will commence operations in the second quarter of 2012 and generate approximately A$50 million of annual revenue when it is fully operational.

"In Canada, we have signed a rail service contract with a new iron ore mine in Labrador that is nearby our existing operations and should start shipments in the second quarter of 2011. In Europe, where we currently operate in the Port of Rotterdam, we are expanding our service to the Port of Antwerp, with our first Belgian shipments expected to start in the second quarter of 2011. In addition to these projects, we remain actively engaged with several other investment opportunities related to the natural resources sector in both North America and Australia." Whew.

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