# THE RAILROAD WEEK IN REVIEW

## August 26, 2011

*"CN's Scheduled Grain Service Plan has provided additional value to farmers by better scheduling deliveries of grain to our elevators." -- Bob Miller, Senior Vice President, North American Grain for Viterra, Canada's largest agribusiness.*

**Canadian National's Scheduled Grain Service Plan**, launched in Jan 2010, was in full swing for the 2010-2011 crop year ending July 31 and certainly proved its worth. The railroad achieved an 81 per cent success rate in delivering cars ordered to specific elevators on the scheduled day. CN says the key to this record performance was paying closer attention to what customers wanted in service design and learning some lessons about how to better collaborate across the entire grain supply chain. CN, the marketers, the country grain elevators, the port terminals and the shipping lines ensured that grain was handled efficiently at each point in the chain, from prairie to port and beyond.

The net result was the best CN export grain volumes in 20 years for the the 2010-2011 crop year ending July 31, moving more than 125,000 carloads to export terminals at Vancouver, Prince Rupert and Thunder Bay. Roughly half the total went went to Victoria, and 60 percent of that was canola. A third of the total -- more than 30,000 carloads -- went to Prince Rupert, the sixth consecutive year for such volumes. CN expects a repeat performance -- or better -- for the 2011-2012 crop year.

**Last week I promised** more details on the P&W's successful use of the 45G tax credit program. Here's what I learned. According to the small print in the 10-Q, P&W "entered into a track maintenance agreement" with a shipper who "paid for qualifying railroad track maintenance expenditures during 2011 in consideration of the assignment of railroad track miles which permits the shipper to claim certain federal tax credits pursuant to Internal Revenue Code Section 45G. During 2011, the Company received $869,000, net of expenses, which offsets maintenance of way expenses."

This is a perfect example of where 45G tax credits can help a railroad and shipper create value. According to P&W's Chief Financial Officer, the credit was posted to the "maintenance of way and structures" expense line on the income statement, resulting in $182,000 of expense. That looks to me like a very low number.

If we look back, we see MOW expenses of $1.4 million, $2.0 million and $2.7 million for 1Q2011, Jan-June 2011 and Jan-June 2010 respectively, making the $182K number a true outlier. But add back the 45G credit and the 2Q2011 MOW line becomes $1.05 million, a much better fit. Unfortunately, it turns the operating income to an operating loss -- assuming none of it is capitalized.

That's minor point, though. The fact is that the 45G credit was there to be used, and P&W has to be credited with stepping up to the plate with it: making the needed infrastructure improvements,

turning a potential operating loss into a gain and producing a six-point drop in the operating ratio in the bargain. Other regional and short line railroads please take note; drop me a note if you have any questions.

**Maury Klein's UP Volume III** is a fascinating read. One reason is that, like Rush Loving's *The Men Who Loved Trains*, the book names names of people you know and situations you lived through. My read, coming on the eve of the 2011 UP Short Line Workshop, helps to gin up questions about how what happened then affects what's happening now, especially in the context of UP's relationships with its short lines.

As regular attendees of short line conferences know, there is a small number of people who generally have questions following senior management presentations and I happen to be one of that number. But the trouble with the Q&A, as any presenter knows, is you never know that's coming yet you don't want to be caught flat-footed. For that reason, let me provide a preview of what's on my mind on the off chance that others would like to build on these themes or even -- how about this? -- have the presenters work these points into their spiels so the Q doesn't even have to be asked.

For Chief Operating Officer Lance Fritz: In your *Railway Age* interview (July, 2011), you cite a record low average freight car cycle time of 8.6 days. What can UP short lines -- especially those where non-unit train moves are the rule -- do to help UP reduce car-cycle time still further? I'd also like to know if all UP short lines are part of the Transportation Control System (TCS) so that a trip plan is generated when the origin customer releases the load to the short line to pull. If not why not and what'll it take to get there?

For CEO Jim Young: In your STB testimony last June you said, "You have to look at the value we provide as a measure of competition." What's the most important thing UP short lines can do to add yet more value? Part II of my question has to do with Customer Satisfaction. How does what Maury Klein calls "Doing it right the first time" manifest itself in customer interface and how can UP short lines become part of the Customer Satisfaction measurement program?

And finally, for Chief Commercial Officer Jack Koraleski: During the Q2 call you talked about getting rates in some domestic IM rates up to "re-investable levels." Are there any merch carload commodity O-D pairs where the present rate levels are not re-investable due to long car-cycle times? How can SLs help bring revenue-cost ratios back to re-investable levels?

Part II of my question to Jack has to do with carload-freight vols, ex-coal. Do you see merch carload vols ever returning to 2006 peak levels? Or should we expect to see UP become an increasingly point-to-point batch process railroad with more first-mile, last-mile work for short lines? Klein cites Jerry Davis calling UP "a pipeline of trains." Sure looks point-to-point to me.

Two other questions I'd like to ask, but am not sure to whom to direct them. First, Klein writes early in Vol III about how John Rebensdorf's team set up "codes and cost centers to learn what expenses were incurred by location and type." Did that include cost by customer and commodity OD pair? How could they tell if poor car handling out on the road was driving down the rev-cost ratio? I ask because there are indications of this happening today on some other properties.

Second, Klein quotes my good friend Woody Sutton, now retired but formerly UP product design, thus: "The choice of car type in head-haul service is now determined by what car type will most likely attract a back-haul." Is this still the case and, if so, how can short lines help?

**Florida East Coast** has taken another step forward toward opening a new intermodal terminal and container transfer facility in south Florida. Just this week the Broward County Board of County Commissioners unanimously approved a Memorandum of Understanding with the railroad to construct and operate an Intermodal Container Transfer Facility on 42.5 acres of land at Port Everglades.

The ICTF in the Southport area of Port Everglades will facilitate the transfer of containerized cargo through the Port onto the FEC rail line via a connecting rail spur. The proposed ICTF is unique compared to similar facilities in other ports in that both domestic and international cargo would be handled on the site. These cargos are currently being handled on a 14-acre site on Andrews Avenue owned by the FEC. Positive environmental benefits are envisioned by the reduction of truck traffic on local roadways. By relocating from the smaller facility on Andrews Avenue, Route 84 highway congestion will also be reduced.

The MOU calls for a 30-year agreement between the FEC and Broward County with two 10-year renewal options. Broward County will contribute the land for the project and participate in joint marketing efforts. The total cost of the project including land value is $72.8 million, of which $18 million would be funded by the Florida Department of Transportation grants. Now that the MOU has been approved, FEC will move forward to secure an additional $30 million State of Florida Infrastructure Bank loan. The balance of the funding is from FEC equity. [*Excerpted* f*rom the RT&S NewsWire*]

**Elsewhere,** the FEC reportedly seeks to assume management and operations of the South Florida Tri-Rail regional commuter rail operations, moving all trains to its own right-of-way along the coast. Tri-Rail currently runs over 71 miles of former Seaboard Air Line that lies further inland and with stations often outside city and town centers. Veolia Transportation currently holds the operating contract for Tri-Rail, while Bombardier Transportation provides maintenance under a separate contract.

A *Palm Beach Post* report said the negotiations talks have been led by the state Department of Transportation, which contributes some $30 million annually to Tri-Rail's $61 million annual capital and operating subsidies. The state legislature would have to approve any transfer of operation. [*Excerpted from the Railway Age NewsWire*]

**The ASLRRA's "Development Spotlight"** letter premiered on Thursday. Says Editor Dave Wharton, "Each edition of ASLRRA's Spotlight will concentrate on either a different market primed for business development within the short line industry, or an operational aspect that is of timely interest. Each of the topics will be repeated every six months. The first article on a topic is geared towards providing basic information needed to allow railroads to gain valuable knowledge about the subject, while the second article will go into more depth about the current trends."

The current issue provides an in-depth look at the natural-gas-from-shale-market, with particular emphasis on opportunities for short lines, citing in particular the experience of the Fort Worth & Western in central Texas and the North Shore Group in north-central Pennsylvania.  Though not specifically mentioned, Norfolk Southern, BNSF and UP have been active on the receiving end and CP's Wisconsin lines have been major players on the origin end. Car suppliers such as Midwest Railcar -- where Watco has an interest -- have also said they're putting more small-cube hoppers in their fleets.

**"The RRIF program is open for business,"** proclaims John Porcari in an end-paper article for the July, 2011 *Railway Age*. The writer is the Deputy Secretary for the US DOT and from all reports he's really trying to drill down into the program process and make it more user-friendy. Such has not always been the way the program has been viewed.

Long-time WIR readers may recall a three-part series on the program back in early 2009 -- the Jan 9, Jan 23 and Feb 20 issues, to be specific. You can link to the index page here:

www.rblanchard.com/week_in_review/2009/09q1/index_09q1.htm

This is where my good friend Chris Rooney, with whom I've collaborated on some RRIF work for the FRA, describes the process and offers up some pointers. I recently checked in with Chris and a few other co-conspirators and have determined there's yet more work to be done.

Thus I'd like to hear from readers about recent RRIF loan experiences -- how much money for what, the workability of the process and so on. Over the next week or so I'm going to do some homework of my own and perhaps by next Friday we can compare notes.

***The Railroad Week in Review, a compendium of railroad industry news, analysis and comment, is sent as a PDF via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 mm annual revenues $150. Corporate subscriptions $550 per year. To subscribe click on the Week in Review tab at www.rblanchard.com.  The Blanchard Company, © 2011. Disclosure: Blanchard may from time to time hold long, short, derivative or debt positions in the companies mentioned in Week in Review.***