THE RAILROAD WEEK IN REVIEW
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"The IANR trackage rights agreement shows how CP can work closely with short lines to develop mutually beneficial growth opportunities." -- Jane O'Hagen, Canadian Pacific

Watco's on a roll. The Kansas-based operator of 46 short lines and contract switching operations, 37 mechanical repair facilities, a Houston industrial park plus multiple terminal facilities has added three more railroads in quick succession. The Wisconsin Southern (WSOR) will operating as part of Watco Jan 1, 2012 with Bill Gardner continuing to serve as President, building on and maintaining the same level of service and commitment to the State of Wisconsin and its shippers that has defined its 30 year history.

The WSOR is a 600-mile regional railroad (Wisconsin's second largest) serving south-central Wisconsin and northeastern Illinois. It has direct interchanges with BNSF, Canadian National, Canadian Pacific, and Union Pacific. Cars are interchanged with NS and CSX through WSOR's Belt Railway of Chicago connection. The railroad also has access to harbor facilities on the Mississippi River at Prairie du Chien and maintains several transloading sites within its system. The WSOR has terminal offices in Madison, Janesville & Horicon and employs 250 people.

Under the agreement, the WSOR will retain its existing corporate structure including its name and all operations to continue to serve its customers and communities. WSOR headquarters will remain in Milwaukee, Wis., for the usual dispatching, customer service and other administrative functions. There will be no changes in WSOR's present operating or grant agreements with state and local government agencies.

In Alabama, Watco's Birmingham Terminal Railway (BHRR) has reached a definitive agreement to purchase the assets of Birmingham Southern Railway (BSRR). BHRR plans to file the appropriate paperwork with the STB later this month, and could begin operations as early as Feb. 1, 2012. This acquisition is a good tuck-in with Watco's three other Alabama properties -- the Alabama Warrior Railway, the Autauga Northern Railroad and the Alabama Southern Railroad. In its press release Watco says these four railroads will move more than 100,000 rail cars a year.

The BSRR serves Alabama's largest steel-making and manufacturing region and provides rail service to Port Birmingham, a rail-to-barge and barge-to-rail transfer facility located on the Black Warrior River. The BSRR operates 75 miles of track and provides service to more than 20 customers. The railroad interchanges with three Class I railroads: CSX, NS and BNSF's ex-Frisco line into Birmingham. BHRR plans to begin staffing up immediately.

And for dessert, Watco ventures into the wilds of Wyoming with the formation of a new short line railroad, the Swan Ranch Railroad (SRR), to operate within the newly-developed Swan Ranch Industrial Park in Cheyenne, Wyo. on the eastern fringe of the promising Niobrara shale formation, an oil play in the Denver-Julesburg Basin, which has long been a major oil and gas producer. Already energy companies are busy leasing land for future drilling. It has been compared by some to the Bakken shale formation farther to the north (and where Watco has a presence with its Yellowstone Valley Railroad).

Enter the SRR to provide rail service in the newly developed Swan Ranch Industrial Park in Cheyenne. The industrial park is hard by the intersection of BNSF's north-south line to the PRB and the UP's main east-west line to northern California as well as the intersection of I-25 and I-80. At the outset, SRR will have just three miles of track, though, when fully developed, the Swan Ranch Industrial Park, will encompass approximately 7,200 acres.

Asphalt manufacturer Jebro is the first company to open in the park and will begin receiving railcars in December. As for what's next, Watco VP Ed McKechnie says, "We'll have a cafeteria of options. This will be a large center that for bringing in concrete, sand, pipe…all the things you need to support large energy exploration and production facilities. We're in on the ground floor to play a major support role for what is literally a billion-dollar industry."

[*In a separate note, Jefferies analyst Peter Nesvold spent some time with UP management in Omaha last week. He reports that UP sees itself on the cusp of significant revenue growth in support of the oil and gas exploration industry. Energy-related volumes could double to some 400,000 annual carloads in 2012. That would be a two percent hike in carload vols against Nesvold's 2011 estimates.*]

Iowan Northern is another short line in an expansion mode. Most recently, they have signed a trackage rights with CP allowing IANR to use the latter's tracks between Nora Springs and Garner, Iowa. The former is where IANR's ex-Rock Island main crosses the CP's ex-Milwaukee/ IMRL route and the latter is where IMRL once crossed the UP's ex-Rock Island line to the northwest corner of the state.

This is an important gap for IANR to close. In October, the North Central Iowa Rail Corridor LLC inked a deal with UP to buy the 28-mile Belmond-Garner-Forest City segment for $1.5 million. The LLC in turn signed a ten-year lease-to-own agreement with IANR to operate the line. A local newspaper reports that UP "was reluctant to operate trains of fewer than 100 cars" making local service awkward at best.

Now, with IANR and its ability to run shorter trains profitably, "The potential for growth is significant, with businesses along the line having more access to rail shipping and farmers having access to more markets, which could lead to higher prices." And the CP deal gives IANR free rein to serve a contiguous system, which can only be good for all concerned.

The timing could not be better. Despite all the gloom and doom we're getting from our "leaders" in Washington, Stifel Nicolaus Managing Director John Larkin -- he of the BNSF shortline worksop Friday morning session -- still sees optimism. He writes:

We spent the week bouncing around the rust belt (Cincinnati, Columbus, Cleveland, and Detroit), where investors and company managements are not crying into their beer. Rather, it is if they have donned ear plugs and blinders and have blocked out the 24/7/365 information avalanche that has hamstrung many of us residing on the "left coasts." Spending time with these folks was like taking a giant breath of fresh air. They are the heart and soul of the USA. They are responsible for the slow but steady economic growth that continues in spite of the litany of headwinds mentioned above.

The railroads have deftly dodged the labor strike bullet. As we suggested last week, the over-hyped potential railroad strike will not happen. Two of the three remaining unions have agreed to terms with the railroads and the third has agreed to extend the "cooling off" period into 2012. And the STB seems to be content while it further analyzes competitive access issues without succumbing to shipper pressure to institute knee-jerk changes to its regulatory approach so with near-term labor and regulatory risks off the table, the railroads are proceeding down an unobstructed route leading to continued margin expansion.

Week 48 rail traffic is still running a bit ahead year-over-year, writes Baird rail analyst Hartford Benjamin in a December 8 note. The week closed up 3.6 percent vs. up 2.0 percent in Week 45. Auto was strongest, up 15.7 percent; ag was weakest, down 6.1 percent and that's going to hurt the short lines more than the heady auto gains. Chems were flat while coal and industrial, both shortline strengths, gained 4.7 and 4.3 percent respectively. Intermodal also gained 4.7 percent for the week.

The more worrying trend in the Baird note is the set of quarterly comps. Whereas every North American Class I saw double-digit year-over-year gains in the 2010 fourth quarter, each successive quarter since has seen smaller gains than its predecessor, with the notable exception being KCS -- up 13.8 percent in the 2011 third quarter vs 11.1 percent in the 2010 fourth quarter. CN and NS did best in the third quarter, up 3.9 and 3.3 percent respectively. The other four posted gains in the minus 2.0 (CP) to plus 1.0 (UP) percent.

But I've not said all. Writer Benjamin attaches a chart showing Week 48 vols jumping ahead of the start of the decline in the 2008 fourth quarter. Regardless of what it is -- intermodal, auto or industrial, this rising tide can lift all boats -- Class Is, short lines and regionals alike. Next: how improved shortline car management can help keep that tide rising.