THE RAILROAD WEEK IN REVIEW

July 6, 2012

"Canadian Pacific is an incredible franchise with significant market opportunity, solid infrastructure, and innovative and hard-working employees." -- Hunter Harrison

It's now official: HH is in at CP. The above quote is from the press release and is brilliant because it addresses two of the three areas where the few critics had faulted Harrison: customers and employees. As for infrastructure, we've already seen what the Green Team had started, particularly in using technology to improve operating results. The press release goes on to say Harrison "looks forward to getting to know the priorities of CP's customers, shareholders, employees, and the communities served by the railway."

I don't see it as a particularly tough row to hoe. Yes, CP has some particularly challenging terrain, as any of the analysts who rode the Investors Day Special to years ago ought to know. But CP already gives CN a run for its money in percent total RTMs in merchandise (including grain and ferts), beats CN in coal as a percent of total RTMs and lags CN by two percentage points in intermodal RTMs.

The big spread CP and CN is in revenue/RTM and I'm looking forward to Jane O'Hagan getting the nod to start improving those comps. After all, revenues are the denominator in the Ops Ratio formula and -- being the bigger number -- a dollar change here has a greater impact on the OR than a dollar change in ops expense. And short lines can help by turning cars faster to improve the value proposition, allowing CP to increase RPUs on a value-perceived basis.

In last week's comments on the virtues of short lines tracking gross ton-miles, I wrote that for a fee RMI will do it for you. Not so. The good folks at RMI called to say not only is there *no fee* for their ton-mile data reports, but that you can run just about any combo you want -- customer, car type, STCC, load/empty, car owner, etc. I'm looking, for example, at a Gross/Net Ton Mile detail report for a short line for the first three days of May.

For each car by initial and number I see load/empty, commodity name, miles, gross tons, net (revenue) tons, net ton-miles, from and to. At the end is a Grand Total with cars, miles, gross tons, GTMs, net tons, and RTMs. The way you get this is easy. Use the" Ton/Mile Selection" screen and fill in the blanks for the details you want. Any choice you leave blank will return all items that link to what you specified. Run it as a text file and you can download the tables into an excel spreadsheet for further analysis.

For Example, the sample report I got from RMI tells me each carload of stone is worth around 3,500 net ton-miles while each car of ammonium fertilizer is worth north of 8,600 net ton-miles. Higher rated commodity, longer haul, private equipment -- obviously margins are better on ferts than stone and the RMI report tells you by how much. Now you have something to measure against.

Barbara O'Neil, Director of Marketing for California's Levin Richmond Terminal and its Richmond Pacific,Railroad subsidiary, tells me they had gone to see the same Ashross unloading system at the Kinder Morgan/Fairless, Pa. facility that was featured here last week.

> We watched them unload anthracite coal and it was so fast and clean. We are handling between two and three unit trains a week of iron ore at our railroad/marine terminal and are seriously looking at upgrading our bottom dump system with the Ashross. We have a couple of Ashross portable truck unloaders that work really well.
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> The iron ore that we are handling is out of the old Geneva mine site near Cedar City, Utah. They have six sets of cars that they split between us and Stockton's Central California Traction railroad. We currently load three vessels per month of iron ore. Stockton has less water draft so they load the vessel first with about 25,000 metric tons and we top the load at our marine terminal with another 25,000MT. This has worked well for the past year and a half and it looks like it will continue.
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> CML (Comstock, Mountain, Lion) has invested in a new concentrate plant to further process the iron ore to a purer form which will be more desirable in China. Last year we handled 7,352 cars – the unit trains have gone from 84 to 100 cars for our railroad. We handled 730,000 metric tons last year and expect the tonnage to increase to over a million this year. Dave Buccolo at the CCT/Port of Stockton has a rotary dump system and they are doing a lot of work there in order to increase the tonnage too.

The Week 26 (June 30) carload stats are in. I just pulled off the RMI RailConnect Index of Short Line Traffic and found the largest YTD gainer was automotive, up 18.65 percent. Though still a small percentage of shortline cars (2.4 percent vs. chems at 17.2 percent), the pure numbers are significant: 80,232 units vs. 67,623 a year ago. From this it would appear short lines are participating in the sudden surge in the auto industry's "Seasonally Adjusted Annual Rate of Sales," or SAAR for short.

Peter Nesvold, the rail guy at Jefferies & Co. in NYC, writes in Thursday's note,

> The June U.S. light vehicle SAAR came in at 14.1 million, vs. Bloomberg consensus of 13.8 million. The 14.1 million SAAR was higher than expected, as most forecasters were expecting results similar to May's result of 13.7 million. The June SAAR was up 22.2 percent year-over-year (YoY) from June 2011's 11.5 million (vs. May's 7.5 percent YoY gain) against a tsunami-impacted year-ago comparison. Actual June unit sales of 1.26 million were up 17.6 percent YoY on a selling day adjusted basis (one additional day in the current year), ahead of our 15.5 percent YoY estimate.

> The American car buyer is alive and well. The big takeaway from June's upside sales surprise was the resiliency of consumer auto demand despite the gloomy economic headlines in the month. With the average age of the fleet standing at 10+ years, some consumers are coming back to the market out of sheer necessity.
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> Still others are attracted by newer, more fuel efficient products that are packed with technology and safety features. With a slew of major new product introductions or revisions across the core car segments, the growing popularity of crossover utilities, and the constancy of pickup demand (10 -11 percent of the market), we think 2H is setting up for an uptick in sales activity. We maintain our current 2012 SAAR forecast of 14.0 million.

One can always depend on Morgan Stanley's Bill Greene for a detailed analysis of transport buyer's opinions, actions to date, and likely future buying trends. His July 2 *Freight Pulse* is no exception and is loaded with goodies for shortline business planners. To begin, Greene writes that railroads are gaining share in the tonnage sweepstakes; a major contributor is the improvement in carload vs intermodal and truckload.

In the past, it's been said that the rails were discounting intermodal rates to buy share. Greene says the trend is toward less intermodal discounting, which tells me the rails are increasing share without buying it through discounts. And since shippers are switching loads between railroads less often, it follows that perceptions of rail service and value remain high.

That stands to reason. Shippers say they perceive intermodal capacity as "less tight." Yet intermodal box counts keep going up, which says the rails are getting better turns on boxes. Better turn on boxes is in part a reflection on railroad system fluidity, which in turn drives more merch car-miles per day. Unfortunately, Greene concludes by noting shippers rank the railroad merch carload sector dead last in service.

Based on what I've seen and heard on recent trips, I think perception lags reality in this regard. And therein lies a huge opportunity to change that perception. Sixty percent of the *Freight Pulse* responders to rail-related questions are in chems, manufacturing, food, mining, lumber etc. The perceived uncertain nature of where the economy is heading has led to a decrease in survey responders who say they plan to increase inventory levels. Same vols plus faster railroads equals more consistent transit time equals improved perceptions of carload service. Got that?