THE RAILROAD WEEK IN REVIEW

February 8, 2013

"I am confident that we will continue down the path that has already begun to restore superior customer service and operational excellence at CP." -- Keith Creel, Canadian Pacific

Genesee & Wyoming and RailAmerica reported separate revenue unit figures for the last time in December, 2012; putting them side-by-side gives us a clue as to what to expect now that all North American Class II and III names are under one roof, as it were. So let's look at each in turn and see what happens when we put them under that one roof.

GWR's North American roads handled 56,183 revenue loads in December, down 13 percent (8,466 units), year-over-year. Coal was the big hit and it shows up in two places: "Coal and Coke" (primarily coal to power plants or industrial customers) and "Other" (mostly NS overhead coal haulage in Ohio). "Coal and Coke" was off 5,793 cars, "Other" was off 2,593. So Coal, Coke and Other carloads were 8,332 of the 8,466 carload shortfall, making all other commodities down 134 carloads, a mere pittance. For the year, GWR did 723,448 carloads, off eight percent.

I expect the negative overhead comps will start going away in Feb-Mar, while coal comps either become less severe or go away entirely as mix changes and customer stockpiles dwindle to mirror more closely actual demand. The lesson to be learned from the overhead experience is that even though monthly vols were half what they used to be, GWR total 2011 vols were less than ten percent of total revenue units and as such the loss was not devastating. GWR has enough positive things going on elsewhere that this Black Swan event -- both unexpected and highly consequential to the Ohio lines -- did not materially affect the health of the GWR organization.

RailAmerica did 67,562 revenue carloads (no intermodal), down five percent; seven percent absent the two roads added in 2012. The RA "coal & coke" commodity group represented 16 percent of units (19 percent a year ago), whereas "other" is exactly that, and no haulage to speak of. (Coal and Other are 21 percent of the total at GWR, but, as noted above, the severe overhead coal hit did grievous damage to the combo.) Elsewhere, ag products were down ten percent and non-metallic minerals -- RA's fourth largest commodity by volume -- came down four percent.

Relative strength in four commodity groups helped trim the losses. In order of carloads as a percent of total vols, Chemicals, the third largest group at 11 percent of total vols, was up 11 percent, followed by STCC 26 paper-related products, eight percent of vols, up nine percent. STCC 24 forest products was third at seven percent of vols, up 14 percent, and STCC 29 petroleum products (RA doesn't bury this with chems) was seven percent of vols, up 23 percent.

As an aside, I have to note that for December the STCC 24 group was up 13-14 percent for both roads and I think it may be sustainable. Barclays Morning Research Summary on Tuesday says, “With home prices now up more than 10 percent nationally, we see the beginnings of a positive feedback loop that should extend far beyond homebuilding to include the remodeling and building products segments, drive increased mortgage availability and spark an eventual commercial recovery.”

I believe these stronger groups have better legs -- long-term staying power -- than the weaker groups, and are a credit to the RA team for creating a well-balanced franchise. The December units delta was 3,327 loads; the coal delta was 3,031 units, leaving a negative delta of 296 units spread across ten commodity groups plus “other.” Another pittance. For the year, vols were up 2.9 percent, better than six out of seven Class Is (only CP did better, up 3.1 percent). So, getting coal out of the way gives us a nicely-balanced workload where a calamitous event in one commodity isn’t going to blow up the entire enterprise.

Now combine the two sets of full-year numbers. Whereas GWR was down eight percent and RA up three percent, the combined companies did 1.6 million revenue units, down two percent or 37,379 units. GWR reports fourth quarter and full-year results Tuesday and I’m willing to bet 90 percent of the shortfall is coal-related and perhaps a third of the combined shortfall is Ohio overhead coal. Stay tuned.

By the time you read this, Keith Creel will have been Chief Operating Officer at Canadian Pacific for three days, having made the not-unexpected jump from CN to join his former mentor, Hunter Harrison. I say not-unexpected because at the December Investors Conference in NYC Hunter had tipped his hand, saying he needed a “closer,” to use a baseball analogy, to complete the team. Tony Hatch reports,

> For CP, it is a win. Cree’s appointment to COO solves three missing pieces of the CP story and strategy. It solves the big missing piece of succession, given that HH is 68 years old and is just beginning the process of changing CP’s culture. It provides CP with a COO, the missing slot on the December org chart. And it solves the question for investors of who that “closer’ will be – and anyone else would have been a (negative) surprise.

Reporting to Creel will be Jane O’Hagan, EVP & CMO, Scott MacDonald, SVP System Operations, Guido De Ciccio, SVP Canadian Operations and Doug McFarlane, SVP US Operations. Creel’s resume includes a US Army commission and combat duty in the Persian Gulf War in Saudi Arabia. As those of us who’ve been there, done that, know, combat helps you get your priorities straight. I for one am pleased he made the move.

There was one more shoe to drop, however. As part of a settlement between CN and CP regarding their differences surrounding Hunter Harrison, and coming hard on the heels of the Creel appointment, CP has agreed not to hire “certain CN employees” before December 31, 2016. Always the gentler gamester, CN’s Claude Mongeau stated, “We wish Keith success in his new role and are pleased to turn the page with respect to the matter of CP's hiring of CN's former

CEO, Hunter Harrison. The settlement arrived at today will allow CN and CP to focus on their respective agendas and create value for their customers and shareholders."

So much for the expense line. As for the revenue line, a pair of recent reports from Schwab are not upbeat about a key CP market: "China should bounce near-term but risks are elevated due to a surge in speculative debt and [because] economic growth may be coming from unsustainable sources." So even as *The Keith and Hunter Show* takes out operating costs, we must stay mindful that the numerator of the OR is still revenue and consider what lack of revenue can do to the operating ratio. Just look at what happened to NS in 3Q2012.

Class II and III revenue units for the first four weeks of the year are up five and a half percent. However, it's all intermodal, which moves on only a handful of names. RMI's RailConnect Index, 427 roads reporting, has non-Class I units ex-intermodal off one percent, though coal and grain (22 percent of all loads) are up eight and two percent respectively. Chems, 19 percent of vols, were up nine percent; STCC 24 wood products were up six percent though STCC 26 paper products slipped one percent.

The Class Is did about as well. Total units increased five percent while carloads ex-intermodal were down five percent, ex-coal and auto up a hair less than two percent. Petroleum, another Class I biggie that bypasses most short lines, jumped 47 percent to nearly 82,000 units. Back that out and what I'm calling shortline-equivalent carloads were off one percent-plus. The economists are threatening us with another year of two percent GDP growth, which means it's another year of short lines watching RTMs and costs with a gimlet eye.

Re shortline success stories about "volume growth in non-bulk, non-hazmat, single-car commodity lanes, boxcar moves in particular," as requested in last week's WIR cover mail. I had barely hit the SEND button when I got a solid response back from a carload-oriented short line that saw 2012 vols getting a nice uptick in consumer-goods packaging, both paper and plastic, nearly enough to offset drops in road salt and energy-related commodities. Net-net, the road finished 2012 down only three percent but with a much more sustainable product mix.

Elsewhere, Pennsylvania's North Shore Rail group has a niche in single-car industrial coal. Most recently, building on its success with bituminous to the Penn State power plant, the railroad now has a new outbound anthracite coal customer on its Shamokin Valley line, on tracks once trod by double-headed PRR I-1 2-10-0s on iron ore trains. A partnership of local businessmen arranged for the construction of a 2,000-foot loadout track plus a 1,500 foot run-around at a cost of about a million dollars. Once again, opportunity strikes when you go looking for it. Well done.