

THE RAILROAD WEEK IN REVIEW

September 13, 2013

“We spend a lot of time looking at each business within a company and how we think its value can be maximized. We're suspicious of management saying they can fix everything.” — Lloyd Khaner, Khaner Capital Group

The US Government may be running out of money but the TIGER grant program continues to benefit short lines needing infrastructure upgrades. The Vermont Agency of Transportation is getting \$9 million toward a \$19 million upgrade of the ex-Rutland main running parallel to Route 7 a third of the way -- 20 miles -- to Burlington from Rutland. The project covers right-of-way rehabs between Rutland and Leicester, includes replacing nine miles of rail, improving 11 at-grade farm crossings, and other items designed to eliminate slow orders and increase speeds up to FRA Class 3 standards (40 mph).

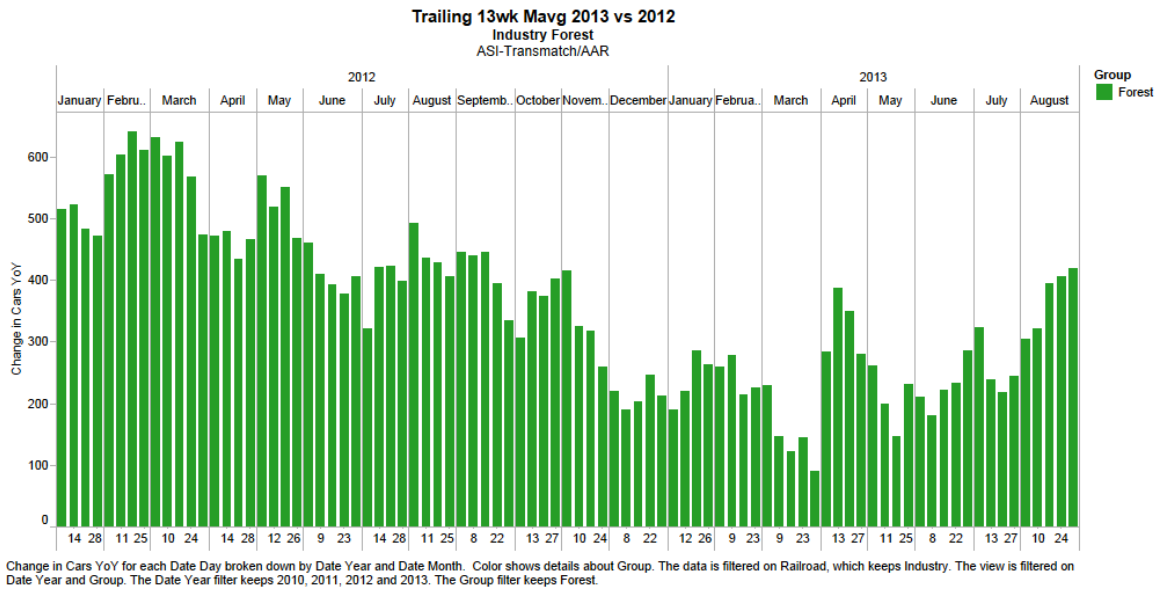
Operator **Vermont Railway (VTR)** celebrates its 50th Anniversary next year. A shortline success story, VTR principal commodities include outbound limestone slurry for New England paper makers and inbound petroleum products. VTR also hosts Amtrak's Ethan Allen on its daily round trip between Rutland and New York City. There is talk of extending it to Burlington, a service extension the present TIGER grant would certainly facilitate. Moreover, VTR has more than 200 employees and is an economically significant employer in Vermont.

The **New Hampshire North Coast Railroad (NHN)** wins \$1.4 million TIGER-dollars for the upgrade and repair of its 42 mile line between Rochester and Ossipee. Operating over a portion of the old B&M Conway Branch, NHN's primary traffic is quarried sand for owner Boston Sand & Gravel; propane and steel products round out the product mix. NHN runs a daily round trip over the line to the Pan Am Rail interchange three miles north of Dover.

A press release from the NH Governor's office says the grant “will help support critical repairs and upgrades” so they can run more freight faster. In other words, this is money being spent in the hopes that if they build it the industries will come. Owner Boston Sand was a big player in the Boston Tunnel project some years ago, doing maybe 10,000 cars a year, though the revenue carload base today is maybe half that. Which means they make the Rule of 100 threshold of 100 cars a year. But 100 cars of rock a week take their toll, so the TIGER money is well-timed.

Rio Grande Pacific's **Nebraska Central Railroad (NCRC)** will celebrate its 20th Anniversary this Sunday September 15 with a birthday bash at its headquarters in Norfolk, Neb. The road operates on 340 miles of ex-UP, CNW and Burlington trackage in the eastern third of the state. The road has more than 100 employee and does some 130,000 loads a year in corn, outbound frack sand, ethanol, scrap, and steel products. At nearly 400 cars a mile, the traffic density is quite satisfactory. Congratulations one and all.

The Forest Products commodity group is in an uptick from its 2012 lows. The Class Is in their earnings calls and gatherings with their short lines are citing this as a strength, But is it?



(The bars represent AAR weekly changes in year-over-year 13-week moving averages. RailConnect says short lines run four cars of paper for every three of wood. Both are down 3-5% YTD so the bars are a good indicator of where the lumber business is going.)

The *Wall Street Journal* Tuesday lead, “Mortgage Buyers, Home Buyers Feel Rate Squeeze,” pulls no punches. “A rise in interest rates is slamming homeowners’ demand for mortgages, prompting large and midsize banks to cut jobs and warn investors of declining profitability in the home-loan business.” The article notes that rate volatility is “the enemy of mortgage banking,” which bodes ill for mortgage-writers.

Industry observers estimate a six percent year-over-year decline in mortgage originations 2012-2014 before turning around in 2015. Part of the problem is lenders had ramped up their mortgage businesses in the past two years to take advantage of a surge in refinancing activity that was spurred by historically low rates. So even though the U.S. housing market is posting its strongest year-over-year gains since the tail end of the real-estate boom in 2006, the bloom may be coming off the rate rose, says the *Journal*.

The rate of week-to-week change is slowing, according to the chart, indicating a slow-down in lumber orders. And not only does the mortgage picture affect housing, it also affects private funding for short lines. The banking industry is already grappling with tepid loan demand from corporate borrowers and higher compliance costs as regulators crack down on a broad swath of banking practices.

Genesee & Wyoming North American carloads for August inched up a scant 1.2 percent over August, 2013; RailAmerica’s own 2012 results are added to GWR’s for the month for a

combined pro forma car count. Year-to-date units are down 4.7 percent and August, 2013 was 1.3 percent behind the July unit count.

Coal & Coke remains the largest single commodity group at 19.3 percent of carload units, though down from 20.7 percent a year ago and down 6.5 percent year-over-year. Ag products, 9.0 percent of carloads, remain in the doldrums, down 4.8 percent. Pulp & paper increased 3.2 percent; minerals & stone and STCC 24 wood products were essentially flat.

As with the Class Is, petroleum products are saving the day, up 31.3 percent and jumping to 6.7 percent of carloads from 5.1 percent -- crude oil and LPG are particularly strong in the Pacific and Southern Regions. Intermodal containers tripled to 1,151 from 307 units but at just eight-tenths of one percent of revenue units, it is hardly a core business. The rest of it? *Pas mal*, as the French have it. Holding one's own in this hunkered-down economy is about all one can ask for.

The STB has reworked paper barrier requirements, adopting new rules expanding the scope of disclosure requirements. The changes go into effect in a month and will affect all railroads filing notices and petitions for exemption for sales and leases that contain what the Board coyly calls "interchange commitments."

The Board will now want to see a copy of the document containing the paper barrier, showing a list of customers that now use or ever have used the line segment over the past two years, and the total number of carloads handled. The Board also wants certification that the filing party has forewarned said customers of its intentions, a list of railroads that can interchange cars to or from the line segment in question, and an estimate of the difference between the sale or lease price with and without the interchange commitment. And you have to name the document so that the existence of the paper barrier is clearly evident. The original action is here:

<http://www.gpo.gov/fdsys/pkg/FR-2013-09-05/pdf/2013-21548.pdf>.

What this will do is slow the further leasing or selling of branch lines to short lines. Class Is looking to control branch line costs (see WIR 9/6) will cut back on service offerings to levels the traffic will bear, shippers' perceived value of rail service will diminish, service will shrink still more and the Rails to Trails guys will move in.

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