THE RAILROAD WEEK IN REVIEW

May 18, 2012

"We continue to believe that Canadian Pacific has favorable long-term prospects, but we remain on the sidelines." -- Jason Seidl, Dahlman & Rose

The Green Team at Canadian Pacific fought the good fight but it wasn't enough. Fred Green has resigned as President and CEO; he had 34 years of service with the company. He also has resigned as a director and did not stand for re-election. Other directors not standing for re-election were John Cleghorn, Tim Faithfull, Ed Harris, Michael Phelps and Roger Phillips, their decisions having been taken given the views expressed by shareholders about the desire for Board change.

Named to the new Board are Pershing's Bill Ackman and Paul Hilal plus Gary Colter, Richard George, Paul Haggis, Krystyna Hoeg, Tony Ingram, Richard Kelly, Rebecca MacDonald, John Manley, Anthony Melman, Linda Morgan, Madeleine Paquin, David Raisbeck, Hartley Richardson and Stephen Tobias.

Naming Tobias to the Board -- and as interim CEO -- brings a certain Norfolk Southern viewpoint to Canadian Pacific. I seem to recall that CP's operating plan has its roots in the Thoroughbred Operating Plan, first introduced when Tobias was Chief Operating officer and Ingram was VP Transportation. Even today CP has trackage rights on the NS Southern Tier (ex Erie-Lackawanna) line in New York and NS uses CP's ex-D&H Albany-Binghamton route to access New England over Pan Am Southern.

The view from here is the Green Team has of late done yeoman work to make the CP run more efficiently and add more value to customer supply chains. Share prices have responded, too, with a double since 2009, closing Thursday at $74 and change, but it's going to take time to build on what the Green Team started. Here's what Jason Seidl at Dahlman & Rose writes:

> We believe Pershing will attempt to implement significant changes at Canadian Pacific to improve the operating ratio, which came in at 80.1% in 1Q12 and 81.3% in 2011... Pershing Square Capital's OR target is 65.0%, with the activist investor's CEO candidate Harrison Hunter admitting such a target would take years to achieve... We are maintaining our 2012 and 2013 EPS estimates of $4.45 from $5.35 until we learn more about the new leadership and its plans for the company... We continue to believe that Canadian Pacific has favorable long-term prospects, but we remain on the sidelines, as we believe further share price upside is limited from this point and in the near term.

RailAmerica appears to be in play. Picking up on a Fred Frailey blog at www.trains.com, necessarily un-named sources have confirmed that an offering document has been prepared and circulated by a major New York bank. Frankly, I'm not surprised. The John Giles team has done a remarkable job of turning what I have called a group of unrelated, unconnected short lines into a much better-run shortline family of short lines with one outlook and one approach to new business development.

Wall Street has noticed, too. After a slow start from the IPO after Fortress bought RailAmerica, shares have doubled to $22 today from as low as $10 in early 2010. In the same period (through 1Q2012, anyway), first quarter revenues increased by more than half again to $143.4 million from $93.1 million, the operating ratio has come down 3.5 points to 79.9 and revenue unit has increased 10 percent on an aggressive shift to higher-rated commodities.

As of Thursday's close RA has a market cap of $1.1 billion with trailing 12-month revenue and ebitda of $570 mm and $195 mm respectively, suggesting a market cap to ebitda multiple of five to six. Given that Patriot Rail (see below) reportedly brought ten times ebitda, RA ought to do better than the present market-cap/ebitda.

Gary Marino sells again. This time, he's selling his Patriot Rail to Steel River Infrastructure Partners, an independent infrastructure investment management firm out of San Francisco. Steel River is to acquire 100 percent of the capital stock of Patriot for something north of $200 million according to informed sources. The transaction is, of course, "subject to customary closing conditions and STB exemption filings." Marino will retire from his President and CEO titles and "provide consultancy services to Patriot's management and its board."

Patriot owns and operates 13 railroad names in 13 states with about 500 route-miles among them. The names include Tennessee Southern; Butte, Anaconda & Pacific; Utah Central; Sacramento Valley; Louisiana & North West; Temple & Central Texas; DeQueen & Eastern; Texas, Oklahoma & Eastern; Golden Triangle; Columbia & Cowlitz; and its newest acquisition, Piedmont & Northern, along with several contract switching operations.

Steel River sees Patriot as a door into the shortline business and one that will "allow Steel River to capitalize on additional consolidation opportunities in the short line rail industry in North America." Patriot's current management team goes with the deal and each firm anticipates a seamless transfer with no service interruptions. Steel River has tapped one John Fenton as the new Patriot CEO. Fenton is a career railroader who became CEO of California's MetroLink in April, 2010 -- some 19 months after the Chatsworth crash.

Providence & Worcester reported a first quarter 2012 operating loss of $1.5 million, an 18.2 percent improvement year-over-year from the $1.8 million loss a year ago. Operating expenses decreased 6.9 percent mainly on lower fuel prices and capitalized recoveries; comp & benefits remain at an industry high of 62 percent of freight sales plus ancillary income. Non-operating income was $123,000, off $70,000, principally on lower property rental income.

Total merchandise carload revenue decreased just half a percent to $6.1 million, even though vols drifted south 4.7 percent on fewer plastics and ethanol moves. RPU increased 4.5 percent to $913, a nice piece of change for a road this size. Container-related revenue jumped 45.3 percent to $260,000 and 4.1 percent of sales; revenue per unit was up two bucks to $73. A new customer for an on-line terminal operator gets the credit. The operating ratio improved 4.2 points to 122.3. The net loss after taxes and preferred dividends decreased 57 percent to $902,000 from $2.1 million.

The Harrisburg Hilton was once again the site for the Pennsylvania Rail Freight Seminar this past week, the 21st consecutive edition of this annual gathering. We were fortunate to have Penn DOT Secretary Barry Schoch open the proceedings with some very encouraging words about the state of Pennsylvania's shortline railroad community. The state has committed nearly $6 million to the Rail Freight Assistance Program and will allocate a portion of the Marcellus Shale Impact Fee assessed the drillers active in the state.

The program segued into a Rails-to-Trails discussion with a twist: how to undo them. The Marcellus Shale boom plus the new industry that will inevitably follow cheap gas have given many present short lines new lives and in the process have raised the question of restoring former rail lines to service. For example, overlay a map of past and present rail lines on the Marcellus Shale field in Northern Pennsylvania and note the gaps where the NYC Lyons line and PRR Elmira Branch once ran. Unfortunately, the latter is gone but the former could be put back.

The next day (NS sponsored a business car trip Rutherford to Enola over Rockville Bridge Wednesday afternoon) North Shore Railroad's Todd Hunter reprised his always informative Marcellus Shale panel series. Tom Murphy, Co-Director of the Penn State Marcellus Outreach and Research Center, led off, setting the scene with an overview of the natural gas market, how it works, how to respond to community enviro concerns, the impact of the wet gas - dry gas phenomenon on area railroads and the drilling outlook by region.

Norfolk Southern's Chris Spiceland, a member of the Short Line Marketing Team, opened his remarks citing the 30,000 carloads of shale-related materials from sand to pipe to drilling mats NS has interchanged with its shortline connections. Once again he repeated the theme of short lines as "market-multipliers" for NS -- getting the class I into destinations they could never touch by themselves. [This is a powerful selling point for short lines, too: getting their customers into rail-served markets they'd never reach without the short line.]

We wrapped with Bill Myles of the Wellsboro & Corning (and RailAmerica's latest acquisition). This is a former NYC branch into Wellsboro off its line into the central Penna coal fields and largely abandoned (and partially rails-to-rails) by its successors. Happily, Growth Resouces of Wellsboro, had been formed in 1956 with the purpose of "creating and maintaining economic development in the Wellsboro area," and acquired the line north to the Ex-Erie connection near Corning, NY, making today's WCOR a reality.

I first visited the railroad nearly 20 years ago when it was being as part of the North Shore Group and was faced with diminishing returns from a shrinking customer base. Along came Tom Myles (Bill's dad) a few years ago with a vision for a regional transload -- before anybody had ever even heard of the Marcellus Shale formation.

Fast forward to the present and WSOR has restored the wye where the Wellsboro stub joined the Lyons-Jersey Shore main, has added to the rail-truck-transfer facilty south of the wye, put in sand-storage silos north of the wye and has even introduced a short on-line water shuttle from a municipal facility to the north to water storage tanks near Wellsboro (see also WIR Feb 3, 2012). Finally, they've begun outbound shipments of drill-cuttings, the first cars to leave Wellsboro for beyond in 25 years. Looks like a good deal for all concerned.

Pennsylvania Rail Freight Seminar NS Special on Rockville Bridge, May 16, 2012.
Reproduced with photographer's permission.