GENESEE & WYOMING INC
Form 10-Q
May 07, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2009

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File No. 001-31456

GENESEE & WYOMING INC.

(Exact name of registrant as specified in its charter)

Delaware	**06-0984624**
(State or other jurisdiction of	*(I.R.S. Employer*
incorporation or organization)	*Identification No.)*
66 Field Point Road,	
Greenwich, Connecticut	**06830**
(Address of principal executive offices)	*(Zip Code)*

(203) 629-3722

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x YES ¨ NO

Indicate by check mark whether the registrant has submitted electronically or posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ¨ YES ¨ NO

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check One):

Large Accelerated Filer	x	Accelerated Filer	¨
Non-Accelerated Filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): ¨ YES x NO

Shares of common stock outstanding as of the close of business on May 1, 2009:

Class	Number of Shares Outstanding
Class A Common Stock	**33,572,010**
Class B Common Stock	**2,558,790**

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GENESEE & WYOMING INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF MARCH 31, 2009 and DECEMBER 31, 2008

(in thousands, except share amounts)

(Unaudited)

	March 31, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 31,134	$ 31,693
Accounts receivable, net	109,127	120,874
Materials and supplies	7,272	7,708
Prepaid expenses and other	12,019	12,270
Current assets of discontinued operations	1,530	1,676
Deferred income tax assets, net	18,101	18,101
Total current assets	179,183	192,322
PROPERTY AND EQUIPMENT, net	995,735	998,995
INVESTMENT IN UNCONSOLIDATED AFFILIATES	4,987	4,986
GOODWILL	151,624	150,958
INTANGIBLE ASSETS, net	222,072	223,442
OTHER ASSETS, net	16,540	16,578
Total assets	$ 1,570,141	$ 1,587,281
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 27,007	$ 26,034
Accounts payable	107,404	124,162
Accrued expenses	35,274	37,903
Current liabilities of discontinued operations	980	1,121
Deferred income tax liabilities, net	2	192
Total current liabilities	170,667	189,412
LONG-TERM DEBT, less current portion	525,788	535,231
DEFERRED INCOME TAX LIABILITIES, net	239,157	234,979
DEFERRED ITEMS - grants from outside parties	113,934	113,302
OTHER LONG-TERM LIABILITIES	27,073	34,943
COMMITMENTS AND CONTINGENCIES		
EQUITY:		
Class A Common Stock, $0.01 par value, one vote per share; 90,000,000 shares authorized; 45,900,478 and 45,830,569 shares issued and 33,505,077 and 33,435,168 shares outstanding (net of 12,395,401 shares in treasury) on March 31, 2009 and December 31, 2008	459	458
Class B Common Stock, $0.01 par value, ten votes per share; 15,000,000 shares authorized; 2,558,790 and 2,585,152 shares issued and outstanding on March 31, 2009 and December 31, 2008, respectively	26	26
Additional paid-in capital	216,580	214,356
Retained earnings	493,545	479,598
Accumulated other comprehensive loss	(16,098)	(14,033)
Less treasury stock, at cost	(202,342)	(202,342)

Total Genesee & Wyoming Inc. stockholders equity	492,170	478,063
Noncontrolling interest	1,352	1,351
Total equity	493,522	479,414
Total liabilities and equity	$ 1,570,141	$ 1,587,281

The accompanying notes are an integral part of these consolidated financial statements.

GENESEE & WYOMING INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2009 and 2008

(dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31, 2009	2008
OPERATING REVENUES	$ 138,458	$ 140,681
OPERATING EXPENSES:		
Transportation	43,129	47,856
Maintenance of ways and structures	13,433	12,968
Maintenance of equipment	17,108	17,941
Diesel fuel sold to third parties	3,389	8,567
General and administrative	24,032	23,394
Net gain on sale of assets	(239)	(550)
Depreciation and amortization	11,506	9,199
Total operating expenses	112,358	119,375
INCOME FROM OPERATIONS	26,100	21,306
Interest income	182	585
Interest expense	(7,180)	(3,909)
Other income, net	42	98
Income from continuing operations before income taxes	19,144	18,080
Provision for income taxes	5,163	6,819
Income from continuing operations, net of tax	13,981	11,261
Loss from discontinued operations, net of tax	(33)	(839)
Net income	13,948	10,422
Less: Net income attributable to noncontrolling interest	(1)	(25)
Net income attributable to Genesee & Wyoming Inc.	$ 13,947	$ 10,397
Basic earnings per common share attributable to Genesee & Wyoming Inc. common stockholders:		
Basic earnings per common share from continuing operations	$ 0.42	$ 0.36
Basic loss per common share from discontinued operations		(0.03)
Basic earnings per common share	$ 0.42	$ 0.33
Weighted average shares - Basic	33,467	31,498
Diluted earnings per common share attributable to Genesee & Wyoming Inc. common stockholders:		
Diluted earnings per common share from continuing operations	$ 0.38	$ 0.31
Diluted loss per common share from discontinued operations		(0.02)
Diluted earnings per common share	$ 0.38	$ 0.29

Weighted average shares - Diluted	36,370	36,033

The accompanying notes are an integral part of these consolidated financial statements.

GENESEE & WYOMING INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2009 and 2008

(dollars in thousands)

(Unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 13,948	$ 10,422
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations	33	839
Depreciation and amortization	11,506	9,199
Compensation cost related to equity awards	1,564	1,338
Excess tax benefit from share-based compensation	(10)	(845)
Deferred income taxes	2,240	2,826
Net gain on sale of assets	(239)	(550)
Changes in assets and liabilities which provided (used) cash, net of effect of acquisitions:		
Accounts receivable trade, net	5,253	(2,994)
Materials and supplies	368	(268)
Prepaid expenses and other	175	594
Accounts payable and accrued expenses	(9,264)	(12,716)
Other assets and liabilities, net	(42)	256
Net cash provided by operating activities from continuing operations	25,532	8,101
Net cash used in operating activities from discontinued operations	(411)	(776)
Net cash provided by operating activities	25,121	7,325
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(20,701)	(15,664)
Grant proceeds from outside parties	3,771	10,360
Cash paid for acquisitions, net of cash acquired	(5,780)	(3,613)
Proceeds from disposition of property and equipment	3,631	1,897
Net cash used in investing activities	(19,079)	(7,020)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term borrowings, including capital leases	(76,671)	(30,058)
Proceeds from issuance of long-term debt	69,000	17,500
Net proceeds from employee stock purchases	660	2,353
Excess tax benefit from share-based compensation	10	845
Net cash used in financing activities	(7,001)	(9,360)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	242	1,067
CHANGE IN CASH BALANCES INCLUDED IN CURRENT ASSETS OF DISCONTINUED OPERATIONS	158	41
DECREASE IN CASH AND CASH EQUIVALENTS	(559)	(7,947)

CASH AND CASH EQUIVALENTS, beginning of period	31,693	46,684
CASH AND CASH EQUIVALENTS, end of period	$ 31,134	$ 38,737

The accompanying notes are an integral part of these consolidated financial statements.

GENESEE & WYOMING INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION:

The interim consolidated financial statements presented herein include the accounts of Genesee & Wyoming Inc. and its subsidiaries (the Company). All references to currency amounts included in this Quarterly Report on Form 10-Q, including the consolidated financial statements, are in United States dollars unless specifically noted otherwise. All significant intercompany transactions and accounts have been eliminated in consolidation. These interim consolidated financial statements have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and accordingly do not contain all disclosures which would be required in a full set of financial statements in accordance with accounting principles generally accepted in the United States of America (United States GAAP). In the opinion of management, the unaudited financial statements for the three months ended March 31, 2009 and 2008, are presented on a basis consistent with the audited financial statements and contain all adjustments, consisting only of normal recurring adjustments, necessary to provide a fair statement of the results for interim periods. The results of operations for interim periods are not necessarily indicative of results of operations for the full year. The consolidated balance sheet data for 2008 was derived from the audited financial statements in the Company s 2008 Annual Report on Form 10-K but does not include all disclosures required by United States GAAP.

The interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2008, included in the Company s 2008 Annual Report on Form 10-K. Certain prior period balances have been reclassified to conform to the 2009 presentation.

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements (an amendment of ARB No. 51) (SFAS 160), on January 1, 2009. SFAS 160 requires the reporting of noncontrolling (minority) interests as a component of equity, separately identifying net income attributable to the parent and noncontrolling interest in the income statement, accounting for changes in a parent s ownership interest while it retains a controlling interest as equity transactions, and initially measuring at fair value any retained noncontrolling equity investment upon the deconsolidation of a subsidiary. The Company s subsidiary, Maryland Midland Railway, Inc. (Maryland Midland), has a 12.6% noncontrolling minority interest. As a result of the adoption of SFAS 160, the Company reclassified $1.4 million from minority interest liability to noncontrolling interest in equity in the consolidated balance sheets. Additionally, income attributable to the noncontrolling interest was reclassified from other income and presented separately in the consolidated income statements. While SFAS 160 requires reconciliation of equity from the beginning of the current fiscal year to the balance sheet date, as well as for the comparative periods presented in each quarterly and annual filing, the Company did not present an equity reconciliation in the consolidated statements as the noncontrolling interest is not material to the Company.

2. CHANGES IN OPERATIONS:

United States

Ohio Central Railroad System: On October 1, 2008, the Company acquired 100% of the equity interests of Summit View, Inc. (Summit View), the parent company of 10 short line railroads known as the Ohio Central Railroad System (OCR) for cash consideration of approximately $212.6 million (net of $2.8 million cash acquired). An additional $4.8 million was paid in the first quarter of 2009 to reflect adjustments for working capital. In addition, the Company placed $7.5 million of contingent consideration into escrow for payment to the seller by October 1, 2009, upon satisfaction of certain conditions. Any amounts paid will be recorded as an additional cost of the acquisition when the contingency is resolved. The Company has included 100% of the value of OCR s net assets in its consolidated balance sheet since October 1, 2008.

Georgia Southwestern Railroad, Inc.: On October 1, 2008, the Company acquired 100% of Georgia Southwestern, Inc. (Georgia Southwestern) for cash consideration of approximately $16.5 million (net of $0.4 million cash acquired). An additional $0.2 million was paid in the fourth quarter of 2008 to reflect adjustments for final working capital. The Company has included 100% of the value of Georgia Southwestern s net assets in its consolidated balance sheet since October 1, 2008.

CAGY Industries, Inc.: On May 30, 2008, the Company acquired 100% of CAGY Industries, Inc. (CAGY) for cash consideration of approximately $71.9 million (net of $17.2 million cash acquired). An additional $2.9 million of purchase price was recorded in the second quarter of 2008 to reflect adjustments for working capital. During the third quarter of 2008, the Company also paid contingent consideration of $15.1 million due to the satisfaction of certain conditions. In addition, the Company agreed to pay additional contingent consideration of up to $3.5 million upon satisfaction of certain conditions by May 30, 2010, which will be recorded as additional cost of the acquisition when the contingency is resolved. The Company has included 100% of the value of CAGY s net assets in its consolidated balance sheet since May 30, 2008.

Netherlands

Rotterdam Rail Feeding B.V.: On April 8, 2008, the Company acquired 100% of Rotterdam Rail Feeding B.V. (RRF) for cash consideration of approximately $22.6 million. In addition, the Company agreed to pay contingent consideration of up to 1.8 million (or $2.3 million at the March 31, 2009 exchange rate), of which 0.8 million (or $1.0 million) was accrued and recorded as additional cost of the acquisition at December 31, 2008, and was paid in the first quarter of 2009. The remaining 1.0 million (or $1.3 million at the March 31, 2009 exchange rate) is payable over the next two years and will be recorded as additional cost of the acquisition when the contingencies are resolved. The Company has included 100% of the value of RRF s net assets in its consolidated balance sheet since April 8, 2008.

Purchase Price Allocation

The allocation of purchase price to the assets acquired and liabilities assumed was finalized during the fourth quarter of 2008 for CAGY and RRF. The allocation of purchase price to the assets acquired and liabilities assumed has not been finalized for OCR or Georgia Southwestern. The purchase price allocation for these acquisitions will be finalized in the second quarter of 2009 upon the completion of fair value analyses. During the first quarter of 2009, there were no material adjustments made to the initial allocation of purchase price for OCR or Georgia Southwestern. The following table summarizes selected financial data for the opening balance sheets of the OCR and Georgia Southwestern acquisitions as of March 31, 2009 (dollars in thousands):

	OCR	Georgia Southwestern
Purchase Price Allocations:		
Cash	$ 2,757	$ 364
Other current assets	6,845	748
Property and equipment	224,119	24,480
Intangible assets	32,490	
Goodwill	60,728	4,754
Other assets	560	
Total assets	327,499	30,346
Current liabilities	9,404	1,159
Long-term debt, including current portion	12,793	5,317
Deferred tax liabilities, net	85,026	6,806
Total liabilities	107,223	13,282
Net assets	$ 220,276	$ 17,064
Intangible Assets:		
Track access agreements	$ 32,490	$
Amortization Period	46 Years	

The deferred tax liabilities in the purchase price allocations are primarily driven by temporary differences between values assigned to non-current assets and the acquired tax basis in those assets. The amounts assigned to goodwill in the purchase price allocations will not be deductible for tax purposes.

Results of Operations

When comparing the Company s results of operations from one reporting period to another, you should consider that the Company has historically experienced fluctuations in revenues and expenses due to economic conditions, competitive forces, one-time freight moves, customer plant expansions and shut-downs, sales of property and equipment, derailments and weather conditions such as hurricanes, droughts, heavy snowfall, freezing and flooding. In periods when these events occur, results of operations are not easily comparable to other periods. Also, the Company has completed and entered into a number of transactions recently which have changed and will change its results of operations. Because of variations in the structure, timing and size of these transactions, the Company s operating results in any reporting period may not be directly comparable to its operating results in other reporting periods.

Certain of the Company s railroads have commodity shipments which are sensitive to general economic conditions, including steel products, paper products and lumber and forest products. However, shipments of other commodities are relatively less affected by economic conditions and are more closely affected by other factors, such as inventory levels maintained at a customer power plant (coal), winter weather (salt) and seasonal rainfall (South Australia grain).

Pro Forma Financial Results

The following table summarizes the Company s unaudited pro forma operating results for the three months ended March 31, 2008, as if the CAGY and OCR acquisitions were consummated at the beginning of the year 2008. The following pro forma combined financial statements do not include adjustments for any potential operating efficiencies, cost savings from expected synergies, the impact of conforming to the Company s accounting policies or the impact of derivative instruments that the Company may elect to use to mitigate interest rate risk with the incremental borrowings used to fund the acquisitions (dollars in thousands, except per share amounts):

	March 31, 2008
Operating revenues	$ 159,347
Net income attributable to Genesee & Wyoming Inc.	$ 11,296
Earnings per common share attributable to Genesee & Wyoming Inc. common stockholders:	
Basic earnings per common share from continuing operations	$ 0.39
Diluted earnings per common share from continuing operations	$ 0.34

The unaudited pro forma operating results include the acquisition of OCR adjusted, net of tax, for depreciation and amortization expense resulting from the property and equipment and intangible assets based on preliminary assigned values and the inclusion of interest expense related to borrowings used to fund the acquisition.

In addition, the unaudited pro forma operating results include the acquisition of CAGY adjusted, net of tax, for depreciation and amortization expense resulting from the property and equipment and intangible assets based on assigned values and the inclusion of interest expense related to borrowings used to fund the acquisition.

The pro forma financial information does not purport to be indicative of the results that actually would have been obtained had the transactions been completed as of the assumed dates and for the periods presented and are not intended to be a projection of future results or trends.

3. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (EPS) (in thousands, except per share amounts):

	Three Months Ended March 31, 2009	2008
Numerator:		
Amounts attributable to Genesee & Wyoming Inc. common stockholders:		
Income from continuing operations, net of tax	$ 13,980	$ 11,236
Loss from discontinued operations, net of tax	(33)	(839)
Net income	$ 13,947	$ 10,397
Denominators:		
Weighted average Class A common shares outstanding - Basic	33,467	31,498
Weighted average Class B common shares outstanding	2,575	3,975
Dilutive effect of employee stock grants	328	560
Weighted average shares - Dilutive	36,370	36,033
Earnings per common share attributable to Genesee & Wyoming Inc. common stockholders:		
Basic:		
Earnings per common share from continuing operations	$ 0.42	$ 0.36
Loss per common share from discontinued operations		(0.03)
Earnings per common share	$ 0.42	$ 0.33
Diluted:		
Earnings per common share from continuing operations	$ 0.38	$ 0.31
Loss per common share from discontinued operations		(0.02)
Earnings per common share	$ 0.38	$ 0.29

For the three months ended March 31, 2009 and 2008, a total of 1,488,187 and 1,148,431 shares, respectively, of Class A common stock issuable under the assumed exercises of stock options computed based on the treasury stock method, were excluded in the calculation of diluted earnings per common share, as the effect of including these shares would have been anti-dilutive, because the exercise prices for those stock options exceeded the average market price for the Company s common stock for the respective period.

4. ACCOUNTS RECEIVABLE:

Receivables consisted of the following at March 31, 2009 and December 31, 2008 (dollars in thousands):

	March 31, 2009	December 31, 2008
Accounts receivable - trade	$ 104,992	$ 114,631
Accounts receivable - grants	7,403	9,150
Total accounts receivable	112,395	123,781
Less: allowance for doubtful accounts	(3,268)	(2,907)
Accounts receivable, net	$ 109,127	$ 120,874

The Company s business is subject to credit risk. There is risk that a customer will fail to meet its obligations when due. Customers and counterparties that owe the Company money have defaulted and may continue to default on their obligations to the Company due to bankruptcy, lack of liquidity, operational failures and other reasons. Although the

Company has procedures for reviewing its receivables and credit exposures to specific customers and counterparties, default risk may arise from events or circumstances that are difficult to detect or foresee. As a result, unexpected credit exposures could adversely affect the collectability of the Company s outstanding accounts receivable and the Company s operating results, financial condition and liquidity.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS:

SFAS No. 157, Fair Value Measurements (SFAS 157), defines fair value, establishes a framework for measuring fair value and expands disclosure requirements for fair value measurements. SFAS 157 specifies the following three-level hierarchy of valuation inputs established to increase consistency, clarity and comparability in fair value measurements and related disclosures:

Level 1 Quoted prices for identical assets or liabilities in active markets that the Company has the ability to access at the measurement date.

Level 2 Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and model-derived valuations in which all significant inputs are observable market data.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) SFAS No. 107-1 and Accounting Principles Board (APB) Opinion No. 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). The FSP amends FASB Statement No. 107, Disclosures about Fair Values of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require the SFAS 107 disclosures in summarized financial information provided for interim reporting periods. This FSP shall be effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for the periods ending after March 15, 2009. The Company adopted the disclosure requirements of FSP FAS 107-1 and APB 28-1 for the period ending March 31, 2009.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument held by the Company:

Current assets and current liabilities: The carrying value approximates fair value due to the short maturity of these items.

Long-term debt: Since the Company s long-term debt is not quoted, fair value was estimated using a discounted cash flow analysis based on Level 2 valuation inputs, including borrowing rates the Company believes are currently available to it for loans with similar terms and maturities.

Derivative instruments: SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, requires that derivative instruments are recorded on the balance sheet as either assets or liabilities measured at fair value. As of March 31, 2009, the Company s derivative financial instruments consisted solely of interest rate swap agreements. The Company estimates the fair value of its interest rate swap agreements based on Level 2 valuation inputs. See Note 6, Derivative Financial Instruments, for a discussion of the fair value of the Company s interest rate swap agreements.

The following table presents the Company s financial instruments that are carried at fair value using Level 2 inputs (dollars in thousands):

	March 31, 2009 Fair Value	December 31, 2008 Fair Value
Financial liabilities carried at fair value		
Interest rate contracts	$ 12,113	$ 12,885

Total financial liabilities carried at fair value	$ 12,113	$ 12,885

The Company s financial instruments are carried at historical cost. The following table presents the carrying value and fair value using Level 2 inputs of the Company s financial instruments (dollars in thousands):

	March 31, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial liabilities carried at historical cost				
Senior Notes, Series 2004-A 4.85%	$ 75,000	$ 69,693	$ 75,000	$ 69,735
Senior Notes, Series 2005-B 5.36%	100,000	88,181	100,000	88,423
Senior Notes, Series 2005-C Libor + 0.70%	25,000	21,230	25,000	20,998
Revolving Credit Facility	88,000	76,716	89,000	76,653
United States Term Loan	234,000	208,417	240,000	212,385
Canadian Term Loan	24,095	21,461	25,458	22,529
Other Debt	6,700	5,959	6,807	6,807
Total	$ 552,795	$ 491,657	$ 561,265	$ 497,530

6. DERIVATIVE FINANCIAL INSTRUMENTS:

The Company adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161), on January 1, 2009, which enhances the disclosure requirements about an entity s derivative instruments and hedging activities. The expanded disclosure required by SFAS 161 is presented below.

The Company actively monitors its exposure to interest rate and foreign currency exchange rate risks and uses derivative financial instruments to manage the impact of certain of these risks. The Company uses derivatives only for purposes of managing risk associated with underlying exposures. The Company designates derivatives as a hedge of a forecasted transaction or of the variability of the cash flows to be received or paid in the future related to a recognized asset or liability (cash flow hedge). The portion of the changes in the fair value of the derivative that is designated as a cash flow hedge that is offset by changes in the expected cash flows related to a recognized asset or liability (the effective portion) is recorded in accumulated other comprehensive income. As the hedged item is realized, the gain or loss included in accumulated other comprehensive income is reported in the consolidated statements of operations on the same line as the hedged item. In addition, the portion of the changes in fair value of derivatives used as cash flow hedges that is not offset by changes in the expected cash flows related to a recognized asset or liability (the ineffective portion) is immediately recognized in earnings on the same line item as the hedged item.

The Company s derivatives are recorded in the consolidated balance sheets at fair value in prepaid expenses and other assets, net, accrued expenses or other long-term liabilities. The Company matches the hedge instrument to the underlying hedged item (assets, liabilities, firm commitments or forecasted transactions). At hedge inception and at least quarterly thereafter, the Company assesses whether the derivatives used to hedge transactions are highly effective in offsetting changes in either the fair value or cash flows of the hedged item. When it is determined that a derivative ceases to be a highly effective hedge, the Company discontinues hedge accounting, and any gains or losses on the derivative instrument thereafter are recognized in earnings during the periods it no longer qualifies as a hedge.

Interest Rate Risk Management

The Company uses interest rate swap agreements to manage its exposure to changes in interest rates of the Company s variable rate debt. These swap agreements are recorded in the consolidated balance sheets at fair value. Changes in the fair value of the swap agreements are recorded in net income or other comprehensive (loss) income, based on whether the agreements are designated as part of a hedge transaction and whether the agreements are effective in offsetting the change in the value of the future interest payments attributable to the underlying portion of the Company s variable rate debt. Interest payments accrued each reporting period for these interest rate swaps are recognized in interest expense.

On October 2, 2008, the Company entered into two interest rate swap agreements to manage its exposure to interest rates on a portion of its outstanding borrowings. The first swap has a notional amount of $120.0 million and requires the Company to pay a fixed rate of 3.88% on the notional amount. This swap expires on

September 30, 2013. The second swap has a notional amount of $100.0 million and requires the Company to pay a fixed rate of 3.07% on the notional amount. This swap expires on December 31, 2009. In return, the Company receives 1-month LIBOR on the notional amounts of the swaps, which is equivalent to the Company s variable rate obligation on the notional amounts under its credit facilities. The fair value of these interest rate swap agreements was estimated based on Level 2 inputs. The Company s effectiveness testing as of March 31, 2009, resulted in no amount of gain or loss reclassified from accumulated other comprehensive income into income.

The following table presents the impact of derivative instruments and their location within the unaudited consolidated balance sheets (dollars in thousands):

	Fair Value of Derivative Instruments			
	March 31, 2009		December 31, 2008	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives designated as hedging instruments under Statement 133				
Interest rate contract	Accrued expenses	$ 1,841	Other long-term liabilities	$ 2,240
Interest rate contract	Other long-term liabilities	10,272	Other long-term liabilities	10,645
Total Derivatives		$ 12,113		$ 12,885

7. INCOME TAXES:

The Company s effective income tax rate in the three months ended March 31, 2009, was 27.0% compared with 37.7% in the three months ended March 31, 2008. The decrease in 2009 was primarily attributable to an extension of the United States railroad track maintenance credit, known as the Short Line Tax Credit, on October 3, 2008.

The Short Line Tax Credit, which had been in existence from 2005 through 2007, expired on December 31, 2007. The extension was retroactive to January 1, 2008 and expires on December 31, 2009. The retroactive effect of the extension was recorded upon enactment in the fourth quarter of 2008. The Short Line Tax Credit represents 50% of qualified spending during each year, subject to limitation based upon the number of track miles owned or leased at the end of the year, inclusive of miles acquired during the year. Historically, the Company has incurred sufficient spending to meet the limitation.

8. COMMITMENTS AND CONTINGENCIES:

Litigation

Mexico

On June 25, 2007, Ferrocarriles Chiapas-Mayab, S.A. de C.V. (FCCM) formally notified the Secretaria de Comunicaciones y Transportes (SCT) of its intent to exercise its right to resign its 30-year concession from the Mexican government and to cease its rail operations. In response to this notification, on July 24, 2007, the SCT issued an official letter informing FCCM that the SCT did not accept the resignation of the concession. On August 8, 2007, the SCT issued another official letter to initiate a proceeding to impose sanctions on FCCM. The amount of the sanctions has not been specified. The proposed sanctions are based, in part, on allegations that FCCM has violated the Railroad Service Law in Mexico and the terms of its concession. On August 30, 2007, FCCM filed a brief with the SCT that challenged the proposed sanctions and introduced evidence supporting FCCM s right to resign its concession. On September 21, 2007, FCCM also filed a proceeding in the Tax and Administrative Federal Court in Mexico seeking an annulment of the SCT s July 24, 2007 official letter and recognition of FCCM s right to resign its concession. As a result of SCT s answer in this proceeding, on June 26, 2008, FCCM filed a brief with new arguments. The SCT has also seized substantially all of FCCM s operating assets in response to FCCM s resignation of the concession. On September 19, 2007, FCCM filed a proceeding in the Second District

Court in Merida (District Court) challenging the SCT s seizure of its operating assets as unconstitutional. The District Court admitted the proceeding on October 11, 2007, and a hearing on the constitutional grounds for the seizure and the legality of the SCT s actions took place on February 1, 2008. On April 30, 2008, the District Court issued a decision upholding the seizure without analyzing the merits of the case. On May 21, 2008, FCCM appealed the decision issued by the District Court, before the Circuit Court in Merida. On March 31, 2009, the Circuit Court confirmed the decision issued by the District Court. In addition to the allegations made by the SCT, FCCM is subject to claims and lawsuits from aggrieved customers as a result of its cessation of rail operations and the initiation of formal liquidation proceedings. The Company believes the SCT and customer actions are without merit and unlawful and the Company will continue to pursue appropriate legal remedies to support FCCM s resignation of the concession and to recover FCCM s operating assets. As of March 31, 2009, there was a net asset of $0.6 million remaining on the Company s balance sheet associated with its Mexican operations.

M&B Arbitration

Meridian & Bigbee Railroad LLC (M&B), the Company s subsidiary, CSX Transportation, Inc. (CSX) and Kansas City Southern (KCS) were parties to a Haulage Agreement governing the movement of traffic between Meridian, Mississippi and Burkeville, Alabama. On November 17, 2007, M&B initiated arbitration with the American Arbitration Association against CSX in an effort to collect on outstanding claims under the Haulage Agreement and on March 26, 2008, M&B filed an amended demand for arbitration to add KCS. To date, the Company s total claims against CSX and KCS under the Haulage Agreement are approximately $6.8 million, which amount could change pending receipt of additional information and resolution of pending legal actions. On April 21, 2008, CSX filed an amended arbitration response, answering statement and counterclaim. On May 5, 2008, KCS filed an answering statement and counterclaims. On August 25, 2008, CSX and KCS alleged that they have suffered damages in an amount exceeding $3.0 million and $0.6 million, respectively, but yet to be finally determined. Arbitration is scheduled for June 2009. The Company plans to vigorously defend itself against the CSX and KCS claims, which it believes to be without merit, and will pursue insurance recovery as appropriate. Although the Company believes it is entitled to payment for its claims, and that it has meritorious defenses against the counter claims, arbitration is inherently uncertain, and it is possible that an unfavorable ruling or an unexpected assessment of damages could have a material adverse impact on the Company s results of operations, financial position or liquidity as of and for the period in which the determination occurs.

Other

In addition to the lawsuits set forth above, from time to time the Company is a defendant in certain lawsuits resulting from its operations. Management believes there are adequate provisions in the financial statements for any expected liabilities that may result from disposition of the pending lawsuits. Nevertheless, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. Were an unfavorable ruling to occur, there would exist the possibility of a material adverse impact on the Company s results of operations, financial position or liquidity as of and for the period in which the ruling occurs.

9. COMPREHENSIVE INCOME:

Comprehensive income is the total of net income and all other non-owner changes in equity. The following table sets forth the Company s comprehensive income for the three months ended March 31, 2009 and 2008 (dollars in thousands):

	2009	**2008**
Net Income	$ 13,948	$ 10,422
Other comprehensive income:		
Foreign currency translation adjustments	(2,571)	753
Net unrealized gains on qualifying cash flow hedges, net of tax provision of $280	492	
Changes in pension and other postretirement benefits, net of tax provision of $8 and $24, respectively	14	45
Comprehensive income	11,883	11,220
Comprehensive income attributable to noncontrolling interest	(1)	(25)
Comprehensive income attributable to Genesee & Wyoming Inc.	$ 11,882	$ 11,195

The following table sets forth accumulated other comprehensive income included in the consolidated balance sheets as of March 31, 2009 and December 31, 2008 (dollars in thousands):

	Foreign Currency Translation Adjustment	Defined Benefit Plans, net of tax	Net Unrealized Gains on Cash Flow Hedges, net of tax	Accumulated Other Comprehensive Loss
Balance, December 31, 2008	$ (5,350)	$ (469)	$ (8,214)	$ (14,033)
Current period change	(2,571)	14	492	(2,065)
Balance, March 31, 2009	$ (7,921)	$ (455)	$ (7,722)	$ (16,098)

The change in the foreign currency translation adjustment for the three months ended March 31, 2009, related to the Company s operations with a functional currency in Australian dollars, Canadian dollars and Euros.

10. DISCONTINUED OPERATIONS:

In October 2005, the Company s wholly-owned subsidiary, FCCM, was struck by Hurricane Stan and sustained significant damage. During the third quarter of 2007, FCCM ceased its operations and initiated formal liquidation proceedings. There were no remaining employees of FCCM as of September 30, 2007. The SCT contested FCCM s resignation of its 30-year concession from the Mexican government and seized substantially all of FCCM s operating assets in response to the resignation. Although the Company wrote off these assets in 2007, the Company believes the SCT s actions were unlawful and is pursuing appropriate legal remedies. See Note 8 for additional information regarding these actions and legal remedies. As of March 31, 2009, there was a net asset of $0.6 million remaining on the Company s balance sheet associated with its Mexican operations.

In November 2008, the Company entered into an amended agreement to sell 100% of the share capital of FCCM to Viablis, S.A. de C.V. (Viablis). At that time, Viablis paid a deposit toward the purchase price of FCCM subject to certain conditions of the sale contract. Completion of the sale transaction is subject to customary closing conditions, as well as the final negotiation with Viablis and the SCT of a mutually acceptable transfer of the concession granted by the Mexican government to Viablis and related undertakings. It is not yet possible to determine when or if these closing conditions will be satisfied.

Having met the criteria outlined in SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144), the assets and liabilities of FCCM and the Company s Mexican subsidiary, GW Servicios S.A. (Servicios), were classified as discontinued operations in the Company s Consolidated Balance Sheet at March 31, 2009 and December 31, 2008. The major classes of assets (at estimated fair value less cost to sell) and liabilities classified as discontinued operations in the consolidated balance sheets were as follows (dollars in thousands):

	March 31, 2009	December 31, 2008
Cash and cash equivalents	$ 483	$ 641
Prepaid expenses and other	1,008	994
Property and equipment, net	39	41
Current assets of discontinued operations	$ 1,530	$ 1,676
Accounts payable	$ 154	$ 227
Accrued expenses	826	894
Current liabilities of discontinued operations	$ 980	$ 1,121

The Company s Mexican operations described above are presented as discontinued operations and its operations are, therefore, excluded from continuing operations in accordance with SFAS 144. The operations and cash flows of FCCM are being eliminated from the ongoing operations of the Company and the Company will not have any significant continuing involvement in the operations of FCCM.

The operating results of the Mexican operations classified as discontinued operations in the Consolidated Statement of Operations were as follows (dollars in thousands):

	Three Months Ended March 31, 2009	2008
Operating Revenues	$	$
Loss from discontinued operations before income taxes	(35)	(851)
Tax benefit	(2)	(12)
Loss from discontinued operations, net of tax	$ (33)	$ (839)

11. RECENTLY ISSUED ACCOUNTING STANDARDS:

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which is effective for fiscal years beginning after November 15, 2007, and for interim periods within those years. On February 12, 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2 which delayed the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP partially defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. The Company adopted SFAS 157 for its financial assets and liabilities on January 1, 2008, and it did not have a material impact on its consolidated financial statements. On January 1, 2009, the Company adopted SFAS 157 for all of its nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, and it did not have a material impact on the Company s consolidated financial statements.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1), which addresses whether unvested instruments granted in share-based payment transactions are participating securities and, therefore, need to be included in the earnings allocation in computing EPS under the two-class method described in SFAS No. 128, Earnings Per Share. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating securities according to dividends declared (or accumulated) and participation rights in undistributed earnings. This FSP requires all prior period EPS data to be adjusted retrospectively to conform to the provisions of this FSP. The Company adopted FSP EITF 03-6-1 on January 1, 2009, and it did not have an impact on the Company s calculation of EPS.

In April 2009, the FASB issued FSP SFAS 141R-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from C