The Railroad Week in Review
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A Sep 4 report from Morgan Stanley's Jim Valentine and Chris Leshock notes that STB service metrics continue to lag last year's performance. Cars-on-line, yard dwell times and system train speed seem to be the major culprits. Though neither the AAR nor Morgan Stanley can break out variances among product lines, my bet is on the non-unit train, non-intermodal single car business as the chief culprit.

If you drill down to trains, blocks in trains, and cars in the blocks, you'll see that a late connection at the first yard after pull inevitably cascades down to a very late connection at the last yard before placement. In one Chicago-LA lane we've seen the advertised 207-hour trip plan transit time ballooned to twice that in more than half the events. True, the majors get pretty good good marks for their scheduled railroad initiatives. But it's not scheduling that does it. The secret is in drilling down to root causes and taking preventive action.

Track work, crew shortages and late interchange from connecting roads are the most common themes Valentine uncovered. Makes sense. Each cuts into average train speed, which cascades into longer terminal dwells, and makes the next interchange that much later. As a result the high-margin single-car product looks worse and loses more share.

In a recent presentation to shortlines (I have it on disk – just ask) NS showed that the average merchandise carload rides on five trains between pull and place. That does not include the yard jobs that switch cars between trains. Now do the math. If the railroad says trains are 90% on time, a car on a fifth train will be on time 59% of the time. That's a tough sell to a customer used to truck or intermodal reliability.

Rail traffic for Week 35 (ended Aug 30) rose a mere 0.7% yoy with carload up 0.7% and intermodal up 0.8%. YTD, total volume is up 1.7% with intermodal up 5.5% and commodity carloads including coal off 0.5%. However, backing out coal and ag YTD carload business actually increased 0.8%.

BNSF and UP were the commodity carload winners in Week 35, up 3.8% and 2.7% respectively, boosted, no doubt by double-digit increases in grain loadings even as automotive traffic slowed as expected. The critical chemical and petroleum group is second only to coal in total rail volumes, up a point-plus in Week 35 after two and a half dismal quarters.

Canadian National will take a 4% rate increase applicable to about 40% of its open tariffs, effective Oct. 1, 2003. CN started increasing open tariff rates on Jan. 1, 2003, with some rates rising as much as 10%, primarily to combat the negative effects on its financial performance due to the continued strength of the Canadian dollar relative to the U.S. dollar, as well as higher costs. CN says it has been hurt by falling profit levels over the last three quarters. Last year's weak Canadian grain harvest last year didn't help.

RailAmerica, according to a feature in *Progressive Railroading* for August, expects to apply for up to $75 mm in RRIF-dollars for upgrades on three of its railroads. VP for Investor Relations Wayne August confirmed this for me, saying that the Puget Sound & Pacific, the New England

Central, and the Dallas, Garland & Northeastern are the roads that will benefit most from full upgrading to 286,000 gross vehicle weight capacity.

August says further that these lines will gain both in terms of enhanced value to the current customer base and in securing more business in the future. IMHO that's what the RRIF program is all about, and these three are ideal candidates. To be sure, there are those who carp that their roads can't support expensive RRIF loans. Maybe not, but to those that can, and who will do the homework to find the optimum payoff, the RRIF program is an excellent tool. I'm glad to see RRA stepping forward for these properties.

Florida East Coast Railroad (FECR) parent Florida East Coast Industries (FECI, NYSE: FLA) has received a favorable ruling from the IRS regarding FECI's reclassification of its Class A and Class B common stock into a single class of common stock. The letter ruling confirms that the proposed reclassification will not have an adverse affect on the tax-free status of the October 2000 spin-off of St. Joe's equity interest in FECI to St. Joe's shareholders.

In May 2003, FECI's Class A and Class B shareholders, voting as separate classes, had approved amendments to FECI's articles of incorporation to allow the reclassification of the two classes of common stock into a single class of common stock. Subject to NYSE approval, FECI intends to file an amendment to its articles of incorporation with the Secretary of State of Florida in order to effect the reclassification on September 22, 2003.

FECI anticipates that the Class B Stock will be delisted from the NYSE prior to trading on September 22, 2003. The single class of common stock will continue to trade on the New York Stock Exchange under the ticker symbol "FLA". FECI Chairman, President and CEO Bob Anestis added, "We believe the elimination of the dual share class structure will enhance liquidity and trading volume in the stock, broaden appeal to a larger investor base, eliminate investor confusion and simplify the Company's capital structure."

CSX Chief Operating Officer Al Crown has announced his retirement after 37 years with the company and its predecessors. A press release dated Sep 11 said CEO Mike Ward would take charge of rail operations. An article the following day in the Baltimore *Sun* noted the unfortunate confluence of events that has hurt CSX rail operations of late – the computer bug last month, the cascading effects of a harsh winter, and deteriorating train speeds.

The CSX "surface transportation" (read railroad and intermodal) 2Q03 operating ratio was 86.3, highest in the industry by more than four points, and 2.3 points above 2Q01. For the first six months the OR was 88.5, up 2.1 points yoy. Still, the 2Q number was a big improvement in Q1's 90.8, and the latter is the baggage dragging down the YTD numbers.

Shortlines and carload customers will want to pay particular attention. CSX in 2Q03 was second only to CN in carload revenues as a percentage of total revenues. However, the high OR seems to indicate the railroad still needs to run better, especially given the complexities of the carload network. So thanks, Al, for your help and friendship over the years; go get 'em Mike.

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