

# THE RAILROAD WEEK IN REVIEW

## JANUARY 21, 2005

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**KCS got the good news** Wednesday that Grupo TMM shareholders finally have OK'd the TFM transaction. TMM will sell its 51% voting interest in TFM to KCS for \$550 mm in cash, stock and notes. There will another amount of up to \$110 mm in cash and KCS common stock due once the VAT Claim and Mexican Put are resolved. KCS shareholders have yet to give their blessing, though that's pretty much a given. The combined system will cover about 5,300 route-miles, half of which will be TFM.

But getting there is half the fun. KCS uses Tex-Mex rights on the UP between Robstown and Beaumont. Back in March 2001 Tex-Mex bought from UP the former SP right-of-way between Rosenberg and Victoria, 85 miles. Once rebuilt Tex-Mex will not only get off the UP main but also will shorten the Houston-Corpus Christie route by 70 miles.

**Union Pacific** plans to reopen its ex-SP California Coast Line and 80 miles of its Nevada desert canyon line for at least partial service by next Monday (1/24). The embargo remains in place and UP has been working with shippers to assure that critical chemical, grain and coal shipments into the affected areas keep moving. The Coast Line was closed when the storm, along with torrential rain and heavy surf along the line triggered washouts, coastal sinkholes and covered the track with mud over a 139-mile stretch that runs next to the Pacific Ocean between Guadalupe and Moorpark, Calif.

In Nevada, storm damage was spread over an 80-mile stretch in a remote canyon south of Caliente, about 130 miles northeast of Las Vegas. The narrow canyon channeled floodwaters that washed the roadbed out from under the tracks in numerous locations and damaged bridges and signals. UP crews have had to rebuild washed-out roads in order to reach portions of the track. Seven work trains are hauling rock to fill the washouts from both ends of the canyon.

Work also is underway to build a new bridge to replace the Cottonwood Wash Bridge buried under up to six feet of mud and rock. The track will be raised ten feet in this area. None of this comes cheap. Avondale Partners' Jason Seidl writes in a note to clients that he expects an earnings hit in 1Q05. He adds, "We expect the events to have lasting effects on Union Pacific's California operations, as shippers have grown tired of persistent problems at the Port of Los Angeles. "Shippers might view this latest setback as the final blow before they consider alternate ports for shipments (e.g. Port of Vancouver, Port of Seattle, Port of Tacoma). APL, a leading shipper of intermodal cargo containers, has already begun sending freight to Seattle after much frustration in Los Angeles. We expect other shippers may indeed follow suit—thereby impacting UNP's rail operations." UP reports 2004 earnings on Monday next. Let's see what they say about 2005.

**BNSF and CN have signed** a "routing protocol agreement" to streamline their exchange of rail traffic at major gateways. The aim is to direct rail traffic flows through the most efficient interchange locations thus reducing transit times and car cycle times. This effects merchandise carload shippers more than intermodal, grain, coal or automotive commodities where unit trains are the norm.

Recall the CN operating plan depends less on unit trains and more on specific schedules than does the BNSF. The IMX program of segregating intermodal by time requirements is part of it; maximizing power and crew turns is another piece. Thus it is that traffic from the Canadian prairies for the western US will come through the Noyes (MN) gateway, most likely in carload lots. The Superior (WI) gateway gets CN cars for the central US and Texas. Memphis and New Orleans will split the south Central US destinations.

**Genesee & Wyoming collected kudos** from my old stomping ground, *The Motley Fool*. Long term readers will recall WIR is an outgrowth of my years as “MF Rails” when that site was in its infancy. The writer calls GWR “the best little railroad that hardly anybody knows about. Net margins are roughly 50% higher than the industry” and return on equity runs in double digits – “no easy feat in the railroad sector.”

Picking up another WIR theme, GWR can “leverage a clean balance sheet to make selective (and accretive) acquisitions of additional small lines with relatively few competing bidders. Using a strategy of buying only when the return on investment is sufficient, the company has pieced together over 24 railroads and 8,100 miles of track into a very profitable business.” See also WIR for 9/24/2004 re South Buffalo RR acquisition.

**RailAmerica’s 2005 eps guidance** press release says they “could either miss or beat” Street estimates. The current estimate is 99 cents; the RRA release suggests a range of \$0.94 to \$1.02 on revenues between \$425 and \$435 mm. The revenue range represents an 8-10% increase yoy. Same-railroad revenue growth should be approximately 5% to 7%, including fuel surcharges of \$4 to \$6 mm. It’s encouraging to see the Class Is making good on their promises to share same.

Same-railroad volumes are projected to increase only slightly (1-2%) indicating significant yield improvements. The balance of the growth is expected to come from the full year impact of the 2004 acquisitions of the Central Michigan Railway, the Chicago, Fort Wayne & Eastern Railroad and the Midland Subdivision.

Note to shortline readers: If RRA is getting handling fee increases in the 5% range and is sharing in fuel surcharges, you ought to be too. My question is how many of the 500+ shortlines even know it’s being done. I’d wager less than half. Somebody please prove me wrong.

**The FRA issued a Jan 11 Safety Advisory** on switch alignment “in response to a number of recent incidents involving trains that derailed because switches that divert them from one track to another were left in the wrong position.” The FRA says that in the recent NS incident in South Carolina “a misaligned switch may have been one of the factors that resulted in a freight train being diverted from a main track onto a siding and into the path of parked locomotives.”

Any idiot knows you *always* put a main-line switch back where it was when you’re done with it, so it’s doubly irritating when the FRA has to advise that “railroads should document when a manually operated switch in non-signaled territory is changed from the main track to a siding and returned back to the normal position for main track movements. In addition, these actions should be communicated to all crewmembers and the train dispatcher.” See photo on Page 3.

**The State of Illinois has awarded Peabody Energy** (NYSE: BTU, and which I own) the air permit for the planned \$2 billion-plus Prairie State Energy Campus, a major coal-fueled electric generating station and coal mine in Washington County, near the burg of Lively Grove. The good news is this is the first new coal-fired generating plant in a long time; the bad news is it’s at the mine mouth. But it’s not all bad news – the plant will use limestone in its scrubbers and that has to come from someplace.

A zip code search of Usraildesktop.com (WIR 1/14, [www.rblanchard.com](http://www.rblanchard.com)) tells us the nearest rail station is Marissa, some six miles away, on the CN’s former IC line between Carbondale and St Louis. My June 1953 *Official Guide* shows the L&N’s St Louis line running just north of there but the current CSX map shows the line cut before reaching St Louis.

Meanwhile, Peabody has won the bid for 324 million tons of high Btu, low sulfur coal reserves in the Powder River Basin, adjacent to its North Antelope Rochelle mine, served by both BNSF and UP,

and which shipped more than 80 million tons in 2003. That's about 80% of what BTU shipped out of the PRB in oh-four. Total reserves in the PRB amount to some 3.3 billion tons, so there's plenty to keep both rails busy for some time. And, FWIW, Peabody coal products fuel more than 10 percent of all US electricity.

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This is how the crew left the switch when they headed for the barn.