The Railroad Week in Review
November 14, 2003
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Michael Giftos, EVP and Chief Commercial Officer at CSX, has decided to retire effective March 31, 2004. Giftos will be turning over his responsibilities at that time to Clarence Gooden, who currently is SVP - Merchandise Service Group. We have assurances that this change is not related to Al Crown's decision to retire and that passing the baton to Gooden will be a routine matter. CSX is on the cusp of a powerful commercial opportunity and Giftos has done an admirable job of positioning CSX in its markets.

Perhaps Morgan Stanley's Jim Valentine sums it up best: "CSX has the most operating leverage and financial leverage of any North American railroad, suggesting greater upside potential. "Approximately 15% of CSX revenues are adjusted quarterly by the RCAF factor, up 1.7% yoy in 3Q03 (but it's a sequential slowdown from the 6.6% increases seen in 2Q03 and 3Q03). Nearly 25% of CSX revenues are from its coal business that has operating margins in the range of 25% to 35%. We expect shipment volumes to improve in 4Q03 as utility stockpiles are now near normal and electricity demand (key driver for coal demand) remains solid (+1.8% year-to-date)."

Meanwhile, CSXT says it will offer retirement to about 1,000 non-agreement personnel as part of a drive to streamline management structure. The goal is to create a smaller, more responsive leadership team focused on increasing *operating income.* The process will reduce management layers from 11 to no more than eight and increase the number of direct reports for many managers. Reductions will be made over the next six months through a structured process, one layer at a time, beginning at the top of each organization.

Says CEO Mike Ward, "Despite our revenue increases over the past three years, I am not satisfied with our efforts to control costs and improve productivity. This initiative will result in broad changes in the way we do business. We will put managers and decisions closer to our customers, increase accountability at every level and establish a far more competitive cost structure." The program will cost $60 mm to $80 mm with a payout spread over the next four quarters.

CFO Oscar Munoz in his remarks before the Smith Barney conference on Wednesday touched on data automation and network rationalization. The first goes to using technology to accelerate many of the previous error-prone back office procedures requiring rekeying the same info multiple times. The second goes to spending money where it will do the most good. It was a very relaxed and to-the point presentation, and that's a good sign. The slides and remarks are available at www.csx.com and are worth a visit.

Norfolk Southern's non-agreement buyout program has been by all reports well subscribed. Of the more than 4,000 eligible to apply, about 500 took the offer, of which 60% were eligible for retirement anyway. The company will post a 4Q03 charge of some $107 mm, $66 mm in cash and $41 mm as a non-cash charge for pension and other post-retirement benefit accruals.

Also this week the STB upheld as reasonable NS' common carrier rates on certain coal shipments to several of Duke Energy's facilities. But the STB also said Duke could initiate a proceeding to determine whether the phase-in constraints of the "Constrained Market Pricing Guidelines" should apply. Where this can go is anybody's guess. Accordingly, NS will continue to bill and collect amounts based on the challenged tariff rates consistent with its past practice. Due to the

passage of time, however, the ultimate outcome could have a significant effect on the results of operations in the particular quarter or year resolved.

Last week's *Review* turned out to be a lot more thought provoking that I had expected. With respect to my Class I model: "You could take it one step further and have the short lines lease all but the highest density merchandise operations from the class Is and then make the class Is into hook-and-haul carriers almost exclusively. Long haul belongs to the class I, all gathering and distribution, merchandise OR intermodal, to third parties, who also do the pricing."

And, "Some Class I marketing folks are so concerned about losing a few carloads if they open things up to shortline FAK pricing, they miss out on numerous opportunities. Much of the so-called 'protection' is counter-productive anyway. If transportation rates need to be manipulated to make a market, margins are being diminished and unintended consequences realized. In the general freight environment, though, it's hard to imagine that strategy being successful. If it were, central planning would still be the rage."

Taking the other side of the intermodal margins argument, this reader writes, "Carload freight is where it is at and intermodal isn't going to do anything more than bring in cash-flow. I think you could read this between the lines in UBS's comments yesterday when they added CSX, NS and UP to buy and left BNSF at neutral with the comment that BNSF's mix of traffic was poor."

Re trucking revenue growth: "Might part of that be accounted for by the much smaller base of trucker revenue?" Actually, no. The total 3Q03 revenue increase yoy for the six North American Class Is (increases less decreases) was $128 mm. So the multi-billion Class Is generated less than half the yoy revenue gain of the much small truck lines. For the record they were YELL, JBHT, Old Dominion, Heartland, Ark Best, Werner and CNF.

As for shortlines: "It all starts from the [Class I] idea that the railroad share of the transportation market is fixed and that all railroads can do is to divide it differently. The short line experience is quite the opposite; many small railroads have grown their business substantially through a thorough understanding of their markets and solid execution." On the other hand, "There are several former Class 1 lines that now are short lines, but really are not viable and should just go away, and eventually will. Suspect you and I are thinking conceptually of the same lines."

And yet, "We move annually more than 6,000 carloads of construction sand with a fleet of fewer than 100 cars. Even though the per-car revenues are modest by Class I standards, it's plenty profitable for us and has accounted for a substantial part of our revenues thus far in 2003. Using Class I cost models, we couldn't move a car. [6000 cpy is 30 cars a day five days a week. 100 cars covers a three-day turn with some insurance. Seems reasonable. – rhb]

Dave Parkinson is back in the shortline fold, now at the helm of the San Pedro Southwestern, a former RRA property off the ex-SP at Benson, Arizona. Dave tells me the line is mainly copper-oriented and according to my RRA notes had at one time a traffic base of more than 3000 cpy. That's a tad light for 70 miles of line, but knowing what Dave did with the Arizona & California among others I have now doubt he'll do well. Welcome home, Dave.

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