The Railroad Week in Review
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Gary Marino is retiring from **RailAmerica** effective immediately after having built the firm from a one-shortline outfit with about a $million in annual sales to a 47-railroad, $360 mm company listed on the NYSE. Though a new President has not officially been named, Don Redfearn will step in as Acting President backed up by CFO Mike Howe and COO Joe Conklin.

Thursday's conference call was brief and to the point. Chairman Gus Pagonis said he and Gary had a chat during which the latter said he felt his "work was done." Gus and the Board agreed. RRA now intends to move "in a rapid manner to keep the train moving." It was a great call because Gus was clearly in charge, setting the stage and responding to the few questions with no pauses or obfuscation. He said the mission of RRA is to reduce debt and add shareholder value. There will be no more offshore excursions. A new President should be named with six months, and if an acquisition target of opportunity should pop up they will take aim. I like that.

It's now official. Early this week both Reuters and the WSJ reported that **Union Pacific** is turning shipments away citing "problems with crew shortages and congestion." Particularly hard hit are the PNW, the LA Basin and the Gulf Coast. Sources tell me Colton continues to be a mess and a friend just returned from Houston says it's SP redux. One west coast company tells me being turned away by the UP makes offshore sourcing cheaper than domestic by truck as rail rates kept domestic producers competitive. Interesting, given the political noise about jobs moving offshore.

Still, rail stocks are attractive from a PEG viewpoint. The attached earnings expectations chart shows all but CN as potential BUY ratings based on PEGs under One. NS, which usually carries a higher PE multiple than its peers, looks like a real bargain. A PEG of 0.84 implies a "fully priced" ticket of $26.78. Of greater interest to me though is the Five Quarters operating income comparison. And the reason I'm using operating income is it eliminates below-the-line "noise" like other income, taxes, changes in share count, etc.

Leaving the current quarter blank, only the BNSF and the Canadians (sounds like a rock band) saw successive quarterly increases. UP took a slight dip in 4Q03 while CSX saw wider swings across the full year. I went back to my 4Q03 revenue and expense analysis for NS to see what accounted for the chasm between 3rd and 4th quarters of 2003. In a word, expenses. The 12% operating expense increase dwarfed the 6% revenue increase, with comp and benefits alone up a third yoy. That kinda takes the edge off the attractive PEG pending an OR beginning with a seven. Let's bring this chart back in a month and see what we got.

A pair of clips hit my desk in the last week, both relating to higher grain prices and their effect on rail traffic. In the first, BNSF is taking a $100 per car increase on wheat from the Northern Plains and from the southwest to domestic users and export points. Recall last fall grain shippers complained there weren't enough cars and now they're saying it takes weeks to get empties spotted. Could it be some elevator operators didn't make their reservations in time? Half the shuttle capacity was booked for the spring by mid-Nov (WIR 11/20/2003).

Tuesday's WSJ notes that soy bean prices hit $10 a bushel putting pressure on farmers to get their beans to market and on users (Kellogg, ConAgra, et al) to start hedging futures. Though no railroad has yet said as much I'm willing to bet there could be a shortage of covered hoppers for beans. That in turn suggests the smart bean-counter will get his equipment reservations in *pronto*. Log on to http://www.bnsf.com/business/agcom/cots/cotsmenu.html for one approach.

According to an item on the *Trains* bulletin board the state of Washington has a proposal to buy the Palouse River & Coulee City Railroad (PCC) from **Watco.** It's a bit thin, running 9400 annual revenue loads on 400 miles of track, about a quarter of what one would need using the Rule of 100. Thus it's not surprising Watco plans to abandon about half of it. It's essentially a grain railroad feeding unit trains to the UP and BNSF, so $200 a car would be my guess. Call it an annual revenue stream of $2 mm.

Figure $5000 a mile per year to keep FRA class 2 track up to spec. That's $2 mm just in track maintenance on the PCC. To put that in context, a 60-mile railroad with 100 cars per mile per year and a $4450 per mile annual track budget will have to average $224 a car to keep the doors open assuming an operating ratio of 80. Track in this case is about 20% of revenues. No wonder Watco's walking.

Now I can report on 4Q03 and FY 2003 results for **KCS, FEC, GWR** and **RRA.** Recall that RRA did not report carloads and revenues by commodity until the 10-K was released, and that came out about two weeks ago. North American rail revenues came in at $315 mm, up 9% yoy. Corporate revenues remained at $358 mm. The difference according to RRA's Susan Greenfield comes from non-freight revenues like demurrage, switch fees, etc. And since operating resources are used to generate those fees, it is only right the OR be based on the higher number, thus a respectable 77.

Ideally one looks for full year operating ratios beginning with a seven or less, double-digit net margins, and a minimal spread "below the line" between operating and net incomes. All but RRA bring baggage below the line: FEC has real estate, GWR has the Australian Interests and KCS has its Mexican affairs. These three pass the double-digit test, but with the help of non-core railroad income. That's one reason we applaud RRA's exit from Australia: it makes the numbers cleaner.

That said, FEC has the most elegant rail operation of the lot – unit trains up and down a 400-mile mainline with minimal gathering and distribution. RRA is at the other end of the scale: many non-contiguous properties that are practically *all* G&D. Which is the right mix? Stay tuned.

KCS and TMM have agreed to postpone the next phase of arbitration. This comes as a bit of surprise as the arbitrator found that the Acquisition Agreement remains in force and is binding on KCS and TMM unless otherwise terminated. Both companies have reserved the right to proceed with the next phase of arbitration at any time and have agreed to discharge in good faith all of the obligations of the Acquisition Agreement signed April 20, 2003. The turn of events suggests that the negotiations continue outside the arbitrator venue.

Earnings Expectations
1Q04 vs 1Q03
CY 2004 vs CY 2003

	BNSF	CN (1)	CP (1)	CSX	NS	UP
1Q04	$ 0.45	$ 0.53	$ 0.24	$ 0.28	$ 0.31	$ 0.62
1Q03	$ 0.40	$ 0.47	$ 0.16	$ 0.20	$ 0.22	$ 0.57
Change	12.5%	12.8%	50.0%	40.0%	40.9%	8.8%
CY 2004	$ 2.39	$ 2.83	$ 1.82	$ 2.22	$ 1.58	$ 4.62
CY 2003	$ 2.09	$ 2.53	$ 1.58	$ 1.94	$ 1.35	$ 4.07
Change	14.4%	11.9%	15.2%	14.4%	17.0%	13.5%
Price	$ 32.09	$ 41.15	$ 24.84	$ 30.18	$ 22.50	$ 58.62
FWD PE	13.4	14.5	13.6	13.6	14.2	12.7
PEG	0.94	1.23	0.90	0.94	0.84	0.94

(1) US $
Source: First Call at yahoo.com

Five Quarters Operating Income

	BNSF	CN (2)	CP (2)	CSX	NS	UP
1Q04						
4Q03	$ 477	$ 512	$ 225	$ 239	$ 224	$ 589
3Q03	$ 430	$ 454	$ 209	$ 213	$ 311	$ 592
2Q03	$ 412	$ 437	$ 191	$ 259	$ 298	$ 584
1Q03	$ 346	$ 374	$ 118	$ 169	$ 231	$ 369

(2) Canadian $
Source: Company reports

Small Class I and Shortline Holding Company Commodity Carload Comps
Quarter ending 12/31/2003
Revenue and income in $millions

Metric	FEC	KCS	GNWR	RRA
Railroad revs (1)	$ 43.0	$ 148.5	$ 61.6	$ 93.8
YOY Pct. Change	2.9%	3.0%	9.8%	12.3%
Carload revs (2)	$ 26.4	$ 99.4	$ 36.5	$ -
Pct carload	61.4%	66.9%	59.3%	0.0%
Mdse Carloads (000)	46.4	121.8	90.9	-
Rev/CL	$ 569	$ 816	$ 402	na
Operating Income (3)	$ 43.0	$ (6.8)	$ 8.3	$ 18.6
Other Income (3)	$ (4.4)	$ 0.6	$ 3.9	$ -
Net Income (3)	$ 26.0	$ 8.1	$ 7.6	$ 1.5
RR Operating Ratio	73.9%	na	86.5%	77.3%
Net Margin (3)	25.1%	5.5%	12.3%	1.6%

(1) Excludes off-shore railroad data
(2) Excludes coal, intermodal, bridge traffic
(3) Corporate

Year ending 12/31/2003
Revenue and income in $millions

Metric	FEC	KCS	GNWR	RRA
Railroad revs (1)	$ 167.1	$ 581.3	$ 244.9	$ 358.0
YOY Pct. Change	3.2%	2.7%	7.5%	7.5%
Carload revs (2)	$ 105.2	$ 384.0	$ 143.2	$ 285.8
Pct carload	63.0%	66.1%	58.5%	79.8%
Mdse Carloads (000)	187.1	473.7	356.7	961.0
Rev/CL	$ 562	$ 811	$ 401	$ 297
Operating Income (3)	$ 43.0	$ 50.2	$ 36.4	$ 81.4
Other Income (3)	$ -	$ 6.8	$ 11.7	$ -
Net Income (3)	$ -	$ 61.4	$ 27.6	$ 14.7
RR Operating Ratio	76.2%	91.4%	85.1%	77.3%
Net Margin (3)	12.7%	9.5%	11.3%	4.1%

(1) Excludes off-shore railroad data
(2) Excludes coal, intermodal, bridge traffic
(3) Corporate