THE RAILROAD WEEK IN REVIEW
DECEMBER 17, 2004

Look for more churning in shortline ownership in 2005. BNSF and CSX are in major programs to shed marginal lines. Preferred buyers come from an exclusive group of multiple-shortline owners that already have successful partnerships with the selling class 1s. Moreover, today's buyers seek to acquire close to home, adding properties contiguous to existing shortlines. The old "any railroad any place" model is dead.

To free up cash for these immediately accretive acquisitions first-tier buyers are selling off their own non-performing shortlines. They're not, as a rule, quite as fussy as the class 1s when it comes to buyer qualifications, creating entry points for small shortline operators that want to grow but lack the credentials to deal with the class 1s direct. Of late I've been getting about a call a week from these second-tier guys looking for leads. It appears there's a lot of money chasing not that many deals, making it a seller's market.

The AAR says that "strong freight demand patterns will continue in 2005. Some modest rate hikes, likely in the 2% to 4% range, can be supported. As the U.S. economy begins to throttle back somewhat from the relatively high growth level seen in 2004, rail demand should remain relatively strong." Which bodes well for profitable shortline operations.

Moreover, the softening US dollar combined with what the WSJ calls "a voracious demand for cheap consumer goods from China" may just help industrial output even as it increases the amount of international container business on the rails. The latter is where the class 1s need to be; the former is the shortlines' bread-and-butter business.

The outlook for food goods (STCCS 01 and 20), forest products (24, 26) and chems (28) is particularly bright. But second-tier shortline buyers had better be careful what they ask for. Paying too much, taking on a pile of debt and then going after the connecting class 1s to increase allowances will not cut it.

So how does one know how much to pay? Twice sales or five times EBITDA seem customary opening bids subject to due diligence after signing the Letter of Intent. And here's where the big get bigger: they can buy at six or seven times EBITDA and wind up at four after melding the new operation into the old. Getting north of five without any combination benefits can be a killer.

There is no argument that railroad shipment volumes are up (Table 1). Three of the five US class 1s are up significantly in 4Q04 over the prior year. Unfortunately, the performance measure tables at www.aar.org do not provide parallel data for CN and CP, so they are omitted here, though volumes were up 18.9% and 6.3% respectively.

This being a carload newsletter, we need to look first at dwell times. Coal and intermodal trains don't typically spend time in classification yards, so this metric affects merchandise carload performance above anything else. BNSF has the lead here, though merchandise carloads represent a smaller part of total revenue than any of the others. CSX, with merch cars bringing in 61% of total revs, is at the top of that particular heap and look what's happened to dwell time.

Cars-on-line includes intermodal boxes and coal, and as business picks up the railroad can be expected to fill up somewhat, so a point or two here or there is no big deal. Ditto train speeds, a misleading metric if there ever was one. It represents train miles divided by hours operated and so includes every local job as well as every intermodal or unit train. In sum, I think the most meaningful metric for the carload trade in dwell time and when one considers traffic mix CSX has the best story.

Last week I wrote about the short line tax credit in the contest of UP's branch lines. I must not have been clear in my note because a reader has reminded me that "the tax credit only applies to Class II and III railroads in existence as of Jan. 1, 2005, so unless UP sells lines by this Dec. 31st the tax credit can not be used to fix up those branch lines." Point well taken. Sometimes one makes assumptions about who knows what and omits vital background information. Thanks.

Genesee & Wyoming reported November 2004 traffic volumes for its North American and 50%-owned Australian operations. North American traffic in November 2004 was 54,370 carloads, an increase of 11,815 carloads, or 27.8%, compared with November 2003. North American traffic for the fourth quarter through November 2004 was 109,070 carloads, an increase of 20,092 carloads, or 22.6%, compared with the fourth quarter through November 2003.

RailAmerica carloads for November 2004 were 107,097, up 9.5% from 97,790 in November 2003. The acquisitions of the Midland Subdivision, the Chicago Fort Wayne & Eastern Railroad and the Central Michigan Railroad in 2004 accounted for 7,815 of the carload increase. On a "same railroad" basis, November 2004 carloads increased 1.2% to 98,487, from 97,273 in 2003, primarily due to increases in food product and petroleum shipments which were partially offset by lower agricultural & farm products, metals and coal shipments. Year-to-date through November 30, 2004, total North American carloads increased 9.2% to 1,137,162, from 1,040,989 in 2003. On a "same railroad" basis for the same period, year-to-date carloads were 1,071,837, up 3.8% from 1,032,486 in 2003.

GATX Rail has acquired the remaining interest in Locomotive Leasing Partners from the Electro-Motive Division of General Motors Corp. Financial details of the transaction were not disclosed. GATX Rail is a unit of financial and leasing company GATX Corp. The deal gives GATX Rail full ownership of a fleet of 486 locomotives. The company formed the 50/50 partnership with GM in 1995 to combine their locomotive lease fleets. GATX stock (NYSE: GMT) as had a nice run since last March, up nearly 50% from its 52-week low and remain slightly ahead of its 50-day MA.

Canadian Pacific maintains earnings outlook as an arbitration decision on coal rates from one of Elk Valley Coal Corporation's mines in southeastern British Columbia to the Port of Vancouver goes it its favor. CP has said it "expects earnings per share of approximately C$2.60 in 2005, based on assumptions of oil prices averaging US$48 per barrel and an average exchange rate of $1.25 per U.S. dollar. This outlook reflects a conservative revenue recognition in 2005 on coal contracts, given the legal and regulatory proceedings."

Kansas City Southern and Grupo TMM have entered into an amended acquisition agreement whereby TMM will sell its 51 percent voting interest in the TFM Railroad to KCS for $200 mm in cash, 18 million shares of KCS common stock, a $47 mm two-year promissory note, and up to $110 million payable in a combination of cash and KCS common stock upon successful resolution of the current proceedings related to the VAT Claim and the Put with the Mexican Government. The $47 million promissory note and a portion of the $110 million contingent payment will be subject to certain escrow arrangements to cover potential indemnification claims. The boards of directors of both companies have approved the transaction.

Week in Review goes to a three-plus page format in 2005. As you've seen in 2004, spreadsheet excerpts and tables are often the best way to make a point or tell a story and that always requires another page. Moreover, the resurgence of the carload business puts increasing pressure on shortlines to fit seamlessly with their class 1 connections. To this end WIR will continue to focus on the operating interface and the financial resources needed to be successful.

We will touch on what's wrong with EBITDA as a measure of success, why the contiguous properties model works and the 'any railroad any place" model does not, and the dangers of overpaying for shortline properties. We also will start a thread on what's wrong with railroad event reporting and why lack of seamless reporting among carriers is a shipper turn-off.

So, with a 50% increase in content it seems only fitting to increase rates by 25%. Accordingly subs for shortlines with less than $12 mm annual revenue and individuals will go to $125 per year. Corporate and large shortline subs will go to $500. E-mail invoices will start going out to calendar year subscribers right after Christmas.

Thanks to you all for your continuing interest and support. WIR looks forward to serving you with though-provoking news and commentary again in 2005. Best wishes to all for a safe and delightful holiday season filled with fun, family and friends.

Table 1. Class 1 STB Performance Measures

Metric	Period	BNSF	CSX	KCS	NS	UP
Cars on line	4Q03	195,658	230,760	25,870	183,784	318,425
Week ending	12/10/04	200,414	230,542	25,784	192,858	328,154
	change	2.4%	-0.1%	-0.3%	4.9%	3.1%
Avg train speed	4Q03	24.1	21.3	27.3	23.2	22.7
Week ending	12/10/04	22.4	22	25.6	22.4	20.5
	change	-7.1%	3.3%	-6.2%	-3.4%	-9.7%
Median dwell	4Q03	29	33.65	23.5	25.2	33
Week ending	12/10/04	25	29.6	25.5	27.5	35.5
	change	-13.8%	-12.0%	8.5%	9.1%	7.6%
Improved		1	2	2	0	0
3Q04 Rev Units		2,467,000	1,817,000	262,800	1,905,000	2,270,000
YOY Change		11.5%	0.2%	7.7%	10.7%	0.0%