THE RAILROAD WEEK IN REVIEW
JANUARY 7, 2005

Wall Street analysts have varied opinions about what's happening now. According to a Reuters release Merrill's Ken Hoexter "cut his rating on UP to 'neutral' from 'buy,' noting the company's congestion issues, which have lasted longer than he expected. The lingering congestion could also suggest additional capital spending on the horizon to resolve disruptions." He remains bullish on BNSF, CN, CSX and NS citing "strong volumes and the best pricing power for the railroads in more than 20 years." [To me, more capex is good in this environment as long as there is sufficient cash flow from operations to sustain it. -- rhb]

Over at Lehman analyst Jennifer Ritter opines that "it's time to get off the train," downgrading CSX and CP to 'underweight' from 'equal weight.' She, like Hoexter, sees more upside for NS and CN but differs in her UP opinion which is decidedly bullish. She warns that "expectations of flawless execution are a tall order as the railroad industry, in particular does not have a great track record of doing such." [Except that four of the Big Six are doing pretty well at executing to plan. -- rhb]

Bear Stearns' Tom Wadewitz this Monday downgraded UP to "underperform" based on deteriorating STB metrics and shipper comments that do not support any significant operating improvements near-term. He concludes that "stronger pricing gains and lower fuel prices are largely baked into earnings estimates and stock price." [Serious students of UP's predicaments and options will find Fred Frailey's "Fixing an Empire" in the January *Trains* required reading. – rhb]

Meanwhile, Market Edge, a service that tracks technical indicators, sees signs of softening demand for shares of CN, BNSF, NS, and, to a lesser degree, CP, with CSX and UP improving. The view from here is that the market's behavior combined with a smattering if knowledge of what makes a given railroad tick is the best indicator of future performance, at least for the near term. This means reaching behind the STB numbers and going out on the railroad for a personal look.

Rail stocks outperformed the broader market averages in 2004. See Table 1. The leaders' strong performance (PWX excepted; see WIR 12/24/2004) pretty much follows our theme that the best operating results drive the best earnings improvements and stock price performance. The same is likely to be true in 2005. Revenue growth and expense control are the biggest determinants of profitability increases and the railroads with the most consistent focus on these two -- *throughout* the organizations -- are always the winners.

CSX Chairman and CEO Mike Ward wants "a boring railroad where we do the same thing the same way every day," according to Dan Machalaba in Tuesday's WSJ. The thread of the piece is that CSX runs a pretty complicated network that's proving a real challenge to bring to heel. Indications are the discipline of the "One Plan," essentially the MultiModal model that powers NS' Thoroughbred Operating Plan in yellow and blue rather than black, will paly a significant role.

Machalaba quotes shippers who see "significant capacity restraints" but who also see signs of improvement. But there are limits. As it happens the January *Trains* "Map of the Month" asks whether the SAL/ACL combo kept the right lines. Used to be you could get from Richmond to Savanna via either Florence (ACL) or Hamlet (SAL). The top end of the SAL was cut years ago and is sorely missed today. Partly as a result of this and other line rationalizations the CSX operating ratio in 2004 remained stubbornly north of 85.

Canadian National faces yet two more strike deadlines. The UTU can walk Jan 17 and the Teamsters (ex-BLE) can walk Jan 25 if the present round of negotiations come to naught. The good news is that CN has agreements in place with both entities in the US so a strike would impact only Canada. The bad news is that these are T&E positions and there will be less opportunity to trim headcount during the strike as CN did with the CAW last Feb. While there may be some hit to earnings in 1Q05, disruptions of this ilk do not generally create long-term damage. But the near-term hassles are needless and are just one more reason not to use rail for the nonce. Don' make no sense.

Watco has added three more BNSF lines: two segments that total 40 miles in Montana and 15 miles in Oklahoma. The former, operating as the Mission Mountain railroad, will run non-contiguous north and south lines, much as Watco does with its Eastern Idaho. The north line begins at Eureka and extends south to Stryker. The south line begins at Columbia Falls and extends southwest to Kalispell. Expectations are for about 9,000 cars a year consisting mainly of forest products and grain.

In Oklahoma Watco's Stillwater Central (SLCR) has leased about 15 miles of track between Wheatland and Oklahoma City. SLCR operates over the former Frisco between Sapulpa and Snyder and this transaction eliminates a trackage-rights gap south of Oklahoma City. Detailed maps at www.watcocompanies.com tell the story particularly well.

OmniTrax has closed on two Class I branchline acquisitions in quick succession. Just this Monday they confirmed a lease-purchase transaction with BNSF for Kettle Falls branch in northeast Washington. The lines to be purchased run between West Kettle Falls and San Poil, and the United States-Canada border; lines to be leased run between Kettle Falls and West Kettle Falls, and Chewelah and the border. OmniTRAX also would acquire incidental overhead trackage rights for a 4.7-mile line between Kettle Falls and West Kettle Falls to ensure access to a BNSF interchange in Kettle Falls.

The company has filed an exemption notice with the STB to lease about 122 track miles in Alabama from CSX. The transaction includes a line between Birmingham and Guntersville, and a branch line in Moragne. Recall in October Omnitrax leased the CSX Fulco Branch Line near Atlanta to enhance service to the Fulton Industrial District and expand opportunities for economic growth and development in the area. At the time Omnitrax said it would undertake a rehab project on the line to including rail replacement, 2000 new ties, and three new turnouts plus surfacing the lot.

BNSF's Bayport build-in project may go by the boards. Agreement has been reached with the UP to provide the shippers in the Bayport Industrial District of southeast Houston, Texas with access to two railroads. Recall that in May 2003 the Board approved the construction of a 12.8-mile rail line to provide the shippers in Bayport with a competitive rail transportation option. Actual construction of the rail line had been delayed by litigation in the Texas state courts.

Commenting on this recent development STB Chairman Roger Nober said in a press release, "Where shippers want rail competition, rail construction proposals continue to provide the opportunity both to construct and to negotiate based on the right to construct. I am very pleased that Union Pacific and BNSF have reached a deal to provide the shippers in the Bayport area with access to two railroads. I want to congratulate Majority Leader Delay and Mayor White for their leadership in helping the parties come to this agreement, as well as the parties for reaching this accord at the bargaining table."

Re trip plan compliance a major chemical shipper writes, "One comment regarding Larry's response concerning measuring actual performance versus trip plan: if the carriers compared the original trip plan for a car with the final actual performance, such a metric would have value to rail customers. The problem lays in the variability of the trip plans. From my experience, the carriers adjust the trip plan for a shipment daily, if necessary. In cases like that, the railroad would literally be comparing what actually happened with what actually happened. That is 'Hollywood' and really holds no value for anyone, either shipper or carrier."

This is indeed odd as senior officers at each of the Big Six have all assured me repeatedly this is *simply not done.* Trip Plan Compliance is always measured against the plan set when the car was waybilled and released. I have asked the writer to send me car data and dates so I can challenge the appropriate official. If any reader has seen trip plans changed to game the TPC score please write with details. We'll talk before I call anybody at the offending class 1.

There's a reason shortlines handling soybeans have seen a slackening of business. It seems farmers were holding beans back until the start of the new tax year, using prices up and hurting meal producers. Look for beans to start moving again shortly as the USDA predicts a record U.S. soybean crop and a 6% increase in global soybean-meal demand in 2005. Players like Bunge, ADM and Cargill will benefit, as will the railroads serving them.

Table 1.

Ticker Sym	12/31/2004	12/31/2003	Change
DJ Indus.	10783.01	10,494.90	2.7%
DJ Trans	3798.05	3,007.05	26.3%
NSC	$ 36.19	$ 23.65	53.0%
PWX	$ 13.49	$ 8.89	51.7%
BNI	$ 47.31	$ 32.35	46.2%
CNI	$ 61.25	$ 42.19	45.2%
FLA	$ 45.10	$ 33.10	36.3%
GWR	$ 28.13	$ 21.00	34.0%
KSU	$ 17.73	$ 14.32	23.8%
CP	$ 34.41	$ 28.15	22.2%
CSX	$ 40.08	$ 35.94	11.5%
RRA	$ 13.05	$ 11.80	10.6%
UNP	$ 67.25	$ 69.48	-3.2%