THE RAILROAD WEEK IN REVIEW
APRIL 15, 2005

***Barrons-OnLine* asks** if this is "The End of the Line for Transports." The recent sell-offs NS and BNSF, to name but two, caught my eye and this article spoke to that trend. What concerns me is the way the sellers have moved in and taken over both these names. Since peaking at $39 on Mar 22 NS closed midweek at $35 after hitting an intraday low of $33.15, a level not seen since the dip in Jan. Over at BNSF the high of $53.73 came on 3/22 as well and closed Wed at $52.82 after an intraday low of $51.26.

On the other hand names that lagged the DJ Transports during the 2004 run-up started in Jan to outperform the index and now lead it – think KCS and CSX. Both CN and CP have, like BNSF and NS, led the DJT all along, however the latest soon has been nowhere near as hard on our Canadian neighbors. As for the smaller rails, FEC, RRA and GWR have all lagged the DJT in the trailing twelve-month period. Where the index was up 20%, FEC managed 10% largely on its real estate results while the two shortline companies are priced about where they were in May 2004.

Then came the sharp sell-off Thurs and Fri. In a note to clients, Morgan Stanley's Jim Valentine opines, "While we can't forecast the direction of the economy, we can quantify the economic sensitivity of the 6 major railroads based on their carload mix." As one would expect, the economic picture won't hit rails with significant grain and coal franchises as much as others. Valentine projects "mid-single digit growth in coal and grain volumes during '05." BNSF and CP are the most insulated, the other four less so in varying degrees thanks to higher exposures in automotive and merch goods.

As for intermodal, about half the traffic base comes from off-shore and that's not going to chance if only because so many goods produced off shore are cheaper than their US counterparts. And Wal-Mart, as you know, will not be undersold. The domestic intermodal side will likely hang in there as truckers find it cheaper to use the rails than pay the fuel bill for remaining on the Interstates.

The sudden drop in rail stock prices could represent a buying opportunity as it doesn't look like the traffic trends are going to have a significant hit to earnings. I'm reprinting my chart from WIR 3/25 with Friday's closing prices. The biggest improvement went to RRA, though the low share price helped. NS and BNSF got really hammered as they'd had one of the best run-ups though at Friday's close they both entered oversold territory.

Of the lot, though, only KCS is up in the last three months, and that by 10%. All others are flat to down. The tech watchers at Marketedge.com give KCS and BNSF a "neutral from long" rating. CP, NS and UP rate a "hold" rating, RRA gets an "avoid but don't short" and the rest get "avoid – short candidate" flag. Put that together with the above and what you see out on the road and draw your own conclusions. It should be an interesting ride from here.

The so-called Dow Jones Theory theorizes that a downturn in transports presages a downturn in the broader indices. The consumer drives this economy and the pundits take the tune that high fuel prices are cutting into citizens' discretionary spending, in turn portending a fall-off in transportation of goods to market. Combine this with the bottom-line impact of fuel costs on the carriers and one can see where demand for transports may be off.

Maybe. The talking heads on CNBC said Thursday that oil prices could hit $40 before they hit $60 and that there's about $8 worth of speculation in the price of a barrel of oil. So, they ask, if oil is coming down, why is the consumer pulling back? Try volatility, uncertainty, the phase of the moon, whatever. But none of this alters the fact that the leading rail stocks have lost their momentum.

According to Clearstation ® consumer cyclical stocks (A-V equipment, automotive, footwear, non-apparel textiles, e.g.) are all off in the trailing 13-week period, roughly coinciding the DJT downturn. Yet the non-cyclical consumer stocks (groceries, tobacco, beverages, etc.) are faring better. My bet is on the P&Gs and ADMs and the carload sectors of the railroads that serve them. (To check this thesis, see 3-month and five-day charts for GPS, PG, WFMI and GM. All held at no change to down 5% while GM tanked.)

Take another look at the shortline YTD commodity pie chart from RMI (attached). Stripping out the intermodal side because most shortlines don't have any, coal, grain, ore, metals, chemicals, aggregates and forest products accounted for more than 80% of the carload volume. The logic is ruthless: coal heats and cools, chemicals include soap, ferts and plastic bottles, ores go into everything from steel cans to aluminum everything, and metals follow on that. Aggregates and forest products support the housing boom. And most of it's carload. So what are you waiting for? Time to make lemonade out of the lemons provided in the latest DJT trend.

Given the above this note from Railinc's Dick Flynn is timely. He writes, "You really got my attention with your piece on shortline to shortline marketing. This topic needs much more attention and can be a key growth strategy that serves Class I and Short line interests alike. Shortlines can be very responsive -- and getting the turnaround time to quote requests down to the same day is doable if they work out the right framework. We are still way too slow in that regard as an industry. The key is simplification and it's for taking a new look at how we do it today."

Right on, Dick. My vision is for the Class I to provide a point-to-point hook and haul service for goods in boxes it does not own, does not have to classify en route, and needs no local freight service to gather or distribute. BNSF has said it wants cars off branch line origins out of the serving yard within 24 hours of customer pull. Ditto on the destination end. Fine. But let the shortlines be the drays to and from the serving yard.

Union Pacific and Watco's Eastern Idaho get close, though UP still sends a local out to the shortline. A shortline waybill and release trigger a UP trip plan to destination, even when it's for beyond UP. The next logical step is to have EIRR run to the serving yard with trains pre-blocked for the distant serving yards. And if the distributing entity is a shortline, voila!, UP is the hook-and-haul carrier. What could be easier?

The downside occurs when a Class I sets up a shortline interchange on a branch line just past some customer the Class I wants to keep. Just this week I found such another such instance. The customer kept gets served at the end of the day, the switch crew goes on the law, and heads for the barn without making the shortline switch.

Happily, there's help. Starting now this shortline will use my Interchange Scorecard to track failures and report performance directly to the Class I shortline rep. It's downloadable if you need it: http://www.rblanchard.com/resources/texts/interchange.html .

Now comes a UP shareholder lawsuit claiming that the board "breached its fiduciary duty" for disregarding FRA rules, among other things, and as a result the plaintiffs "suffered substantial monetary losses and other injuries." Granted, UP had more than its share of incidents but by my reckoning UP management disclosed the monetary side through its usual communications with the investment community. So where so these guys get off "seeking compensatory damages against the directors, other non-monetary remedies and relief, and an award of the plaintiff's reasonable expenses and attorneys fees?"

Granted UP has had its share of troubles with congestion, mud slides, and choked yards. But we all knew about it and UP did a good job reporting on the clean-up process. Shipper clients have seen improved transit times and a good-faith outreach to get the goods to market. Having spent a good many years in the shortline industry I know blatant disregard of safety regs, and this ain't it. Gimme a break. Sheesh.

Norfolk Southern made *Fortune* magazine's Top Fifty list of companies ranked by total shareholder return in 2004. It's the only railroad on the list and the competition was tough. Total return at NS was 55.1% while Valero (oil and gas) and Peabody (coal) were in the high 90s. Monsanto (chems), Nucor (steel) and Toll Brothers (building products) all bested NS as well. The good news here is that the NS franchise serves 'em all. And as one's customers' fortunes go, so go one's own fortunes.

Shortline holding company Genesee & Wyoming rang up a 9% yoy gain in North American revenue units for the quarter (see chart). The total gain was more than 13,000 units, representing a revenue gain north of $4 mm based on the average RPU at last quarter's prices. Excluding results from the Tazewell & Peoria Railroad which opened 11/1/2004 the quarterly yoy increase was 4.7%. Coal, lumber, pulp and paper were the winners, offset by a slight decline in Canadian grain movements.

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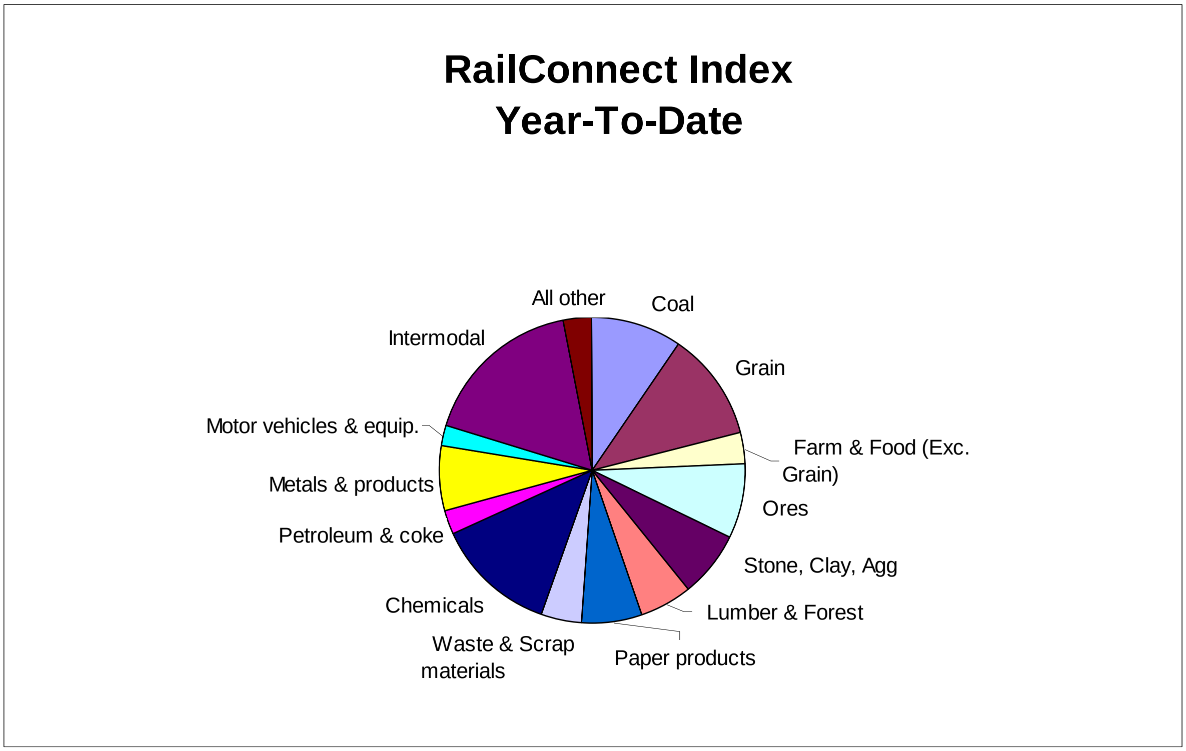
Relative PEGs of NYSE Rails with Analyst Estimates

	Price	PE '05	PEG '05	3/25 PEG	Change
BNSF	$47.22	13.6	0.64	0.75	-14.9%
CN	$57.00	14.0	0.65	0.71	-8.3%
CP	$34.10	14.4	0.41	0.43	-3.6%
CSX	$38.22	14.6	0.62	0.69	-10.4%
GWR	$23.50	13.7	0.73	0.83	-11.6%
KCS	$18.66	24.6	0.26	0.27	-4.1%
NS	$30.65	12.3	0.87	1.07	-19.1%
RRA	$10.13	10.1	0.13	0.17	-21.0%
UP	$62.97	19.7	1.77	1.97	-10.1%

Source: Yahoo.com

Shortline Rail Traffic, Week Ending 3/26/2005



Genesee & Wyoming First Quarter 2005 Revenue Units

1Q05	1Q04			YTD05	YTD04	
25.4	23.0	10.5%	Pulp & Paper			#DIV/0!
8.8	8.3	5.7%	Pet Prods			#DIV/0!
14.1	12.7	11.1%	Mins & stone			#DIV/0!
21.0	18.0	16.4%	Lumber & FP			#DIV/0!
18.2	17.8	1.8%	Metals			#DIV/0!
9.3	7.5	24.5%	Chemicals			#DIV/0!
13.4	11.5	16.8%	Farm & Food			#DIV/0!
4.0	4.2	-5.4%	Automotive			#DIV/0!
3.8	2.9	32.5%	Other			#DIV/0!
117.8	105.7	11.4%	Total	-	-	#DIV/0!
45.9	44.0	4.1%	Coal Coke & Ores			#DIV/0!
1.1	1.4	-16.3%	Intermodal			#DIV/0!
0.7	0.8	-16.3%	Mdse CL Equiv	-	-	

From Week in Review's *First Quarter Review,* due out mid-May.