THE RAILROAD WEEK IN REVIEW

JUNE 17, 2005

Shortline traffic volumes continue to increase at a faster rate than the Class Is (see table). GWR increased North American revenue moves for May 2005 by 6.5% and QTD by 7.2%. For the month, yoy comps include 3,500 units on railroads that were not yet in the fold last year; excluding them volumes were flat. Coal, coke and ores traffic fell by a combined 3,000 units in the Illinois and Utah regions. Growth in lumber and forest products made up 40% of the shortfall and the some. The quarter-through-May traffic volume excluding acquisitions was up less than a percent. Once again forest products loadings helped offset losses in coal, coke and ore loadings.

Over at RRA revenue units were up 10.3% in May and 9.6% YTD. On a "same railroad" basis, May 2005 carloads increased 5.5% as the increase in bridge traffic, which is lower margin business, was partially offset by lower auto shipments. On a "same railroad" basis, shipments in ten out of fourteen commodity groups increased. "Same Railroad" volumes YTD increased 4.8% and exclude carloads associated with railroads, or portions of railroads, sold or acquired since January 1, 2004.

Here again we have mixed reporting formats. The AAR, RMI and RRA give you YTD revenue units while GWR offers QTD. We also have three ways of reporting commodities. Month to month is nice to know, but as an investor one likes to know the trends. Which means it would be nice to see how the shortlines and Class Is (the AAR column) feed and support each other.

And that brings me to "same railroad" revenue moves ("carload" is misleading and I won't use it). GWR excludes properties acquired in the yoy period; RRA excludes not only acquisitions but also backs out properties sold in the yoy period. Personally, I don't much care. Just as I disregard "same store sales" for GPS or HD, I treat shortlines the same. Investors (and Class I partners) want to know how well managements are tending to their franchises and adding value.

Continuing the thread on shortline fees (WIR 5/27 et. seq.), the Treasurer's office of NS has generously provided a copy of the FASB's paper, "Reporting Revenue Gross as Principal versus Net as an Agent" (EITF 99-19). The paper addresses "whether a company should report revenue based on (a) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or (b) the net amount retained (that is, the amount billed to a customer less the amount paid to a supplier) because it has earned a commission or fee."

The Class I paying a shortline a fee to bring freight for shipment on the Class I certainly appears to fall under (a) above. Now, being neither accountant nor lawyer, I'm reluctant to drill down into the fine points. However EITF 99-19 goes on to say, "In assessing whether revenue should be reported gross with separate display of cost of sales to arrive at gross profit or on a net basis, the [SEC] staff considers whether the registrant:

1. acts as principal in the transaction,
2. takes title to the products,
3. has risks and rewards of ownership, such as the risk of loss for collection, delivery, or returns,
4. acts as an agent or broker (including performing services, in substance, as an agent or broker) with compensation on a commission or fee basis."

From this it would appear the Class I must report gross revenue because it acts as principal in the transaction and has risks and rewards. Moreover, "Indicators of Gross Revenue Reporting" include instances where the "company is the primary obligor in the arrangement, has latitude in establishing price, is involved in determination of service specifications and has credit risk."

But if all the above is true, how is it then that CSX can expense drayage fees related to a dock-to-dock intermodal service? There is a separate line item on their 1Q05 Income Statement for "Inland Transportation," fees paid truckers to move boxes between CSX intermodal ramps and customer loading docks. In this case, the intermodal drayer performs essentially the same service as a shortline. And if so, how can these fees be expensed when shortline fees are revenue deducts? Anybody?

Paying attention to details is one reason shortlines can increase volumes at a faster pace than do the Class Is. Community involvement is a major part of this, though its direct impact on revenue enhancement may be somewhat illusory. Still, it pays dividends. Shortline operator Watco Companies believes in community involvement and as a result has been awarded the 2005 Kansas Governor's Award of Excellence for the jobs and educational opportunities it provides its employees.

The firm first opened its doors in 1983 with less than a dozen employees. Today, Watco remains family owned and operated with its corporate HQ in Pittsburg, a small town on the Missouri border about 100 miles south of Kansas City. Total employment now runs well north of a thousand with switching operations in ten states and shortlines in twelve.

Shortlines operate on government-owned rails in many states: the M&E in New Jersey uses county-owned tracks, Virginia's Eastern Shore Railroad uses rails owned by a two-county commission and the Caney Fork & Western in Tennessee uses former L&N track owned and maintained by a three-county authority. Yet it's often asked whether county ownership of a railroad is worth it.

Michigan's Adrian & Blissfield can answer that with a resounding "YES!" The A&B got its start in 1991 as a contract operator using 17 miles of railroad leased from the state. There being only 400 revenue loads a year on the line, owner Dale Pape went into the dinner train business, making more money on the liquor license than on the freight operation.

Fast-forward to 2005 and the A&B handles more than 2,000 loads a year and the key, once again, is customer service. An article in Monday's *Toledo Blade* quotes a number of A&B customers on matters from cycle time to responsiveness. Each of the businesses cited contemplates expansion and the A&B is clearly a factor. The shortline has connections with Norfolk Southern and Canadian National, adding options for its customers. And if the state had not made the investment, who knows how many jobs there would be or the impact on the local highway system?

The Washington DC hazmat argument showed up in Baton Rouge as city leaders there claim a CN derailment illustrates the potential for disaster in the downtown area. On Memorial Day, a CN train carrying propylene oxide derailed in the heart of downtown, prompting evacuation of all buildings for several blocks. There was no hazmat leakage but just to be sure there never is the mayor wants CN to route around his burg because "something terrible could happen in the future."

Last year CN's petroleum and chemical group generated revenues of about C$1.1 billion, roughly 17% of total revenues, generating some C$363,000 in ops income at the system OR of 67. If hazmat is say 20% of the total chemicals business that's less than C$100,000 in operating income or three-one-hundredths of a penny a share. How long before the Class Is start asking themselves whether handling hazmats is worth the aggravation and risk? I'd like to know how hizzonor will explain why there's no more chlorine for drinking water or LPG for cooking and heating.

Here in Philadelphia the current Amtrak Follies generate a lot of ink. Just a few blocks from where I'm sitting 30th Street Station is reportedly one of the busiest on the entire Amtrak system and they do a pretty good job of getting passengers in and out of town. But when I hear the Bush administration talk about awarding infrastructure ownership and maintenance to one company and operating franchises to yet other companies, it gives me the willies.

It's said the definition of insanity is doing the same thing over and over again hoping for different results. Recall what happened in England when they gave the railroad tracks to RailTrack and pitted operating companies against each other for timetable space. Maintenance deteriorated, training was erratic, and different operators had different types of equipment with different operating characteristics. Net result: a series of spectacular train wrecks and the bankruptcy of RailTrack.

Amtrak is still the best way to get to NY. Driving is impossible. The bus – well, you get what you pay for. You can do the Septa-NJ Transit scramble changing at Trenton but that's two and a half hours each way to Amtrak's 90 minutes. However, it's a consistent 2.5 hours. Amtrak schedules are like the Code in *Pirates of the Caribbean* – "more like guidelines than actual rules."

My rule is always allow half an hour more than the schedule. Take this past Wednesday. I had to be at Penn Station by 10:45 AM I aimed for the 8:45 with a scheduled 10:15 arrival. Train time came and went with no announcements. When I asked the gate-keeper what was going one he said the lights on the train were not working. Nine o'clock came and went with no results so I opted for the 9:22, scheduled arrival 10:45.

The 8:45 got away at 9:05 but by that time I'd booked a business class seat on the 9:22. I'm sure we passed the 8:45 along about Princeton Jct. – the late get later, as you know. The 9:22 platformed at about 11:00, just 15 minutes late. The IRT cooperated and I got to my meeting not too bad off. After a delightful dinner with another rail investor-enthusiast I got on the 8:45 PM Amtrak train and it did much better, off by only five minutes or so at 30th Street.

Yes, Amtrak is still better than the alternatives, but the right move is for the US to join the rest of the civilized world -- and much of the Third World -- and give its citizens a rail system that's clean, comfortable, does not break and is reliable. I'm reminded of what E.M. Frimbo said: "We must always remember to maintain our best bedside manners beside our favorite patient, the passenger train." But RailTrack redux will not do.

I've just updated the search feature at www.rblanchard.com to cover all WIR index pages except those password-protected for paid subscribers. If you've forgotten or lost the password drop me a note. Happy hunting.

The Railroad Week in Review, a weekly compendium of railroad industry news, analysis and comment, is sent via-mail 50 weeks a year. Individual subscriptions and shortlines with less than $12 mm annual revenues $125. Corporate subscriptions $500 per year. The Quarterly Review, a statistical analysis of the ten largest publicly traded railroad operating companies is $50 per copy to subscribers, $100 per copy to non-subscribers. Both are publications of the Blanchard Company, © 2004. Subscriptions are available at www.rblanchard.com/week_in_review/index.html ***or by writing*** rblanchard@rblanchard.com **.**

Week 21 YTD Traffic Growth

Periods as indicated

	Primary	YTD	YTD	May YTD	Q2TD	Q2TD
Commodity Group	**AAR STCC**	**Class Is**	**Shortlines**	**RRA**	**Class Is**	**GWR**
Coal	11	3.2%	-0.3%	4.3%	-0.3%	
Coal, coke & ores						-8.4%
Grain	01	-0.2%	1.9%		0.8%	
Other Farm	01	0.0%			9.9%	
Grain Mill Products	204	3.3%			9.0%	
Food & Kindred Products	20	0.4%			4.4%	
Farm & Food (Exc. Grain)			17.0%			60.6%
Agriculture & Farm				15.8%		
Food Products				24.6%		
Ores	10	5.4%	4.6%	-1.0%	6.3%	
Crushed Stone, Sand	142	8.2%			10.0%	
Stone, Clay, Aggregates			27.4%			
Stone, Clay, Glass	32	0.1%			1.1%	
Minerals & Stone						-2.4%
Minerals				13.3%		
Non-metallic minerals	14	-4.4%			-4.8%	
Lumber & Forest products			13.8%	8.6%		16.9%
Primary Forest Prods	241	-5.7%			-4.3%	
Lumber& Wood	24	4.7%			4.0%	
Pulp & Paper	26	2.2%			0.2%	21.0%
Paper products			12.8%	4.8%		
Waste & Scrap materials	40	-5.0%	12.7%		-1.1%	
Chemicals	28	0.1%	12.1%	16.4%	-0.4%	15.8%
Petroleum & coke			28.9%			
Petroleum	291	5.6%		15.4%	4.7%	6.4%
Coke	299	9.5%			6.0%	
Metals & Products	33	2.3%	32.0%	5.8%	0.2%	13.2%
Motor vehicles & equip.	37	-3.8%	-2.0%	-19.4%	-3.0%	-7.0%
Intermodal		6.5%	25.4%	3.9%	5.3%	-30.8%
Bridge Traffic				13.4%		
All other		-3.5%	-5.4%	9.8%	7.9%	-20.6%
Totals		3.6%	12.5%	9.6%	2.6%	7.2%

Sources: Shortlines from RMI RailConnect Service; Class Is from AAR