THE RAILROAD WEEK IN REVIEW
JULY 8, 2005

"It's ridiculous not to be able to take the trains home. If we didn't kowtow to Hitler, why should we to this lot?" – Overheard from an elderly lady in Chelsea, July 7, 2005 as reported in the WSJ.

CSX Service Alert: Based on the current projections for Hurricane Dennis, CSX plans to cease train operations by 10 p.m. on Saturday, July 9, on its lines between New Orleans, La., Montgomery and Flomaton, Ala., and Chattahoochee, Fla. Floodgates in New Orleans will be closed at 6 p.m. on Saturday, July 9. Current projections for landfall show Dennis reaching the Florida Panhandle near Pensacola at approximately noon on Sunday, July 10.

At this time, CSX is preparing in advance of the storm by staging the necessary materials and equipment at various locations. An operating plan is in place to restore service after the storm passes. CSXT's Engineering Department will arrange track inspections prior to initiating any train movements following the storm. All precautions will be taken to ensure the safety of our employees, customers, and the public with minimum delay to shipments as we continue to monitor the progress of the storm. For more information, customers can call their local CSX representatives or the CSX Customer Service Center at 877 - SHIP CSX (877-744-7279).

The AAR reported on Thursday that June U.S. freight railroad carload traffic increased by a mere 2245 loads (a tenth of a percentage point) yoy while U.S. intermodal loads went up by 4%. On U.S. railroads ten of the AAR's 19 commodity categories posted increases led by crushed stone and gravel up 8.2% and grain mill products up 10.0%. Laggards were primary metal products down 11.2% and waste and scrap material down 8.3% yoy.

For Q2 there were 12 commodity groups up, led again by stone and grain mill products plus metallic ores. YTD it was 12 of 19 again with the same leaders while laggards were automotive (not surprisingly) and scrap metal (do these two somehow go together?). North of the border Canadian merchandise carloads were down 1.9% (coal and grain were the happy exceptions) and intermodal was off 0.4% yoy.

Once again, it's the bulk products that fare well even when the higher-rated stuff is down. RMI's rail Connect Index of Shortline Traffic shows YTD through 6/26 that bulk products make up 40% of shortline loads from grain (10.4%) to waste and scrap (4.3%). This presents a double challenge: on the one hand Class Is are taking steps to improve yields on low-rated goods and on the other shortlines operating fewer than seven days a week work against better yields for low-rated groups.

A change in Ohio state tax laws will add about $95 mm, or 23 cents a share, to Norfolk Southern's second-quarter results to be reported July 27 in NY. Recent legislation phases out the Ohio Corporate Franchise Tax and phases in a new gross receipts tax called the Commercial Activity Tax. The Corporate Franchise Tax was generally based on federal taxable income, but the Commercial Activity Tax is based on current year sales and rentals in Ohio . NS says the elimination of Ohio's Corporate Franchise Tax will result in a favorable adjustment to Norfolk Southern's deferred income taxes in the period of enactment, as required by Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes."

There are by my count some two dozen shortlines in Ohio operating on more than 2,500 route-miles of railroad with about 400 locomotive units. In 2004 they handled roughly 350,000 revenue units for a shortline system density comfortably north of 100 cars per mile per year. But the question now becomes whether the change in legislation will help or hurt the shortlines. If there is a significant federal income tax liability, this may help.

If the operation is marginal or a money loser, then it can hurt. Here in Philadelphia we have a gross receipts tax that merchants pay whether or not they are making any money and that contributes to the high turn-over of small businesses. Many of the Ohio shortlines are under 100 cars per year per mile and the only thing that saves them is being part of a larger holding company. But if Ohio starts taxing gross receipts by line rather than ownership the marginal may become even more so.

Recent brokerage house reports indicate truck drivers are returning to their cabs. The impact on railroad pricing could be important. Recall that when drivers are in short supply, capacity goes down creating an imbalance between supply and demand, making it a seller’s market with fairly inelastic pricing to the shipper.

Truckload capacity constraints combined with higher trucking rates have opened the doors to the rails for recapturing many lanes with both higher prices and better yields as per-unit operating costs come down. That’s why we see lower operating ratios on the incremental business (Y2 revenues minus Y1 revenues divided by Y2 expenses less Y1 expenses).

Remember too that pricing to market means pricing to what the traffic will bear. And if truck capacity is up and pricing becomes more elastic, then the market will eventually bear lower prices. What I worry about is what happens when shippers who’ve paid ever higher prices for rail because they had no choice suddenly have a choice once again.

This week KCS and RailAmerica joined the lengthening list of rail stocks whose technical indicators are on the mend. KCS has been toying with $20 since early March and only this week has it broken out to the upside. The SMA-50 is right at $19, so the stock has remained slightly ahead of that curve. On the other hand, First Call gives KCS a 2.4 on a scale of 1 to 5 where 1 is buy and 5 is bail. Estimates for CY05 and CY06 are $0.77 and $1.03 respectively, yielding PE’s in the range of 27.5 to 20.6 at a late-Friday price of $21.20, a tad rich perhaps.

Since late April RRA has tried and failed several times to break though resistance at its 200-day SMA of $12. Now however the SMA-50 is closing on the longer average from below and there are more buyers than sellers. First Call gives RRA a 2.0 on its buy-bail scale. Estimates for CY05 and CY06 are steady at $0.97 and $1.17 respectively. A stock price in the neighborhood of $14 is not out of the question with a nominal PE of 14.

There are caveats, however. Only four analysts follow RRA and KCS but two according to First Call. Thus it’s imperative one follow the fundamentals and the tech signs and draw one’s own conclusions. Both stocks are testing previous resistance levels and more than ever the trend is your friend. My own preference is to watch the MACD curves as they tend to lead the action on the floor.

From upstate NY comes word that the newly-minted Western NY and Pennsylvania (WNYP) shortline has had some notable success in building business back along the former Erie mainline that it leases from NS. One of the success stories deals with a plastics receiver converted from a transload to rail-direct. My sources tell me this was another instance of getting close to the customer, identifying the supply-chain needs and objections to rail and solving for the unknowns.

The end result is a new seven-car unloading facility on two-stub-end tracks. Pneumatic tubes carry product from cars on the far side overhead and into the plant. What’s particularly satisfying is the railroad’s ability to switch twice daily so there are always cars waiting to come in. Rotating five cars a day takes 100 truckloads a week off the local highways. That’s got to make many people smile.

Meanwhile, about 100 miles to the south in central Pennsylvania the North Shore Rail Group continues to find new ways to build the business, this time on its Nittany & Bald Eagle where they're helping clean up an acid rock problem related to the construction of yet another Interstate highway. The idea is to see if Bauxol, a non-toxic alkaline powder produced from aluminum reefing waste, can be used to reduce the acid run-off from 900,000 cubic yards of acid-producing rock.

The Bauxol originates in St Croix in the US Virgin Islands and from thence in barges to Chesapeake, Va. where NS loads it in gons and ships it to the Nittany in Penna. Transloading Services out of Roanoke handles the gon-truck transfer with a back-hoe that literally crawls along the tops of the car sides. The first eight carloads – 675 cubic yards in all – is part of a pilot program over the next two months to see how effectively Bauxol-and-water injections will neutralize the acidity of about a fifth of the total acid-based pile. If it works, it'll be more kudos (and another 40 carloads) for the Nittany.

Pinsley's Florida Northern Railroad has signed an agreement with CSX to operate the rail line from High Springs, Florida to Red Level Jct., Florida. The line is about 70 miles long and will handle approximately 35,000 cars per year. The rail line provides service to customers in High Springs, Newberry, Romeo and Progress Energy in Red Level Jct. Says John Levine, President of the Pinsly Railroad Company, "This line acquisition is a good fit to the existing core of our Railroads and will enhance our operations in Florida." I'll say. Good move.

More Earnings dates: CN, www.cn.ca , at 1430 on July 20, RRA, www.railamerica.com , at 1030 on July 28; GWR, www.gwrr,com , on Aug 1, no time given. Several shortline managers have told me they find the RRA and GWR webcasts particularly helpful because these are the only publicly-traded shortline operators and the remarks often mirror the concerns of the smaller, private operators. The trends in carloadings and acquisitions can be particularly meaningful, especially as they relate to operating earnings and debt levels.

We often hear of Class I plans to sell surplus material to shortlines. Norfolk Southern has stepped to the plate with MOW material and equipment being sold "as is, where is." There are ten lots of supplies ranging from bumper posts to turnout parts to a couple of fork lifts. Details are in the ASLRRA's "Views and News" for July 6, 2005 and at www.aslrra.org .