THE RAILROAD WEEK IN REVIEW
AUGUST 12, 2005

Factoid: Railroads can move 396 tons for every gallon of fuel consumed. Trucks can move 136 tons for every gallon.

CSX hosted the analyst community at the New York Stock Exchange on Thursday for its annual presentation. For me, the sequence of events and structure of the presentations were particularly helpful – from the Big Picture to the nuts and bolts and back gain. Shortlines got a nice nod, too, as CEO Mike Ward noted that the Class IIs and IIIs can grow the business *first* through better customer TLC and *possibly* lower cost – the emphasis was encouraging. (Don't go looking for any massive line transfers to shortlines, however. Maybe a thousand miles this year and less the next.)

There must have been 150 or so in the filled-to-capacity room and Ward's opening gambit was exactly right. "How does CSX," he asked, "position its unique operating asset to meet our customers' needs and exceed their expectations?" Everything that followed for the next five hours went straight to that point. It was a well-programmed, well-rehearsed story, the likes of such I've not seen since the BNSF analysts' KC gathering last November. (Presentation slides at www.csx.com .)

Les Passa, VP Strategic Planning, was up first to talk about how the CSX rail network is a "competitive advantage" given the outlook for strong market trends and new long-haul opportunities to serve the established northeast and growing southeast. Then Alan Blumenthal, SVP Service Design, identified traffic lanes and densities by commodities, showing how the relatively high-speed, high volume merchandise, intermodal and automotive networks run the Chicago-Selkirk-Waycross-Chicago loop while coal, coke and iron ore run pretty much inside that loop.

I was especially pleased to hear them talking in terms of predecessor roads and the legacies that either help or hinder CSX strategic design plans. The ex-NYC main west of Selkirk if flat and fast, was once four tracks and since reduced to two, so there's room to put stuff back. On the other hand, the Chicago to Waycross side was always single track and never very fast (In 1954 the "Dixie Flyer" took 33 hours to cover the 1086 miles Chi to Jax.) Getting more trains over that ex-C&EI-L&N-ACL route will be challenging, but CSX has budgeted $300-$400 mm over the next to years to put back or even add capacity to these fallen-flag corridors.

Take a look at the three corridors and the coal network on slides 32-40. Terre Hautre-Waycross is almost all new "network investment" while the ex-NYC West Shore line is the only other spot so marked on the entire core. Not mentioned is the fact that they can't run double stacks on the I-95 corridor north of Washington while NS is running a fast, high density I-81 service out of the NY area to Atlanta, Birmingham and New Orleans.

Getting back to the program, COO Tony Ingram drilled down to the operating details and it was clear that cultural hurdles remain. As Tom Murray observed in the September 2005 *Trains*, "For too long CSX has been unable to develop and plan and stick with it." It's pretty much agreed that CSX has been mired in a "flavor of the week" mentality and Wall Street needs to be convinced they can get out of it. I think Tony's remarks that linked safety, productivity and customer service with leadership, discipline and execution went well to that point.

But the fact remains it's largely a single track railroad out there and that's an expensive way to railroad. For 1H05 both CSX and NS chalked up revenues of $2.2 bn, CSX up 8.5% yoy to NS

18.8%. CSX revenue loads were off 1.9% vs. NS at plus 3.9%. On the pricing front, merchandise RPU (ex coal, IM) grew 7.8% at CSX vs 10.9% at NS. Finally, CSX took its yoy OR down 4.7 points to a respectable 80.5 while NS dropped 4.0 points to 72.5. They both serve essentially the same markets with the same inverted-triangle core route structure, so it's got to be a question of playing the hand one is dealt. This CSX team is the best I've seen and if anybody can turn CSX around they can.

Florida East Coast Industries (NYSE: FLA), in addition to the railroad, also operates Flagler Development Company, a commercial real estate investment and management firm. It owns, leases and manages 7.6 mm square feet of commercial and industrial space. It has another 680,000 square feet under construction and owns 3,300 acres of developable land and properties. Flagler does about $100 mm in annual sales.

The FEC Railway (FECR) does twice that and more. In 2Q05 FECR accounted for 71% of FECI's $83 mm in sales and 66% of FECI operating expense. Total FECI revenues increased 18% yet expenses were held to 11% producing a 49% gain in operating income. Below the line FECI shareholders were rewarded with a 41% jump in diluted eps, 32 cents vs. 22 cents a year ago.

The owners of the Virginia shortline presently operated by the Eastern Shore Railroad, Inc., issued an RFP on August 5 seeking a new operator for a lease arrangement. Interested parties are invited to contact Robert C. Oliver Jr. by e-mail, rco@eslaw.net, to receive a copy. Non-binding initial responses to the RFP via e-mail are due no later than 12:00 noon on August 26, 2005. *Full disclosure:* I have been engaged by the owners to manage the rail aspects of the transaction. If interested, drop me an e-mail and I'll send you the Confidentiality Agreement and the RFP.

Rail Trends, a conference organized by *Progressive Railroading*, will run for two days at the Cornell Club in NYC Sep 15-16, 2005. The focus is "financing capacity and growth in the railroad industry" and there will be panels and presentations on topics ranging from an analyst round-table to legislative matters to shortlines. Speakers include Ron Russ, CFO at KCS, Mike McClellan, VP auto and intermodal at NS, and the AAR's Ed Hamberger. Registration fee is $895. Log on to www.progressiverailroading.com/railtrends2005 for further details.

Two tidbits from GWR. First, the Philadelphia *Inquirer* reports that the Buffalo & Pittsburgh division has reopened the freight line into the Homer City (PA) generating station to receive coal from an on-line mine near Kittaning, about 100 miles away. The paper quotes B&P's Kevin Bowser who says the plant burns about 6 mm tons a year and his line plans to deliver about a sixth of that in year one.

Line rehabilitation was $9.6 mm in government funding at all levels, preserves and adds about 800 jobs, and will take 40,000 coal trucks a year off the local roads. The project consumed 16 miles of CWR, 41,000 ties and 30,000 tons of ballast. They also put in ten new turnouts and rebuilt 34 highway crossings. The goal is to get the line up to FRA class 3 to allow 40 MPH operation so one crew can make a turn a day.

Second, GWR's Charlie Marshall called the other day to say that the Rail Link family of shortlines – exclusive of their switching and terminal operations – now handles something on the order of 100,000 revenue moves a year. What's more, they're all counted in the monthly carload reports. This is an important clarifier to my note re GWR earnings in last week's WIR.

I wrote that big swings in commodity mix could not be a function of the RMC acquisition because the S&Ts weren't counted in car counts. That's still true re S&Ts, but where Rail Link runs shortlines they count in the monthly and quarterly carload reports. And since RMC is mostly shortlines, they

count in the car count and can thus now impact mix figures. Moreover, with the addition of RMC and other recent acquisitions Rail Link's freight revenue now exceeds its switching revenue.

The Paducah & Louisville (PAL) seeks approval to lease 124 track miles from CSX Transportation to create a new shortline subsidiary to operate the line between Evansville and Okawville, IL. PAL recently filed exemption notices with the Surface Transportation Board seeking the approval. The line, which includes CSXT's Mount Vernon Branch, would be operated by Evansville Western Railway, Inc (EVWR), a new Class III carrier. Shippers on the line include GE Plastics, CF Industries, Cargill, Growthmark Refinery and the Indiana PA's Southwind Maritime Center.

UP and CSX have teamed up to provide unit train service for fresh produce out of a gathering facility in Walla Walla Wash to Albany, NY, starting in 1Q05. UP is building 110 new 64-foot reefers to make two 55-car trains scheduled for 124 hours one way. With a decent load and unload time each train set ought to make two trips a month. Commodities include pears, onions and potatoes, "hard" foods all and well-suited to damage-free rail transport.

The reefers themselves are what UP calls "a new generation" with enhanced insulation, energy efficient cooling systems and GPS monitoring to ensure proper temperature control. The non-rail partner is Railex, LLC, a new division of AMPCO Distribution Services, that will own and operate both loading and unloading centers and will manage handling and distribution of product on each end.

July Class I rail freight loadings increased just 2.1% yoy and 3.0% YTD with BNSF and CN leading the pack. The former's revenue units increased 5.4% in July and 6.8% YTD while the latter scored gains of 8.6% and 4.0% respectively, though NS edged out CN in the YTD class with its plus 4.8% score. CSX fared least well, off 4.6% for the month and 1.0% YTD.

Over in shortline land, July same-store car revenue units were up 1% yoy on GWR and down 7% at RRA, the latter largely the victim of new NS-CN routing protocols and lower PRB coal volume. On a total yoy revenue-unit basis, GWR loadings increased 25% and RRA was up 7% for July, comparing favorably with the leading Class Is, perhaps even better because they do so much business with the Class Is that are not seeing such great volume gains and *still* come out ahead.

But it's also a sign of a worrisome trend. There's a sizeable point spread between same railroad and total units at both names, which seems to say the only way to grow a shortline network is to buy more network. However the bigger the shortline holding company becomes, the more it looks like a Class I. Then the Class Is begin asking themselves whether the shortline "partner" is now the competition.

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 .

Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies discussed here. A list of such holdings is available on request.