THE RAILROAD WEEK IN REVIEW
OCTOBER 7, 2005

The Institute of Supply Management (ISM, www.ism.ws) Production Index shot up 7.2 points in Sep from Aug's 55.9 – anything over 50 is, in the words of the ISM, "generally consistent with an increase in the Federal Reserve Board's Industrial Production figures." Railroaders depending mainly on the merch carload trade will be pleased to know the gainers in Sep included lumber and wood products (STCC 24), paper (26), chemicals (28), primary metals (33), and fabricated metals (34).

More telling is the ISM's "new orders" category. The Sep index rose to 63.8% from Aug's 56.4%, with 51.1% the "generally consistent" number. Winners included "Food" (could be STCC 01 or 20), STCCS 24, 26, 28, 33 and 34. Table 1 puts that in the context of 2Q05's Big Six carload business. I don't have complete breakouts for carload *vs.* coal and intermodal, though if the past is any guide commodity revenues will increase along with intermodal, though at a lower rate.

CSX already pays its shortlines on a division of revenue basis. They share in price increases and fuel surcharges, so the "$100 per box of rocks or carload of chems" allowance is a non-issue. Moreover, CSX intermodal in 1H05 contributed only 15.4% of revenues, lowest of the Big Six and lagging fifth-place CN by 150 basis points. Which ought to tell CSX shortlines to start beating the bushes for new carload opportunities, and the higher the revenue to CSX the better for the shortline.

And if you can't tell what commodity lanes generate what revenue, take a look at usraildesktop.com's costing model. Apply a reasonable multiple and there's a pro forma rate. Take your usual division and see if it's worth your while. *Then* call up the market manager and put the move together.

Week 39 (thru Sep30) AAR revenue units increased just 2.7% yoy, trailing the six-week and Q3 trend of slightly better than 3% yoy. Intermodal and coal were up as expected though chems were off due to the effects of Hurricane Rita on the Chemical Coast. KCS chems were off by half, taking total loads down a fifth. BNSF and UP also took double-digit hits in chems, though the former eked out a net volume gain of 0.4% for the week to UP's net negative 1.5% yoy.

In the east CSX total volume increased 8%, three points better than its six-week trend, with the easy intermodal comps providing a 6% yoy gain. NSC continues to accelerate volume increases, up 7.4% in the week *vs.* the six-week trend of 5.7% with coal and IM up 11% and 14% respectively. CN chalked up a 7% traffic gain in Week 39 vs. 11% over the past six weeks. CP's Week 39 was off 6% yoy *vs.* less than 1% growth over six weeks.

RailAmerica closed the Alcoa transaction on schedule, paying $77.5 mm for four railroads with 25 total route-miles, $20.8 mm in revenues on 30,000 revenue loads and $10.3 mm in EBITDA. This ought to be great news for shortline sellers – 7.5 times EBITDA and 3.7 times revenues. But then again, RRA gets a railroad generating nearly $700 per load, averaging 1,200 carloads per route-mile per year serving only one customer in one industry. Not that's concentrated goodness!

Two days later RRA revised its 3Q05 eps estimate downward to 19 cents from 25 cents citing the August chemical car event in Cincinnati, Katrina effects on the Alabama Gulf Coast RR, and higher than anticipated fuel prices. The tank car incident will take four cents with another penny or two for the storm and fuel.

Commenting on the announcement, R W Bair's Jon Langenfeld writes, "We're maintaining 2006 estimates for now although they could be subject to further downward revision. Accretion from recent acquisitions (estimated $0.10 annually) could offset more challenging external environment and higher fuel prices, assuming improvements in RRA operations. We remain Neutral-rated, as lingering rail service issues and continued cost pressures leave RRA fully valued at current levels, in our view. Our $13 price target reflects 11x our 2006E EPS."

RRA shares over the past four years have traded in a range of $10-14+, except for a dip to $5 in 1Q03 and hitting resistance just shy of $15 twice – in 1Q02 and 2Q04. Operating income was right around $11 mm in three of the past five quarters, with a high of $15 mm in 2Q05 and a low of $3 mm in 3Q04. Over the same five quarters net income has ranged from a $33 mm loss (3Q04) to a plus $9.3 mm (2Q05). On the surface of things it looks from here line the Alcoa lines acquisition should be accretive in short order. Let's hope so as RRA needs a couple of home runs.

Elsewhere, I received a forwarded e-mail citing a CSX decision to move some dispatchers from Jax to other locations. The author, one Timothy J. Gibbons, has no affiliation cited in the release. He writes CSX is "eliminating about 10% of the jobs and moving them to other locations." Eliminating jobs means in my book that the jobs are g-o-n-e gone, not just relocated to less sunny climes – Chi and Indy in this case.

Then he says there are 340 dispatchers in Jax and that 20 jobs "will be cut with 15 jobs moving to Chicago" and the remaining five reassigned. Net job loss: zero. The writer goes on to say another 15 jobs "will be cut" in Jax and moved to Indy. Again net loss of jobs is zero. Now if you're still reading, you'll find buried in the middle of the piece that some workers have evidently found the new dispatching software "difficult to use" and as a result "union members told the company they are considering going on strike."

IMHO, if the software is difficult to use and you don't want to move to Chi or Indy then there's always the door. I'm sure the 300 or so souls whose jobs stay in Jax would like them to remain in Jax. Life is full of choices, and whether to keep your job and move or quit and stay is up to the individual. But…dispatchers need to be close to the action anyway and putting more of them physically *in* the divisions they dispatch might just make their jobs easier and what they do of greater value to CSX. The point is CSX putting more people near the action is what counts. Not some ill-written press release about how difficult the work is. Sheesh.

The argument for paying SLs as expense is appropriate if the Class I is buying a drayage (see WIR 6/17/2005) but does not hold water if shortlines are paid interline divisions. As noted above, CSX pays its shortlines on a "junction settlement" basis wherein the shortline negotiates its portion of the rate and is shown in the routing on the waybill. This is fair. Shortlines are thus rewarded for their participation in commodity lanes with decent revenue-cost ratios (and commensurate fuel surcharges) whereas lanes with thinner margins won't work and the discussion ends there.

That said, I've heard reports of certain Class Is "don't want single carload business." I've checked around and confirmed my earlier sentiment that this is errant nonsense. There will always be lanes where margins are so thin the market rate won't even support car replacement cost yet in the vast majority of cases single-car rates can be made attractive.

One way is to get a lot of cars moving in the same direction. BNSF has told shortlines wanting to break up 75-car unit trains of aggregates for multiple customers that it's OK as long as BNSF gets 75 empties when they come back with the next loaded train. NS has begun sending Penna aggregates to a rapid-discharge facility in southern Delaware that could threaten the single-car trade now coming across the car float to Virginia's eastern shore. Muliple-car shipments to single destinations put the economics of intermodal at the fingertips of the carload shipper. All it takes is a little cooperation.

CN has become more customer friendly. North Shore Rail Group's Todd Hunter passes along a long list of what he calls "bold moves" that CN wants to make in 2006. Says CN on its website (www.cn.ca), "Supplemental services are a fact of life. By knowing what a supplemental service costs, you can weigh the advantage of incurring the cost against other options." And now they're making these supp service fees saner and more easily understood. To wit:

You will get a bill for supp services rendered within 30 days or the service is free. Intra-plant switching is $175 US or Loonie regardless of plant location. More repetitive transactions on e-Business tools. A revised demurrage tariff targeted for completion in 3Q06. All cross-border service offers and renewals are to be in US dollars with the FX rate reset weekly. Suspension of the $200 empty private car diversion for one year. See also www.cm.ca/supplementalservices.com and let me know if it makes sense to you.

If you don't think it's time to get aggressive selling service and satisfaction, consider this shot from my good friend Jim Giblin, who's probably forgotten more about supply chain management than most of us will ever know. He writes, "Both FedEx and UPS want bigger trucks and both say the truce between railroads and trucking agreed to in 2003 ended once SAFETEA-LU was passed. An ATA spokesman says that ATA has not changed its position regarding heavier loads or triples, but given the fact the UPS and FedEx are the two largest transportation companies in North America not hard to figure out the future. Guess the party's over." Maybe so. Time to go sell *value.*

The Lexington Group in Transportation History moves its annual meeting around every year and Harrisburg PA got the nod for oh-five. Among other things it's a superb opportunity to meet and greet old friends, whether you've ever met them in person or not. This was my first year annual meeting after having been asked to join last May and to have (among others and in no particular order) Jim Hagen, Herb Harwood (author and photographer), Fred Frailey (Kiplinger and Trains), Bill Middleton (traction books, articles in Railway Age and Trains), Rogers Grant (author), Jim Wrinn (Trains ed.), Larry DeYoung and Bill Schafer (Trains articles), the senior Northeast ops officers of NS plus Wick Moorman all in the same room was, to say the least, memorable.

Presentations ran the gamut from Dan Cuppers' "Century at Enola" slide show to Rush Loving's Al Perlman retrospective to Henry Posner's witty history of his own Rail Development Corp. Jim McClellan's "Growing the Business" panel included NS' Dave Brown, Indiana Railroad's Tom Hoback, and John Williams of Woodside Consulting. To a man they agree the business is there – you just have to make room for it. Tom did the best job showing the relationship between BD and railroad revenue; we need more of the same.

Of course, the highlight of the meeting was a train ride sponsored by NS and Conrail with Bennett Levin's lovingly restored ex-PRR (really!) E-8s, some of his own passenger cars plus the NS dome and theater cars. Harrisburg-Horseshoe Curve-around the helper turn at Gallitzen (now *there's* rare mileage), back to Altoona for a box lunch and museum tour, return to Tyrone and up the Nittany & Bald Eagle to the NS (ex-PRR) Buffalo line and thence to Harrisburg. Twelve hours flat, stops included. And the meets – coal, intermodal, manifest, Amtrak, every few minutes. Wow.

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Table 1. YOY Class I est revenue gains

	Pct 3q chg	2Q05	Avg Merch
	2004-5	Pct Carload	RPU
BNSF	14.7%	45.0%	$ 1,971
CN ($C)	6.5%	72.6%	$ 1,721
CP ($C)	25.6%	52.9%	$ 1,957
CSX	5.7%	58.7%	$ 1,467
NS	12.1%	53.3%	$ 1,539
UP	10.5%	58.9%	$ 1,860

Source: First Call on yahoo.com; CN from Morgan Stanley