THE RAILROAD WEEK IN REVIEW
OCTOBER 14, 2005

Shortlines rely on forest products (STCC 24, 26) for about 15% of carloads on average. Yet stock prices for five of the biggest players hit new lows this week. The Rita-Katrina duo did double damage on Mead Westvaco (MWV) and International Paper (IP) from loss of woodlands and higher costs. *Barron's* suggests Abitibi (ABY) and Bowater (BOW) may be suffering from too much capacity and too little demand for newsprint. JP Morgan has downgraded Domtar (DTC) to neutral.

The same guys making paper also make lumber and the builders are getting hit as well. Pulte (PHM), Ryland (RYL) and Toll (TOL) stocks are down 20-30% over the past three months with only D R Horton (DRH) barely tracking the DJIA. RMI reports lumber and for prods down 2% yoy in the week ending 9/30 and paper up nearly five points, a 10-point reversal over Week 38. See chart attached.

Of course, the whole market seems headed south. Cyber-Trader and Schwab Tech gooroo Ken Tower is quoted in *Barron's On-Line* thus: "Today's economic stats point to higher inflation and a slowing economy, which will fuel stagflation fears and worry investors. Nothing new there; the Standard & Poor's 500 index has declined in seven of the last eight sessions. A declining market tends to fall until it becomes oversold or is overwhelmed by good news. This one appears headed further into oversold territory."

The take-away for shortliners is stock prices go down when the market perceives a weakness in a company's model. Unfortunately, too few shortline operators follow their customers' stock performance or, if they're not publicly traded, the relative performance of their industries. Exchange traded funds (ETFs) can help. Paper and forest products company stocks make up 15% of the Building Materials SPDR (XLB) with IP and Weyerhaeuser 5% each.

The 52-week high is $32, hit in March. Since then it's drifted steadily southward to around $26. It might be a good time for shortliners to call on their paper and forest products guys to see what's keeping them awake at night and tune RR operations accordingly. And while they're at it, I'm willing to be they'll find a receptive ear at their connecting Class I marketing groups. Please advise.

Which takes me to Sep Carloads. As usual, I'm not getting mired in the "same railroad" railroad argument because as an investor I want to see revenues go up and as a railroader I want to see volumes increase. "Same railroad" matters not a whit to either. So, on a strict month-to-month, year-to-year basis GWR increased 22% yoy and 16% YTD over the first nine months of 2004. Sep 2005 carloads were off 2% over Aug 2005.

RailAmerica on the other hand saw Sep 2005 cars up 3% over Sep 2004, down 2% from the previous month, and up just 1% yoy for the third quarter. Both BNSF and CSX have been very active transferring branch lines to shortline operators and the recurring names are GWR, OmniTrax and Watco. There was a big RailNet sale that went mostly to OmniTrax and GWR got Earl Durden's rails plus two small east coast branches from CSX. RRA has been largely absent since the big Indiana deals in 2004.

The 2005 carloads show it, too. The jump in GWR traffic mid-year was Durden, for sure. But even before that yoy monthly increases were running 7-9%. RRA followed suit through about May and the pace has slowed since. IMHO Rail America still has too many railroads spread too far apart to manage cohesively and chasing too few carloads. The Q205 operating ratio was 86.2 and for 1H05 it was 87.9%. GWR on the other hand, operates five regional clusters plus a network of industrial switching locations, posting ops ratios of 83 for both Q2 and the half. YTD stock prices are up 7% through today for GWR and down 13% for RRA. Earnings week will be instructive with RRA on Oct 26 and GWR on Nov 1.

Adding insult to injury, RailAmerica shares have been unable to break through resistance at $12 and have fallen precipitously through $11 creating a potential short opportunity. As it happens, the SMA-200 is acting as resistance with the SMA-50 and SMA-20 actually trading beneath it. The volume chart since May shows up days about equal to down days but most of the big trading days – above the average volume – have been down. The October 6 announcement taking the Q3 eps estimate down a nickel or so appears to be partly to blame.

The problem with shorting RRA at this point is the trading range is so narrow. Resistance on the way up is around $12 and support is a little under $11. Short it at $11.40 and you risk 60 cents a share for a potential gain of 60 cents a share. The time to short was in early Mar when RRA hit and was repelled by resistance at $13 for the third time. Support was $11.50 and in late April it broke through, stopping at $10 in early May. It's now three o'clock on Friday and RRA has bounced back to $11.48 from yesterday's sub-$10 low.

North Carolina's Aberdeen Carolina & Western is featured in the "Focus on Safety" feature in the October 2005 issue of *Railway Track & Structures*. I think GM Bill Bartosh sets exactly the right tone taking safety to every employee, making sure each understands what's expected, and providing the tools to do every task with safety foremost. ACWR has won the Jake With Distinction Award every year for the past five years plus the ASLRRA's bronze safety award in the 10,000-50,000 hour group.

Bartosh starts every day with a safety briefing, an equipment check and time to discuss and ask questions to be sure all expectations of the day are carried out as intended. It's a challenging property – the southern-most 130 miles of the original Norfolk Southern between Norfolk and Charlotte. It's typical Deep South railroading – no engineering to speak of, laid to the contour of the land, and with rail that ranges from 85 to 130 lbs. Some is CWR, most is not. And they're running unit trains of grain as well as a mix of commodities from log logs to LPG.

Says Bartosh, "Everyone takes ownership and pride in the company and, to me, that shows their dedication to safety. If a piece of equipment or tool becomes defective you take it out of service, and then get it fixed." That way, each employee picking up a tool can be assured the tool will work because the guy before him didn't break it and put it away without telling anybody. Bartosh again: "We measure ourselves by everyone getting home in he same shape in which they came to work." And that's the way it *should* be. Nice going, guys.

Watco's Arkansas Southern Railroad (ARS) opened for business last weekend. The ARS operates 65 route-miles over two ex-KCS line segments. The northern branch runs east from Heavener, OK to Waldron, AR. The southern branch runs northeast from Ashdown to Nashville, AR. The ARS interchanges with the KCS at Ashdown, AR and Heavener, OK and with the UP at Nashville, AR.

Jimmy Horner, Director of Railroad Operations for Watco's Central Region, said the start-up was a success. "We ran our first train last night (Sunday) and we are looking forward to a successful future for the Arkansas Southern," Horner said. "We have an excellent operating team that has all of the supports necessary for us to meet and exceed our Customer's needs." The commodity is mainly ag products –corn and soybeans -- with industrial products such as bauxite and sulfuric acid rounding out the mix. Printable maps of the ARS are available at www.watcocompanies.com ; click on Railroads and then Arkansas Southern Railroad.

It appears STB Chair Roger Nober is stepping down at the end of this year. Jim Valentine notes that "the STB has made a number of very favorable rulings for the railroads under Chairman Nober's leadership." However, says Jim, "We believe it highly unlikely the White House will nominate a successor who would take an adversarial stance towards the railroads."

Reasonable enough, what with Republicans dominating both houses of congress and an administration that is unusually heavy in rail-savvy staff. (Cheney was on UP's board and we all know John Snow's pedigree.) Valentine concludes, "It will likely take considerable time to nominate and confirm a successor not to mention as long as two years to rule on cases that are just now being filed, suggesting that we're not likely to see any major changes in 2005 or even 2006."

Fellow Lexingtoner Jim Giblin dropped me an insightful and entertaining note about the trucking industry and how it's faring under the new Hours of Service (HOS) rules and other regs. Quoth Jim, "One of the main reasons that the change in HOS has not had more of a negative impact is the issue of driver waiting time. There was an enormous amount of inefficiency built into the system with poor loading and unloading practices being tolerated by too many carriers for far too long. Unfortunately it was the poor drivers who were bearing the burden and cost of this mess.

"One of the good things to come out of the HOS changes is the fact that carriers are now charging for waiting time, and collecting, and passing this money on to the drivers. Many drivers are actually making more money from line haul operations today than they did in the past just from the improvement in the waiting time problem. The side benefit is that this will also make the entire supply chain more efficient as shippers and receivers invest in improvements to their warehouse operations to avoid having to pay waiting time charges." In other words, let the customer decide how best to use the new paradigm and stand back.

In a similar vein, Bill Zollars of Yellow Freight pulled a real coup with his "Exact Express," a service that promised delivery within a specific hour – and free if not delivered as agreed. True to form, the back-office bureaucrats fussed because they said all customers would find something wrong just to get free freight. Didn't happen. The hits to company took were "infinitesimal" in comparison with the new business they wrote. Here again, the decision was pushed out Yellow's door and into the customer's lap. And the scold-some paper-pushers in the back room got to find new lines of work.

Railroads are still beset with too many functionaries whose job it is to say NO. A shortline wants to make interchange in a serving yard but the ops guys say NO because they *know* the shortline will be late or leave too many cars or otherwise clutter up the yard. Another says NO to shortline trackage rights because they *know* the shortline will interchange with a competitor while on the line. Yet in each case the shortline can save the Class I loco time, crew time, and generates more carloads for the Class I. Fortunately, the shortlines in these instances said, "Look, if I do what you don't want me to do the deal is off." And another decision is transferred from the organic bureaucracy to the customer.

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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.

Table 1.

GWR vs RRA Revenue Units

2005 by month, YTD

	2004	2004	2005	2005	Change	Change	2005
RRA	**month**	**YTD**	**month**	**YTD**	**Month**	**YTD**	**ch MTM**
Jan	97,821	97,821	105,508	105,508	7.9%	7.9%	
Feb	95,506	193,327	106,256	211,764	11.3%	9.5%	0.7%
Mar	108,214	301,541	118,115	329,879	9.1%	9.4%	11.2%
Quarter	301,541		329,879		9.4%		
Apr	102,035	403,576	111,993	441,872	9.8%	9.5%	-5.2%
May	99,407	502,983	109,648	551,520	10.3%	9.6%	-2.1%
June	101,429	604,528	105,429	656,949	3.9%	8.7%	-3.8%
Quarter	302,871		327,070		8.0%		
July	104,662	709,190	102,158	759,107	-2.4%	7.0%	-3.1%
August	106,631	815,821	109,287	868,394	2.5%	6.4%	7.0%
Sep	104,406	920,227	107,570	975,964	3.0%	6.1%	-1.6%
Quarter	315,699		319,015		1.1%		
Oct							
Nov							
Dec							
GWR							
Jan	48,462	48,462	52,705	52,705	8.8%	8.8%	
Feb	49,291	97,753	53,316	106,021	8.2%	8.5%	1.2%
Mar	53,455	151,208	58,765	164,786	9.9%	9.0%	10.2%
Quarter	151,208		164,786		9.0%		
Apr	53,586	204,794	57,787	222,573	7.8%	8.7%	-1.7%
May	53,464	258,258	56,919	279,492	6.5%	8.2%	-1.5%
June	50,412	308,670	66,937	346,429	32.8%	12.2%	17.6%
Quarter	157,462		181,643		15.4%		
July	52,942	361,612	66,213	412,642	25.1%	14.1%	-1.1%
August	55,114	416,726	67,141	479,783	21.8%	15.1%	1.4%
Sep	53,736	470,462	65,734	545,517	22.3%	16.0%	-2.1%
Quarter	161,792		199,088		23.1%		
Oct							
Nov							
Dec							

RailConnect Index of Short Line Traffic

Traffic Type: All

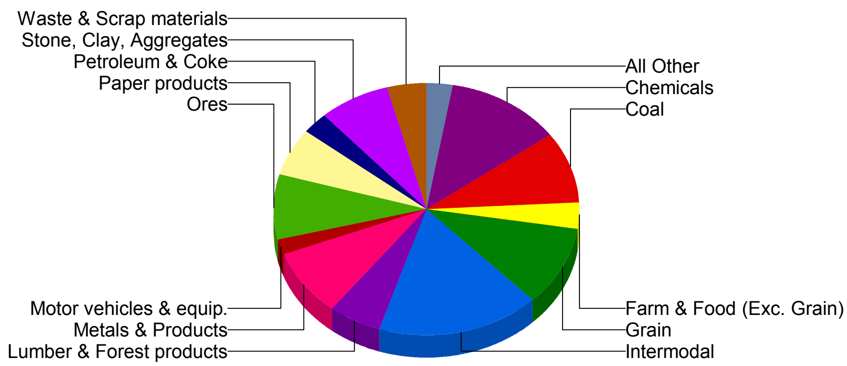
For the week ending: 10/1/2005

Week Number: 39

Carloads Handled	Current Week			Year-To-Date		
	2005	2004	% Change	2005	2004	% Change
Coal	10,912	10,541	3.52%	345,663	322,729	7.11%
Grain	10,637	9,181	15.86%	392,941	373,294	5.26%
Farm & Food (Exc. Grain)	3,866	3,633	6.41%	125,726	109,826	14.48%
Ores	7,990	7,985	0.06%	310,042	292,046	6.16%
Stone, Clay, Aggregates	8,030	8,265	-2.84%	277,969	228,504	21.65%
Lumber & Forest products	5,251	5,343	-1.72%	211,942	193,916	9.30%
Paper products	6,314	6,019	4.90%	237,220	217,293	9.17%
Waste & Scrap materials	4,698	4,551	3.23%	163,234	148,688	9.78%
Chemicals	10,530	11,693	-9.95%	463,717	415,306	11.66%
Petroleum & Coke	2,681	2,277	17.74%	106,561	82,108	29.78%
Metals & Products	9,144	8,558	6.85%	319,687	262,853	21.62%
Motor vehicles & equip.	2,200	2,397	-8.22%	79,843	82,510	-3.23%
Intermodal	18,659	14,599	27.81%	657,080	521,755	25.94%
All Other	3,026	3,118	-2.95%	103,663	115,694	-10.40%
Total	**103,938**	**98,160**	**5.89%**	**3,795,288**	**3,366,522**	**12.74%**

RailConnect Index

Year-To-Date



All Other	2.7%
Chemicals	12.2%
Coal	9.1%
Farm & Food (Exc. Grain)	3.3%
Grain	10.4%
Intermodal	17.3%
Lumber & Forest products	5.6%
Metals & Products	8.4%
Motor vehicles & equip.	2.1%
Ores	8.2%
Paper products	6.3%
Petroleum & Coke	2.8%
Stone, Clay, Aggregates	7.3%
Waste & Scrap materials	4.3%
Total:	100.0%