THE RAILROAD WEEK IN REVIEW
NOVEMBER 4, 2005

Florida East Coast Railroad doubled Q3 operating income to $16.5 mm vs. $7.8 mm a year ago. Revenue increased 30% to $60 mm while operating expense gained but 13%, once again showing the powerful leverage of increasing sales at a significantly faster pace than above-the-line outgo. The OR shed an astounding 1063 BP even in the face of double-digit increases for fuel (70%), materials (44%), and intermodal ramp-related expense (64%).

The 10-Q provides expense line-item details not normally found and they tell us a lot about the FEC's operating philosophy. For example, "Materials increased $0.9 mm primarily due to increased freight car wheel replacement and repairs required by rules of the AAR, the Company *raising its repair standards for owned equipment* (emphasis added), and the replacement of certain defective wheels manufactured in 2005 by a certain vendor."

Continuing the thread of whether Class Is should pay shortlines out of revenue or as an operating expense, FEC reports that "outside [intermodal] contractor delivery costs increased $0.7 mm in third quarter 2005 over 2004 due to the increased business and increased costs for driver services." And if FEC can expense trailer drayage fees, why can't the Big Six expense shortline drayage fees? Both accomplish the same thing: getting the goods to the customer from the core railroad terminal.

But I digress. FEC rang up double-digit revenue increases in every commodity group, and they were not small with chems being the lowest at 10% and construction materials taking the brass ring at a 52% yoy gain. Not that volumes were all that bad, either, as carload business increased 21% and intermodal 17%. Carload RPU increased just 6% and intermodal 9% but the high volumes in stone and const materials helped keep the cash register ringing.

FEC has also obliged us with some capex details in the 10-Q, providing yet more of a glimpse into what makes FEC tick. They've ordered $4 mm in new rail for a joint project with the state of Florida to extend passing sidings to increase corridor fluidity. They sent a $3.6 mm order to GE Transportation for Ultra Cab loco units to replace older equipment. Then there's $7.6 mm for four new locos and $3 mm to outsource a year's worth of rail undercutting with options to renew for two more five-year terms. Not bad for a 400-mile line paralleling I-95 from JAX to MIA.

Genesee & Wyoming's North American shortline railroads (US, Mexico, Canada) increased operating revenues 34% in 3Q05 to $76 mm. The Rail Link division that runs some of the smaller shortlines as well as ports and terminals grew its Q3 revenues by 43% to $29 mm, so total revenues to the corporation came in at $105 mm, up 37%. Same railroad revenue increases accounted for $6 mm or 8% of the gain, another $17 mm or 22% came from the Earl Durden transaction, Tazewell & Peoria brought in $3 mm or 4% and the balance came from the CSX leases in Florida.

The same railroad gains -- $6 mm – were 2/3 rate increases and 1/3 fuel surcharges. Rail Link brought in $900,000 more, but that was offset by an equal amount in volume shifts. A look at the commodity carload and revenues tells the tale. All the major commodity groups – paper, minerals and stone, forest products and chemicals showed strong double-digit revenue and volume growth.

These are all areas where Rail Management had a significant franchise and a lot of it is low-rated and/or short haul – think chips to paper mills, construction aggregates, etc. Even though non-coal and intermodal freight revenues were up by 40%, carloads were up 34% and RPU up 9% yoy. So there wasn't much of a premium on a lot of the acquired franchises. Railroad operating expense increased

32% yoy before the gain on asset sales for an 83% yoy operating income bump and an OR of 80.3, down 2.61 points yoy.

Below the line equity earnings from the GWR investment in Australia typically offset some of the usual items – taxes, interest – pushing much of the core business earnings – North American operating income – to the bottom line. Operating income after adjustments was $24 mm, up 83% yoy and the 3Q net was $17 mm, up 69%. Recall that when Wisconsin Central owned a piece of the EWS in England that we saw the same phenomenon.

One place this really helps is in Free Cash Flow, which GWR defines as cash from operations less cash used for investing exclusive of the cost of acquisitions. For the nine months ending 9/30/2005 GWR generated $33 mm in FCF or 85% of net income. The only other railroads in that league are CN (90%) and NS (96%). Nice going.

RailAmerica had a 12% increase in freight revenues to $101 mm from$90 mm in 3Q04. "Other revenues" (Amtrak fees, real estate, excursions, demurrage) added another $12 mm for total revenues of $113, up 13% yoy all-in. Operating expenses vary, depending on what you want to include. RRA's press release cites total expense of $99.3 mm including a $1 mm credit for asset sales for an OR of 88.2, four points worse than the 84.4 I calculated for 3Q04. But if you add back the $13 mm E&N impairment charge taken in 3Q04 the OR then was 96.5, so this year is better.

The 12% gain in freight revenues came from a 12% gain in the merch carload side on a 14% volume gain. System-wide revenue units increased 2% and RPU was up 10% yoy. Intermodal (IM) revenue was off 9%, bridge revenue off 2% but coal was up 16%. During the conference call the revenue increase breakout was yield 6%, foreign exchange 2%, acquisitions 2%, and fuel surcharge 2%. Lumber/forest products, Ag and Farm, chemicals, paper and metals account for more than half the revenue and all took double-digit revenue increases. Of these, only ag/farm and metals posted double-digit volume increases.

As a result RPU increases for the merch group was up just 8% yoy. Bridge traffic did best with RPU is up 18%, though, as we've written before, overhead business depends mostly on the kindness of others and to have a sixth of the volume there is scary.

Diesel fuel was the big expense gainer, up 44%, so no surprises there. RRA paid $1.85 a gallon in 3Q, one of the higher numbers we've seen and up 32% over the $1.40 paid a year ago. I'm a bit concerned that consumption was up 9% on only 2% more volume. Equipment rents were up 25%, again seeming high for the volume changes. One must ask whether the railroad is slowing down and if so, why. Two of RRA's biggest partners are UP and CSX and it's possible congestion and velocity challenges there may have had a deleterious effect.

RRA anticipates 4Q05 revenues in the neighborhood of $111 mm and an OR still in the high 80s, right about where RRA has been for the past three quarters. Thus it is that RRA suggests full year revenues of $445 to $450 mm with no change in the OR, so 2005 looks like a very flat year for RRA. Which may not be altogether bad as RRA has been working hard to morph into a shortline *system* from a portfolio of shortlines that may or may not have anything to do with each other.

This strategic shift costs money, takes time, and requires considerable re-thinking of the franchise. Where it shows up is in wide swings in net income below the line. For example RRA lost $0.91 cents a share in 3Q04 and earned $0.20 this year. YTD 04 the loss was $0.88 vs. a gain of $0.60 this year. Once the below-the-line "noise" subsides RRA will be on a lot sounder footing. And maybe the stock will *finally* break out of the $10-$12 trading range. I think it will.

Kansas City Southern wrapped up the third quarter earnings round on Wed with its first consolidated earnings report with TFM, essentially doubling the 3Q04 figures reported by KCS. Please keep in mind that all 3Q05 figures in this analysis are the combined KCS+TFM and the 3Q04 figures are for KCS+Tex Mex only. Though COO Art Schoener talked of US operations by themselves on the conference call, the accompanying press release does not.

But that's OK. The yoy analysis for GWR shows the effect of acquisitions yoy and there's no reason we should not address KCS in the same manner. Here we go. Operating revenues more than doubled to $385 mm from $163 mm. That's a 135% gain and keep that number as we walk through some of the other yoy metrics.

Merch carload revenues increased 173% on 128% more volume; include coal, intermodal and "other" and you get to the 135% gain above. Merch carload RPU increased 20% and system RPU gains 27%. That's the good news. The bad news is that ops expenses grew by 168%, creating negative leverage and creating a $2 mm operating loss for the quarter and OR of 100.5, down 12 points from KCS-US a year ago. Five of seven operating expense line items were up more by than 200% with casualty and insurance up nearly 300%.

Below the line there would have been a $20 mm loss were it not for the $131 mm benefit from the VAT/Put gain. As it was, net to common shareholders after preferred dividends was $1.14 vs. $0.14 a year ago. Yes, it's a heady gain but the VAT gain is a one-shot deal. But I also think this is the first quarter for KCS' 100% ownership of TFM and there are bound to be opportunities to bring ops expenses under control.

Track and power are great places to start. KCS has already put down $142 mm in capex YTD in 2005 and has budgeted $260 mm more excluding locos and including the Tex Mex RRIF loan. There's also $59 mm for 30 additional KCS locos scheduled for delivery late this quarter. So, like RRA, KCS is a work in process. Results are bond to be a bit lumpy for the next few quarters but these are investments for the future, and it ought to be a very good future indeed.

Fuel surcharge redux. Last week (WIR 10/28) I wrote that BNSF's fuel surcharge and car hire reclaim proposals were firsts in the shortline arena. A good friend of more than 10 years' standing and one of my staunchest critics writes, "All [the] U.S. Class Is are passing on the surcharge in some form except BNSF." What I meant to say was that BNSF was the first one actually to propose a program and put it up in a PowerPoint presentation. My sense was that details of the present programs for sharing FSC revenues with shortlines were pretty much behind the curtain and not for public discussion.

So, given my friend's observation I did some checking. I wrote all the Class I shortline managers and asked two questions: First, do you have a program to share fuel surcharge revenue with ALL your shortline connections? Second, has that program been publicly announced and if so where may one read about it?

The response was prompt and gratifying and in a couple of instances we had long chats that flowed nicely into the car hire question as well. The reality is that all the Class Is *but BNSF* have in place fuel surcharge sharing programs open to all shortlines that are not switch carriers or ISS roads. The latter two write their own tariffs and if they want a fuel surcharge they have the ability to put one on. Junction settlement shortlines and handling lines do not and so share in a proportional basis in all the FSC revenues the Class I collects on traffic that touches their shortline connection.

As for car hire reclaim, it's a throw-back to some of the early shortline deals and is a mixed bag. Some reclaims are commercial arrangements laid on for the convenience of the carriers. Some are a matter of practice – the 120 hours reclaim for switching lines, for example. Still others are baked into the legal documentation that went with a line sale or lease. In the first case, commercial arrangements can always be amended on a hand-shake if the parties agree. S&Ts are not so easy as they serve multiple railroads and a flat 120 hours has been the norm.

That leaves allowance-based shortlines where reclaim was part of the transaction that set up the shortline in the first place. Changing the reclaim provisions is not an easy sale, especially since the Class Is generally take a dim view of any shortline wanting to change the terms of the deal after the fact. Now comes the Class I to do the same thing? My feedback suggests it's a non-starter.

One means to this end that has met with some success is increasing the allowance payment by enough to cover the car hire expense for number of days of relief being foregone. Let's say I average $20 a day car hire cost on my shortline. I have three days relief. Increase my allowance by $60 and as long as I turn cars in three days I'm whole. If I take four it's on me; if I take two I make $20.

My correspondents seem to agree that BNSF has to get credit for putting up a program for all to view and take pot-shots at. But it was my mistake for writing my piece so that it appeared that BNSF had the first such program. To be sure, it's the first time we've seen FSC and car hire reclaim linked. But the more I think about it, the more I come to the opinion that they ought to be dealt with separately.

The message is clear enough: extended car dwell times on shortline will not do. Katie Farmer's slide of the 10-day average dwell shortline (it's # 112 if you have a copy of the whole set) depicted a property that (a) was getting car hire relief, (b) was taking longer to turn cars in spite of pleas to clean up their act. Perhaps this is an instance where BNSF needs to drill down to customer process using some of Dave Garin's "Last Mile" tools. That might be a more acceptable place to start than linking everybody's reclaim to their share of the FSC take.

I stand by my earlier comment that BNSF got a dialog going. That we've had this exchange is proof thereof and it's brought the whole discussion out into the open. Thanks for giving me the opportunity.

A note on the attachments. Table 1 is a repeat of last week's Big Six Class I comps. There were a couple of glaring omissions that an astute reader brought to the fore. Table 2 compares the four roads in this report on much the same metrics. As usual, please let me know if I've missed anything.

Lagniappe. Fred Green has been tapped President of CP Rail effective November 1, 2005 and will keep his Chief Operating Officer hat as well. Fred began his career with CPR in 1978 and has held senior management positions in both operations and marketing across the railway's network. Rob Ritchie, will continue as CEO. Congratulations, Fred. Maybe you and Wick Moorman ought to throw a party to celebrate your new jobs.

Big Six Class I Commodity Carload Comps

Quarter ending 9/30/2005

Revenue and income in $millions

Metric	BNSF	CN	CP	CSX	NS	UP
Railroad revs (1)	$ 3,317	$ 1,810	$ 1,105	$ 2,125	$ 2,155	$ 3,461
YOY Pct. Change	18.8%	5.3%	11.6%	9.4%	16.0%	12.5%
Total revenue units	2,570	1,216	670	1,819	1,992	2,433
YOY Pct. Change	4.2%	0.2%	-0.1%	0.1%	4.6%	1.1%
Carload revs (2)	$ 1,463	$ 1,311	$ 592	$ 1,249	$ 1,138	$ 1,999
Pct carload	44.1%	72.4%	53.6%	58.8%	52.8%	57.8%
Pct Intermodal	34.2%	18.3%	26.7%	15.9%	21.9%	18.8%
Pct Coal	18.8%	4.1%	17.5%	24.1%	25.3%	18.8%
Mdse Carloads (000)	702	781	286	833	713	1,026
Rev/CL x coal, IM	$ 2,035	$ 1,679	$ 2,070	$ 1,499	$ 1,596	$ 1,948
YOY Pct. Change	18.2%	5.4%	6.3%	8.3%	13.9%	16.4%
RR Avg RPU	$ 1,252	$ 1,416	$ 1,585	$ 1,168	$ 1,082	$ 1,357
YOY Pct. Change	12.8%	5.4%	12.0%	9.2%	11.0%	10.9%
RR Operating Income	$ 778	$ 665	$ 250	$ 361	$ 528	$ 481
YOY Pct. Change	37.7%	11.6%	14.2%	44.4%	12.6%	15.1%
RR Operating Ratio	75.8%	63.3%	77.4%	83.0%	75.5%	86.1%
YOY Point change	(3.54)	(2.07)	(0.50)	(4.12)	0.75	(0.31)
GTM/gallon diesel fuel	772	879	888	805	771	789
Fuel/gallon (US$)	$ 1.43	$ 1.44	$ 1.62	$ 1.34	$ 1.52	$ 1.88
YOY Pct. Change	44.7%	34.7%	30.3%	17.5%	87.6%	50.4%

Nine Months ending 9/30/2005

Revenue and income in $millions

Metric	BNSF	CN	CP	CSX	NS	UP
Railroad revs (1)	$ 9,437	$ 5,354	$ 3,225	**$ 6,399**	$ 6,270	$ 9,502
YOY Pct. Change	18.4%	6.3%	11.9%	9.2%	16.9%	10.2%
Carload revs (2)	$ 4,219	$ 3,921	$ 1,744	$ 3,767	$ 3,372	$ 5,782
Pct carload	44.7%	73.2%	54.1%	58.9%	53.8%	60.9%
Pct Intermodal	33.2%	17.4%	26.0%	15.6%	20.8%	17.8%
Pct Coal	19.2%	4.8%	17.8%	24.4%	25.4%	19.6%
Mdse Carloads (000)	2,143	2,292	880	**2,558**	2,175	3,078
Rev/CL x coal, IM	$ 1,969	$ 1,711	$ 1,982	$ 1,473	$ 1,550	$ 1,878
YOY Pct. Change	15.2%	5.4%	6.0%	7.7%	13.9%	13.1%
RR Avg RPU	$ 1,231	$ 1,406	$ 1,554	$ 1,157	$ 1,081	$ 1,334
YOY Pct. Change	10.7%	-2.3%	13.9%	9.5%	11.0%	9.3%
RR Operating Income	$ 2,122	$ 1,904	$ 700	$ 1,134	$ 1,523	$ 1,262
YOY Pct. Change	108.4%	17.5%	26.1%	**66.4%**	22.8%	15.7%
RR Operating Ratio	77.5%	64.4%	78.3%	82.3%	75.7%	87.3%
YOY Point change	(3.54)	(2.07)	(2.44)	(4.28)	0.75	(0.55)
GTM/gallon diesel fuel	758	565	846	778	749	772
Fuel/gal (local currency)	$ 1.30	$ 1.74	$ 1.98	$ 1.22	$ 1.30	$ 1.66
YOY Pct. Change	37.6%	25.7%	31.9%	18.1%	87.6%	45.6%

(1) CN, CP in $Canadian

(2) Excludes coal, intermodal

Small Class I and Shortline Holding Company Commodity Carload Comps
Quarter ending 9/30/2005
Revenue and income in $millions
North American Rail Operations Only

Metric	FEC	KCS	GNWR	RRA
Railroad revs ($mm)	$59.9	$384.6	$105.3	$112.5
YOY Pct. Change	29.6%	135.6%	36.5%	12.5%
Revenue Units (000)	131.3	488.2	199.1	319.0
YOY Pct. Change	18.7%	85.7%	23.0%	1.7%
Carload revs	$31.5	$304.4	$63.0	$85.1
Pct carload	52.5%	79.2%	59.8%	84.6%
Pct Intermodal	45.5%	7.8%	0.5%	0.9%
Pct Coal	0.0%	8.6%	12.3%	8.5%
Mdse Carloads (000)	50.9	293.6	146.2	226.1
Rev/mdse CL	$618	$1,037	$431	$376
RR Avg RPU	$456	$788	$384	$315
RR Avg Cost per Unit	$331	$792	$408	$311
Avg Rev/cost ratio	1.38	0.99	0.94	1.01
Operating Income	$16.5	-$1.8	$24.2	$13.2
YOY Pct. Change	111.1%	-110.1%	32.2%	278.1%
RR Operating Ratio	72.5%	100.5%	80.3%	89.1%
Price/gallon of fuel	$ -	$1.64	na	$1.85

Nine Months ending 9/30/2005
Revenue and income in $millions

Metric	FEC	KCS	GNWR	RRA
Railroad revs	$ 175.3	$ 963.9	$ 282.1	$ 333.4
YOY Pct. Change	21.0%	107.3%	26.1%	14.1%
Revenue Units (000)	391	1,302	546	976
YOY Pct. Change	14.1%	69.6%	16.0%	6.7%
Carload revs	$ 96.8	$ 746.1	$ 168.6	$ 253.4
Pct carload	55.2%	77.4%	59.8%	76.0%
Pct Intermodal	42.9%	8.3%	0.6%	1.0%
Pct Coal	0.0%	9.4%	13.6%	8.2%
Mdse Carloads (000)	159.9	767.5	394.8	685.2
Rev/CL	$ 605	$ 972	$ 427	$ 370
RR Avg RPU	$ 456	$ 379	$ 382	$ 315
RR Avg Cost per Unit	$ 331	$ 729	$ 408	$ 311
Avg Rev/cost ratio	1.37	1.02	0.94	1.01
Operating Income	$ 47.4	$ 14.5	$ 51.0	$ 39.9
YOY Pct. Change	49.7%	-74%	33%	33%
RR Operating Ratio	73.0%	98.5%	81.9%	88.3%