THE RAILROAD WEEK IN REVIEW
DECEMBER 16, 2005

"I've always believed that if you could run a railroad like a business you could do well." – Tom Hobak, President, Indiana Rail Road

Shortline YTD Carloadings increased 6.4% yoy through Week 47 (ended Nov 26) compared to the AAR's Class I count up 2.4% for the Thanksgiving holiday week. Intermodal skews the results as always, up 4.4%; absent those boxes the carload count including coal was up a measly 0.9%. Farm and food ex-grain and aggregates were two big shortline gainers, up 10 and 14% respectively. Yet the AAR reports total food ex-grain down 28% and aggregates up just 5%.

I think two forces are at work here. Farm and food ex-grain is largely a carload business whereas STCC 01 grain is a huge trainload business for the Class Is. Aggregates have never been a favorite Class I commodity group. A ton of low-rated aggregates costs more to haul than a ton of high-rated plastics if only because there's car hire or replacement cost in the former.

That's one reason why branch lines heavy in aggregates and single carload STCC 20 (think meal and canned goods) are the first to be spun off: the revenue base can't support either capex exposure or equipment cost. Yet shortlines are equipped precisely to handle the high service demands of these single-car commodities -- placing and pulling nearly on demand, turning cars faster, and becoming an important part of the customer supply chain.

Genesee & Wyoming (GWR) Nov 2005 loads were up 17% yoy, though most of this came from the First Coast and Rail Management acquisitions. For the quarter to date, GWR loads increased 19% including not only Rail Management and First Coast but also Tazewell & Peoria, the former Peoria & Pekin Union Railroad (PPU). Once again, the double-digit gains were in the acquisitions. YTD loads were up 16.6%. I should note that on a month-to-month basis the 4% drop Oct-Nov 2005 is the gain in Nov 2004 from the PPU acquisition. It was not there in Oct 2004 and GWR had in Nov 2005 all the same RRs it had in Nov 2005. Comps can be weird, so one has to watch one's step.

By way of background, my 1976 *Moody's Transportation Manual* shows the PPU as owned jointly by the Illinois Central Gulf, Norfolk & Western, Peoria & Eastern (NYC, later Penn Central), and the Chicago Northwestern. In addition, the Illinois Terminal, the Toledo Peoria & Western and the Illinois Midland (Chicago &Illinois Midland) also used the PPU tracks. Interesting how what goes around comes around as the C&IM became part of the GWR system in1996.

Over at Rail America (RRA) Total carloads for November 2005 were 2.1% yoy. The acquisitions of the Fremont line in Michigan and the Alcoa roads net of the impact of the sale of the Arizona Eastern Railway in 2004, accounted for nearly the entire change. Quarter-to-date loads rose 2.2% yoy and YTD traffic increased 5.3%, overshadowing the AAR numbers handsomely.

Results for GWR and RRA provide an excellent proxy for the shortline community as a whole. Not only do they bear out the RMI data, but also because of their size relative to the shortline community. RRA and GWR operate some 100 discrete rail properties of more than 12,000 total North American route miles of railroad and handle roughly 2 mm cars a year. The total shortline community handles roughly 12 mm loads a year over 52,000 route-miles off track.

However, this number includes the 30-odd Class I-owned switching and terminal railroads ("S&Ts") with their 2,700 route miles and 5.2 mm carloads. I strip them out of the shortline count because they exist mainly to move cars between and among Class Is – originating and terminating traffic is *de minimus*. So, exclusive of the S&Ts, GWR and RRA operate 20% of total shortline names, operate 25% of total shortline miles, and handle 40% of total shortline cars. That's why I think it's safe to say as they go so goes the whole shortline neighborhood.

Rail stock upgrades and downgrades are not important to them, say some shortline readers. However, earnings outlooks are driven mainly by yoy revenue projections, and without revenues there can be no operating income let alone net income, so the astute shortline operator *does* pay attention. The lack of interest in rail stock performance – especially for one's connecting Class I – seems to have two root causes.

First, too many shortline operators look no farther ahead than the next carload and what shows up shows up. Second, the Class Is have not done a good job of communicating to shortlines exactly how the latter's contribution affects net earnings. Not that there isn't any interest, though. Shortline operators have often complained to me that the 30,000-foot view works only as long as they know what's in it for them. The October 2005 BNSF shortline meeting came closest to meeting that need.

Canadian Pacific has reduced the low end of its 2006 guidance by a Canadian dime to C$3.60. Bear Stearns' Ed Wolfe writes that a chief driver is the reduced coal production from Fording Canada (NYSE: FDG). But it may not a lack of coal that's pushing down the numbers – would you believe a *shortage of truck tires*? Wolfe notes that the tires thing may have been "at least in part posturing ahead of annual coal rate negotiations with steel producers, our sense is that the outlook for CP's coal volumes is less clear than we had thought prior to our downgrade last week." Wolfe's wrap: "We remain on the sidelines with a Peer Perform rating on CP stock." Shortline wrap: improve the yield on your commodity O-D pairs by taking out cost per unit and increasing revenue per unit for CP.

Jim Valentine of Morgan Stanley sent out notes on *BNSF* and *UP* this week. Regarding the former, he writes that, based on a management meeting in Ft Worth, the stock has an 8-15% upside in 2006 though a softening in export grain may take the edge off. He also suggests that BNSF's success in market-pricing may limit further pure rate increases while the improved operating practices don't leave that much room for taking more cost out of the equation.

Shortlines may take this as a positive. As noted above, the grain business is mostly unit trains, and most of that is between BNSF's own O-D pairs. And the one place BNSF still has more work to do is shifting gathering and distribution activities to its shortline connections. So, if I were a shortline operator with BNSF, I'd be looking for opportunities to give back power and crews for core assignments, turn cars faster than they can, and become a more active supply chain partner. Thanks for the idea, Jim. .

Union Pacific continues to carry an overweight rating from M-S even though they took down their 2006 estimate by two bits thanks to the continued GM follies and a diminished grain outlook. On the other hand, M-S boosted their 2007 earnings estimate to $6.50, 17% above the Street consensus. But the slippage in grain and auto "should not impact UP's overall long-term pricing story or effort to improve operations." UP will continue to be a carload powerhouse for shortlines, tied with CSX for second place behind CN in percentage of total revenue from non-coal and intermodal traffic.

Lastly, and a fitting *finis* to this week's stock reports, Bear Stearns' Ed Wolfe and Greg Ryan had the *GWR* folks in town. Looking strictly at North America, BSC came away with the sense that the Earl Durden acquisition will continue to play out well and there will be increased coal revenue both from the Buffalo & Pittsburgh division and from the PRB. Moreover, the recently passed Congressional bills provide more finding and tax incentives to help pay for shortline infrastructure improvements.

People on the move. At Norfolk Southern *John Kramer* and *Tom Brugman* have swapped chairs. John goes from AVP Shortline Marketing to Group VP – ag products and fertilizers and Tom takes John's seat. Great moves for both, for the shortlines, for shippers and for NS itself.

John joined shortline marketing at the height of the Conrail transaction and inherited a collection of shortlines that varied widely in size, skills and attitudes. There has always been an edge to northern shortlines that was at odds to the more gentile southern way of doing things. But John's skill at consensus building has wrought an integrated whole that has benefited everybody.

I've known Tom for more than ten years, having first worked with him on the consumer goods trade into the near south from the far west. As group VP he was equally at home with the core unit train franchise as with the single-car model that predominates shortlines. He was particularly helpful in conveying the shortline contribution to his product managers and sales staff as well. Having John and Tom swap chairs is a brilliant move and once again everybody benefits.

I should have mentioned a month ago that BNSF's *Katie Farmer* steps up to Group VP Consumer Products while the previous occupant of that chair, *George Duggin*, moves up to VP Domestic Intermodal. Katie is no stranger to shortlines – her presentation last October was one of the meeting high points. And I'm still dining out on George's Shortline Model slides from two years ago, so his knowledge of carload supply chain networks will stand him in good stead. Once again, everybody benefits and congratulations to all.

Core constituencies are key to any railroad, but to shortlines they are particularly important – customers, co-workers, communities and connecting Class Is. A fifth C, communications, is essential for keeping one's core constituencies well-informed, and there is nothing more immediate than a well-designed website.

As Exhibit "A" I'd like the readership to recognize the Indiana Rail Road site, www.inrd.com , as a leading example of what works. The opening page provides at a glance where to find what one is looking for and does it without any distraction – pop-ups, "Active-X" controls, jumps to PDF files, etc. Even the newsletters are posted in *.html formatting, allowing one to cut and paste, print, etc.

But that's simply mechanics. The content is what stands out, and it's a true reflection of INRD's President, Tom Hobak. I've known Tom for at least fifteen years, and he can be depended upon to see the other person's viewpoint. As such, he can ask, "What would I want to see if I were looking at the INRD website?" And then set up the site accordingly. Tom puts out the Welcome mat and you should too.

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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	109,839	1,030,066	112,360	1,088,324	2.3%	5.7%	4.5%
Nov	107,097	1,137,163	109,304	1,197,628	2.1%	5.3%	-2.7%
Dec							
Quarter	216,936		221,664		2.2%		
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	54,700	525,162	66,418	611,935	21.4%	16.5%	1.0%
Nov	54,370	579,532	63,616	675,551	17.0%	16.6%	-4.2%
Dec							
Quarter	109,070		130,034		19.2%		
Source: Company material							
Blanchard's Week in Review, 12/16/2005							

RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 11/26/2005

Week Number: 47

Carloads Handled	Current Week			Year-To-Date		
	2005	**2004**	**% Change**	**2005**	**2004**	**% Change**
Coal	10,793	11,291	-4.41%	436,725	454,070	-3.82%
Grain	10,861	10,098	7.56%	486,110	475,036	2.33%
Farm & Food (Exc. Grain)	3,279	3,906	-16.05%	159,038	144,148	10.33%
Ores	8,603	9,578	-10.18%	362,980	368,419	-1.48%
Stone, Clay, Aggregates	6,123	8,087	-24.29%	362,553	321,202	12.87%
Lumber & Forest products	4,620	5,530	-16.46%	247,776	240,109	3.19%
Paper products	5,914	6,374	-7.22%	284,655	273,544	4.06%
Waste & Scrap materials	3,908	5,141	-23.98%	196,111	196,653	-0.28%
Chemicals	10,947	11,948	-8.38%	561,464	524,045	7.14%
Petroleum & Coke	3,533	3,307	6.83%	125,308	110,154	13.76%
Metals & Products	8,639	9,536	-9.41%	360,645	349,189	3.28%
Motor vehicles & equip.	1,765	2,208	-20.06%	96,386	99,480	-3.11%
Intermodal	17,809	15,524	14.72%	809,887	642,321	26.09%
All Other	2,401	3,139	-23.51%	126,010	140,022	-10.01%
Total	**99,195**	**105,667**	**-6.12%**	**4,615,648**	**4,338,392**	**6.39%**