RAILROAD WEEK IN REVIEW

JUNE 23, 2006

"This reorganization -- a key piece of our Process Improvement Project -- will create a leaner, more profitable, and more competitive RailAmerica ... a company that is even more responsive to our customers needs." RRA CEO Charles Swinburn

RailAmerica is reorganizing into three business units, departing from its current five regions and two corridors. Under the restructuring plan the company will move certain of its corporate functions to a shared services model that will provide more effective and efficient support across the three new business units. Each will be headed by a newly appointed president from within the ranks of management: RailAmerica Operations East by Jan Polley, RailAmerica, Operations Central by Scott Hulstrom and RailAmerica Operations West by Ray Stephens.

This reorganization will result in the immediate elimination of 20 positions, virtually all from upper and middle management. About half the positions come from the corporate office; the other half are from RailAmerica field locations. Prior to this, the company had about 130 managers at the levels affected by the reorganization. The restructuring of the organization will result in a pre-tax charge of approximately $1.8 million in the second quarter.

The announcement is surely welcome as some of us have long maintained that RRA has too many non-contiguous operations. For more than 20 years the RRA and its predecessor companies grew by acquiring other railroads, each with its own processes, procedures, and structures. Under the restructuring plan, the company will move certain of its corporate functions to a shared services model that will provide more effective and efficient support across the three new business units. Moreover, the reorganization will give managers in the field the resources and responsibility to make market- and customer-based business decisions without having to involve higher levels of management. It's a good start; let's see where it goes.

On another note, last week I reported a significant spread between GWR and RRA average RPU. It was evidently not a good comparison because RRA is largely an allowance-based property and many of their names have negotiated various amounts of car hire relief. Thus what they report as car hire expense is net of relief credited. GWR on the other hand is largely an ISS organization and there is little if any car hire relief, so they pay car owners for whatever time their cars are on GWR and *that* most likely shows up as car hire on the Income Statement.

RRA's car hire relief will vary by lanes, car types, RRA property and Class I railroad. Moreover, the specifics are contract matters between the parties and are not open to discussion. As it happens, in 1Q06 RRA paid 11.6% of revenues as car hire in 1Q06 to GWR's 8.8%, which tells me that without relief RRA's car hire bill could be higher. Also, RRA's Q1 traffic base was 85.1 carload (mdse plus bridge, ex coal and IM) to GWR's 74.7% mdse (no bridge per se).

But then again, who knows how much biz is in private cars or what arrangements are made behind the curtain. Suffice to say comparing RPU for these two companies is an apples-to-oranges question.
So the take-away is really that shortlines need to measure car hire as a percent of revs and see that it falls a range of 9% to 12% of revs. A special thanks to the sharp-eyed reader who caught this.

GWR's Empresa Ferrovia Oriental may well get pulled under by the wave of nationalization going on in Bolivia. As has been reported elsewhere, the Bolivian government has expressed an intention to take majority control over a group of formerly state-owned utilities and is licking its chops to do the same with rail and telecom companies. The official story is that the takings "will reduce poverty and boost economic growth." (Sounds familiar. See *Atlas Shrugged*, page 123, "…provide pork every Sunday…")

The railroad is a 1,243 km meter-gauge network privatized in March 1996 and is owned 50% by pension funds on behalf of the Bolivian people. To complete the transaction, the government will have to do an audit of the railroad and buy enough pension fund shares to gain majority control. That will take money, yet by its own admission Bolivia is one of the poorest of the poor, so funding will be interesting.

According www.gwrr.com there are more than 400 employees and two dozen locos capable of hauling more than 30,000 revenue carloads of freight and half a million passengers annually. The most heavily traveled portion of the line is from Santa Cruz, adjacent to the most productive soybean region in the world, to Puerto Suarez on the eastern border with Brazil. This portion of the line typically carries about 88% of the Oriental's cargo and 80% of its passengers. The remainder is transported along the southern portion of the line to Yacuiba, on Bolivia's southern border with Argentina.

Customers include Cargill, ADM and Brazil's Petrobras, with 11% destined locally. More than half of the traffic is in soybeans, the raw beans and derivatives, with the remainder in wheat and related flours, petroleum products, cement and construction materials. Since privatization in 1996, the line has grown 37% in volume of cargo and 92% in passengers, with continued growth anticipated. In 2000, the Oriental continued its strong financial performance, netting US $7.9 mm in net income on $30.6 mm of sales.

CN taps two for new marketing slots, naming Stan Jablonski and Jean-Jacques Ruest SVP-Sales, and SVP-Marketing, respectively. Stan has been on my NEARS panel and Jean-Jacques and I have had some inspired discussions at MWARS and at the CN shortline meetings. My sense is that both are pro-shortline and will be receptive to shortline proposals that will improve asset management and bring new revenue opportunities on line.

Stan had been VP-Sales since 2004. In his new position he will remain responsible for all sales activities related to the Forest Products, Industrial Products, Bulk Commodities and Intermodal businesses. He joined CN in June 1999 as VP-Forest Products, and was previously VP-Sales, at Kruger Inc. – a Montreal-based forest products company.

Jean-Jacques had been VP-Marketing, also since 2004. He continues to be responsible for all marketing activities related to the Forest Products, Metals and Minerals, Petroleum and Chemicals, Bulk Commodities, and Automotive businesses. He joined CN in 1996 as VP-Petroleum and Chemicals, and, in 2003, was appointed vice-president, Industrial Products. Prior to that, he worked 16 years for ICI, a major chemical company. Congratulations to both.

Art Shoener takes on the dual roles of President and COO at KCS while Mike Haverty retains Chairman and CEO. Art will continue to lead The Kansas City Southern Railway Company (KCSR) as president and CEO, will oversee Kansas City Southern de Mexico, S.A. de C.V. (KCSM) operations as vice chairman of the KCSM board, and will oversee the Shared Services organization at KCS. Shared Services provides support in purchasing, marketing, human resources, labor relations, information technology and legal for both KCSR and KCSM. He will also work closely with Jose Zozaya, KCSM's president and executive representative.

It's an good move and bodes well for the company. KCS has treated its investors very well. Six years ago KSU traded for $5.20 split-adjusted. Then in late 2003 it took off with consistently higher highs and higher lows and the trend ought to continue. The Meridian Speedway was a brilliant move and the pending purchase of the old SP line between Rosenburg and Victoria will bring Mexico City and Atlanta that much closer together. Also this week the KCS board of directors also approved the acquisition of 30 ES44ACs from GE and 30 SD70ACs from EMD for delivery through 3Q07.

Bringing on these newer, more efficient and environmentally friendly locomotives is part of the first phase of a five-year plan which will allow KCS to replace three older locomotives with two newer locomotives, improving the economics of fuel and maintenance for KCS' operating subsidiaries, and reducing the overall number of units.

Pennsylvania's Keystone State Railroad Association, one of the more effective shortline lobbying groups around, is seeking to increase the state's Rail Freight Assistance Program funding from $8.5 to $10.5 mm and Capital Budget funding for rail freight projects from $20 to $25 mm annually. In addition to being home to some 60 shortlines, more than any other state, Pennsylvania is home to several railroad industry suppliers, including major Pennsylvania companies, such as GE Transportation Systems, Koppers, Union, Switch & Signal and Wabtec.

Trinity Industries got a boost after the Dallas-based diversified industrial company increased its second-quarter earnings projection, noting strength in its rail and barge businesses. The company anticipates earnings of 60 cents to 65 cents a share, up from earlier guidance of 52 cents to 57 cents. Analysts, on average, predict a profit of 57 cents a share. The forecast doesn't include a one-time gain resulting from the sale of the company's fittings business. But still – sold out though 2008 and down 20% since the split? What *are* they smoking up there in NY?

Larry Kaufman shares this excerpt from a recent *Rail Business* column on the tiff between the utilities industry and the railroads: "In a sign that the railroads are tired of being used as a convenient public punching bag, and that sometimes it is necessary to engage in a public squabble with customers, the railroads said FERC should not only focus on transportation of coal, but also should include utility management of coal inventories, patterns and consequences of heavy investment in gas-fired plants and its impact on companies that produce and transport coal, unloading capacity at power plants, coal producers' ability to meet rapidly increasing demand, lack of adequate investment in transmission line capacity, capacity of waterways to move coal, and the impact of higher natural gas prices on coal demand.

"That is a big 'oops.' If FERC expands the study, it puts the utilities in a position of having to defend their behavior as much as they would criticize that of the railroads. FERC, by the way, has not provided much support to utility carping recently. The agency says utility coal inventories are adequate, well above last year's levels, and continuing to grow, and that many utilities have stopped purchasing coal in spot markets due to strong coal inventories and a drop in natural gas prices."

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