RAILROAD WEEK IN REVIEW
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"I am going to talk about the future – something that we are often urged to do." – Hank Wolf, Norfolk Southern CFO.

Hank Wolf's recent Merrill Lynch presentation provides more detail on some of the "digital railroad" tools at work on NS [WIR 6/9/2006]. Astute shortline readers will see immediately where they can augment the benefits of these programs by working smarter in their daily transactions with NS. At the end of Hank's comments I'll offer a few shortline suggestions.

Said Wolf: "To keep ahead of the curve and manage the growth and changes in our business, we are systematically implementing new systems that plan and control train operations. The railroad of the future will literally run on these new systems which are represented by the acronyms that you see here.

"*Operating Plan Developer*, or OPD, allows us to plan our traffic movements and make changes in our operating plan. OPD provides "what-if" capability that allows us to make simulations on yard, train and blocking changes to our merchandise transportation network. This system allows planners to quickly evaluate the potential impact of infrastructure and traffic changes on our TOP operating plan. The capabilities of this system were perhaps best illustrated in our preparation for the Gulf Coast hurricanes. OPD let us quickly clear out equipment and re-rout traffic based on the storms' projected paths. This technology enabled us to safeguard our assets and to keep our network fluid.

"*The Locomotive Engineer Assist Display and Event Recorder* system, or LEADER, provides the locomotive engineer with real-time information about the train's operating conditions so as to improve safe handling and fuel efficiency of the train in long-haul operations.

"Optimized Train Control, or OTC, combines data communications, train movement and positioning systems, and onboard computers tied to locomotive control systems to enhance visibility of network operating conditions and provide safer and more efficient train operations.

"Unified Train Control System, or UTCS, replaces existing equipment with networked, computer-aided dispatching work stations that function with tactical information systems and provide a seamless and disaster-hardened transportation management system.

"Once fully implemented and integrated, these systems will provide a more comprehensive picture for our employees and customers as to where freight is and how it is moving across our system with respect to our transportation plan. Going forward, this new technology will enable us to operate our railroad more safely and with a reduced workforce." And now that your appetite has been thoroughly whetted, log on to www.nscorp.com to read Hank's remarks and see some neat slides.

What's particularly intriguing is why a CFO would give a non-financial presentation to analysts. I think it's brilliant. Most financial presentations focus on past results with some small nod to what's coming. Here, Hank has told the world what NS is doing to run a faster, safer more efficient railroad and is letting the analysts draw their own conclusions.

So with NS making quantum changes to the way it runs the railroad – especially with respect to data exchange and management – it's a bit off-putting to know nearly half the shortlines connecting with NS can't even meet the event reporting standards for timeliness [WIR, 6/9/2006]. If LEADER can tell an engineer within the first three minutes of a run how best to handle the train, why should NS wait eight hours to learn whether a car has been pulled from a shortline customer or placed at the interchange?

At every shortline conference the message is the same: help us integrate your IT processes with ours. And you can bet that when branch lines come up for shortline consideration, the operators with lines with the best IT fits will be in the "A" list. Recall also my thesis that a third of the shortlines extant today will be fallen flags in ten years or less. Less than timely data reporting will contribute.

Union Pacific is realigning its regional operating organization around three operating regions effective July 1. Dennis Duffy, EVP – Ops, says the realignment supports the train flows on the northern portion of the Union Pacific and the terminal interdependencies in the Gulf/North-South Corridor. The Northern Region realignment will provide unified management of all Central Corridor routes to the east, as well as UP's two highest-volume eastern gateways -- Chicago and St. Louis. The Southern Region alignment will result in the key terminals of North Little Rock, Pine Bluff and Houston being managed as an integrated operation.

The Kansas City and St. Louis service units will join the Northern Region (12,121 miles) based in Omaha, and the North Little Rock and Wichita service units will join the Southern Region (8,670 miles) based in Spring, Texas. These service units currently are part of the Central Region, which has been eliminated. The Western Region (11,600 miles) based in Roseville CA remains unchanged.

Personnel moves: Joe Santamaria to VP-Transp replacing Jeff Koch, 59, who will retire later this year; Lance Fritz to VP-Southern Region from VP-Northern Region; Randy Blackburn to VP-Northern Region from VP-Central Region. Also, Rod Richardson to general superintendent, Proviso service unit, from general superintendent -- Harriman Dispatch Center. And Rick Turner moves to VP-Premium Operations (auto and intermodal) from VP for the NCSC. Linda Brandl will replace Turner at NCSC, coming from AVP Union Pacific Distribution Services.

Meanwhile, the UP hiring program continues unabated. More than 40% of the UP workforce reaches retirement age within ten years and UP has job openings at many locations throughout its 23-state operating system. Opportunities are available in train service, skilled disciplines (e.g., diesel mechanics and electricians) and management. The railroad provides all training required for the positions and train service positions offer excellent benefits and pay of up to $40,000 in the first year and $75,000 in future years.

Have railroad stock prices hit a bottom? Perhaps, and if so GWR may have been the first to turn. The stock started its reversal June 14 though with a PEG of 1.37 it's not the cheapest of the rail stocks. The majors are still clustered around 1.0 and have all – with the exception of RRA, even after Thursday's surge – headed north since. The higher the ask gets, the closer it is to the target price, the smaller the gain and the higher the PE. Ergo the PEG shrinks making the name more expensive. It looks like a case of the sooner the cheaper.

Another play that could be amusing and quite worthwhile is a BNI buy-write. You can buy the stock for around $75 and sell Aug 85 calls for a buck. If BNSF gets to $85 in six weeks (which I doubt) you make a cool $11 (15%) less commish for tying your money up for 50 days, or 104% APR. If the contract expires without BNSF hitting 85 you can do it again, selling Oct 90s assuming BNSF is in the low 80s.

On the broader front, it looks like three of the Big Six will see double-digit revenue increases this quarter (see table following disclaimer). Two caveats: first, GWR and KCS have both had significant recent acquisitions affecting yoy revenues so we're not really looking at legitimate comps here. Second, fuel surcharges of late have contributed as much as a third of the yoy revenue change and operating expenses have been increasing faster than unit volumes, so the core yield picture maybe somewhat skewed.

Car builders too have turned the corner. My split-adjusted position in TRN has improved to a 5% loss from an 8% loss as all players have seen stock prices improve. Greenbrier (GBX) got a nice write-up from Bear Stearns' Peter Nesvold this week under the heading, "Earnings Power with Leverage Like a Coiled Spring." Fiscal Q3 earnings increased 28% yoy to 86 cents a share before items. With the below-the-line charges eps grew 18% yoy to 58 ccnts per diluted share.

GBX also raised its fiscal 2006 earnings guidance to $2.45 to $2.50 per diluted share excluding charges of $.19 per diluted share for the tentative tax settlement in the third fiscal quarter. GBX earned $2.03 in the previous year according to First Call. New railcar manufacturing backlog was 16,900 units valued at $1.14 bn at May 31, 2006 and subsequent to quarter-end GBX the Company received an order for another 600 double-stack intermodal platforms.

Getting back to the "coiled spring," Nesvold writes that forward manufacturing margins ought to remain in the 13% range into 2007 while revenues are expected to grow at a rate five times that. He concludes, "This would imply earnings power in excess of $4 (vs. FY 2008 consensus of $3.18)." The more conservative consensus as reflected in the First Call estimates projects 5-year earnings growth at 12% against a PE of 12, for a forward PEG or 1.0, which means if Peter has his way the denominator will increase significantly, taking the PEG well below one and into the Land of the Screaming Buy. The coiled spring analogy seems apt enough. Thanks, Peter.

Nonsequitur: "UPS has been awarded a three-year contract by the US Postal Service (USPS) to provide domestic air transportation of primarily First Class and Priority Mail, to and from 98 cities. UPS will use existing capacity to handle the new postal volume. With more than 575 aircraft either owned or chartered, UPS has daytime capacity to meet postal requirements. According to UPS chairman & CEO Mike Eskew, the new contract will create new growth opportunities for the company." (UPS News wire).

You know how this stuff hits the blogosphere. I had no sooner thought about how they might hook up mail sacks from the ground than this one hit my screen: "Now if UPS could line the walls with little sorting bins and drop mail sacks out as they fly over small towns the would really have something. Also, big towers could be constructed with a hook system so that the plane could grab outbound sacks as they went by. They could call it an Airway Post Office or APO for short.

Wow! Sorting *en route*! What a concept!

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Table 1.

2Q06 revenue ests from First Call

$ US millions)

Tick	2Q06e	2Q05a	Change
BNSF	$ 3,650	$ 3,140	16.2%
CN	$ 1,780	$ 1,480	20.3%
CP	$ 1,120	$ 1,060	5.7%
CSX	$ 2,380	$ 2,170	9.7%
GWR	$ 117	$ 93	25.8%
KCS	$ 403	$ 195	106.7%
NS	$ 2,390	$ 2,150	11.2%
RRA	$ 115	$ 111	3.6%
UP	$ 3,650	$ 3,340	9.3%