RAILROAD WEEK IN REVIEW
DECEMBER 15, 2006

"We have downwardly adjusted our 4Q earnings estimates for each of the Class I rails to reflect nine weeks of weaker than expected volume." – Ed Wolfe, Bear Stearns

As the quarter winds down we begin to see various predictions and prognostications about what to expect come the Jan 2007 Earnings Season. Bear Stearns' Ed Wolfe is always one of the first out of the box: "We expect reports mostly in-line with reduced Consensus for the rails during 4Q:06. Our sense is reports will not be as strong or as clean as we have seen recently, with likely some support from gains on sales, tax rates and share repurchases to make numbers." In other words, yoy ops income is not likely to move that much.

Bear has "4Q06 eps estimates for the large cap rails by 3.6% on average to reflect 3-4 percentage-points slower than expected vol. growth, offset partially by improved pricing and productivity combined with lower fuel costs. As a natural offset to weaker than expected vols., the rails have improved y-o-y velocity and dwell times by 5.4% and 9.9% on average QTD. Our sense is over the next few months the rails will even better be able to remove equipment off the network to maximize profitability." BNI and NSC the only roads garnering BSC's Out-perform ranking.

On the shortline side, BSC has reduced estimates for GWR and RRA. "While we only have one month of volume data for GWR, we are lowering our 4Q estimate from $0.30 to $0.28/share. This compares with Consensus and guidance of $0.30. GWR's October volumes were up 8.6% y-o-y (down 4.3% on a same carload basis), well below our prior estimate of 12.0% growth. We are now forecasting 13% revenue growth and an 85.2% OR, versus guidance of 16% revenue growth and an 85% OR.

"We are also lowering our 4Q:06 RRA estimate from $0.25 to $0.22. This compares with Consensus of $0.25 and RRA's guidance of $0.23-$0.28. While volumes in October were softer than expected, we believe RRA is trading on the likelihood of the Fortress acquisition and not on fundamentals. We expect the Fortress deal to close in mid-February."

Class I carloads inched up 2% in Week 49 (Dec 8) following two successive weeks of flat-to-down loadings. Coal was up 10% as utilities rebuilt stockpiles, intermodal was up 2.4% and "farm" (STCCs 01, 20) increased 10%, further supporting my thesis that intermodal sees downturns before coal or grain. My most recent shortline report from RMI's RailConnect Index was for Week 47 (Thanksgiving Week) and it showed YTD pet/coke (which includes LPG), coal, "farm," and metals the best performers. Chems were up slightly, or at least not down.

Among the Class Is BNSF loads increased 9% in the west, compared with UP's 6%. In the east NS bested CSX barely, up half a percent to CSX's down 3%. NS was up in coal while CSX coal and chems were the laggards. Same story in Canada as CN loads were up a percent to CP's down 7%, really getting hammered in coal and grain. IM, farm and chems saved the day at CN.

Union Pacific's November coal loadings hit 20 mm tons from the SPRB and Colorado and Utah, an increase of nearly 8 percent over November 2005. The railroad posted its third best average daily performance in the SPRB, averaging 35.7 trains per day. The movement of Colorado and Utah coal posted its best daily train numbers of the year in November, averaging 11.6 trains per day.

The railroad also set train-size records during the months of October and November. UP trains moving coal out of the SPRB averaged 15,135 tons each—an increase of 200 tons over last year's annual average. A new wheel-changing process at Bailey Yard in North Platte (and which we saw from the August 2006 Shortline Express), helped UP achieve the increased tonnage record. Wheels are changed without removing cars from a train, saving handling and processing time. The enhancement has the potential to increase train tonnage out of the SPRB by more than 750,000 tons next year with no additional train starts.

Minnesota Public Radio's Cara Hetland interviewed me last week on the DM&E's build-in project to the PRB. See http://minnesota.publicradio.org/display/web/2006/12/11/dmefraloan/ for her fine article. During the interview I made no bones about my opposition to the federal loan so it was nice to see how my objections were mirrored in quotes from others. My biggest beef is that if it's such a good deal why aren't the private equity guys all over it? They paid a $billion for RRA and are hungry for more if the number if calls I've received looking for leads are any indication.

If the feds have that kind of money to toss around there would be much more public benefit from funding Chicago's CREATE and putting Amtrak on a solid footing. We already have both western carriers in the PRB where they are hauling all the coal the mines can load. One source tells me that just last week they would have loaded 10% more coal but for the mines' inability to load all the cars they'd ordered. Doubtful a third carrier would change any of that.

In the final analysis, public funding for a new line to the PRB will diminish the value of further private capital for infrastructure improvements along the BNSF-UP spine line. Even if the line is built, it's not clear to me where the coal will go. DME/ICE doesn't serve *that* many generating facilities itself and it's doubtful either NS or CSX is going to upset long-standing commercial relationships with the western carriers to accommodate PRB coal over Kevin's RR.

Larry Kaufman writes, "With regard to rail stocks, analysts, and the future, I periodically remind myself that analysts always have to have a 'story' to differentiate their efforts from those of their competitors. Rail stocks have done so well over the last few years that knocking them down prospectively makes sense from an analyst perspective, even if it does not make any sense at all from a thoughtful perspective.

"I still do not believe most of the analysts have determined yet that the railroads no longer are as cyclical as they historically have been and that most of the change is secular. Congestion, fuel prices, driver shortages, etc., are drivers of secular change because they ain't going to go away anytime soon.

I recall that at the June analyst day in Denver, BNSF made a very strong case that it would do fine even if the country had a real economic slowdown. Coal will move because electricity still will be generated. Grain will be moved because of export, domestic food and feed, and ethanol demand. Intermodal will continue to move because globalization has made long supply chains inextricably intertwined in our logistics system." Larry writes for the *Journal of Commerce* where a recent thread has been what he calls "secular change, intermodal growth and such mundane things as that."

A friend at NS writes re ethanol: "Saw your note about corn loadings in WIR for 12/8/2006. I'd argue that most corn will move to ethanol plants by truck, not rail (at least in the Midwest/east), and that will in fact moderate the demand for covered hoppers for corn service. There may be an offsetting surge need for DDG capacity, but it's unclear how that stuff will move, and to where. Corn consumers are looking for new unit train supply points as many of their current elevators are 'ethanized,' so the opportunity for short lines here is 'one last shot' for country elevators that didn't invest in unit train loading, or were on the margin due to economics. Participate now or forever hold your peace."

The Class I ethanol focus seems to be on unit trains exclusively, though there may be opportunities for short-haul out-and-back trains of 25-50 cars between shortlines where there is a processor at one end and a blender at the other. A shipper recently lamented to me that the 100-car unit train requirement would have him spending megabucks on tank farms. Yet on drilling down into the specifics, we found a 25-car train three times a week would meet the needs of both parties without any extra tanks. Talk about queuing theory: incoming interval equals processing interval eliminating any need to eat up working capital (and capex) for inventory.

On a more somber note, it has come to my attention that the shortline tax credit transfer may be at risk. A friend writes, "In one of its final acts (over the weekend, yet) the 'Lame Duck' Session of Congress passed language setting aside IRS regulations that severely restricted the ability of shortlines to transfer the Sec. 45G Railroad Maintenance Tax Credit to shippers, suppliers or contractors.

"The ASLRRA launched a major lobbying effort to roll back IRS regs issued on Sept. 8, 2006, retroactive to 1/1/2006. The industry took the position that the IRS frustrated the will of Congress by effectively repealing statutory assignment provisions that allow other eligible taxpayers to claim the Sec. 45G Credit if they pay or incur track maintenance expenditures on behalf of a Class II or Class III railroad that can't use the credits itself. The ASLRRA must now gear up to get the Maintenance Tax Credit extended. The current legislation is due to expire on Dec. 31, 2007.

"This task has been made more difficult by the fact that Harlem Congressman Charlie Rangell (D-NY), the new Chairman of the House Ways and Means Committee, has no shortlines in his district. Outgoing Ways and Means Chair Bill Thomas of California had a significant RailAmerica presence in his district, as do several senior Republican members of the Committee like Rep. Phil English of Western Pennsylvania (who has four shortlines). English was particularly helpful in getting the IRS regulations repealed." Seems to me there were a lot of Democrats in and around the shortline community who could hardly wait till they threw the Republicans out of Congress. Could it be we're seeing the beginnings of buyers' remorse?

Wall Street may be downgrading rail stocks on signs of slowing volumes but that's not slowing down the car builders. FreightCar America (Nasdaq: RAIL) delivered its 100,000th aluminum railcar, a BethGon ® II, as part of a 2,695-car order for NRG Energy. The car was built at RAIL's Danville, Illinois, facility where the first new car it ever built was for an NRG predecessor company. Since 1997, NRG has acquired over 4,500 aluminum coal cars from FreightCar America, all of them built at the Danville facility.

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RailConnect Index of Short Line Traffic

Traffic Type: All

For the week ending: 11/25/2006

Week Number: 47

	Current Week			Year-To-Date		
Carloads Handled	**2006**	**2005**	**% Change**	**2006**	**2005**	**% Change**
Coal	15,300	14,457	5.83%	709,512	662,896	7.03%
Grain	12,861	12,864	-0.02%	589,598	562,724	4.78%
Farm & Food (Exc. Grain)	4,043	4,100	-1.39%	204,268	195,500	4.48%
Ores	6,386	9,100	-29.82%	399,557	419,176	-4.68%
Stone, Clay, Aggregates	7,954	8,131	-2.18%	481,046	460,652	4.43%
Lumber & Forest products	5,064	6,681	-24.20%	297,263	324,683	-8.45%
Paper products	8,050	8,419	-4.38%	334,334	344,371	-2.91%
Waste & Scrap materials	4,575	4,958	-7.72%	272,250	253,085	7.57%
Chemicals	14,380	13,441	6.99%	660,160	652,198	1.22%
Petroleum & Coke	5,411	4,630	16.87%	267,593	235,109	13.82%
Metals & Products	8,532	9,556	-10.72%	529,263	486,480	8.79%
Motor vehicles & equip.	2,152	1,985	8.41%	101,782	104,486	-2.59%
Intermodal	14,048	17,847	-21.29%	778,207	813,396	-4.33%
All Other	2,157	2,685	-19.66%	146,515	141,435	3.59%
Total	**110,913**	**118,854**	**-6.68%**	**5,771,348**	**5,656,191**	**2.04%**