RAILROAD WEEK IN REVIEW
JUNE 8, 2007

"Institutional knowledge and experience count for a lot." -- Wick Moorman, NS Analysts' Day

Norfolk Southern came to NYC on Wednesday to update the financial community on its progress of late. There was a lot less hard-core financial data than one sees at the usual quarterly earnings presentations, and this was good because it gave NS the opportunity to tell a lot more about what they do and why.

There were several key take-aways for short line operators and others with a carload focus. First, the new corridor expansions – Heartland (Norfolk to Columbus) and the just- announced Crescent Corridor (Dallas to NY) – will offer collateral benefits to carload shippers. Second, the shift to railroad-owned from leased and private equipment in coal and paper will improve turn times and revenue per unit. Third, NS is committed to better margins achieved through superior (I lost count of the number of times Wick used that word) service and pricing to match service quality as perceived by the customer.

It was clear throughout that NS has really zeroed in on running a smarter, faster railroad and using the institutional knowledge and experience plus the latest in technology to get there. As Morgan Stanley's William Greene put it, "NS already has some of the fastest and most reliable service in the industry, but the company is committed to driving service levels higher. In fact, early shipments hinder NS' on-time performance metrics more than shipments that arrive late. NS sees a huge opportunity for truck conversion if service levels can improve from here."

That said, NS is not out looking for business at margins that make no sense or with service design requirements that take assets off the core system without due compensation. Reading between the lines of Wick's answer to one question about the gathering and distribution network, one might conclude NS will be taking another look at its branch line and short line networks with that in mind. Recall that BNSF has done a great job of transferring G&D to short lines in a way that improves asset utilization and lowers margins all at once.

And even though intermodal is more sexy than carload as far as the analyst community is concerned, it's still the basic merch carload franchise (everything but IM, coal and auto) that delivered 43% of NS revs in 2006. Moreover, the sector brought in revs of $4.1 bn last year, up 58% from 2001's $2.6 bn. And since short lines share in about 20% of that, it's a good bet that nearly a $million was paid out in short line allowances and divisions last year.

JPM's Tom Wadewitz sums up the session succinctly: "NS provided plans that illustrate how it expects to drive long-term growth through a focus on consistent service and through capacity investments aimed largely at expanding its intermodal service. Although NS did not provide numbers, we believe the presentations did indicate the strength of the management team and the ability to execute its strategies."

This was bar far the most revealing NS presentation I have seen in an investors' forum. True, I do get a lot of nuts and bolts at short line gatherings and in private meetings, but this was the first time in my recall they have shared such a broad insight into their though process. If I could offer one suggestion, it would be to but a "sell line" on every exhibit. Tell us what's important in a way that it can be immediately recalled without digging out our notes. But at the end of the day I was glad I went. I think we call came away with a better sense of who's doing what at NS and why.

Here's a report that some lumber buyers are getting more product out of eastern US and Canada partly due to rising rail rates which make eastern truck lumber cheaper than western rail lumber. How long this trend last will depend on how long flatbed truck supply exceeds demand. This suggests that eastern short line operators in the lumber-producing regions may be able to link up with northeastern and north central short lines with lumber customers and get creative. I seem to recall there is a fair number of parked center-beams looking for work in the southeast.

Taking the other side, an article in *Forbes* suggests there's a turnaround in store for the STCC 24 and 26 forest products group as the pulp and paper industry are making some serious moves to lower logistics costs. The article cites CN as a beneficiary "as cost-conscious wood-products companies are choosing rail transportation over more-expensive trucking." Recall CN's forest products loads were off 14% in Q1.

The story wraps, "Due to the better economics in rail transportation versus trucking, these initiatives have created a favorable dynamic for the rail sector – even if it is not showing up in the near-term results." But what it says to me is that the CN focus on "precision railroading" and running to plan is indeed creating a superior (Wick's word again) product that adds value to the whole logistics and supply chain process. Some analysts seem to agree with this "superior product theme," positing that CN stock could blow by par (Wall-Street-ese for $100) in the next couple of years. Aggressive share buy-backs plus PE-multiple expansion in the rails might do the trick. My intrinsic value model puts CN at $90 so at Friday's close of $54 one might say CN is trading at 49 cents on the dollar.

Credit Chop Hardenbergh with this scoop from New England: "The new rules on TIH will require railroads to move cars with TIH out of rail yards within 48 hours, and to have a person physically present at any hand-over of the car. Although the rule is not yet final, the nation's railroads are already implementing it, and charging more money.

"'The railroads are using multi-pronged strategies to recover the cost they incur to purchase additional liability insurance for TIH materials and more,' according to a May 10 White Paper from The Fertilizer Institute, a DC-based industry group. 'Railroads are not renewing rate contracts and instead are moving all TIH shipments from contracts to tariffs. By doing so, rates can be increased every 20 days at the sole discretion of the railroads." Short lines may want to check with their connecting Class Is to see where this stands before any of their customers get caught off guard.

It looks like the rails are having second thoughts about some of their aggressive pricing practices. We've all heard remarks on how one can raise rates to a point where the rail shipper seeks other modes. Recall too that a repeated theme at the recent BSC conference (WIR 5/11) was that there's more truck capacity out there than the rails would have you believe and the second-tier guys and owner-operators are hungry.

A shipper client writes, "We have seen some aggressive [reductions in] rates by trucking companies. I was very surprised we've seen this much at this time of the year. I have been inundated by trucking companies looking for more freight." Partly as a result, he continues, "NS has dropped rates in one of our heavier lanes. The others RR's have been reluctant to so at this point." I've also heard UP is rethinking some of its recent rate hikes that have caused good business to take a hike.

It would be helpful if others out there in WIR-land could provide some insights as to what they're seeing with respect to customers switching from rail to truck and back again. I'm also looking for instances where carload business has been lost to transloads. I came across one last week where the there appears to be a $600 rate spread between the rate to the transload and the rate to the short line (advantage transload).

My model tells me it costs about $5 a ton for bulk transload plus $2 a mile to drive a tank-truck, double that if the truck has to run empty one way. In the present case, the rail-equivalent truck rate was $2,400, six times the rate advantage to the transload. Something ain't right. Any ideas?

RMI is been bitten by the private Equity bug. According to a press release on Monday, the Carlyle Group, a Washington, D.C. based global private equity investment firm with more than $56 bn of equity capital under management has acquired a majority stake in the company. Funds for the transaction came from Carlyle Venture Partners III (CVP III), a U.S.-based multi-stage growth capital fund that invests in venture capital, growth equity and growth buyout transactions. CVP III invests primarily in companies operating in growth sectors of the economy, including technology, technology-enabled services, business services, telecommunications, media and healthcare. Financial terms were not disclosed.

RMI Chief Executive Officer Pete Kleifgen said, "Now is the right time to re-capitalize the company by bringing in a new equity investor. Carlyle's extensive knowledge of the transportation sector, as well as its global network, will enable us to further the growth of our business. This is good news for our existing customers and for the future of RMI. We will have the resources to continue to pioneer new technologies and industry-wide initiatives, as well as to develop new business in related markets." RMI was represented by Updata Advisors, Inc. in this transaction.

Founded in 1979, RMI provides critical web-based transportation and logistics solutions for a variety of participants in the transportation industry, including short-line, regional, Class I and terminal switching railroads, railcar leasing companies, rail shippers and barge operators. RMI's mission-critical, integrated services assist customers with many aspects of managing their operations, including transportation, equipment, freight and revenue management services. The internal operating structure of RMI will not change. The entire executive management team has invested in RMI and will remain in place to continue to build the company.

Amtrak is looking for a few good men and women. Specifically, my good friend -- and former Conrailer -- Paul Vilter is looking for two good people to fill positions in his organization at Amtrak. Paul's team negotiates all of Amtrak's business arrangements and contracts with Amtrak's host railroads around the country. They also plan Amtrak's strategy for improving On-Time Performance on host railroads, which gives them significant access to senior Amtrak management, and gets them involved in selected tactical operating issues. The positions can be located in either Philadelphia or Washington, DC. If you or somebody you know might be interested in more details, drop a note to Paul at vilterp@amtrak.com, or call him at 215-349-6804, and take it from there. No need to call me.

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