RAILROAD WEEK IN REVIEW
AUGUST 3, 2007

"Housing woes have all the freshness of a rehashed musical." – Kopi Tan in Barron's

Don Seale, EVP for sales and marketing at NS, once remarked that housing's woes cascade through a much wider swath of commodities than just the usual suspects – forest products and construction materials from plywood to cement to roofing granules. Now comes minyanville.com to ask, "What do these companies have in common: Owens Corning, Burlington Northern Santa Fe, DuPont, Furniture Brands International and Office Depot?"

Minyanville.com cites a Bloomberg report on companies that "make and sell something that is used to build, furnish, design, sell, live in, be carried into, or out of, or in some cases simply very near, a house." It's an easy argument to follow. Owens Corning produces residential and commercial building materials, DuPont makes kitchen and bathroom counter tops. Furniture Brands International owns the Broyhill and Thomasville brands and said back in April that it would cut 330 jobs and close three North Carolina plants. As for Office Depot, its North American retail president said the housing slump affects its small-business clientele and thus their spending patterns.

Both NS and CSX, the dominant Class Is in the consumer-rich northeast and southeast markets, posted volume declines in their industrial products commodity groups for the first half of 2007 and neither is particularly upbeat about second quarter prospects for the IP sector. The attached RMI Index of Short Line Traffic shows the broad IP sector represents 45% of reporting short lines' commodity loads so the Class II and III carriers are really going to have to scramble.

CSX on Monday ran full page ads in the *Washington Post* and *WSJ* (and possibly elsewhere though these are the only two I know of) touting the reasons why CSX is "Good for America" and "Good for Investors." The "America" column addresses the rail industry's benefits in terms of pollution, congestion relief and community service; the "investors" column hits shareholder returns, earning power, and capex commitments.

The message is not in what's said, it's in the fact that CSX took the trouble to say it at all. Among the entire railroad community NS has been the only other voice out there, though its story rarely includes direct investor benefits. As a former ad-man myself, I found the CSX ad a remarkable example of print's capacity for communicating a Unique Selling Point. Back this up with the recent CSX press release series on safety and security initiatives with Kentucky, NY and NJ and a pattern emerges of a company committed to its three constituents: coworkers, co-owners and communities.

With respect to this last, here in Philadelphia a long-running dispute between CSX and users of the Schuylkill River Trail is finally being addressed in an adult manner and to CSX must go the credit for raising the process to that level. The Trail is a paved multi-use path that runs between the old B&O main and the banks of the Schuylkill River between Locust Street and the Art Museum. When I moved to the neighborhood ten years ago this was a rutted dirt road accessed over a rude crossing of ties and rocks and rarely used by anybody but intrepid bikers and the odd homeless person.

Fast forward to now and it's a very popular landscaped paved lane suitable for bilking, blading, jogging and ambling. Trouble was, Locust Street was a crew-change and car set-out point for CSX and as a result the crossing was often blocked for long periods. Worse, CSX would use the passing track to park its North Jersey MSW train for hours, usually the hours of heaviest trail usage.

Now, thanks to CSX leadership, trains stop short of the Locust Street crossing to make the crew changes, we rarely see the trash train, and, best of all, CSX replaced the rip-rap and board crossing with a rubberized paved crossing when it did its T&S program through here last month. They're keeping trains moving, making shareholders as well as the neighbors happy.

The DME sale momentum seems to have slowed. We know that there were several railroads and PE players looking at the property and we know that books went out to a number of interested parties. However there may be some flies in the ointment. The Pierre SD *Journal* reported that a judge in the 6th circuit Court of Appeals ordered the SD Transportation Commission to stop its planned eminent-domain hearings on the DME expansion. According to the paper, the Commission has been asked to grant DME right of eminent domain to cross lands owned by others who are not interested in selling. Hizzoner directed the parties to show cause why they should be allowed to proceed.

Meanwhile, the Sioux Falls *Argus Leader* reports that DME President Kevin Schieffer thinks financing for the PRB extension could be in place by year's end. The two possibilities being talked about now are a Class I buyout or purchase by a consortium of power companies that might benefit from a third railroad on the PRB. But it still comes down to the availability of cash. The paper concludes, "The availability of private money might not be as bountiful as it was a year ago."

That's' reasonable. The recent stock market downdraft may have diminished the hedge funds' appetite for LBOs and other creative financing schemes. So-called activist shareholders are urging target companies – see The Children's Fund at CSX – to leverage up balance sheets even as market caps are going into the toilet, ratcheting up debt/cap ratios. As no less than *Barron's* notes, "leveraged buy-backs" of stock have provided some support for equity prices. However, the present market increases debt/cap ratios and as a result the desirability of yet more credit may diminish and along with it the eagerness to pick up more companies.

The Genesee & Wyoming call was one of the worst calls I have ever heard in terms of transparency. The press release says Q2 income dropped 90% to $10 mm from $118 mm and eps plummeted to 27 cents from $2.76 even as total sales gained 16% yoy to $132 mm from $113 mm. Operating expenses were up 17% limiting ops income to a 7% gain. The reported OR increased 116 BP to 86.8 as a result. However, by adding back the "extraordinary items" above the line one gets three other yoy pairs of ops ratios, depending on whether one is looking at corporate, Mexico or Australia. It's all very confusing.

Starting with eps, GWR would have you take out $2.41 a share gain from the 2Q06 Australian transaction and 11 cents from the 2Q07 hurricane in Mexico. This gets you back to a more direct comp of 16 cents this year vs. 35 cents last year, still a drop of 54%. Above the line, across the two yoy quarters GWR took expense-line charges and credits of plus $2.3 mm in 2Q07 and minus $2.0 mm a year ago. Factor those in and the OR comps are 88.5 vs. 83.9 yoy with this year the higher. This year's Mex follies and last year's AUS adjustments yield ORs of 83.0 and 80.9 for 2Q07 and 2Q06 respectively.

Commodity carload revenues were $86.2 mm, up 4% from $82.9 mm in 2Q06 on 2% fewer revenue units. Minerals and stone was the outlying commodity group, up 42%, thanks mainly to Australia. Back in the US, forest products, coal and intermodal all took hits variously from the economy and generating plant maintenance. But the big change came in what GWR calls "non-freight" or switching revenues from its Rail Link division serving mainly ports and operating a handful of non-core short lines. Q2 non-freight accounted for 35% of revenue, up from 27% a year ago. This is, as

Bear Stearns' Ed Wolfe said, "worrisome." Rail Link revenues are mainly from switching and handling fees that do not change as sponsor railroad rates rise and as costs inevitably go up margins shrink. But because neither revenue units nor expenses are broken out by rail ops and Rail Link we can't tell how much of the OR yoy delta is Rail Link's.

Jason Seidl at Credit Suisse puts it this way: "Although our long term view on the stock remains favorable, we note that sustained weakness in the freight environment gives us pause for the near term. Indeed, management indicated that it has yet to observe a rebound in volumes." With all these moving pieces, it's too hard for this simple soul to tell what's happening now and – worse yet – where all this is going. I shall remain in the sidelines for the nonce.

Norfolk Southern rolled out the Roanoke red carpet to more than 370 short line owners and operators this week for its Sixth Annual Short Line Meeting. Rob Robinson, AVP for Short Line Marketing, noted that 2006 was the third consecutive year of shortline gains in revenue units and Don Seale said through 1H07 NS shortlines are on track to hit the million-carload mark for the second consecutive year with a 6% five-year CAGR. Over lunch, CEO Wick Moorman said he sees "a resurgence of the carload sector" and added "the community-based" short lines can bring a lot more to the table.

To that end, Robinson challenged each short line to add at least 250 carloads of new business in the next 12 months. He asked for a show of hands for who could do that and almost every hand went up. He then raised the ante to 500 and then 1000 cars and there were hands in every group. Finally, Robinson asked those with their hands raised to jot down their names, railroads and the number of new loads on easels set up in the back of the room. I checked the lists at the end of the day and the results were encouraging, to say the least.

I ought to add that short lines proposing to bring new business to NS need to do their marketing homework first. In discussing past new business proposals with a number of shortliners, I came away with the impression that too often the nature of the competition, the equipment needs, the cycle times and the annual volumes were not well known. This season's earnings calls showed that every Class I is looking to increase RPU and decrease cycle times. Thus every carload proposer has to know his position in the food chain and package the product to rise to the top.

Two other highlights: Chick Wehrmeister, VP for safety and environmental, offered to have NS pay the $1500 tuition for up to 45 shortline attendees at the week-long Safety and Security class at Pueblo. (Talk about stepping up for safety!) And CYO Director Brad Fitzgerald is giving shortlines real-time access to TYES and the ability to download their advance consists in real time, a first for any Class I.

In short, NS has presented new challenges and added to the short lines' tool box to meet those challenges. Shortline horses have thus been led to fresh water. Let's see how deeply they drink.

The Railroad Week in Review, a weekly compendium of railroad industry news, analysis and comment, is sent via e-mail 50 weeks a year. Individual subscriptions and subs for short lines with less than $12 mm annual revenues $125. Corporate subscriptions are $500 per year. A publication of the Blanchard Company, © 2007. Subscriptions are available by writing rblanchard@rblanchard.com . Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned.

RailConnect Index of Short Line Traffic

Traffic Type: All

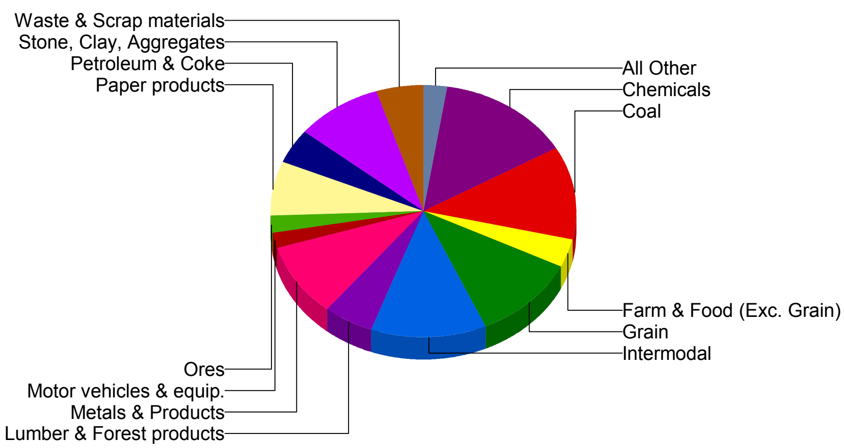
For the week ending: 7/21/2007

Week Number: 29

Carloads Handled	Current Week			Year-To-Date		
	2007	**2006**	**% Change**	**2007**	**2006**	**% Change**
Coal	15,307	14,128	8.35%	411,422	422,056	-2.52%
Grain	16,184	13,214	22.48%	378,540	388,253	-2.50%
Farm & Food (Exc. Grain)	4,495	4,354	3.24%	127,980	134,363	-4.75%
Ores	2,066	3,075	-32.81%	75,254	85,285	-11.76%
Stone, Clay, Aggregates	11,669	12,258	-4.81%	306,683	326,615	-6.10%
Lumber & Forest products	6,293	7,032	-10.51%	180,849	221,255	-18.26%
Paper products	8,090	8,559	-5.48%	235,413	255,454	-7.85%
Waste & Scrap materials	5,969	6,575	-9.22%	173,482	178,625	-2.88%
Chemicals	16,505	15,483	6.60%	479,215	443,665	8.01%
Petroleum & Coke	6,109	6,016	1.55%	160,429	169,152	-5.16%
Metals & Products	11,659	11,346	2.76%	325,481	350,561	-7.15%
Motor vehicles & equip.	1,623	2,086	-22.20%	61,951	66,356	-6.64%
Intermodal	14,694	17,937	-18.08%	413,991	513,786	-19.42%
All Other	3,087	3,465	-10.91%	85,776	98,397	-12.83%
Total	**123,750**	**125,528**	**-1.42%**	**3,416,466**	**3,653,823**	**-6.50%**

RailConnect Index

Year-To-Date



All Other	2.5%
Chemicals	14.0%
Coal	12.0%
Farm & Food (Exc. Grain)	3.7%
Grain	11.1%
Intermodal	12.1%
Lumber & Forest products	5.3%
Metals & Products	9.5%
Motor vehicles & equip.	1.8%
Ores	2.2%
Paper products	6.9%
Petroleum & Coke	4.7%
Stone, Clay, Aggregates	9.0%
Waste & Scrap materials	5.1%
Total:	100.0%