THE RAILROAD WEEK IN REVIEW
JANUARY 25, 2008

"The challenges are external; the opportunities are under our control."—Jim Young, Union Pacific CEO, fourth quarter 2007 earnings call

CSX opened Earnings Week breaking the $10 billion annual revenue mark for the first time. Ops income for the Q increased 21% in spite of a 3% drop in revenue units as the soft economy continued to take its toll across all commodity groups save ferts (CSX hauls 88% of all ferts consumed in North America) and – logically enough—ag products. You could tell from the call they were going after TCI's complaints hammer and tongs, stressing shareholder value and this team's performance.

Yield management and ops cost control played a key role. One way to keep costs down is to run a sharper railroad. Chief Commercial Officer Clarence Gooden opened his remarks with a shot across the bow of the forces of darkness (re-regulation) saying, "working with our customers in a free-market environment is the best way to sustain a vibrant rail industry and global competitive advantage for our customers." Same-store sales (moves with same car-type and commodity between the same OD pairs) represent 75% of the CSX traffic base and were up 7% in the Q, consistent with what we've seen three years running. The 2008 outlook is 5% to 6%.

System RPU was up 11% in the Q on 3% fewer revenue units. The merch carload side posted a 6% revenue gain with 4% fewer units pushing RPU up a respectable 10%. Total sales grew 8% for the Q and 4% for the year on expense deltas of 1% and 2% respectively. CEO Michael Ward put it this way: "Terrific service delivery performance translated into greater value for our customers who are getting more of what they want when they want it." (To be sure, some of my short line friends may object to this statement, but the message is it's better and better and better in more and more places as the inconsistencies are ironed out across the system. CSX is getting better at fixing the process as opposed to merely undoing the same mistakes as they occur over and over again.)

Three interlinked metrics that affect service delivery and the OR are OT departures, OT arrivals and daily recrews. COO Tony Ingram said this was the best Q4 in CSX history for OT departures (measured to the minute, he said), 80%, up four points yoy. As every WIR reader knows, the best way to guarantee OT arrivals is with OT departures so it follows OT arrivals hit 73%, a 10% improvement (surely better than most airlines). Recrews dropped 13% in the process and the OR came down seven and a half points (excluding insurance-recovery adjustments) to 76.7 for the Q.

The traffic mix shifted slightly in the Q as coal grew to 26.5% of revenue, up 1.3 points, while IM shed a point to 13.9% and merch slid 0.7 points to 57% of the total revenue pie. This is good as we see higher rated commodities that can support aggressive rates replacing lower-rated commodities that move in single-car lots with too many moves between too many OD pairs. Thus it is not surprising the strongest outlook is for ag, chems, coal, mets, phos and ferts. Food and consumer (canned goods to refrigerators) and forest products will continue to lag. However, I have no doubt shippers, short lines and shareholders will continue to be delighted.

Canadian National took its usual evening slot on Tuesday with CEO Hunter Harrison saying, "Precision execution continues to deliver." I'll say. In 2007, CN opened Price Rupert, bought the J and the Alberta Northern, expanded its freight forwarder services with its CN Word-wide and sold Montreal's *Gare Central* and the EWS. (At last week's MWARS meeting we were treated to a fullbore PPT show on how and where CN will invest the $100 mm needed to integrate the J, the CN and all the predecessor and other roads from north to south.)

For the quarter CN took a 3% yoy revenue hit as forest products sank 19% and a mix change in metals/minerals contributed a 2% revenue gain on 29% more units, pushing RPU down 21%. In fact, the 58,000 unit increase here accounted for all but a thousand of the units that propelled CN to a 5% gain in system units yoy.

Ops expense came down 3% yoy matching the revenue softness; operating income came down by 3% and the OR remained at 62 (a number many would kill for). During the wrap Chief Commercial Officer Jim Foote said their pricing momentum remains on target as better service supports the price story and that intermodal and bulk (read ferts, grain and some minerals) will be the growth stories in 2008. Forest products isn't looking any better though others in the industrial product group may offset losses there.

Norfolk Southern was in town Wed morning and I sure wish I could have been there. There was more transparency than in any NS earnings call over the past ten years at least. After the usual commercial and financial remarks COO (and *Railway Age* Railroader of the Year) Steve Tobias told us what they are doing to run a more efficient railroad and why. Then SVP for strategic planning Debbie Butler gave her usual stellar performance drilling down into capex details. Even the format got kudos as Merrill's Ken Hoexter opened his turn at the mike during the Q&A saying, "Thanks for the white slides" (NS has for years done everything in white, red or green against black) and Tony Hatch called it "one of the more comprehensive and clear industry analyst meetings in memory."

CEO Wick Moorman opened the proceedings noting, "Even though volumes were down, there were gains in several commodity segments producing a 6% total revenue gain and propelling NS to record Q revs." The quarter's operating ratio improved 1.5 points to 72.0, a post-Conrail split record. Said Wick, "Lowering the operating ratio continues to be a primary goal for us," so we know where that's headed. Hunter Harrison, look out.

Total sales hit all-time highs of $2.5 bn for the Q and $9.4 bn for the year. Merch revs were up 10% yoy with gains in every commodity group except paper/clay/forest. On the flip side, revenue units slid 4% yoy though merch carloads as a whole were essentially flat as ag/consumer/govt grew 3%, metals/const and automotive increased 2% and chems contributed another 1% increase. NS held ops expense at a 4% gain though fuel was up 38% on a 43% jump in the price of a gallon of diesel fuel ($2.56 – ouch!). Note that this Q NS started reporting all fuel – locos, track machines, support fleet, etc. – as fuel expense. One gets at loco fuel expense through gallons consumed times ppg.)

Drilling down to details, Don Seale said the 8% RPU gain ex-auto contract settlement benefit was roughly half price and half a combo of fuel surcharges and mix. This was the first time NS had *ever* broken out the pieces of any RPU gain (*de rigueur* among other rails) and we welcome it. Short lines please take note. The big Tobias take-away is the inclusion of unit trains in network scheduling. They had previously been treated as a separate network with the divisions responsible for fitting them into the merch network TOP. On capex, Butler put the 2008 capex budget at a $billon-four and crumbs, up 6% yoy. The break is 71% maintenance and 29% to growth and productivity, another bit of transparency new to NS.

In sum, this was one of the best NS presentations I've seen based on transparency, substance and style. It behooves every stakeholder, especially short line operators, to download these presentations and graphics to see exactly where you fit in the network and where you can build on the franchise strength Wick cited in his closing remarks.

Union Pacific Chief Commercial Officer Jack Koraleski can be a tough act to follow. For two reasons. First, his enthusiasm and excitement about the tale he's telling are infectious. Second, the delivery is so concise and to the point you really need the transcript to get all the *mots* and nuances. Dennis Duffy, EVP-Ops, does it well, too, positively bubbling through what *could* be a deadly dull presentation of operating metrics. CFO Rob McKnight brings the accountant's *gravitas* while CEO Jim Young simply makes the listener smile with his candor. No spin here.

Union Pacific hauls more of the stuff of life than any other franchise: more grain (bread and feed), chems (soaps, shampoos and fertilizers), and coal (keeping the house comfortable and the TV on) than anybody else reporting this week. So it's not surprising that among this group Union Pacific core revenue units were essentially unchanged yoy for the Q and down only a point for the year.

Total revenue for the Q rose 6% yoy to $4,2 bn; ops expense also rose 6% aided by a 31% increase in locomotive fuel (the fuel and utilities line on the income statement includes other uses). Still, the railroad used 2% less fuel to haul 2% more GTMs in the Q. Ops income was up 7% to $864 mm and the OR came down less than a point to 79, still high for the group. RPU system-wide went up 6% and so did the merch carload group.

In his prepared remarks Koraleski noted the ag increase was a product of more wheat to the gulf and corn in, DDGs out at the ethanol stills. Chems remained "the bright spot," with volume increases in all four quarters with ferts and plastics the leaders; expect more of the same in oh-eight. Finally on the carload side industrial products revs were up a point on 2 points down in vols as RPU went up three points. Here again, 2008 looks like a repeat of 2007.

Out on the railroad, Duffy said they've cut car-cycle time by 7% "to best-ever levels" citing on-time place and pull at the customer that not only lowered UP equipment rents but also gave private-fleet operators better turn times and lower per-ton lease costs. Moreover, UP is going for bigger trains meaning more GTMs for the same number of crew-starts. In fact, said Duffy, first-crew starts declined 4% on 1% lower volume and the rate of improvement accelerated as the quarter wore on.

Jim Young concluded the call by mentioning his Washington concerns. "The STB just issued another decision on Cap M last week and we expect Congress to refocus on the rails when they're back in session. No matter how you look at it though, rails must be part of the solution to addressing America's need for increased trans-station infrastructure. These challenges are largely external factors. Our opportunities, however, are within our control, and we have initiatives underway that will drive record performance in 2008 and beyond."

Class I Commodity Carload Comps

YTD through 12/31/2007

Revenue and income in $millions

Metric	CN	CSX	NS	UP
Railroad revs (1)	$ 7,897	$ 10,030	$ 9,432	$ 16,283
YOY Pct. Change	-0.4%	4.9%	0.3%	4.5%
Revenue Units	4,744	7,116	7,593	9,733
YOY Pct. Change	-1.7%	-3.3%	-3.9%	-1.2%
Mdse Carload revs (2)	$ 5,419	$ 5,829	$ 5,196	$ 9,469
YOY Pct. Change	-1.3%	4.2%	-3.9%	4.1%
MGTM	347,898	458,500	384,000	1,052,300
YOY Pct. Change	-1.4%	-3.4%	-4.6%	-1.9%
Pct carload	68.6%	58.1%	55.1%	58.2%
Pct Intermodal	17.5%	13.5%	20.4%	17.9%
Pct Coal	4.9%	26.0%	24.5%	19.3%
Mdse Carloads (000)	3,059	3,143	2,773	3,981
YOY Pct. Change	-0.9%	-4.4%	-3.9%	-2.9%
Rev/CL x coal, IM	$ 1,771	$ 1,855	$ 1,874	$ 2,379
YOY Pct. Change	-0.4%	9.0%	5.9%	7.2%
Operating Expense	$ 5,021	$ 7,779	$ 6,847	$ 12,908
YOY Pct. Change	2.5%	4.6%	0.0%	1.7%
RR Operating Income	$ 2,876	$ 2,251	$ 2,585	$ 3,375
YOY Pct. Change	-5.1%	5.9%	1.1%	17.0%
RR Operating Ratio	63.6%	77.6%	72.6%	79.3%

(1) CN, CP in $Canadian

(2) Excludes coal, intermodal

Source: company financials

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