The Railroad Week in Review
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CSX and **Norfolk Southern** have filed a petition with the STB to establish direct ownership and control of two Conrail subsidiaries -- New York Central Lines LLC (NYC) and Pennsylvania Lines LLC (PRR). In other words, they want to own outright the properties they currently operate through lease agreements with the Conrail holding company created in the 1997 transaction. After the consummation of the proposed transaction, CSX and NS, as direct owners of NYC and PRR, respectively, would no longer be dependent upon the consent of the other for many decisions relating to their management of the underlying assets of NYC and PRR.

The proposed transaction would not affect rail operations, service or competition, and would have no adverse effect on CSX or NS customers or employees. However, and this is a very important distinction, the proposed transaction *does not involve* the Conrail Shared Asset Operations (CSAO) in northern NJ, South Jersey/Philadelphia, and Detroit. Moreover, Conrail would continue to own, manage and operate the Shared Assets Areas as previously approved by the STB. And, IMHO, it's doubtful the pro-competitive STB would approve breaking up the CSAO even if asked.

CN has backed away from its offer to buy **Ontario Northern** (ONR) thanks to the Ontario government's demands for public sector-like job guarantees for employees of the provincially owned railway. CN entered exclusive negotiations to acquire ONR in October 2002 after Jim Wilson, Ontario minister of northern development and mines, announced that the Ontario Northland Transportation Commission's directors had concluded CN's plan for ONR best met the commission's objectives of job protection, economic development and improved freight and passenger services.

Which only goes to prove the observation of Rail Development's Henry Posner: "Competition from the public sector represents greater risk than floods, famines, giant spiders, etc. What we are looking for is a serious government and rational competition." Is ONR following the failed British Columbia model or are they serious? CN evidently thinks not.

BNSF and **RailAmerica** consummated their 288-mile, $15 mm lease/purchase of the former Frisco lines in western Alabama to RRA's Alabama & Gulf (AGR). The transaction increases AGR's mileage and carloads to 429 and 58,000 respectively with the new business worth about $12 mm in revenue. Traffic density rises to a healthy 131 cars per mile per year. Up to now AGR connected with BNSF at Kimbrough, AL. At that point BNSF tracks linked the AGR to the rest of the world at Amory, MS. Now it's AGR all the way. In addition, AGR takes over the BNSF rights on NS to Mobile. Major shippers include Gulf States Paper Corp., EKA Chemicals, Kerr-McGee Chemical, Weyerhaeuser and the Port of Mobile.

Union Pacific will redeem half its remaining $1.0 bn 6-1/4% convertible preferred on July 7. This is part of UP's efforts to improve free cash flow by replacing expensive debt with lower cost securities, in this case 4.42% paper. There is a near-term redemption cost that will knock down Q3 eps by about $0.03 a share. The estimated earnings impact of this refinancing will be a reduction of $0.02 per diluted share in the Q3 and a 4Q credit of $0.02 per diluted share. The full year 2004 benefit is estimated at $0.07 per diluted share. I'll take it.

Great Lakes Transportation Company (www.gltx.com), operator of the **B&LE** and **DM&IR** railroads plus the Pittsburgh & Conneaut Docks and the Great Lakes Fleet Inc., is on the block. The Duluth (MN) *Daily Tribune* reported Monday that majority owner Blackstone Group of NY had received an "undisclosed, unsolicited offer for the company"and is "considering" a sale.

John Giles, president and CEO of Great Lakes was not willing to go into detail, which is not surprising. Publicly available information puts the two railroads at about 500,000 carloads per year, of which 90% is on the DMIR. The two railroads operate more than 400 route miles and a hundred or so locomotives.

Assuming a nominal $200 per car revenues are in the vicinity of $100 mm and an 80 operating ratio produces an EBITDA figure around $30 mm. Conservative railroad multiples of five times EBITDA and 1.5 times revenues both yield a value of $150 mm. Scouring the universe for likely buyers doesn't generate a lot of names, so we'll just have to wait and see how it plays.

Norfolk Southern's annual shortline confab in Roanoke was another success, in some ways even better than the 2002 performance. Two things stand out. On responses to rate requests, SVP Don Seale committed NS to a 24-hour turn on NS-local traffic and 72-hour for off-line quotes. On the scheduled railroad, the "Shortline Scorecard" and Local Operating Performance Adherence metrics (LOPA) are going to remove a lot of the guesswork, random events, and wide dispersion around the target norm.

Granted, some shortlines are still asking, "What's in it for me?" And some operating guys are saying, "If this is spozed to be a seamless operation, why am I getting shortline resistance about ISAs?" The reason is, in part, because for so long the shortline has seen the ISA as a tool to be ignored by the Class I at will; there has been no penalty for the Class I ops manager to ignore it.

LOPA, as we've written before (WIR 4/4/2003), leaves no place to hide for anybody on either side, and until LOPA is in full effect for the shortlines the Scorecard can graph interchange performance starting now. Interestingly, I found a couple dozen shortlines with ISAs yet only two were measuring compliance on either side. If we're ever going to get scheduled dock-to-dock service we gotta do better than that.

Especially if NS wants to get 35,000 more shortline carloads yoy. To date NS has 5,000 new carloads off shortlines and commitments for another 24,000. In 2002 NS ran 676,000 merchandise carloads (not coal or intermodal), up 1% yoy or 7,000 carloads. For shortlines to touch 35,000 new carloads in 2003, even if there were no increase in non-shortline cars, the 2003 merchandise carloads total would be 711,000 cars, up 5.2% yoy.

The 2002 average merchandise RPU was $1,352, so the target addition means $47.3 mm to NS and $11.8 to the shortlines at a 25% share of NS charges. Across 200 shortlines that's $59,150 each, enough to keep 11 miles of track at FRA class 2 for another year. That's what's in it for the shortlines.