THE RAILROAD WEEK IN REVIEW
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Capital goes where it is welcome and stays where it is well treated –Wriston's Law

Cost of Capital continues to loom large on the railway scene. It was a theme oft-repeated at the recent Kansas City Fall Peak Forum and it came up several times during last week's NEARS conference outside Boston (*see below*). The remarks prove once again that the profitable railroad with a solid business plan and superb performance metrics treats capital the best and a robust revenue-cost ratio plays a large part.

In the shortline arena over the past few months we've seen instances where capital was well-treated and instances where it was not. Free cash flow (EBITDA less capex) is perhaps the most-widely applied measure because it is here that operating margins and plant maintenance practices meet. The short form is the shortlines that treat capital the best are buying those that do not as long as there is a business case for the latters' continued existence. The rest will go away.

Even as the DJIA shed about 2% to close at 10,055 on Friday the rail group continued to outperform. RRA really shone at +8% with CSX, BNI, KSU and UNP all posting gains of about 4%. Both Canadians were up about 2% while NSC held the line at 1%. GWR and FLA matched the broader average, off two percent. But the trend is your friend, and over six months it's a different picture.

NSC is the clear winner, up 40% followed by CSX, CNI and BNI with gains in the 20-22% range. Then come KSU at 15%, CP and UNP around 10%, GWR flat and RRA off 5%. What's particularly revealing is that RRA's 10-K for 2003 shows that cars interchanged with UP and CSX accounted for 45% of revenues while BNI+NSC were less than a sixth of the total. If anything, the CSX portion is bound to increase given the direction of CSX' recent line sales.

Wakefield, Massachusetts hosted the fall meeting of the North East Association of Rail Shippers (NEARS) this week and the turnout was most gratifying. The theme of the session was "The Business is There; Can You Handle It?" My assignment was to gather up a panel of senior railroad execs to give chapter and verse on how their roads are handling the volume surges.

Representing the New England Rails were David Fink, EVP Guilford Transportation, Mario Brault, President, St Lawrence & Atlantic, and Frank Rogers, Director of Marketing, Providence & Worcester. Clarence Gooden, EVP and Chief Commercial Officer for CSX, and Tim Heilig, AVP Transportation Network for NS held their respective forts. Stan Jablonski, VP- Sales for CN, Woody Sutton, VP Business Development & Interline Services for UP, and Denis Smith, VP Industrial Products Marketing at BNSF rounded out the panel.

The NEARS program organizers invited early registrants to submit questions and we used them to frame what turned out to be a wide-ranging discussion. Speeches and Power Point presentations were proscribed as were rate-specific and anecdotal arguments. Rather we restricted the remarks to the concerns we hear most often fro shippers: switching reliability, trip plan compliance, empty car supply, even public-private partnerships.

Cost of capital came into play for the generic discussion of rates, particularly why some rates have increased at double-digit rates this year. The Class Is are working hard to get average train speeds up and car-cycle times down. Having a fluid network requires moving trains seamlessly with minimal stops between end-points. It's why intermodal and unit trains work better than single-car shipments and why slowing down the network to accommodate local switching degrades fluidity and thus the value-added aspect of single O-D pair trains.

Low-value trains occupying high-value mainline space must either pay their own way or be eliminated. The cost of their presence is a function of how much they track space they take away from the loads with better yield ratios. And higher values in the eyes of the customer equate to higher revenues and lower unit costs, ergo better ROIC. Thus explained, everybody seemed to Get It.

The objective of the program was to help shippers make better use of the railroads in their supply chain processes to lower the total cost of goods sold. Judging from the rapt look on many of the faces during the session we certainly held everybody's attention. One attendee said to me during the reception that followed, "Now I know why railroads do what they do, and as a result I'm going to have an easier time convincing my boss to use more rail." We must have done OK.

Southwestern Railroad (SWRR), a shortline operator based in Ogden, has added a third property to its holdings. Effective October 3 SWRR leased the 263-mile BNSF Carlsbad Sub between Loving Junction and the BNSF interchange at Clovis. GM Ron Lindsey is based in Carlsbad. The other SWRR operations are in southern NM and in the Texas-Oklahoma panhandle.

SWRR is part of The Western Group L.C., an association of independently operating shortlines owned by Dave Durbano, President and CEO. In addition to shortline railroads, during the early 1990s The Western Group expanded its association to include ranching affiliates. The Western Group continues to grow internally by developing each segment of its present business by improving sales and profitability of each of the associate short lines, and through favorable new acquisitions and expansion.

Illinois RailNet will acquire two rail lines total about 25 route miles from BNSF in Northern Illinois. The two rail lines being acquired by Illinois RailNet are between Oregon, Ill. and Mt. Morris, Ill. and between Zearing, Ill. and La Salle, Ill. Illinois RailNet will take control of operations on both lines on October 9, 2004. Illinois RailNet will interchange with BNSF at Oregon and/or Flag Center for traffic originating or terminating between Oregon and Mt. Morris, and at Zearing for traffic originating or terminating between Zearing and La Salle. With this expansion Illinois RailNet, created in 1997, increases its operation to some 113 route-miles of track.

Rob McKenney, Illinois RailNet, Inc. Chairman and CEO, said this transaction "will benefit the customers on the lines by providing them with the flexible local service options provided by Illinois RailNet while continuing to provide the long haul reliability of BNSF." Illinois RailNet, Inc. is owned by North American RailNet, Inc. based in Bedford, TX, a holding company that owns and operates four short line properties in six states and one Canadian province.

Genesee & Wyoming (GWR) has selected RMI's RailConnect solution to centralize operational and accounting control on the three ex-Georgia Pacific railroads. RailConnect is designed to enhance the data interface between the railroads and GP cutting dwell and turn-time. Though the press release does not say specifically, one would conclude that better plant through-put will increase equipment velocity and lower the equipment cost component of the freight rate.

Next step is GWR's planned implementation of RMI's ShipperConnect and eBOL (Internet Bill of Lading service) system to automate some of the billing functions, as well as improve and automate operations and communications between the plant and the railroad. Getting rid of manual fax and phone communication between the mills and the railroads will be an added plus.

Kansas City Southern has gotten the authority from Mexico's Foreign Investment Commission ("FIC") to acquire TMM's interest in the TFM. This is a key development because the FIC's blessing is required for a foreign company to become a majority owner of a Mexican railway company. The authority will remain valid until October 5, 2005. It was just three weeks ago that KCS and TMM announced that they had agreed to extend the previous deadline under the April 20, 2003, acquisition agreement until June 15, 2005.

North Shore Rail Group (NSHR), a shortline holding company in central Pennsylvania has achieved what Marketing Director Todd Hunter calls "a major success story." He writes, "The Del Monte Foods canning plant on NSHR in Bloomsburg has finished construction of a brand new two-car loading dock. There is a second track adjacent that can be used for loading with dock plates to bridge between cars. This dock is the culmination of more than six years of promoting this facility to switch from truck delivered frozen meat and fish ingredients to rail delivery.

"DLM Bloomsburg consumes a million pounds a day of frozen meat and fish parts. Starting the second week of October, it will no longer be all truck delivery. Volume will start out small – one or two reefers a week. But I am comfortable that we could see as many as 200 cars per year or more of new business. Handling reefers will be a first-ever for the North Shore Railroads. DLM Canning plant consumes Fish (including Salmon and catfish), beef, and chicken parts in the production of various brands of pet food.

"I would like to especially thank NS Sales rep Chad Ciotti for his assistance in making this project happen. There have been many phone calls, e-mails, meetings and one minor winter- time auto accident that Chad has been involved with on this specific project. We at North Shore Railroads appreciate his time and dedication to seeing this one through." Now *that's* a partnership.

Continuing the thread on cost of capital (9/17/2004) Larry Kaufman writes, "Kel MacKavanagh is absolutely right. I remember Jerry Davis explaining to me one day at the SP how we were taking a bath on intermodal because all of the revenue disappeared with every box that didn't move on our railroad, although we still ran the train and still had about 90% of the expenses, based on our OR. Of course, the calculation works in reverse when you are gaining incremental business. Just look at BNSF." Which is one reason why voids in double-stack trains are abhorrent and why trailers need a higher rate than chassis-free containers.

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