THE RAILROAD WEEK IN REVIEW
FEBRUARY 4, 2005

After the close Friday rail stocks were little changed, with one exception (more on that anon). The DJI was up a shade north of two points for the week, matched by NS and CP. Florida East Coast (FLA) beat the average, up 4%, while CN lagged slightly at plus 1.5%. Essentially unchanged were BNSF (BNI), CSX, GWR, RRA and UP. Kansas City Southern (KSU), on the other hand, was quite another story.

KCS had a great Q4 and FY 2004 story (see below) and Wall Street took notice, sending the stock up 2% on Monday, another 2% Tuesday, up 9% by Wed's close and 11% by week's end. This high-powered performance puts KCS more than 12% above its 50-day moving average, double the lead of any other rail. Moreover, the upward move this week forms the right-hand side of a classic cup-and-handle chart formation, breaking above the MA-50 resistance level and not even stopping to look back. It may be a bit over-bought at this point, so expect a brief pullback. Looking at the tea leaves in this particular cup, I'd say the signs are good for another push upward. A buyer at $18?

Canadian National (CNI) is another cup-and-handle. After six months of steady advances, CNI faltered a bit in early Jan, dipped below its MA-50, leveled out an started up again, crossing resistance last week. Now the handle forms with the classic downward dip. As we saw with KSU, volumes ebbed on the downside of the cup and picked up as resistance was crossed. A strong sign.

Kansas City Southern Railway revenues climbed 18% in Q4 and 11% for the full year with double-digit gains in all carload commodities ex-coal in both periods. This was the seventh consecutive quarterly gain. Revenue units increased 6% in the Q and 7% for the year indicating a nice yield improvement. The expense side of the ledger was held to an 11% gain excluding last year's $21 mm casualty reserve expense item (Table 1 includes this item). KCS was not immune from a sizeable fuel hit, up 67% yoy, thanks to a 57% price hike and only a 7% burn increase on a 6% increase in revenue units.

Note too that absent the casualty item Q4 operating expense was up only 11% and that, combined with the 18% revenue increase leveraged a handsome 62% jump in operating income and took five points out of the OR, down to a very respectable 81.8. Table 1, an excerpt from my *Quarterly Review,* tells us that the merchandise carload business grew at a slightly faster rate than intermodal in the Q and at a rate approaching IM for the year. This may seem an anomaly, but when you recall that much of the KCS intermodal trade is relatively short haul, it's not a total surprise.

The TFM story is gaining momentum as well. The amended and restated Acquisition Agreement between KCS and TMM was signed six weeks ago. All reviews and approvals are in place and it's now ready for approval by KCS Shareholders. The KCS Proxy is under review with SEC, comments were received last week and KCS has responded. There has been a series of favorable court decisions on the Mexican VAT Issue. The STB approved KCS Control of Tex Mex starting 1/1/2005, so 4Q04 results are recorded as an equity investment while operating in a voting trust. Thus starting with the present quarter Tex Mex results will be consolidated with the KSU financials. No wonder the stock is up. They've been busy and it's paying off.

Speaking of which, independent analyst Tony Hatch opines in a client note, "The new KCS is born, and the old smaller one officially ceases to exist. Initially this will be a refinancing and productivity story, as we expect that TFM will be almost instantly accretive. KCS is putting money into the connectors (using FRA loans and the short line tax credit to help do so!) and talking about revenue growth of 7% in the first year. Eventually, if allowed to be by the other major rails, the NAFTA Railway will be a *growth* story."

Railroad traffic in Week Four (through Jan 29) was up 4.2% yoy: 7.8% intermodal and 2.0% in carload including coal, 0.4% in carload ex-coal. KCS, CN, CP , CSX and UP all posted commodity gains that either exceeded or were within a point of intermodal's yoy changes. BNSF, CN and NS were the double-digit intermodal winners while CSX and UP saw yoy intermodal declines.

Morgan Stanley's Jim Valentine conveniently links commodity changes with three AAR service performance measures -- speed, dwell, cars-on-line. CN leads in speed and COL improvement; CP wins dwell with BNSF third. UP took second in COL and third in speed while CSX got into the top three in COL alone.

A cautionary note, though: roads with higher percentages of intermodal volumes (NS, BNSF, e.g,) will have relatively fewer cars in class yards. Roads with higher merch carload volumes (CSX, KCS) will have more cars in class yards and so a negative dwell change will have more of an impact. COL in any event isn't worth much as IM "cars" can be anything from a single flatcar for one trailer to a five-platform articulated unit with a ten-trailer capacity.

A note in Tuesday's WSJ suggests that CSX service is improving thanks in part to the One Plan, and confirming what we saw and heard at the recent analysts' presentation in NYC. The paper zeroes in on coal and the writer cites traders and brokers who see service on the mend. Evidently not all trains that were scheduled to run actually did as one source said it was "the first time in eight months that we've loaded every scheduled train."

A key point in this story is that service makes a difference in selecting carriers and the carrier selected can make a difference in the price the mines can get. According to the WSJ, "Premium coal shipped on Norfolk Southern is being offered at $68 per ton, $6 dollars more than the same coal moved on CSX's lines. Traders say the Norfolk Southern contracts are more desirable because the company's rails are less congested than its competitor's."

Now translate this over to the merch carload side. Just this week a grain trader told me her company avoids carriers and routes where leased equipment can't get two turns a month. Shortline operators across the country can cite revenue opportunities missed because of circuitous routings on the Class Is that drive up the equipment cost component of the rate. Happily, there are solutions like the NS "Operating Plan Developer" that can cost out routing options and pick the most efficient routes. Unhappily, there are still shortline owners and shippers out there that don't know these tools exist.

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Table 1.
Kansas City Southern Railway Results

	Fourth Quarter				YTD	
2004	2003	Pct Chg		2004	2003	Pct Chg
$ 120.3	$ 99.2	21.3%	Carload	$ 435.3	$ 384.0	13.4%
$ 24.3	$ 22.8	6.6%	Coal	$ 92.1	$ 92.7	-0.6%
$ 16.5	$ 13.9	18.7%	Intermodal	$ 61.3	$ 53.5	14.6%
$ 2.6	$ 2.6	0.0%	Haulage-adj	$ 10.6	$ 9.5	11.6%
$ 10.0	$ 8.4	19.0%	Other Revs	$ 36.4	$ 35.6	2.2%
$ 173.7	$ 146.9	18.2%	Total	$ 635.7	$ 575.3	10.5%
69.3%	67.5%	2.6%	Pct carload	68.5%	66.7%	2.6%
9.5%	9.5%	Nil	Pct Intermodal	9.6%	9.3%	3.7%
14.0%	15.5%	-9.9%	Pct Coal	14.5%	16.1%	-10.1%
$ 173.7	$ 146.9	18.2%	**Revenues**	$ 635.7	$ 575.3	10.5%
			Expenses			
$ 55.6	$ 50.3	10.5%	Comp & benefits	$ 208.1	$ 193.7	7.4%
$ 13.8	$ 15.5	-11.0%	Purchased svcs	$ 56.6	$ 57.4	-1.4%
$ 20.6	$ 12.3	67.5%	Fuel	$ 66.4	$ 47.8	38.9%
$ 12.5	$ 12.8	-2.3%	Equipment Costs	$ 50.4	$ 57.4	-12.2%
$ 14.0	$ 16.1	-13.0%	Depr & Amort	$ 52.7	$ 63.6	-17.1%
$ 10.6	$ 28.9	-63.3%	Cas, Ins	$ 37.7	$ 51.9	-27.4%
$ 6.2	$ 5.7	8.8%	Mtls & supp	$ 25.2	$ 27.1	-7.0%
$ 3.5	$ 3.7	-5.4%	Other Taxes	$ 14.5	$ 14.6	-0.7%
$ 3.0	$ 2.4	25.0%	Other Leases	$ 11.8	$ 9.7	21.6%
$ 2.2	$ 1.2	83.3%	Other	$ 11.3	$ 7.6	48.7%
$ 142.0	$ 148.9	-4.6%	**Total Ops Exp**	$ 534.7	$ 530.8	0.7%
$ 31.7	$ (2.0)	-1685.0%	**Ops Income**	$ 101.0	$ 44.5	127.0%
81.8%	101.4%	(19.61)	**Operating Ratio**	84.1%	92.3%	(8.15)