THE RAILROAD WEEK IN REVIEW
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Factoid: Once the railroads passed the break-even point, large volume guaranteed huge profits to their high-fixed, low-operating-cost businesses." – Clark, John E., Railroads in the Civil War.

"The Trend is your Friend" (WIR 8/19/2005) stirred up the intended fuss. A good friend and student of the industry writes, "I'm not so sure that it is. The trend may be determined by disembodied factors based on algorithms. It is numerically valid. It also may be missing fundamentals of the railroad business. The trend is, to put it mildly, a short-term measurement or phenomenon.

"The railroad business is one that has very long-lived assets and that expects the players to be around for many years -- probably through several 'trend cycles.' This is not a criticism of the analysts. They work on behalf of their clients, many of whom tend to live in a short-term world, while the people who manage railroads have a duel responsibility of pleasing investors in the short run and managing the enterprise to ensure that it is around many years from now. Capital investment is a perfect example and the long term health of the company may call for higher capex."

He has a point. Recall how Rob Krebs and David Goode were written down by Wall Street for investing in the railroad when traffic was in a lull. Now BNSF and NS are running the wheels off everything in sight. The fundamentals are favorable and First Call ranks both a 1.9 on a 1 (buy) to 5 (sell) scale. Continues my friend, "BNSF has capacity in a capacity-constrained environment and not only is able to raise rates rapidly it is able to handle additional traffic at the higher rates, kicking up revenue by double digits."

Bottom line, and this is where my friend and WIR are in agreement, the creative, aggressive railroad manager with a longer term view – revenue with staying power on an infrastructure that won't break – will get the long-term stock price movement. But since the institutional investors make the rules, stock prices vary as much on momentum as on fundamentals. My portfolio is up 10% YTD making the trend my friend while trading mostly railroad and rail-related stocks.

"One More Catalyst for Union Pacific Stock," writes Morgan Stanley's Jim Valentine in his 8/25 client note. He reports that feedback from the recent UP Board meetings seems to "reinforce our belief that meaningful change is taking place at the company" and that a near-term price of $75 is not beyond the pale and $100 three years out is doable.

My recent conversations with shipper clients and contacts inside UP tell me there is a fundamental change in their business model. And if feedback from the Board meetings supports that theme, so much the better. Valentine notes that "UP still has more untapped upside from the recent upward price trend." Have to agree, especially in view of UP's position on the unit revenue/unit cost ratio rankings (see below).

The AAR Performance Measures are improving, too. Over the past four weeks cars on line have come down 1.2% from the 3Q04 average and average train speeds are holding at 21.6 MPH though intermodal is up one MPH over four weeks (remember on UP a one MPH train speed delta is worth 250 locomotive units to do the same work). System terminal dwell is an hour better than a month ago with key terminals like Houston/Settegast, Roseville and Colton posting double-digit improvements. If a cranky board can keep *this* trend going there will be smiles all round.

BNSF Logistics, LLC, has been named as one of the top logistics providers in *Inbound Logistics*' annual "Top 10 3PL Excellence Award" survey. BNSF got the nod because of its success in "helping their customers adapt their enterprise to leverage logistics excellence." Recall last week we wrote about the importance of new products in generating new revenue streams. Here's one such.

By way of review, BNSF Logistics is an indirect wholly owned subsidiary of Burlington Northern Santa Fe Corporation and provides customers with a comprehensive set of supply chain solutions ranging from management and execution of single shipment transactions to daily management of complex distribution and sourcing networks. See also www.bnsflogistics.com .

And if you want an even better idea of BNSF Logistics actually does, go to the Careers page of the website. Then think about the overlap between the service offerings and talent being hired and put them in the context of the typical shortline railroad. I mean, if a boxcar of goods can make it to a shortline railroad customer's dock in better shape at lower cost and with greater consistency via transload than it can via the shortline, whither said shortline? That's one reason the successful shortline scores its ISAs, anticipates customer requirements and turns cars quickly.

Canadian National has substantially increased intermodal train capacity across its transcontinental Canadian network. Capacity for overseas containers moving between the Port of Vancouver and Montreal and Toronto is up by more than 20% and by 10% in and out of Montreal. The new plan went into effect on Monday 8/22 and increases intermodal capacity on these lanes by 15% overall – some 125,000 units.

Putting that in perspective, CN handled 1.2 mm IM units in 2004 at an average RPU of C$929. The added capacity in these lanes brings about 10% more volume system wide and does so using the existing infrastructure. Not only does the Civil War factoid fit 100 years later, here's another new product offering that's going to mean real money in the till at the end of the day.

Elsewhere, Canadian National is offering up 33 locomotives for sale. Mostly 4-axle, mostly Alcos and GEs, the list includes ex-BCOL and ex-WC units (see pix at www.cn.ca). Sales are "as is, where is, with all faults." CN invites interested parties to download the "tender document" on the website to learn more. Sale ends Sep 6, 2006. Get 'em while they're hot.

Among major railroad equipment suppliers, again on First Call's 1-5 scale, GATX (GMT) leads the pack with a 1.5, followed by Wabtec (WAB) with a 1.7, then Greenbrier (GBX) at 1.8 and Trinity at 2.0. Now put these numbers in the context of Canadian National (CNI)'s 2.1 or CSX at 2.5 and the leading vendors get interesting. However, the builders seem fully priced compared to the rails: PEG ratios are all north of 1.3 compared to the 0.65 and 0.60 sported by CN and CSX respectively.

I think the suppliers are attractive because new equipment goes to shippers as well as rails and *all* the rails get to use it. Look at GATX for example. Rail equipment leasing in 2004 generated 63% of the $158 mm revenue total with the balance in commercial aircraft leasing, specialty leasing and other. The June 30 Form 10-Q shows 106,553 units in the wholly-owned North American railcar fleet with a utilization rate of 97.9%, up from 106,360 units and 96.2% yoy.

GATX reports that 2Q05 and YTD improvements came mainly from higher per-unit lease income and having more units on active lease. On average the rail division had some 4,000 more cars on active lease in 1H05 over the prior year. Investors have taken note, pushing share prices up some 20% YTD vs. flat for the S&P since June 30. A mid-week close of $39.80 came on a continuing strong upward trend and high demand.

Shortlines need a better tool for evaluating the rate-making practices of their Class I connections. Market managers seem – and I have no concrete proof, it just looks this way – to price commodity lanes according to system costs. Commodity X moving Y miles commands a rate of Z irrespective of whether the O-D pairs are Butte and Biloxi or Yadkin and Youngstown. Yes, there's the mantra of market-based pricing but if the proposed lane doesn't make the cost threshold there's no move.

Spoze the shortline marketeer were able to say to his Class I counterpart, "I know the avoidable cost for this commodity lane is such and such and with a nominal revenue-cost ratio of a one-five the rate ought to be this number. Your website says the fuel surcharge is this based on the current average retail highway diesel price of [whatever] so the total freight bill ought to be this. Let's make a deal."

Or say the shortline has a customer with an opportunity to use leased equipment rather than rail-owned equipment and wants to know the rate differential for some specific lanes. What about the relative annual shipping expense of using 286 or 263 equipment? How does the shortline allowance affect the overall freight rate the customer sees?

You can get the answers to all these questions and more at www.usraildesktop.com . Just today we were looking at the effect of fuel surcharges in certain lanes. Last month I used the tool to help put a value on a piece of industrial trackage between two Class I track segments. And it came in handy when a shortline was trying to negotiate a change in handling allowance by lane.

Remember the importance of new products in sustaining a business (WIR 8/19/2005)? *Nobody* in shortlinedom is doing anything like this yet rail shippers pay big bucks to get it. Give me a call with your knottiest pricing problem and I'll bet you a steak dinner we can solve it.

And while we're on the subject of pricing, take a good look at the table below, especially the line in RED. This is system averages at the broadest possible level yet it tells us a lot about how well the Class Is manage margins. The revenue unit/cost ratio is really revenue per unit divided by cost per unit. Start with total freight revenue before ancillary charges and divide by total revenue units. Then divide total operating expense by revenue units. Now divide revenue per revenue unit by expense per revenue unit. The result is a measure of profit margin across the entire basket of commodities.

Not surprisingly the revenue-cost ratios correspond exactly to the operating ratios. On the other hand, average RPU among US roads (CN and CP excluded due to FX rates) is lowest on the railroad with the best RCR and highest on the railroad with the lowest RCR. This tells me there is still room for rate increases on BNSF and NS before they reach parity with their regional counterparts.

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Big Six Class I Commodity Carload Comps

Quarter ending 6/30/2005

Revenue and income in $millions

Metric	BNSF	CN	CP	CSX	NS	UP
Railroad revs (1)	$ 3,138	$ 1,838	$ 1,105	$ 2,166	$ 2,154	$ 3,344
YOY Pct. Change	16.9%	10.4%	10.0%	8.5%	18.8%	10.4%
Total revenue units	2,465	1,204	675	1,869	1,947	2,391
YOY Pct. Change	4.4%	-2.6%	-2.7%	-1.9%	3.9%	1.0%
Carload revs (2)	$ 1,411	$ 1,334	$ 585	$ 1,272	$ 1,148	$ 1,970
Pct carload	45.0%	72.6%	52.9%	58.7%	53.3%	58.9%
Pct Intermodal	33.2%	17.0%	25.8%	15.2%	19.9%	17.9%
Pct Coal	18.8%	4.4%	18.8%	25.0%	26.8%	18.8%
Mdse Carloads (000)	697	775	299	867	746	1,059
Rev/CL x coal, IM	$ 1,971	$ 1,721	$ 1,957	$ 1,467	$ 1,539	$ 1,860
YOY Pct. Change	14.2%	14.7%	3.6%	7.8%	10.9%	11.8%
RR Avg RPU	$ 1,234	$ 1,527	$ 1,564	$ 1,159	$ 1,106	$ 1,337
YOY Pct. Change	10.6%	13.3%	13.2%	10.6%	14.4%	9.1%
Unit Rev/cost ratio	**1.25**	**1.63**	**1.26**	**1.24**	**1.38**	**1.11**
YOY Pct. Change	3.5%	7.0%	3.4%	6.8%	5.6%	2.3%
RR Operating Income	$ 710	$ 713	$ 270	$ 422	$ 592	$ 468
YOY Pct. Change	39.8%	24.0%	22.5%	43.1%	39.3%	30.4%
RR Operating Ratio	77.4%	61.2%	75.5%	80.5%	72.5%	86.0%
YOY Point change	(3.71)	(4.26)	(2.49)	(4.71)	(4.04)	(2.14)
GTM/gallon diesel fuel	752	845	863	792	769	776
Fuel/gallon (US$)	$ 1.32	$ 1.34	$ 1.53	$ 1.19	$ 1.27	$ 1.67
YOY Pct. Change	36.9%	39.8%	33.5%	19.7%	48.6%	44.0%

Six Months ending 6/30/2005

Revenue and income in $millions

Metric	BNSF	CN	CP	CSX	NS	UP
Railroad revs (1)	$ 6,120	$ 3,544	$ 2,120	$ 4,274	$ 4,115	$ 6,200
YOY Pct. Change	18.3%	14.2%	12.1%	9.1%	17.4%	9.2%
Carload revs (2)	$ 2,756	$ 2,610	$ 1,152	$ 2,518	$ 2,234	$ 3,782
Pct carload	45.0%	73.6%	54.3%	58.9%	54.3%	61.0%
Pct Intermodal	32.6%	16.9%	25.5%	15.4%	20.3%	17.3%
Pct Coal	19.4%	5.0%	17.9%	24.5%	25.4%	20.0%
Mdse Carloads (000)	1,424	1,564	595	249	1,463	2,054
Rev/CL x coal, IM	$ 1,935	$ 1,669	$ 1,936	$ 1,460	$ 1,527	$ 1,841
YOY Pct. Change	13.7%	14.7%	5.7%	7.4%	na	11.3%
RR Avg RPU	$ 1,219	$ 1,482	$ 1,538	$ 1,151	$ 1,079	$ 1,322
YOY Pct. Change	9.5%	13.6%	14.7%	9.6%	na	8.4%
Unit Rev/cost ratio	**1.24**	**1.54**	**1.22**	**1.22**	**1.32**	**1.08**
YOY Pct. Change	4.2%	5.7%	4.6%	8.6%	na	0.3%
RR Operating Income	$ 1,344	$ 1,239	$ 450	$ 773	$ 995	$ 781
YOY Pct. Change	46.4%	27.7%	33.6%	9.1%	29.1%	16.0%
RR Operating Ratio	78.0%	65.0%	78.8%	81.9%	75.8%	88.0%
GTM/gallon diesel fuel	750	829	829	766	738	763
Fuel/gal (local currency)	$ 1.23	$ 1.30	$ 1.92	$ 1.16	$ 1.20	$ 1.56
YOY Pct. Change	33.9%	7.4%	33.0%	18.5%	na	43.1%

(1) CN, CP in $Canadian

(2) Excludes coal, intermodal