THE RAILROAD WEEK IN REVIEW
SEPTEMBER 2, 2005

Katrina's impact on the railroads is yet to be fully assessed. All the Class Is but CP run directly into New Orleans and have been affected in various ways. Hardest hit will undoubtedly be the New Orleans Public Belt -- the tracks run right along the Mississippi River levees and up to the area where Lake Ponchartrain broke through. The photos at www.rblanchard.com/katrina will give you some idea of the railroad damage. (NOPB comes into Gentilly across that truss bridge.)

BNSF uses NOPB to make its eastern connections, though we've seen in the past that the Memphis route works as well. NS reported disruption into Louisiana, Mississippi and Alabama but said it had rerouted traffic wherever it could. NS said in a press release Wed that all operations except in the immediate New Orleans area were returning to normal and that in the next few days they will start repair work on the 5.8-mile long concrete-and-ballast trestle across Lake Pontchartrain. NS' Oliver Yard in New Orleans was under still water as of Wed morning.

In a note to clients Bear Stearns suggests that several of the transports will "cite costs related to rising fuel and Katrina as reasons for 3Q earnings misses/downward revisions." Moreover, the roads with the biggest infrastructure presence (CSX, UP) will take the biggest hits. CSX once again takes the brunt of a storm on its 150-mile ex-L&N Jax-NO line and, given its major UP interchange in NO, may see some added costs from re-routes, though revenues ought to remain stable. CSX expects some Q3 business interruptions and additional costs due to rerouting and rebuilding efforts however for the nonce it appears insurance over the $25 mm SIR will cover the expense.

CN (former IC) grain exports will undoubtedly be off in the Q as will the petroleum and chemicals trade for all. Some analysts suggest that the rails may benefit from the rebuild efforts, supplying chlorine for drinking water (assuming Joe Biden doesn't object) and building materials to the region. Coincidentally, stocks of Caterpillar (CAT), Home Depot (HD) and Lowes (LOW) all saw short-term spikes this week. Amtrak's Crescent will not operate west of Atlanta for the next few days and the Sunset Limited's western leg won't get east of San Antonio. The City of New Orleans will operate between Chicago and Memphis and no further.

Something I hadn't realized before this is that the Port of South Louisiana (POSL) is on its own merit the largest port in the United States by tonnage and the fifth largest in the world. It exports more than 52 million tons a year, of which more than half are agricultural products -- corn, soybeans and so on. A large proportion of U.S. agriculture flows out of the port. Almost as much cargo, nearly 17 million tons, comes in through the port -- including not only crude oil, but chemicals and fertilizers, coal, concrete and so on.

Chop Hardenbergh writes in his *Atlantic Northeast Rails & Ports* newsletter that Maine's Irving Woodlands LLC and Bangor and Aroostook (BAR) successor Montreal Maine & Atlantic (MMA) are building a thriving business. Irving calls dependable rail service vital for volumes that run to 7,000 cars a year for raw pulp (long wood, chips) and lumber. A spokesman for Irving says, according to Chop, "MMA's new energy and commitment to improve service has allowed Irving to grow the business" and invest in railcars and infrastructure.

I'm always a little skeptical when I learn that rail customers add to the fleet, lest more cars on line clutter up an already crowded system. Such appears not to be the case here. Irving bought pulp cars and that implies short-haul business, probably entirely on MMA. But I've known the folks running the MMA a long time and if there were not an almost immediately accretive benefit they wouldn't have allowed it. Thanks, Chop, for the encouraging word.

The march of new products continues. GBX' Greenbrier Management Services (GMS) division is now handling car hire payables processing for the FEC. No small task, this, covering FEC's own fleet of 10,000 units plus another 128,000 owned by third parties. The GMS system is a web-enabled, state-of-the-art proprietary product that processes car hire payables data on a daily basis and lets users stay ahead of car hire exposure. The service was first offered last year and recent additions to the client list include the Minnesota, Dakota & Western Railway and the International Bridge Terminal Railroad.

The FEC product draws upon the many automated processing features that have been built into the system specifically for customers with complex operations. Generally speaking GMS provides scalable, custom solutions to shippers, leasing companies and railroads of all sizes. These include maintenance management, equipment management and accounting services. Maintenance management services include: auditing repair invoices, managing Association of American Railroads repair billing, performing ongoing maintenance of railcars, compiling maintenance data and servicing damaged equipment.

Equipment management services assure effective utilization of equipment through administering deprescription activities and leases, auditing car hire and equipment register files and tracing equipment. Accounting capabilities allow customers to optimize cash flow through processing and auditing car hire payables and receivables, working car hire claims and performing other back office functions, and implementing cash management settlement systems.

Rail stocks have been in a lull for a month now. We kind of expected this as the technical touts had been predicting a late July-early Sep slow-down since April. Now comes a note from Bear Stearns pointing out that the "large cap rail index has pulled back modestly over the past three weeks and is now trading at the mid-range of both recent 3-5 year historical and longer term 20 year historical 11x-15x forward P/E and 6x-8x forward EV/EBITDA ranges."

Setting aside the Kartrina effects on chemicals and grain BSC "expects the trends of strong yields and margin improvement to continue." Outperform rankings go to BNI and NSC "for their ability to combine decent volume growth with strong yields." On the other hand (and my carload bias shows here) a slowdown in low-end consumer spending may well impact IM flows from the Pacific Rim near term whereas the combination of fuel shortages and high prices may make many shippers rethink their use of long-haul trucks.

Morgan Stanley's recent reports are instructive in this regard. They break out railroad commodity revenue groups according to "sensitivity to increased truck capacity" from High (domestic intermodal) to low (coal) and the percent of rail industry revenue represented by each group. Pulp and Paper (STCC 26) is the only carload commodity rated "Somewhat High." All other carload commodities are ranked "Moderate" (STCC 20, 24, 33,, e.g.) or "Low" (STCC 01, 14, 28) and account for 2/3 of total sales.

Put these carload opportunities up against the US Big Four Class Is' performance and carload business outlook as they impact shortlines. The attached scorecard puts Morgan Stanley's forward freight revenue estimates in terms of carload revenues and volumes based on the percent carload business (everything ex-coal and IM) that I calculate for my Quarterly Review. Then I divide carload revenue by my average merch RPU to see where the volume growth will be. And that, Mr. Shortline

Operator, is where you ought to be looking to grow your business assuming you have a choice of Class I connections.

What this says is that carload volumes by the end of 2007 will be up 6% over 2005 on BNSF, 4% on UP and 2% on both NS and CSX. Volumes trump revenues because shortlines by and large are paid a flat fee per car. Moreover, the Class Is couch their shortline shares of total railroad business in carloads not revenue and it typically stays in the 20% range. I've also held the annual merch carload rate increase to 5% as I see the present double-digit increases slackening.

You'll note that the biggest increase may come from the outfit with the smallest percentage of total revenue coming from the carload sector – BNSF. That's because BNSF revenues are increasing faster than anybody else. The Morgan Stanley study suggests that what I call merch carloads (BNSF's industrial, agricultural, automotive and "other consumer" groups) will stay right around 44-45% of total through 2007. The RPU increase also declines from low double-digits in 2005e to low-to mid-single digits by 2007 so the potential 6% gain in shortline cars seems reasonable.

Ah, you say, but there are paper barriers. True, however where the incumbent carrier elects not to participate in the route or cannot participate in a rate that works, you have options. See "Routing Alternatives and Access" on page 3 of the Railroad Industry Agreement. Fact of the matter is that business that *wants* to move by rail *will* move by rail.

ASLRRA President Rich Timmons' closing words at last week's UP shortline meeting are worth repeating (slides are at www.aslrra.org if you ant the full show). In a series of not-so-rhetorical questions he charged the group to think about where they are headed and how to get there. Timmons sees a greater need for shortlines to work *as one* to address the same priorities, focus on common areas of concern, eliminate manual procedures and build operating plans that avoid excess car handling.

His close: "As a team have we examined every conceivable factor in the service equation and polished it again – car plans, trip plans, ISA's, routing, switching, blocking, reporting, technology, support, commo, customer focus and feedback, crews, power, cars, coordination, discipline and accountability." Sound like the old artillery motto to me -- shoot, move and communicate. Shoot as in know your operating, financial and commercial targets, move as in let no car stand beyond its time, communicate as in keep everybody informed. Thanks, Rich.

This just in: BNSF will contribute $1 million to aid victims of Hurricane Katrina and has made an offer to the governors of Louisiana, Mississippi and Alabama to provide railroad transportation in support of hurricane relief and recovery efforts. Please read the full announcement at www.bnsf.com .

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Class I Carload Outlook

CY 2005-2007

BNSF	**2005e**	**2006e**	**2007e**	**3-yr delta**
Total Frt Rev (mm)	$ 12,359	$ 13,486	$ 14,425	16.7%
Pct CL*	45%	45%	45%	
CL revs (mm)	$ 5,562	$ 6,069	$ 6,491	
2Q04 Mdse RPU**	$ 1,935	$ 2,032	$ 2,133	
Esl CL vols (000)	2,874	2,987	3,043	
Pct SL	20%	20%	20%	
SL vols (000)	575	597	609	5.9%
CSX				
CSXT+CSXI Revs (mm)	$ 8,737	$ 9,362	$ 9,866	12.9%
Pct CL*	59%	59%	59%	
CL revs (mm)	$ 5,146	$ 5,514	$ 5,811	
2Q04 Mdse RPU**	$ 1,460	$ 1,533	$ 1,610	
Esl CL vols (000)	3,525	3,597	3,610	
Pct SL	20%	20%	20%	
SL vols (000)	705	719	722	2.4%
NS				
Total Frt Rev (mm)	$ 8,347	$ 8,958	$ 9,413	12.8%
Pct CL*	54%	54%	54%	
CL revs (mm)	$ 4,532	$ 4,864	$ 5,111	
2Q04 Mdse RPU**	$ 1,527	$ 1,603	$ 1,684	
Esl CL vols (000)	2,968	3,034	3,036	
Pct SL	20%	20%	20%	
SL vols (000)	594	607	607	2.3%
UP				
Total Frt Rev (mm)	$ 13,451	$ 14,543	$ 15,379	14.3%
Pct CL*	61%	61%	61%	
CL revs (mm)	$ 8,205	$ 8,871	$ 9,381	
2Q04 Mdse RPU**	$ 1,841	$ 1,933	$ 2,030	
Esl CL vols (000)	4,457	4,589	4,622	
Pct SL	20%	20%	20%	
SL vols (000)	891	918	924	3.7%

*1H05

** increase 5% pr year

Source: Revs from Morgan Stanley, carload data from company reports