THE RAILROAD WEEK IN REVIEW
JANUARY 27, 2006

"*Our operations team is gaining traction in executing the ONE Plan, even while re-constructing our storm-damaged infrastructure on the Gulf Coast." – Mike Ward, CSX*

Five of The Big Six Class Is have reported earnings for the quarter and full year and it drives home the point that we're in a growth industry. Double-digit earnings gains across the board, comping very well with some of the tech stars, in fact. Most improved was CSX before accounting adjustments, up 46% and 115% for the quarter and full year respectively. It was clear during the call that the Gang of Three – CEO Mike Ward, COO Tony Ingram and Chief Commercial Officer Clarence Gooden are getting the traction and leadership they need to turn around the franchise. Details below.

Every railroad's earnings success started above the line with healthy revenue gains and middling expense increases that in turn created still larger ops income gains, from the high teens in the west to the neighborhood of 30 in the east. A common theme throughout the calls was gains in successive quarters, a good sign for shippers, shortlines, shippers and investors all.

Some caveats are in order before we begin, however. In all cases the WIR operating ratio is the operating expense divided by total operating revenue (freight+other). Canadian roads are shown in Canadian dollars as reported in the railroad's data packets. CN includes results for Great Lakes Transp and BC rail for only a partial year in 2004. CSX data is for the full calendar year; their pro forma 52-week schedules may have value internally but WIR aims to compare the lot on the same measures and the full year is the rule.

This quarter I'm going to try something else: Comparing the Class Is on performance and not getting bogged down in the carload commodity details and other below-the line minutia. The two pages of charts at the end show you where the growth is and where to put your efforts to make more money this year if you're a shortline, where to get the best transportation value if you're a shipper, and who's got the money for capex if you're a supplier.

You'll find a few counter-intuitive surprises. For example, who's the low-cost operator in the east in terms of operating expense per GTM in cents? Note that it isn't the same guy with the lowest OR, yet the ops exp/GTM winner's load/empty ratio is better and they get more GMs per gallon of fuel. But see how the OR leader increased revenue units where the low-cost per GTM leader was down, handled more revenue units, and is within $90 mm of its larger competitor in annual revenues.

In the west BNSF is just $71 mm shy of UP's 4Q05 revenue number, handled more revenue units and was able to charge 10% more per merch carload than its competitor. BNSF also beat out UP in revenue units for the full year by 480,000 units and increased ops expense at just 1.7 times the rate of volume increase whereas at UP it was 11.5 times. The specifics…

Burlington Northern Santa Fe blew out the lights with another superb quarter and year with revenues, ops income and eps all up double digits. There's just one word to explain this BNSF phenomenon – execution! Commodity group revenues were up double digits for the Q and year in every category but coal for 19% revenue increases for the Q and year on 3% and 5% more revenue units for the Q and year respectively. Industrial products and ag product volumes were essentially flat, though GTMs rose 3% on a shift to longer-haul products.

Industrial products posted record quarterly revenues with double-digit gains in petroleum, construction and building products. Chems rose a mere (!) 7% yoy. Ag products also posted record revenues with double-digit gains in every commodity but soybeans. Gulf exports were particularly good, rising 64% yoy.

Out on the railroad, unit miles, GTMs and units per train all hit record levels. On the other hand, car miles per day continued a downward drift. Part of this is due to slow turns in the singe-car merch business, and the AIM strategy that Industrial Group VP Dave Garin presented at last October's shortline meeting (Slide 55 et seq) is part of the fix.

All of which has got to be very good news for my friends out there in shortline land. Remember that BNSF is the only Class I where the guy in charge of shortlines – Pete Rickershauser – has a direct line to the CEO, Matt Rose. We already know BNSF wants to put more shortlines in the gathering and distribution business.

Meanwhile, BNSF announced its 2006 Capital Plan of $2.4 bn, the fifth consecutive year of capex expansion. The figure includes $1.4 bn for infrastructure ($400 mm earmarked for capacity expansion) and $550 mm for 310 new locomotives. Said Matt Rose, "We are confident our Return on Invested Capital (ROIC) will continue to improve. For 2005, ROIC was 10.1%, up from 7.9% on 2004 and 6.6% in 2003." The press release at www.bnsf.com tells what, where and when.

CSX checked in with record results across the board – the 8th consecutive quarter of revenue and operating income growth on record revenues. But the percentage gains weren't all that robust: 4Q05 revenue was a record 2.22 bn but 4Q04 was 2.18, both of which round to $2.2 bn, albeit up 1.8%. Revenue units were off in almost every category for the quarter and year, though the loss of a major short-haul phosphate customer in Florida hurt that group and the Katrina devastation took its toll on chems. Forest products, another CSX biggie, saw declines in both paper and lumber-related loads.

That said, I got the distinct impression that the One Plan is truly beginning to take hold as CSX rang up double-digit RPU increases in every merch carload category as well as coal. And though intermodal fell a bit short with a 7% gain the system average RPU increased 11%. In his remarks Chief Commercial Officer Clarence Gooden said that the economic outlook for CSX is encouraging with continued expansion in domestic manufacturing and off-shore trade.

CSX' merch carload business is 59% of the total pie, slightly ahead of UP and second only to CN. RPU increased 12% yoy in the quarter, taking the top spot among all commodity groups. All but emerging markets and auto took double-digit increases indicating a service product worthy of the gains and something shortlines should ask about when they descend on Jax for their annual gathering in Feb. It's good to see CSX taking a real hard look at commodity yields because it will force better network management, and that's the whole purpose of the One Plan.

During the call COO Tony Ingram remarked that better leadership practices, the focus on safety and the One Plan roll-out are being felt in the field. IMHO, the 81.3 OR for the quarter shows it's working, down 4.3 points in a year. Wow!

Canadian National brought up the markers for Tuesday, posting revenue gains of 8.5% for the Q and 10.6% for the year while revenue units slipped 3.0% and gained 5.7% respectively. As expected, the OR came down another 3.2 points to 61.8 for the quarter while the year came in it 63.8, a remarkable feat for an outfit where the merch carload trade represents nearly three-quarters of the revenue base every period.

Here again, the story is execution. CN runs to plan because it's the best way to have the assets where they're supposed to be. CN continues to set Class I records for the lowest OR by running the railroad the same way every day. In this regard, traffic mix works very much in CN's favor. Merchandise carloads (chems, forest products, metals, grains and ferts, automotive) account for 73% of CN revenue, a higher portion than any of the Big Six Class Is everything but coal and intermodal. With a carload contribution of this magnitude the only way CN can keep fluid is to schedule everything. It's the IC redux and on steroids.

Thanks to what CEO Hunter Harrison calls "Precision Railroading" CN was able to earn double-digit RPU gains in its merch carload group led by metals/minerals and forest products, both up 15%. These two account for 53% of all merch carloads and are well-represented on CN's 66 shortlines. These entrepreneurs would do well to mirror CN's penchant for seven-day a week operation and encourage their customers to do likewise. In fact, CN has made good on its offer to increase shortlines' allowances to offset the extra expense of seven-day operation.

Finally, turning to the operational efficiency chart, note that CN pulls more MGT per gallon of fuel and ranks second to NS in MGT per employee and revenue per RTM (I've left CN in $C because the RR runs in Canadian dollars). Revenue is *still* the biggest driver of profitability and it takes service quality in the eyes of the buyer to earn the right to charge premium prices.

Norfolk Southern once again knocked the cover off the ball with a 29% operating income gain in the quarter. Revenues increased 16%, ops expense up less than 12% while revenue units were up just 3%. Once again, it was a pricing story. CEO Wick Moorman called 2005 "an extraordinary year" thanks largely to "the higher value of the NS transportation product. He added, "Lowering the OR every quarter is a key NS focus as we seek to add resiliency and capacity to the network."

Vice Chair and Chief Commercial Officer Ike Prillaman noted that 50% of NS' book of business is up for repricing in 2006. That would seem to imply continued top-line strength across the board, except for auto where Ford was off 11% and GM was down 9% yoy in 2005. Shortlines may be affected because, as I see it, they are more likely to be in the parts business feeding the Big Three. The so-called "transplants" – Honda, Toyota, etc. – tend to source closer in to the plants so probably never did figure that much in NS auto parts traffic. Their business was up 13% in 2005, partially off-setting the US makers' declines.

This was David Goode's swan-song as Chairman as he retires Feb 1 and hands the reins to Wick. The super results for the Q and year are a fitting conclusion to David's 14-year tenure as Chairman. He guided NS through years of consecutive quarterly gains leading up to the Conrail transaction and, though NS lost a bit of momentum in that process, it looks like it's back and the railroad is running better than ever. NS has the tools and talent for continued excellence in execution and thanks are due David for setting up his successor so well.

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Disclosure: Blanchard does not and will not own stock in the companies covered in Week in Review though he does and seeks to do project work for these companies.

Big Six Class I Commodity Carload Comps
Quarter ending 12/31/2005
Revenue and income in $millions

Metric	BNSF	CN	CSX	NS	UP*
Railroad revs (1)	$ 3,550	$ 1,886	$ 2,219	$ 2,257	$ 3,621
YOY Pct. Change	19.2%	8.6%	1.8%	15.8%	12.6%
Revenue Units (000)	2,581	1,208	1,818	1,983	2,419
YOY Pct. Change	3.2%	-3.0%	-8.3%	2.9%	1.0%
Carload revs (2)	$ 1,572	$ 1,383	$ 1,305	$ 1,214	$ 2,132
Pct carload	44.3%	73.3%	58.8%	53.8%	58.9%
Pct Intermodal	34.8%	18.0%	16.5%	23.0%	19.2%
Pct Coal	17.9%	4.1%	23.5%	23.2%	17.4%
Mdse Carloads (000)	719	785	818	720	1,021
YOY Pct. Change	-1.0%	-4.0%	-10.5%	-0.3%	-1.8%
Rev/CL x coal, IM	$ 2,208	$ 1,762	$ 1,595	$ 1,686	$ 2,088
Operating Expense	$ 2,750	$ 1,488	$ 1,804	$ 1,663	$ 3,088
YOY Pct. Change	19.0%	3.3%	-3.3%	11.8%	11.6%
Ops exp chg/Vol chg	5.95	(1.10)	0.39	4.07	11.06
RR Operating Income	$ 800	$ 720	$ 415	$ 594	$ 533
YOY Pct. Change	19.8%	18.6%	31.7%	28.6%	161.3%
RR Operating Ratio	77.5%	61.8%	81.3%	73.7%	85.3%
YOY Point change	(0.10)	(3.21)	(4.25)	(2.61)	(0.70)

*Before $247 mm asbestos charge taken in 4Q04

Full Year Ending 12/31/2005
Revenue and income in $millions

Metric	BNSF	CN	CSX	NS	UP
Railroad revs (1)	$ 12,987	$ 7,240	$ 8,618	$ 8,527	$ 13,578
YOY Pct. Change	18.6%	10.6%	7.2%	16.6%	11.2%
Revenue Units	10,024	4,841	7,350	7,786	9,544
YOY Pct. Change	5.1%	5.7%	-2.4%	4.3%	0.9%
Carload revs (2)	$ 5,791	$ 5,304	$ 5,072	$ 4,586	$ 7,560
Pct carload	44.6%	73.3%	58.9%	53.8%	55.7%
Pct Intermodal	33.6%	17.5%	15.8%	21.4%	20.8%
Pct Coal	18.8%	4.6%	24.1%	24.8%	19.0%
Mdse Carloads (000)	2,855	3,145	3,376	2,896	4,102
YOY Pct. Change	1.9%	6.7%	-3.4%	0.5%	-1.4%
Rev/CL x coal, IM	$ 2,028	$ 1,686	$ 1,502	$ 1,584	$ 1,843
Operating Expense	$ 10,065	$ 4,616	$ 7,069	$ 6,410	$ 11,783
YOY Pct. Change	8.7%	5.4%	1.3%	14.3%	10.4%
Ops exp chg/Vol chg	1.70	0.94	(0.56)	3.31	11.48
RR Operating Income	$ 2,922	$ 2,624	$ 1,549	$ 2,117	$ 1,795
YOY Pct. Change	73.3%	21.0%	7.2%	24.4%	16.4%
RR Operating Ratio	77.5%	**63.8%**	82.0%	**75.2%**	86.8%

(1) CN, CP in $Canadian
(2) Excludes coal, intermodal

Source: Company financials
Week in Review for Jan 27, 2005
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Big Six Class I Operating Efficiency

Full Year Ending 12/31/2005

Revenue and income in $millions

Metric	BNSF	CN	CSX	NS	UP*
Railroad revs (1)	$ 12,987	$ 7,240	$ 8,618	$ 8,527	$ 13,578
RR Operating Expense	$ 10,065	$ 4,616	$ 7,069	$ 6,410	$ 10,673
RR Operating Income	$ 2,922	$ 2,624	$ 1,549	$ 2,117	$ 1,795
GTM in millions	1,061,108	342,894	463,200	375,800	1,043,900
RTM in millions	596,575	179,701	246,800	198,300	548,800
Fuel Consumed (mm)	1,402	403	596	513	1,353
Route Miles	32,154	19,221	21,537	21,300	32,615
Employees	39,254	22,246	na	29,851	49,747

Measures	**BNSF**	**CN**	**CSX**	**NS**	**UP**
Operating Ratio	77.5	63.8	82.0	75.2	78.6
Ops exp/MGTM	$ 0.9485	$ 1.3462	$ 1.5261	$ 1.7057	$ 1.0224
Ops exp/RGTM	$ 1.6871	$ 2.5687	$ 2.8643	$ 3.2325	$ 1.9448
Rev/MRTM	$ 2.1769	$ 4.0289	$ 3.4919	$ 4.3001	$ 2.4741
MRTM/MGTM	0.56	0.52	0.53	0.53	0.53
MGTMs/gallon	756.85	850.85	777.83	731.98	771.54
MGTMs/emp	27.03	15.41	na	12.59	20.98
MGTMs/route mile	33.00	17.84	21.51	17.64	32.01

CN, CP in $C

Revene line includes freight revs plus other ops rev.

CN includes partial year for GLT, BC Rail

* UP before asbestos charge in 4Q04

Source: Company financials

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