THE RAILROAD WEEK IN REVIEW

MARCH 3, 2006

"The momentum we experienced during 2005 is being carried forward in 2006." – Timothy R Wallace, CEO, Trinity Industries

Feedback from the CSX Short Line Workshop continues to flow in. At the New Jersey Short Line Association meeting this week the consensus was it was the best ever, that CSX is doing well in terms of building carload volumes with its shortlines, and that the CSX capital program will have quantifiable benefits for shortlines.

The only note of concern that I've received has to do with car supply. My contact writes that some people returning from the Jax workshop seem to think that CSX will "require the shortlines to supply cars with no additional revenue split." IMHO the best thing to do with something like this is to go to the source, in this case, Steve Potter, AVP Car Management at CSX.

What's really going on, says Steve, is that CSX, along with the other Class Is, is moving toward a national pool of "universal" cars. Many car types have not been replaced as they aged and as a result the Class Is face what Steve calls a "bow wave" of capital spending on new cars. During the January earnings call CSX said that of the $1.42 mm 2006 capital budget 15% -- $233 mm – is going to equipment. And naturally they want to put the money where the returns will be the best.

The boxcar fleet is a particular challenge. Over time it has morphed into a national fleet of a literal dog's breakfast of car types: 50-foot, 60-foot, Plate C, Plate F, 100-ton, 70-ton, 286 capable and not, RBL, plug doors, sliding doors, cushion cars and every combination thereof. The more specialized the car, this higher the cost and the smaller the universe of users for that car. Conversely, the best way to increase use of a particular car is to match it to as many customers' needs as possible.

CSX led the charge to the standard box car some years ago when it decried the specialization practice among certain paper loaders. They told customers, if you want car type X then build it and own it and put on car initials ending in "X." That's essentially what my contact heard. And yes, it could have a negative impact on customers whose access routes can only take Plate C cars or are limited to 263s.

But asset management is the name of the game today and it's behind the improved financial performance of all the railroads. The so-called "national boxcar" fleet is in its infancy, but the benefits are there. Whereas the typical box car spends half its life empty, cars in the national pool are averaging less than half a mile empty for every mile loaded, an enviable record. Part of the impetus for this was the national fleet of auto rack cars averaging 0.5:1.0 empty:loaded miles.

The bottom line is that shortlines and shippers may be asked to supply their own cars when the rate/usage factor does not meet the CSX hurdle rate for investing in new equipment. Which is entirely reasonable. Any questions, call Steve Potter at (904) 359-3205 about specific concerns. Or you can e-mail him at steve_potter@csx.com and tell him I sent you.

Elsewhere, I erred in my earlier comment that CSX' Oscar Munoz is the only CFO to have addressed a shortline work shop. CN's Claude Mongeau did the honors last May at Montreal and CP's Mike Waites spoke to the Sep 2005 shortline assembly in Calgary. Let me restate: Oscar Munoz is the only CFO of a *US* Class I railroad to address the host road's annual shortline meeting. Rave Reviews all.

The Dow Jones Transportation Index hit another high this week and the rails are certainly doing well. Dan Fitzpatrick, technical analysis columnist for RealMoney.com, writes (2/16) that the "sleepy" transportation sector has been racking up gains and the rails "are the most attractive." As regular WIR readers are aware, I use a fair amount of technical analysis in my own trading and I rely on it to give WIR readers additional insights they might not find in the normal course of a day's reading.

BNSF (BNI) broke above $80 two weeks ago after a sharp run-up in late Jan. The patter for BNI over the past year has been to run up, consolidate, and run up again. The present lull looks like the previous consolidation periods and Fitzpatrick suggests "this may be the beginning of the next leg up." Norfolk Southern (NSC) looks very much the same, closing today at $52.12.

CSX' price gains have been a steady climb northward, with fewer rest stops along the way than we've seen with either BNI or NSC. However the double peaks reached at the beginning and end of Feb suggest it may be time for a pause – Fitzpatrick recommends a stop at around $52 to be sure. I might set a trailing stop with an alert set at 3% off the opening price. It's been climbing the top edge of a 20-day Bollinger band and that's good enough for me. And it's amazing how much the Union Pacific (UNP) mirrors CSX. Same rules.

Canadian National enjoyed a nice northward run Jul-Dec, then stalled around $80 for a few weeks before tacking on another $10. Now it's hovering at $90 more or less. Fitzpatrick suggests that it may be ready to break out and a pull-back to $85 would be a low-risk entry point. CP was not mentioned in the RealMoney.com article but I'll give it my two cents.

Looking at the 250-day chart you can see CP stuck at $35 a year ago, then heading nicely up to the $43 range in October where it stayed until late Jan 2006 when it gapped up to $47 and again to $52, hitting a new high this week. CP, too, is climbing the top side of the Bollinger band. Zooming in to the 20-day chart one might detect some support around $51 and no signs of resistance.

Proof of Steve Potter's "bow wave" is the status of car orders, back logs and the financial results of the four publicly-traded car builders: American Rail Car (ARII), the Jan 20, 2006 Carl Ichan IPO; FreightCar America, the former Johnstown Car (RAIL); Greenbrier (GBX) and the daddy of them all, Trinity (TRN). Order books are at a three-year high (Table 1) and the outlook is for more of the same. For example, sources say TRN is "sold out" for 2006.

The tea leaves line up nicely. First, the ARII *Prospectus* notes that "orders for new railcars are expected to average 59,400 railcars per year from 2005 through 2010." Second, stock prices indicate that investors agree as every one of these four suppliers has seen their share price hit new 52-week highs thus far in 2006.

Investors may want to look at the four in terms of revenues, operating income, operating margin, debt and cash flow (Table 2). Charts of the four are instructive as to price trends and here TRN and RAIL stand out. The current uptrend began in April 2005 for both TRN and RAIL. Though GBX got a head start doubling to $32 from $16 in 2H04, it has only just now begun to break out of that range to the up side. ACII has only been traded for a matter of weeks and appears to have timed its entrance to the market rather well.

RAIL is a three-bagger from its June 2005 breakout from $20 and rates a "B" from Schwab based on financial fundamentals and momentum. Moreover Zacks cites RAIL's "highest ROE currently listed under this Profit Track. The company's price to sales ratio is .95. RAIL recently delivered fourth-quarter earnings of $1.38 per share, jumping ahead of the consensus estimate by nearly 27%. The company commented that its strong earnings performance reflects the ability of its management team to increase its production levels while improving productivity."

RAIL's emphasis is on OT hoppers for coal (see www.johnstownamerica.com for more detail). Covered hoppers are TRN' s bread and butter while ACII (*Prospectus* again) wants to build covered hoppers and tank cars. Only GBX is positioning itself as a box car provider, and if the industry does in fact move to a "vanilla" Plate F 286-compatible car GBX will be the probable winner.

How many cars does a shortline move in a month or year? RMI's RailConnect Index supplies shortline "carloads" (in actuality, revenue units) for the Current Week matching the AAR methodology plus a YTD number. RMI reports YTD units for 2005 Week 52 at 5.1 mm units and 4.6 mm units for Week 47, implying 500,000 units for December. Railinc posts total monthly "carloads originated" in Railway Age – no YTD data – at 371,000 units for December 2006. To find out why the spread, I wrote RMI's Paul Pascutti and Railinc's Dick Flynn.

Flynn first: "The Railinc Short Line Index shows loaded shipments originating on short lines and is based on all Class II and III railroads reporting to TRAIN II (484 names in December). Counts in The Railinc Index represent all trips that ended in the specific month based on information we extract from the event reports we receive and build the corresponding trips. We then match the waybills we receive to these trips.

"The trip building process allows us to fill in any gaps we might have resulting from events for a specific car not having been reported by a railroad. It also allows us to count individual shipments based on originations to avoid the double or multiple counting that can result from basing the count on handlings.

"While we believe this approach provides a more accurate count and indication of economic activity, it is still possible to miss some traffic if it is not reported by any railroad. This could happen, say for local traffic on a non-reporting road."

The RMI method, according to Pascutti, counts "all carloads handled by shortlines including originating, terminating, bridge and local. Because our Index is intended to be a true measure of shortline traffic, we must include all traffic types. Obviously some shortlines handle a large percentage of terminating and bridge traffic.

"Keep in mind we only count 'same store' carloads. So we must have at least 53 weeks of data before we include a railroad's data in the Index. Each week, a new short line might have satisfied the 53 week requirement, thereby increasing the overall carloads somewhat. During the time period in question we added five shortlines to the Index."

Thus it appears the difference is between "originated" (Railinc) and "handled" (RMI). That may be the reason that the RMI number is 1/3 bigger than Railinc's. Personally, if that's the case I'll go with the latter. Most shortline-originated loads are also loads for others as well and get counted by the others in their financials. Thanks, guys.

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Table 1. Car Orders

Year	Orders	Deliveries	Backlog
2005	80,703	68,567	12,136
2004	70,626	46,871	23,755
2003	47,249	32,184	15,065

Source: Railway Age

Table 2. Car Builder Comps

FY 2005 Car Builder Results

	ARII	GBX	RAIL	TRN
Revenues	$ 542.9	$ 1,024.2	$ 927.2	$ 2,902.0
Ops Income	$ 14.3	$ 50.0	$ 78.1	$ 170.4
Ops Margin	2.6%	4.9%	8.4%	5.9%
Net Income	$ (1.1)	$ 28.8	$ 45.4	$ 83
Net Margin	-0.2%	2.8%	4.9%	2.9%
EPS (ttm)	$ (0.95)	$ 1.92	$ 4.04	$ 1.69
Recent Price	$ 33.32	$ 36.84	$ 64.56	$ 51.60
PE (ttm)	(35.07)	19.19	15.98	30.53
Debt	$ 58.8	$ 294.8	$ 0.2	$ 689
Debt/Equify	5.5%	159.7%	0.2%	58.7%
Ops Cash Flow	$ 9.3	$ 8.9	$ 65.8	$ 170.4
OCF as % revs	1.7%	0.9%	7.1%	5.9%

Source: Company Reports