THE RAILROAD WEEK IN REVIEW

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"The company's primary interests with regard to any potential line moves are the continued ability to meet vital customer needs and to be made whole for costs related to the moves." – CSX statement regarding Mississippi's desire to to relocate the railroad.

Six hundred short lines today will, in ten years or less, whittle down to half that number. How do I get 600 if the ASLRRA reports 400+ members and RMI has 300+ subscribers? By taking all the short line names listed on the Big Six Class I maps and weeding out the duplicates. My survival metric is 4,000 revenue units a year based on $250 average revenue per load and the fact that it takes about a $million in revenue to open the doors of any shortline, regardless of size.

Railroads that have a *raison d'être* and have the economic strength to stand alone will continue to do so. Weaker lines will either be absorbed as part of a larger structure where weaknesses can be offset by the economies of scale brought by the buyer or go away. The trend is already at work. North American RailNet's five struggling lines went to three new operators that already had a presence in the serving areas. Georgia Pacific and Alcoa sold their lines to GWR and RRA respectively. The Caney Fork & Western, a light-density stand-alone in Eastern Tennessee, went to Greg Cundiff, who specializes in smaller lines and who has enough of them to make a fit.

This is not about new shortlines created by Class I spin-offs. It's about existing shortlines changing hands or going out of business and there are two types of line in play: existing lines and corporate spin-offs. There are still several forest products companies with their own railroads. I have reason to believe one is in play even now and the others are sure to fall eventually. Then there are the steel roads and – at least in the case of the larger ones – I can see certain Class Is being interested.

The ASLRRA has a vital role to play in this arena. Success in any business is measured by what's in the till at the end of the day and that in turn depends mostly on what goes into the till during the day. The shortlines that survive will do so by adding value to the Unique Selling Proposition and will get paid for it. Thus it's heartening to see the commercial side of shortlines getting a bigger play at this month's Annual Meeting in Orlando. One hopes they will do more by and by.

First Quarter traffic volume on North American Class Is increased 2.7% yoy as the rate of increase accelerated in the last four weeks to 4.5% in Week 13 (April 1). Once again intermodal was the clear leader, up 5.6% while carload (less coal) was essentially flat. Of particular interest to shortlines, grain and grain mill products, aggregates, forest products ex-paper, metals and scrap all increased a point or better. BNSF and NS took the honors in commodity carload (coal included) gains, 3.6% and 2.4% respectively. All others lost ground.

Railroad share prices moved mostly higher on Wednesday following several analyst reports anticipating strong first-quarter earnings results. UBS' Rick Paterson cited "unprecedented power" driven by the strength of the economy, high demand for long-haul shipping, and problems in the trucking sector. Jordan Alliger of Deutche Bank increased his forward estimates based on "mild winter weather combined with pricing that is stronger than initially anticipated."

Stifel Nicolaus analyst John Larkin said CSX was most likely of all rails to beat Wall Street estimates for the first quarter, adding that Wall Street is "starting to give company credit for the turn-around that is underway." CSX is the only railroad Larkin has rated a Buy. The trend for the last three months has been generally up, though RRA and KSU are still treading water.

My market basket of companies that use a lot of rail transportation is generally up as well. Agriculture (ADM), Coal (BTU), Steel (X), and materials (MLM) have been the best performers while forest products (IP, though WY did better than its peers in this space) and automotive (Toyota) did just OK. It's also encouraging (from a rail marketing viewpoint) to note that the ETFs representing these industries have positive three-month trends. What we're seeing is a "rotation" out of healthcare, tech, financial and consumer stocks into resource stocks from aggregates to corn to steel. And that bodes well for the good guys.

Pride, Leadership, Organization. You can go into any organization anywhere and tell immediately how well customers are being served by how well the organization takes care of its people and its infrastructure. Loyalty is a two-way street and if the operating staff does not feel it has the backing of its managers, taking pride in a job well done falls by the wayside.

There is no better test of leadership than combat. Those of us who've experienced that environment know how quickly priorities get sorted out. And though the civilian workforce may not see combat, the aftermath of Katrina created a combat zone in many ways. Pride, leadership and organization on the ground were sorely lacking in the news stories we read and saw. But these attributes were clearly in evidence on the railroads.

I remarked last week about the DVD included with the NS *2005 Annual Report*. Now that I've seen it – several times, I might add – I have to say it ought to be required viewing for every shortline manager and employee. "Following the storm," says the narrator, "New Orleans looked like a ghost town." Then starts CEO Wick Moorman's voice-over: "I saw only three places with any activity. First, there were a few helicopters and boats. Second there were some cranes working on a levee. Then there was the army of Norfolk Southern people and machinery working to restore the railroad."

The hurricane hit the morning of August 29. NS had ordered evacuation on Friday; everybody and everything was gone in 24 hours. The "army" was comprised of more than 150 people working out of a base camp that had to be totally self-contained, just like any military outpost in a combat zone. Fast forward to Sep 13 when NS ran its first revenue freight train having put the track bacon on the bridge and after rebuilding miles of mainline railroad. And they did it all without a single injury. You can thank pride, leadership and organization for that.

On the flip side of the coin, CSX had to rebuild its entire Gulf Coast line across Mississippi at a cost of $300 mm and now the local government (backed by its Senators in Washington) want to seize the line to make way for redeveloping the lost coastline communities and forcing CSX to relocate several miles inland. Conservative estimates put the cost at $700 mm in taxpayer's money.

Happily, Porkbuster Watchdog Senator Tom Coburn (R-OK) has picked up on this outrage. The *Washington Post* quotes Coburn as saying, "It's ludicrous." In response, according to the *Post*, Sen. Trent Lott (R-MS) said, "I'll just say this about the pork busters. I'm getting damn sick and tired of hearing from them. They've been nothing but trouble since Katrina. We in Mississippi have not asked for any more than we deserve." Maybe so, but taking private property for private investment comes under Kelo, not Katrina.

Kansas City Southern and Norfolk Southern have cleared the last regulatory hurdle for the proposed KCS/NS joint venture transaction involving KCS' Meridian Speedway. The STB gave its blessing effective a minute after midnight Sunday or 0001 hours Monday. This transaction goes back to last Dec when KCS and NS announced an agreement to form a joint venture to increase capacity and improve service on KCS' Meridian Speedway between Meridian, Miss., and Shreveport, La.

This rail line is an important direct rail connection moving rail traffic between the southeast and southwest U.S. The joint venture involves the contribution of KCS' 320-mile line between Meridian and Shreveport to the joint venture company and an NS investment of $300 million in cash, substantially all of which will be used for capital improvements to increase capacity, adding yet another transcontinental rail corridor. The Market reaction was muted as KSU gained half a point to $54.06 and NS lost half a point to $54.13.

Paper Barriers – a final shot. A reader writes, "I think your ongoing debate on paper barriers leaves one major player un-addressed. You've discussed the class I, short line, and shipper perspectives, but you've completely cut labor out of the debate. If you include the labor protection issue in the debate I think the Class Is' imposition of paper barriers is even more objectionable because after all isn't that what the selling of branch lines to create short lines is really all about? To say the Class I is perpetually entitled to the traffic while being allowed to shed labor protection on the line is to have their cake and eat it too."

He adds, "Those you quote who should be knowledgeable on this subject seem to be arguing that Class Is would favor abandonment and liquidation over line sales without paper barriers. The economist in me (granted I'm a novice at best) finds this argument to be very, very suspect. I'm sure there are exceptions but for most situations I think Class Is would be hard-pressed to prove that they'd be better off financially with less up-front money (if purchase price is higher than liquidation value) *and* no traffic going forward vs. competing for traffic going forward.

"It's all very short-sighted voodoo economics. It's especially faulty logic when you consider the Class Is are all selling branch lines and they are all imposing paper barriers. If they looked at the big picture, from a strategic vantage point well above the individual line sale perspective, they'd see more traffic for everybody if they eliminated paper barriers.

"At the very least the STB could encourage the Class Is to look for situations where dropping the paper barrier restrictions on a reciprocal basis is in everybody's best interest. After all it's not unlike reciprocal switching isn't it? And despite the Class Is' dislike of reciprocal switching it is a proven mechanism for helping the industry grow its traffic base."

All these things are valid arguments, but the fact remains that a deal once struck should stay struck. One friend who is very much of the view expressed by the writer above, when pressed, conceded that this is the case. However, the rules are still unevenly applied among the Class Is and even within the same Class I, a point I make in my *Railway Age* article, "Complex Chemistry" (March 2006, page 27). Get all of the players on the same page and the paper barrier problem will largely go away.

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