

The Blanchard Company
www.rblanchard.com

The Railroad Week in Review 7/14/2001

Copyright © 2001 All Rights Reserved

Quick! How much to send a shipper-controlled trailer or container San Bernardino to New Orleans on BNSF? The answer is at <http://bnsf.railprices.com/rates.asp> and prices range from \$727 to \$847 depending on whether it's a trailer or container and you want 7-day availability or weekday availability. This is another addition to the toolbox BNSF has assembled to make good on its drive to make it Easy to Do Business.

We'll see exactly how well they're all doing when Earnings Week begins in earnest July 24 with BNSF and CN. The BNSF consensus is around 50 cents, a dime off from 2Q00, thanks in part to flooding (WIR 5/26/2001), fuel, and a soft business climate. But these shall pass.

The reporters crossing this desk give BNSF high marks for its detailed plan to reduce debt and increase free cash flow. Looking out 12 months, it's trading at a modest 10x earnings through 2Q03. Given what I continue to see in terms of walking the talk, I think BNSF is emerging as the clear standard setter in terms of creating shareholder value by creating customer value.

CSX said in a conference call that it expects 51 cents per share for 2Q01 vs a consensus 36 cents per share and 23 cents last year. But wait! There's more. The last para of the press release notes, "In this year's second quarter, other income including real estate activities will be approximately \$34 million versus \$24 million a year ago."

Rail and Intermodal operating income for 2Q01 is expected to come in at \$242 mm vs \$158 mm yoy. Says Morgan Stanley's Jim Valentine, "A clean number is closer to 36 cents" citing the real estate sales and what he thinks is a below normal tax rate.

Another indicator that all is not well is the dividend cut, to a dime from 30 cents a quarter. Recall NS cut its dividend earlier, too, partly because -- though never said publicly -- quarterly eps had been lagging the 20-cent quarterly div for some time. So here is CSX with a 30-cent div requirement for the Q and only 36 cents "clean" earnings to cover. CSX is thus to be congratulated for doing the honorable but painful thing of cutting the div back to a third of earnings.

To be sure, it's nice to see even 2Q01's 36 cents over last year's two bits or so. But let's go back pre-Conrail follies and do some comparing. CSX earned \$4 a share in 1996 vs the 2001 consensus for \$1.59, and even that's a drop from the \$1.70 consensus three months ago. The eps low point was 1999, the first FY close following Conrail Split Date. Let's be kind and simply say south of a dollar.

Also, as noted earlier, market caps of both the eastern class 1 rails are now about half what they were five years ago. Bottom line: it's a long way to go to get back to Go. Try a doubling in share price. But at least the first steps, however small, are being taken in the right direction. The '02 estimate is for 2.53. Friday's close of \$38 and change yields a PE of 15. A tad rich, maybe, but ballpark. And encouraging.

CP made the *Globe & Mail* with a story that it is “reviewing options” for its Delaware and Hudson subsidiary. This could have ramifications for the entire northeast. CP is seen as the third carrier in the Phila and NY markets thanks to rights over CSXT and NS. Moreover, a recent a marketing agreement with CN gives CN access to key CP markets in the northeast in exchange for CP’s right to use the Detroit tunnels. This will be interesting to watch, and reader comments are invited.

Canadian National’s proposed acquisition of Wisconsin Central has cleared the Canadian Government’s Competition Bureau review and so the \$800 mm transaction (\$1.2 bn with debt) can move ahead. Recall that the STB classified this deal as a “minor transaction” and so misses the Ex Parte 582 scrutiny recently trumped by the press. Approval is expected Sep 7 assuming no environmental assessment is required and there is no oral argument.

Meanwhile, going into Earnings Week CN and CP were the only North American railroads to post 2Q01 yoy carload increases. The big drivers were grain, chems and intermodal on CN and coal on CP (good for the coming split, to be sure). CN total carloads were up 2.4% vs CP’s 0.9%. We remain convinced the scheduled railroad has a lot to do with it because customers and clients keep saying better consistency will be the biggest factor to woo them back to the rails.

Not only is CN clearly treating its customers right but also shareholders ought to do OK in the bargain. My estimate for total earnings per share through 2Q02 is \$3.55, returning a PE of a very nominal 12.5X. The 2Q01 eps estimate is for 79 cents. If it comes in at just 80 cents it’ll be the sixth quarter in a row to beat estimates. Moreover, TTM eps though June 30 will be about \$3.02. The 2Q02 twelve trailing months estimate of \$3.55 thus represents a 17.5% growth rate. That on top of a 12 PE gives us a PEG ratio of 0.7. If fair value is a PEG of 1.0, what does that suggest?

Greenbrier posted results for its fiscal 3Q ending 5/31. Revenues for the quarter were \$148 mm vs \$175 mm yoy, down 15%. Net earnings before charges for workforce reductions and production slowdowns were flat; after charges the net was a \$1.3 mm loss vs \$4.2 mm profit yoy. For nine months into the fiscal year revenues were even yoy at \$459 mm however earnings fell 80% to \$1.7 mm from \$9 mm.

The company's new railcar manufacturing backlog, as of May 31, 2001, was 4,600 units valued at \$230 mm, compared to 4,300 units valued at \$260 mm as of February 28, 2001. Greenbrier anticipates results to range from break-even to a small loss for the fiscal year as a whole, prior to any charges that could result from the evaluation of certain of its rail investments.

Looking back, fortune has not exactly smiled on Greenbrier. Revenues from both manufacturing have declined every quarter for the past 12 months. Earnings got some reprieve in the quarter ending 8/31/00 as pre-tax income rose 15% on the strength of reduced operating expenses and interest. Looking ahead, it does not look like the August quarter will be a money-maker, either. That will have to wait another year. August 2002 may see \$0.20/share.

Roy Blanchard

Disclosure: Blanchard may from time to time hold long, short, or debt positions in the companies mentioned here. A list of such holdings is available on request.