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**The Railroad Week in Review 2/2/2002**  
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There was some good news for our Industry Watch stock group amid Tuesday's market carnage. Four companies, ADM, Lafarge, Nucor, Potash Corp of Sask, and Tyson escaped with slight gains. Elsewhere our 27-stock market basket of rail shippers took as much a beating as anybody. YTD, the gainers have been Nucor (+7%) and Lafarge (+5%) with the markers being brought up by Ford (-12%) and Martin Marietta (-17%). Interesting that the leaders are in steel and aggregates and the losers are a steel user and another aggregate vendor. Among the rails themselves CN was least hurt, off 0.27%, and NS the most, off 2.36%. There were no ups.

Thursday's KCS earnings call continued the theme of increased revenues and earnings in a generally crummy economic environment. CEO Mike Haverty led things off saying KCS pretty much delivered what they said they would in terms of more revenues and a slowing expense stream. Net earnings in 4Q01 tripled to \$11.1 mm from \$3.6 mm, or 18 cents a share vs. 6 cents on revenues of \$146 mm vs. \$135 mm, up 8%. International operations (Grupo TFM, Panama Canal) contributed \$0.02 to the bottom line vs (\$0.04) yoy.

For the year, net income was up 18.6% to \$0.51 from \$0.43 before extraordinary items on flat revenues of \$577 mm with international operations contributing \$0.18 per share vs. \$0.2 yoy. However, even though we see some nice growth on the international side, this is still a KCS railroad story, and that's where we shall focus our efforts. It's all about how operating income grows faster from revenue enhancement than expense control.

Freight revenue in 4Q01 was up 8% to 143 mm from \$132 mm while operating expenses hardly budged at \$122 mm yoy, producing an *eight point* improvement in the OR to 84.7 on a doubling of operating income to \$22.0 mm from \$9.7 mm. For the year, not so dramatic however – flat revenues of \$566 mm, flat expenses and ten measly basis points off the OR to 88.3 yoy. No wonder Haverty opined there is work to be done. But 4Q01 shows what's possible. See chart attached for KCS metrics and how they compare.

Attention must be paid to the revenue/carload mix for the full story (slide 10 of the earnings presentation at [www.kcsi.com](http://www.kcsi.com)). Note that loadings were up in three out of five commodity groups while revenues were up on four out of five and the revenue decrease in the 5<sup>th</sup> category was less than the decrease in carloadings. Flip over to slide 14 and see the bottoms in all five categories happened before 4Q01 and the trends are up everywhere but intermodal, where unit revenues will dip as they demarket trailers and push containers where the net per box is better.

Looking forward, count on KCS to continue the Q4 theme – more revenue for the same expenditure. The safety story, the major push to remote-control operations (see the CN story on this in WIR for 1/26), consecutive quarters of 100% on-time service for UPS, increasing train speed and an unrelenting focus on yield make this a property to watch. A corner has been turned.

**BNSF** got the go-ahead from the STB to build 7.8 miles of new track in the Texas Gulf Coast area to access a Union Carbide plant in Seadrift TX, presently served only by the UP. Located between Galveston and Corpus Christi, the industry is served by a branch off the former MP main. The BNSF will build in from a still extant and parallel former SP branch slightly to the north and that came off the now-abandoned parallel SP main line between Houston and Brownsville running some miles west of the remaining MP line.

It appears the SP got permission to build into the plant 20 years ago but never went ahead with it. Now comes BNSF with rights over the old MP as part of the UP-SP merger but with no rights into the Union carbide complex where "billions of pounds" (says the STB) of material are made and then shipped out on the UP. The old SP application is still "live" according to the STB and so BNSF gets to claim it thereby showing once again that what goes around comes around.

Also this week the STB blessed the DM&E's plan to build a new 280-mile rail line extension to tap into the coal mines of Wyoming's Powder River Basin, subject to a number of conditions (naturally). This is the largest rail line construction proposal (\$1.4 bn for 900 miles new and rehabbed RR) ever considered by the agency, and it shows. The environmental review process alone runs 2,500 pages.

For its part, DM&E is elated. The railroad estimates that demand for Powder River Basin coal will grow from nearly the 300 million tons mined in 1996 to more than 500 million tons by 2010. The railroad also says its project will produce 6,000 construction jobs over two years, approximately 2,000 permanent rail-related jobs and more coal mining jobs, and other economic benefits for communities along its route. DM&E envisions moving dozens of trains a day, each with 115 to 135 cars running at speeds up to 45 mph. That is a significant change from current rail traffic - three trains a day hauling an average of 57 cars apiece at speeds of about 17 mph.

According to a newswire, not everybody is pleased. The president of a Rochester MN neighborhood association declaims the project as "disastrous" and that "the fallout will almost certainly contribute to the demise of a neighborhood." There are the nature groups who said they would continue to oppose the project, which will take the railroad through national grasslands in So Dak and Wyoming. And let's not forget the rancher who will file suit, claiming "the tranquillity will be spoiled by rumbling trains." Ah, progress.

A note from Anacostia's Peter Gilbertson sends the reader to the newsletter of the Pacific Harbor Lines, ably run by Andrew Fox in LA. It is one of the better shortline newsletters around and the Jan 2002 issue is now on line. To get your copy, go to PHL's "Latest News" web page, located at <http://www.anacostia.com/phl/news.html>. I was particularly impressed with the Toyota success story and the new dispatching link-up with the class 1s. Talk about seamless!

Getting back to the NS earnings presentation for a minute, the shifts in coal traffic and what NS has done in response is an object lesson in managing change to improve one's position. Ike Prillaman noted (slide 13) that "This was a watershed year for our coal business as we made the transition from a historical dependence on export and domestic metallurgical coal to developing opportunities and growing the utility market business." In other words, when given lemons make lemonade. Moreover, the shift from export coal dependence presents new opportunities in all business lines. And the carload charts show it. Bravo all.

Sorry, wrong number department: In the metrics spreadsheet attached with last week's WIR the BNSF fuel consumption was mis-stated at 1.737 mm gallons. It should be 1.177 mm gallons, according to my good friend Dick Russack, VP Corporate Affairs in Fort Worth. Making the change puts BNSF firmly in the No. 2 slot for RTMs per gallon of fuel: a commendable 426. Also, two corrections for CSXT. Locomotives should be 3500, revs/mile \$307. Thank the sharp eyes of Les Passa for pointing out the error. A revised chart is attached with the KCS numbers added.

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.*

**Class 1 Railroad Metrics reflecting full year results. Updated 2/1/2002**

<b>Benchmarks</b>	<b>BNSF</b>	<b>CNI</b>	<b>CP</b>	<b>CSXT</b>	<b>KCS</b>	<b>NS</b>	<b>UP</b>
<b><u>Railway Operating Data</u></b>				<b>"Surface Tr"</b>			
Year Ending	12/31/01	12/31/01	12/31/01	12/31/01	12/31/01	12/31/01	12/31/01
Ops Revs*	\$ 9,090	\$ 5,457	\$ 3,699	\$ 7,194	\$ 566	\$ 6,170	\$ 10,391
Ops Exp*	\$ 7,453	3,607.08	\$ 2,858	\$ 6,287	\$ 499	\$ 5,163	\$ 8,916
Equipment rents (1)	\$ 740	\$ 332	\$ 272	\$ 581	\$ 20	\$ 433	\$ 1,214
Employees	39,217	22,868	15,480	36,189	2,800	29,675	50,523
Rev Carloads (000)	8,155	3,821	2,423	7,118	975	6,625	8,916
Route miles	33,000	17,986	13,893	23,400	2,756	21,800	38,654
Locomotives	5,000	1,800	1,825	3,500	495	3,575	7,007
Diesel Fuel Used (mm gals)	1,177	351	266	580		478	1,287
Rev ton-miles (mm)	501,800	153,095	110,622	206,600		182,200	503,723
Gross ton-miles (mm)	896,566	293,857	211,157			348,700	957,668

(1) CSX includes building rent

**Railway Statistica Data**

Op Ratio	82.0%	66.1%	77.3%	87.4%	88.2%	83.7%	85.8%
Equip Rents as % RR revs	8.1%	6.1%	7.4%	8.1%	3.5%	7.0%	11.7%
Revs/mile	\$ 275	\$ 303	\$ 266	\$ 307	\$ 205	\$ 283	\$ 269
Revs/loco	\$ 1,818	\$ 3,032	\$ 2,027	\$ 2,055	\$ 1,143	\$ 1,726	\$ 1,483
Revs/CL	\$ 1,115	\$ 1,428	\$ 1,527	\$ 1,011	\$ 581	\$ 931	\$ 1,165
Revs/emp	\$ 231,787	\$ 238,630	\$ 238,953	\$ 198,790	\$ 202,143	\$ 207,919	\$ 205,669
Revs/MRTM (cents)	1.81	3.56	3.34	3.48	#DIV/0!	3.39	2.06
CL/route mile	247.1	212.4	174.4	196.7	348.1	303.9	230.7
CL/emp	207.9	167.1	156.5	196.7	348.1	223.3	176.5
CL/loco	1,631.0	2,122.8	1,327.7	2,033.7	1,969.1	1,853.1	1,272.4
RTMs/gal	426	436	415	356	#DIV/0!	381	391
MRTM/emp	12,795	6,695	7,146	5,709	-	6,140	9,970
Load to empty ratio	56.0%	52.1%	52.4%	#DIV/0!	#DIV/0!	52.3%	52.6%
RTMs/CL	61,533	40,067	45,655	29,025	-	27,502	56,497
Tons/car	80.00	80.00	80.00	80.00	80.00	80.00	80.00
Length of haul	769.16	500.83	570.69	362.81	0.00	343.77	706.21

**\*Rail operations only**

**\* Railroad operating revenues and expense. CSXT includes CSXI. Load/empty ratio is revenue-ton-miles divided by gross ton-miles. Locomotive and employee counts based on most recent available. Tons per car my arbitrary choice. Copyright © 2002, The Blanchard Company**