

The Railroad Week in Review

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Union Pacific this week held its annual investor conference in St. Louis and true to form there was a lot of good news for shortlines and carload shippers. I was particularly taken with Greg Barbe's Industrial Products presentation and its emphasis on growing revenue faster than units and growing profits faster than revenue. This goes squarely to the argument that all carloads are not created equal and \$100 in new revenue to a shortline could be worth \$150 in new cost to the connecting Class I railroad. Shortlines, be careful what you ask for.

Barbe got it exactly right saying the three IP growth engines are market-pull product development, customer-focused and simplified products, and ease of doing business. Note particularly the use of product branding, something mentioned here following the UP shortline meeting in August. No wonder the IP group estimates truckload conversions in 2003 will hit 12,000 loads, triple what they were in 2001.

The most striking aspect of Diane Knutson's Ag products presentation was the fact that more than a fifth of the revenue stream (\$300 mm worth) is from food and frozen. This is the very STCC 20 group we've been touting as one of the best growth opportunities for shortlines (UP says 57% of Express Lane carloads originate on shortlines). Here again, the emphasis is on products with identifiable and unique brand names, just like toothpaste. And, like IP, the 2003 truckload conversion run rate is again triple 2001, to 30,000 units.

The chemicals group is a third topic of vital interest to shortlines. And again the focus is on lanes and products. The principal commodities are LPG, soda ash, plastics, fertilizer, and of course chemicals, liquid and dry. Ed Sims laid out the specifics on how two sample customers in very different businesses – Rohm & Haas and Simplot – used UP products and services to take cost out of their supply chain processes.

The common theme between this session and the August 2003 shortline meeting (WIR 8/28/2003) is the emphasis on the merchandise carload business. These three presenters alone talked of growth rates in excess of 3% over the next 12-15 months and in terms of revenues in the tens of \$millions. Then SVP Operations Ed Duffy got up and drilled down into trip plan compliance, car cycle times, corridor initiatives, and alliance savings – each of which bears on how well the merchandise carload network works. The slides are on the web at www.up.com/investors. A visit is highly recommended.

Wabtec's Global Services division has won a three year, automatically renewing contract with BC Rail to implement an automated car repair billing system. It collects repair and inspection data from field locations, automates administrative billing tasks, and is integrated with the railroad's corporate accounting system. Recording and invoicing for repairs on foreign freight cars is dramatically improved as a result. It is expected that 2003 billings will be up about 10%.

The system lets maintenance personnel use a wireless, hand-held device to record inspection and repair work conducted on freight cars in off-site field locations and to transmit the information to a central network server. Repairs are validated in real time for completeness and compliance with AAR specifications. Maintenance staff can also retrieve car repair history information, access work orders, and print work orders and repair records to a network printer from the field.

Norfolk Southern's TRANSCAER train will visit five southeastern cities Oct. 7-11. The acronym stands for Transportation Community Awareness and Emergency Response, a nationwide program to increase community understanding of the safe transportation of hazardous materials and the importance of emergency planning. The train will be available for demonstrations and tours between 0900 and 1500 as follows:

- Oct. 7 - Jacksonville, Fla. (NS Simpson Yard, 3059 Old Kings Rd.)
- Oct. 8 - Forsyth, Ga., (Georgia Public Safety Training Center)
- Oct. 9 - Savannah, Ga., (Norfolk Southern, One Charlie Gay Dr., Garden City)
- Oct. 10 - Augusta, Ga., (Taylor Street, off Gordon Highway at Walton Way)
- Oct. 11 - Charleston, S.C., (Norfolk Southern, I-26 at Goer Drive Montague Rd.) Road

At each location, state and local emergency planning committees, emergency responders and government officials can participate in hands-on drills and training sessions. Railroad training tank cars, specialized emergency response vehicles and over-the-road tank trucks will be on display. Any shortline or shipper personnel who have not seen this train are urged to go.

An item in today's Philadelphia *Inquirer* explains why transportation buyers are shifting their buying patterns from fast-at-any-cost to consistent-and-reliable. Says the *Inky*, "To trim inventory costs, many companies are replenishing supplies less frequently, taking larger shipments when absolutely necessary to restock shelves." The thread of the article is that regular over-the-road trucking wins over Fed Ex, but the unspoken implication is that it's even better for boxcars.

The writer continues, "Companies looking to pinch pennies switched from overnight air deliveries to cheaper alternatives" where reliability trumps speed. In the rail industry we've seen the handwriting on the wall for years but have only recently been able to capitalize on it. Trip plan compliance is taken seriously and woe betide the operating manager who thinks otherwise.

Railroad performance estimates for 3Q03 are now down to the wire and some of the dates have already been announced. Table 1 shows that for the Big Six quarterly yoy changes range from plus 9.3% (NSC) to minus 5.6% (CSX). A better measure is the estimated yoy change 2003 to 2004. Here, a much more positive picture emerges, with everybody in the black and with double-digit growth rates at that. CP takes the honors at 33%; BNI brings up the markers with 15%.

All of these rails are undervalued by the 2004 price-earnings-growth metric. Recall a PEG of one says stocks are fairly priced -- the PE ratio and the yoy growth rate are equal. Anything less than one is a buy, and a score of 0.5 or less is a screaming buy. Is it a coincidence the best scores go with the rails that have high percentages of single-carload revenue?

On a related note, it is instructive to see the stock price changes over the third quarter and YTD through 9/30/2003. The Canadian roads win the honors for the quarter and year, but as we've pointed out before growth on the Toronto Exchange has been nowhere near as robust as the currency exchange effects do not apply. That said, BNI takes the brass ring in both categories. My take is they're doing a great job in carload yield and the IM pricing is more aggressive than one finds elsewhere. See Table 2.

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Table 1. Big Six Class I estimates and stock prices as of 9/30/2003

As of close:	9/30/03						
Ticker	BNI	CNI	CP	CSX	NSC	UNP	
Exchange	NYSE	NYSE	NYSE	NYSE	NYSE	NYSE	
Price (\$USD)	\$ 28.87	\$ 52.02	\$ 23.61	\$ 29.25	\$ 18.50	\$ 58.17	
EPS							
3Q02a	\$ 0.51	\$ 0.84	\$ 0.44	\$ 0.60	\$ 0.32	\$ 1.19	
3Q03e	\$ 0.56	\$ 0.96	\$ 0.45	\$ 0.57	\$ 0.35	\$ 1.16	
change	9.8%	14.3%	2.3%	-5.0%	9.4%	-2.5%	
FY02a	\$ 2.00	\$ 3.32	\$ 1.64	\$ 2.16	\$ 1.18	\$ 4.30	
FY03e	\$ 2.09	\$ 3.61	\$ 1.56	\$ 2.04	\$ 1.29	\$ 4.07	
change	4.5%	8.7%	-4.9%	-5.6%	9.3%	-5.3%	
FY04e	\$ 2.40	\$ 4.20	\$ 2.08	\$ 2.62	\$ 1.53	\$ 4.99	
change	14.8%	16.3%	33.3%	28.4%	18.6%	22.6%	
# analysts	13	10	7	13	14	13	
Fwd PE04	12.03	12.39	11.35	11.16	12.09	11.66	
Fwd PEG	0.81	0.76	0.34	0.39	0.65	0.52	

Table 2. Big Six Class I quarterly and YTD stock price changes

	BNI	CNI	CP	CSX	NSC	UNP	DJIA
6/30/03	\$ 28.44	\$ 48.26	\$ 22.60	\$ 30.09	\$ 19.20	\$ 58.02	8987
change	1.5%	7.8%	4.5%	-2.8%	-3.6%	0.3%	3.2%
12/31/02	26.01	41.46	19.7	28.31	19.99	59.87	8356
change	11.0%	25.5%	19.8%	3.3%	-7.5%	-2.8%	11.0%

Source: First Call as reported at Yahoo.com