

# THE RAILROAD WEEK IN REVIEW

## NOVEMBER 5, 2004

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**Canadian Pacific** started off the week promoting Fred Green to EVP and Chief Operating Officer. Fred started his CP career in 1978 and has held senior management positions in both operations and marketing across the railway's network. He was most recently EVP Operations and Marketing. I think it's a great move. Fred's door is always open to those with something to say, is innovative, and knows how to create a Unique Selling Proposition, a skill most welcome in this business. Thanks, Rob, for making the appointment. Fred, as they say in the theater, "Break a leg."

Turning to Q3 results, CP racked up C\$990 mm in sales, up 9.4%, with five of seven commodity groups reporting double-digit revenue gains. RPU was flat in the merch carload groups with coal and intermodal posting gains of 13% and 6% respectively. Grain was the only negative as a late harvest delayed rail shipments. More than half the contract renewals are for multi-year periods the balance of increases in tariffs and single-year deals. Prices are up 6% YTD within a tight range of 4-8%. Look at Fred's Slide 15 at [www.cpr.com](http://www.cpr.com) to see the full effect.

Operating expense was also up 10% leaving only a smallish ops income gain of 7.5% yoy to C\$219 mm. CP was not immune to the usual fuel hit as expense rose 29% on a 23% increase in price per gallon and a 5% burn increase for a 6% gain in GTMs. In addition CP incurred a temporary surge in training expense as it added train crews, again in-line with the trends we're seeing elsewhere. The OR drifted north by four-tenths of a point to a still-respectable 77.9 yoy.

Net income before a C\$70 mm below-the-line foreign exchange gain was C\$106 mm, up 11% to C\$0.67 from C\$0.60 last year. Put the FX gain back in earnings jump 94% to C\$1.11 per ticket. Looking ahead to Q4, CP says it is on target with guidance given in Q2: revenues up 5-7% with positive views of all commodity groups but forest products, fluid operations, and a continued productivity increase run rate of 5% targeting better use of the asset base and improving service quality.

**Genesee & Wyoming operating income** for 3Q04 was up 43.4% yoy to \$13.2 mm as North American revenue increased 25.6% to \$77.2 mm, compared to \$61.5 mm a year ago. Of this \$15.7 mm increase in revenue, \$9.4 mm was same-railroad growth and \$6.3 mm was from the acquisition of rail lines from Georgia-Pacific Corp. The growth in same-railroad revenue was balanced across multiple commodity groups, with particular strength in coal shipments, with sales up 24.1%.

The 3Q04 North American operating ratio improved by 2.1 points to 82.9 compared with an operating ratio of 85.0 a year ago. The double hits of fuel (up 37% per gallon yoy) and property damage on the B&P caused by the remnants of Hurricane Ivan added about 1.3 points to the OR. During the conference call CFO Jack Hellman said the "uniformly strong North American carloadings" contributed to an incremental OR of 74.5, not shabby by any measure but Hellman says they can do even better.

As with all shortline operators, cost savings are the most reliable profit drivers as per-car allowances are largely determined by the connecting Class Is, though there are opportunities for shortlines to share in fuel surcharges and market-based price increases. Revenues and carloads were up double-digits in most commodities while RPU increases were moderate, in-line with what we've seen on the Class Is. Operating expenses were up double-digits with fuel, casualty & insurance and equipment rents posting the largest increases. Fuel burn increased 11% on 23% more carload equivalents; had the price per gallon remained unchanged yoy the OR would have been 80.8, two points better.

The fuel tax repeal impact will be nominal until 2007 when the full 4.3 cent-per gallon tax comes off and even then worth maybe \$500K. On the other hand the lower effective tax rate through the track tax credit program could be worth \$13 mm over time. GWR says it has about 2100 route miles that qualify and it won't have to change its track spend to get the full \$3,500 per mile credit.

Australian Railroad Group (ARG), increased Q3 sales 35.6% to US\$83.7 mm. Operating income rose 49.8% to US\$16.7 mm; the operating ratio came down 1.9 points 80.0%. Drivers were a larger Q3 grain harvest partially offset by higher contract driver costs due to a locomotive engineer shortage in Australia, and a 35.1% increase in the price of diesel fuel. Equity income from ARG was US\$3.5 mm, up 30.0% yoy.

**Florida East Coast Railway (FECR)** really got hammered by the consecutive hurricanes. Going into Sep railway revenues were up 11% yoy yet the quarter revenue closed up a mere 3.4% to \$46.3 mm. Operating expense increased 13% to \$38.4 mm for and OR of 83.1, up 7.12 points yoy. During the conference call CEO Bob Anestis said revenues were off \$4 mm and expenses up 2% due to the storms. Making those adjustments revenues would have been up 12%, operating expense up 7%, operating income up 29% and the OR down 3.5 points to 72.5.

Total carload revenues ex-intermodal were lower by 5.8% due to lost revenue during days of suspended or limited train service as a result of the hurricanes. Aggregate revenues were down 8.1% as a result of the hurricanes. Despite the impact from the hurricanes, intermodal revenues (which include drayage) increased 15.3% compared to the prior year period, reflecting new customers, increased revenue from the international business segment, continued success with the "Hurricane Train" (that's irony for you) and improved pricing.

In other words the core railroad is as sound as ever. Anestis expects the recovery momentum will continue into Q4 with double-digit yoy percentage increases in FECR revenues and operating profit. The current outlook for the 2004 full year is for double-digit growth in operating profit. Railway capital expenditures, before the purchase of any strategic land parcels to be used by future Railway customers, are expected to range between \$30 and \$33 mm.

**The attached table** compares all six Class Is' third quarter performance with the usual emphasis on merchandise carload revenues. New this quarter are YTD Free Cash Flows, FCF margin, fuel prices and yoy change in price per gallon. Note that the three rails with double-digit revenue increases are also the three stock-price out-performers YTD and had the best FCF margins. Debt-to-cap ratios are, happily, in that 30-50% sweet spot across the board.

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**Big Six Class I Commodity Carload Comps**

**Quarter ending 9/30/2004**

**Revenue and income in \$millions**

<b>Metric</b>	<b>BNSF</b>	<b>CN</b>	<b>CP</b>	<b>CSX</b>	<b>NS</b>	<b>UP</b>
Railroad revs (1)	\$2,793	\$1,709	\$ 990	\$1,938	\$1,857	\$3,076
YOY Pct. Change	16.6%	20.9%	9.4%	6.3%	16.2%	4.1%
Carload revs (2)	\$1,209	\$1,247	\$ 548	\$1,171	\$1,006	\$1,737
Pct carload	43.3%	73.0%	55.4%	60.4%	54.2%	56.5%
Pct Intermodal	33.7%	17.7%	27.7%	16.6%	21.8%	18.8%
Pct Coal	21.1%	4.0%	14.6%	21.8%	24.1%	20.4%
Mdse Carloads (000)	659	791	282	852	717	987
Rev/CL x coal, IM	\$1,722	\$1,576	\$1,946	\$1,374	\$1,403	\$1,760
Rev/IM CL equiv	\$1,339	\$1,640	\$1,543	\$979	\$904	\$1,218
IMCLE/avg CL rev (3)	78%	104%	79%	71%	64%	69%
RR Operating Income	\$ 565	\$591	\$ 219	\$250	\$469	\$418
YOY Pct. Change	31.4%	30.2%	7.5%	12.1%	50.8%	29.4%
RR Operating Ratio	79.8%	65.4%	77.9%	87.1%	74.7%	86.4%
YOY Point change	(2.28)	(2.45)	0.40	(0.67)	(5.79)	6.44
YTD Free Cash Flow (4)	\$240.0	\$577.0	\$ 10.0	\$ 67.0	\$440.0	\$135.0
FCF as Pct Revs	8.6%	33.8%	1.0%	3.5%	23.7%	4.4%
Debt/Cap	41.3%	36.7%	45.4%	50.9%	49.5%	45.1%
GTM/gallon diesel fuel	751	874	861	827	784	773
Fuel/gallon (US\$)	\$ 0.99	\$ 1.06	\$ 1.24	\$ 1.14	\$ 0.81	\$ 1.25
YOY Pct. Change	12.2%	22.3%	23.0%	25.0%	5.5%	38.9%

(1) CN, CP in \$Canadian

(2) Excludes coal, intermodal

(3) Intermodal carload equivalent revenue as percentage of average carload RPU

(4) Cash from operations less capex less divs paid; excludes acquisitions and sales