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The Railroad Week in Review 7/21/2001

Union Pacific was first out of the box with 2Q01 earnings on Thursday. Net income for 2Q01 was reported as $243 mm on total revenues of $3 bn, up one percent from 2Q00. That works out to 98 cents a share before dilution, the same as 2Q01. Included is a $51 mm gain from real estate sales and $15 mm in flood effects (half lost income, half added ops cost). Back both out and you get 84 cents before dilution vs. the 90-cent street estimate.

Fuel costs increased to 12% of revenues from 11% of revenues in 2Q00, and that added $25 mm to operating expense. Moreover, had fuel remained at 11% of revenues the OR would have been nearly a point lower than the 82.3 reported, up from 80.4 YOY. Fuel and flooding were the big factors. Happily, the floodwaters have receded and fuel prices appear to be doing likewise.

Railroad commodity revenues rose 2% on no change in carloads with coal the big driver (up 16%) and Ag distant second (up 3%). Everybody else was off, including intermodal, down 2%. If you'll go to www.up.com and pick up the presentation materials, you can see the improvements in gross ton-miles, revenue ton-miles and revenue per carload.

Amidst the good news, there remains one disturbing trend: non-intermodal revenue per revenue ton-mile dipped to $2.09 from $2.17 YOY, off 4%. For six months it's off 2%. So even though revenue per carload is up, UP is still hauling more for less, and it's been a continuing trend in the industry for years. Shortlines in particular at risk because as their allowances and divisions go up the percentage of revenue per revenue ton-mile goes up even faster.

Canadian Pacific reported net income of $C576 mm, up 52% YOY with earnings per common share of $C1.82, up 53% YOY. The railroad chipped in $C206 mm of the net income, up slightly from last year's record quarter. The OR edged up half a point to 77.9 YOY and net income declined slightly to $C95 mm vs $C96 mm YOY.

Carload volumes increased 2%, fuel consumption improved 5%, locomotive utilization was up 6%, and average train weights were up 4% indicating follow-through on an earlier promise to run bigger more efficient trains. Revs revved up 3% to $C931 mm YOY with coal, sulfur, and ferts leading the way. Overall, revenue growth for the quarter more than offset the combined negative impacts of the revenue cap on Canadian grain, which came into effect in August 2000, and the softer economic conditions experienced in the automotive and forest products.

Canadian National issued a press release saying it was pleased with the conclusions of the Canadian Transportation Act (CTA) Review Panel yet troubled by some of the recommendations. The review concluded that Canada's regulatory regime for railroads works effectively for most shippers, that rail competition is substantial and that the system needs only minor revision, not wholesale change. That's the good news.

The bad news is that panel is urging the repeal of an existing CTA provision ensuring only shippers suffering substantial commercial harm are entitled to various regulatory remedies, resulting in rates set by regulatory intervention rather than through commercial negotiation.

Another idea is to widen the scope of existing running rights provisions to permit one railroad to solicit traffic on another. WIR agrees with CN wholeheartedly.

Schemes such as these open the door to the division of responsibility for track maintenance and train operation and run the risk of replicating the situation in the UK. The unending battle between and conflicting interests of the train operating companies (TOCs) and RailTrack has, we think, contributed to some of the horrendous track-related accidents there. As for opening the tracks of A to the solicitation of B, it's a franchise invasion. Customers are certainly capable of voting with their feet and if A fails enough customers the track will eventually be sold anyway.

Kansas City Southern, in partnership with Mexico's Grupo Transportacion Maritima Mexicana (TMM), will now go to work on acquiring the Mexican Governments 24.6% interest in TFM. KCS and TMM sit on the TFM board and plan to close the deal for about $170 mm. It is anticipated that the acquisition of this additional equity in TFM will be highly accretive to both TMM's and KSU's shareholders and will provide both partners with the additive value of ten-percent additional cashflow for each partner.

Wabtec (NYSE: WAB), the rail equipment supplier comprised of the old Westinghouse Air Brake and relative newcomer Motive Power industries, reported 2Q01 diluted eps of 21 cents exclusive of restructuring costs. In 2Q01 WAB earned 27 cents a diluted share before restructuring costs. Net sales fell 3% YOY with lower sales in the Freight Group offsetting higher sales in the Transit Group. No surprises here.

The decrease in Freight Group sales of $13 million resulted primarily from lower sales of freight car and locomotive components in both the original equipment and aftermarket businesses. Higher Transit Group sales of $5 million reflected the strength of the market for new passenger vehicles, for which the group supplies various components.

NYSE short interest ran Friday in the WSJ and all the rails save UP saw significant drops in short interest, potentially a good sign for rail investors. NS saw the biggest drop in short interest, 25%. Not bad in a market that saw a 3% gain in short interest month to month. With the earnings outlook not particularly encouraging, more downs than ups remain a distinct possibility. Isn't it nice the rails are holding up?

Neither CSX nor NS had a very good week in the Northeast. On Wednesday a 60-car CSX freight train derailed inside a Baltimore tunnel and caught fire. Commuter rail services in the area were halted and parts of I-95 and I-395 were closed for the evening rush. Further north, NS got an earful from the good citizens of Altoona, PA. According to the Pittsburgh Post Gazette, NS was chided for saying it would keep the Hollidaysburg car repair facility open when wooing the citizens pre-merger then announcing closure 18 months after merger completion. The view from here is that when carload business tanks you do what you can to minimize impact on the corporate whole. Less carload business, fewer cars needing repairs. Maybe the growing number of 80 MPH trucks on I-80 in Penna has something to do with it.

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