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The Railroad Week in Review 11/17/001

Wall Street by consensus this week added Alcoa (AA), General Mills (GIS)…to the BUY list. GIS got good marks for its planned Pillsbury acquisition and the potential to see a 14% ACGR in earnings over the next four years. AA is close to inking a deal to buy Australian aluminum producer WTC, Inc. AA's main interest is Alcoa's main interest an alumina joint venture, Alcoa World Aluminum & Chemicals, that is 60%-owned by Alcoa and 40%-owned by WMC.

Meanwhile, GM is not shrinking from its commitment to JIT parts supply. Manufacturers agree the benefits from lowered warehousing and inventory on the books at the present outweigh inconvenience at border crossings to Canada. Still, the fragile nature of JIT supply chains cannot be ignored. But rather than increase basic loads manufacturers will watch goods' progress through the transportation system ***very*** closely to avoid or side-step trouble spots.

This past week we asked those on our shortline advisory list to rank their carload traffic base across four commodity groups: grain and grain products, forest products, chemicals and petroleum, and manufactured products. Of particular interest to the respondents, week 45 carloads (see http://www.railmatch.com/Railfax) are an improvement over 2000 but still behind 1999. Against 2000, grain fared best, up 15%, chems up less than a point, forest prods off 14%, metals off 10%. Year-to-date numbers are down across the board, however coal was up 5% yoy.

Among class 1s YTD only CP is in the plus column -- by a mere 1% yoy. CSXT and NS got hit worst, off 3% and 4% respectively. UP and BNSF dipped 30 BP and 40 BP respectively while CN was off a point. All are positive against 1999 YTD, and that's a good sign. For the last four weeks alone total traffic, including auto, coal, and intermodal carloadings were dead even yoy.

Genesee & Wyoming Inc. (GNWR) has posted October 2001 traffic volumes for its North American and 50% owned Australian operations. North American carloads increased by 5,828 carloads, or 18.9%. Excluding 3,677 carloads shipped by the South Buffalo Railway, acquired October 1, 2001, North American carloads were up 7%, still not too shabby given the class 1s' performance, above.

Australian carloads in October 2001 were 65,082 compared with 21,056 carloads yoy. Australia's 2000 carloads include traffic on the Australia Southern Railroad (ASR) only, while Australia's 2001 carloads are the results of the Australian Railroad Group (ARG), which is composed of ASR and the Australia Western Railroad (AWR) -- formerly known as Westrail Freight. As of December 16, 2000, GNWR contributed ASR to ARG and now owns 50%.

RailAmerica (RAIL) posted a remarkable 90% jump in quarterly earnings per share yoy after acquisition costs. Back 'em out and eps rose 60% yoy on a 2.5% revenue increase against just 1.7% more operating expense. The big benefit comes below the line mainly from $3 mm less interest expense thanks to lower debt (down $60 mm yoy) and lower interest rates.

North American revenues were up 6% while COO Gary Spiegel and co. took another 5.4 points out of the OR, now 72.9. International (Australia, Chile) revenues were up 12% in constant currency, a nice trick against a mere 4% bump in carloads. More money, less work, as Aden Adams (former CSXT marketing VP) was wont to say.

Looking ahead, RAIL figures on shedding another $25 mm in non-performing assets even as it looks for further acquisitions in this hemisphere and in the South Pacific, being already hard at work on the upcoming AUS privatizations. In the conference call CEO Gary Marino said they expect the StatesRail and Park Sierra acquisitions to be accretive on '02 to the tune of 20 cents a share. There's more to say, however for the nuts and bolts I've prevailed on Wayne August, the IR guy at RAIL. Stay tuned. It's a good story getting better.

Focus and USP (unique selling point) are continuing WIR themes. Now comes Harvard's Michael Porter (*Competitive Advantage*) in Monday's WSJ: "How to Profit from a Downturn." Says he, the "essence of strategy" is creating a product that the competition is ill suited to offer. Say moving 100 tons in one box on a schedule that meets the users needs. "Downturns," he continues, "make it easier to get it right strategically."

Cutting expenses across the board will not do; mergers are to be eschewed unless they enhance the USP. Class 1 moves toward interline alliances, web-based pricing, dock-to-dock carload trip plans, and the scheduled railroad come to mind. The goal of any change, says Porter, "is to move the company to a distinctive position." Sound familiar?

Here's the wrap: use the downturn to enhance the USP and position the company for the coming upturn. "Clean the slate" by putting the financial focus back where it belongs, on yoy earnings from the core business. "A return to fair reporting will make strategy even more important."

Crude oil price makers fell into disarray on Wed after OPEC members agreed to cut production 1.5 mm bbl a day effective Jan 1 but only as long as non-OPEC producers followed suit. CNN reported later in the day that Russia, for one, was having none of it. In fact, Moscow has actually increased production in recent years, hitting as much as 3 mm bbl a day, leaving OPEC to, as CNN so eloquently put it, "prop up prices while losing market share."

How delicious. Mr. Putin is with George W in Texas this week where they are discussing their mutual problems in the Mideast. The Saudis are not pleased with the oil thing, saying, "Russia has the biggest capability and is they key to price stability" as they pushed for the $25/bbl target. On Thurs crude closed the day at $17 and change. Highway diesel fuel is already down below $1.30/gallon and that translates to about six bits a gallon for the rails.

Of course, as fuel prices drop for the rails they do the same for the trucking companies. Then the question becomes one of keeping the service quality spread high enough to justify the rails' pricing to market.

This just in: DM&E's 11/19 press briefing on the PRB build-in Final EIS Report will available on phone hookup by calling (800) 403-2031, confirmation # 106701, starting at 1300 CST.

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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.