The Railroad Week in Review 6/15/2002

In the last six months I've been to Montreal, Jacksonville, Norfolk, Omaha and Fort Worth to discuss *Shortlines and The Scheduled Railroad* and the dialog has been most gratifying. There are three aspects: physical carload interchange, data interchange and running to schedule. Attendant to the ISA are responsibilities on both parties.

Among other things, the class 1s are committing to providing accurate advance consists, advance notice of service failures that could impact scheduled interchange times, and a reliable method for ordering *and receiving* empties by quantity and date. On the other side of the interchange shortlines must provide transit-time tables between interchange and customers, to include O-D pairs, commodities, and expected carloads per week (month, year, as agreed). Tables must show when loads and empties for loading are scheduled to arrive at destination dock based on interchange time, also the reverse for empties and loads released to shortline.

Shortlines *absolutely must* report via Train-2 or other customer-visible means movement events – wheel, place, pull, etc. – in real time. Shortlines also can help speed the car on its way by preblocking for distant nodes. The July *Trains* goes into this in great detail, esp Fig. 11 on page 46. Finally, each shortline must be prepared to measure its own performance against the ISA and be prepared to share that data with the connecting class 1 road.

Morgan Stanley's Week 22 traffic reports shows some heady gains in chemicals (11% yoy) and intermodal (10%). Coal was off 6%, coke 13%. Net-net, total rail volume for the week was up 2%. The chemicals trend is particularly significant as a leading indicator of manufacturing activity. It was down 2.6% in 1Q, is up 5.2% in Q2TD, up 6.5% for four weeks, and up 11.1% YTD. Only containers shows anything like that improvement, though that may be due in part to advance shipments anticipating a summer strike at West Coast Docks.

Among the Big Six class 1s, CSX wins top honors for chemicals growth, up 17.1%. Part of the reason may be two innovative programs CSXT has brought to the fore. The Redi-Rail program is a short-term lease program set up in partnership with GATX designed to attract shippers who may not be in a position for long-term leases. Moreover, as an additional incentive, the program offers a $1,000 refund off the first $2000 or more in freight charges for the first car.

The second program, Warehouse on Wheels, is particularly attractive to shortlines with excess capacity. The brochure copy has it exactly right: "Demand and production changes make storage a necessity." As class 1s are seeking to reduce cars on line to free up capacity, shortlines can step into the breech by offering up capacity and getting paid for it. As of this writing, more than 14,000 car spots have been identified by CSXT and its shortlines. You can call Mike Ohorodnik, CSXT's Director of Chemicals Marketing, at (904) 359-3366 to sign up.

Back in March we offered some comments on non-GAAP reporting and cited a "Heard on the Street" column in WSJ as additional flavor (WIR 3/23/2002). Now comes William & Mary Business School accounting professor Wanda Wallace writing in *W&M Business*, spring/summer 2002. "GAAP," she notes, "was the agreed-upon rule, the gentleman's agreement, if you will, for reporting financial performance."

Professor Wallace says we've entered "an era of non-GAAP information disclosure, putting hope ahead of substance." So much for reporting great income growth while omitting the fact (in the headlines at least) that eps is diluted by new shares issued to make an acquisition. The good professor also picks up on EBITDA and *pro forma* reporting results "almost inevitably better than GAAP-based numbers."

Her wrap? Investor beware. "Companies choosing non-GAAP disclosure practices appear to be less profitable – many incurring losses – by traditional standards, as one might expect. The disparity between the two seems to have torn the safety net presumed by efficient, regulated, transparent markets." (See www.business.wm.edu/media/publications for the full article.)

Merrill Lynch held its Global Transportation Conference in NYC this week. Some highlights: Matt Rose says BNSF expects modest revenue growth, sufficient productivity improvements to offset inflation, double digit eps growth and $500 mm in free cash flow. Speaking for NS, CFO Hank Wolf cited the six-point operating ratio improvement in 2001 yoy and the two points shaved in 1Q02 yoy – eight points in five quarters on small revenue growth. NS looks to lower the $7.5 mm debt load by another $300 mm from FY 2002 free cash flow.

UP's CEO Dick Davidson sees the year ending with FCF in the $400 mm range with the OR breaking 80 and double-digit earnings growth on 1-3% revenue growth. UP also has a failure cost measure I'd never seen before – 15 cents of every expense dollar funds a failure. That's something you can get your arms around. Al Crown, CSXT's Transportation EVP, reiterated the CSXT "Better is Cheaper" mantra and went on to prove it with metrics from Industrial Switching Excellence to yard dwell time. Check out the individual RR websites for replays and slides for these presentations.

RailAmerica threw a reception on the trading floor of the NYSE Thursday evening. The location and food were great, to be sure, but the best part was catching up with old friends and learning what's new from the operating side. Not surprisingly we talked quite a bit about the class 1 interchange process and measurement thereof.

I think Ops SVP Gary Spiegel has assembled a top-flight operations management team from in-house and class 1 veterans. This is a real plus because they know how the big railroads work and can play to their strengths while working around weaknesses. Reports are filtering in from the class 1s that even as their loadings are ho-hum, the shortlines are growing traffic at 4% or better YTD. Look for RRA measures to do well in the merchandise carload environment.

Genesee & Wyoming (GNWR) reports May carloads up 17% in North America and 3% in Australia. North American same-railroad carloads slipped 6% thanks partly to the poor coal season. For 2QTD the company reports NA total carloads up 15%, same-store off 8% and Australia up 3%. In both periods forest products, metals and automotive took top growth honors.

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Roy Blanchard provides railroad financial and operating performance measurements for shortlines and shippers. 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.