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The Railroad Week in Review 7/19/2002

Stock options are very much in the news this week as Coke (KO) and Washington Post (WPO) said they would start treating stock options as compensation expense. The WSJ on Tuesday said the move drew mixed reviews. Merrill Lynch was basically supportive whereas Morgan Stanley sniffed that KO is an "Old Economy company" that hasn't used options much to pay its poohbahs. The article goes on to say that options were used a lot in tech startups that had little (or no) income to expense compensation against.

There aren't many companies more "old economy" than railroads as so I thought it might be instructive to see how the major US class 1s and two largest shortline operators stack up in this regard (see chart). Figures are drawn directly from the 10-Ks and the hits are relatively small compared to, say, MSFT ($2.8 bn off reported $7.7 bn) or CSCO ($1.5 bn off an already negative $1.0 bn net loss).

The FRA's RRIF program is finally picking up steam according to a source who follows the matter. To be sure, there were some delays involving the IMRL and DME applications. To begin with, the IMRL loan was conditionally approved yet did not close due to the pending merger with DME. In parallel, DME had filed its own application with FRA, which was also in process. At present, DME has not submitted a new/revised version of its own application to FRA nor has the IMRL application been withdrawn, as far as I can tell.

On June 24 the merger parties told the STB they would postpone completion of the transaction until July 26 and two days later the STB agreed to uphold earlier stay requests until July 25 unless resolved earlier. Thus the stay effectively sidelines not one but two big, high profile RRIF applications that were well along in the approval process.

That being said, it should be noted that there have been several modest short line applications approved and are somewhere along in the closure process. Here again, there have been delays however some of the delay belongs with the applicants. The FRA is pretty strict about its due diligence and if the application is incomplete or the analysis wanting, applicants can bet the FRA will follow up. Delays may ensue until the FRA's work squares with application requirements. See www.rblanchard.com/resources/texts/benchmarks.html for suggestions.

RailAmerica (RRA) says total revenue carloads and intermodal containers rose 17% for June 2002 and YTD over 2001's performance, including StatesRail and Park Sierra for 2002. Total North America carloads were up 27% in June and 23% YTD over 2001. Same railroad (lines owned in June 2001 and in June 2002) carloads were about even in June 2002 and off less than 2% YTD. Offshore total and "same railroad" June carloads were down 9% and unchanged YTD.

Also this week RRA approved a share repurchase program of up to 2 mm shares of its common stock effective immediately. The two-year repurchase program will allow the company to repurchase its shares from time to time in the open market and replaces the Company's previous plan under which it repurchased approximately $4 mm worth of its common stock over the past two years. Not a bad buy, either, if the PE's any guide – 8.9 on 2003 ests.

Genesee & Wyoming (GNWR) June 2002 carloadings rose 11.5% over June 2001 with operations in the US, Canada and Mexico up 11.5%. On a "same railroad" basis, however, loadings were off that much. Australian loads were up 4.5% yoy for June. For 2Q02 (GNWR does not report YTD) the NA properties were up 13.8% total and off 9.3% same railroad. Australia was plus 4.8% quarter-to quarter. Illinois coal comps continue to pull the North American same railroad loadings southward.

BNSF will not renew the Dakota-Montana differential pricing structure at its July 31 expiration date. Its purpose had been to offset the trend of reduced wheat harvests in Montana by lowering the transportation rates to the Pacific Northwest (PNW) for wheat that would otherwise go to the domestic market. Starting Aug 1 BNSF will benchmark carloads against the trailing four-year average to make certain that this change in pricing practice does not detract from the PNW traffic base.

BNSF also announced a change in its demurrage policy. Effective August 1, demurrage charge for covered hoppers in grain service will be reduced to $50 per chargeable day from the recently announced $75. In addition, BNSF will allow 26-car and 52-car unit grain trains that are spotted for loading on Thursday or Friday to have Saturday as free time, in line with BNSF's April 1st change for single cars. Shortlines please take note – this is an excellent relationship-builder,

Wabtec (WAB), the former Wabco+MotivePower Inds, saw 2Q02 net income fall in part due to New York City's TA holding back on the purchase of 60 subway cars and in part due to the economy in general. As a result WAB net for 2Q02 slid to 11 cents a share from 15 cents a year ago. Sales in the period were off 7% to $180 mm from $194 mm a year ago. For the year, WAB said it now anticipates EPS to range from $0.45 to $0.50, implying second-half earnings of between $0.28 and $0.33.

Union Pacific (UNP) kicked off Earnings Week with per-share 2Q02 earnings of $1.15 against an estimate of $1.06 and $0.95 for 2Q01. Rail revenues were up in five of six commodity groups (coal was down a tad) with intermodal leading the way at 11%. Shortline operators will be particularly encouraged by gains in chems, agriculture and industrial products. UP's outlook for 2H02 is strong for all three; shortlines should take that to the annual shortline meeting to be held in three weeks. Ask about Express Lane and Pipe Line services in particular.

The railroad operating ratio dropped three points to a second quarter record 79.3. UP's unique "cost of quality" measurement continued the downward trend to 11 cents per dollar of revenue as customer satisfaction continued its continuous quarterly upward movement. In sum, this was the best overall quarter for total car loadings and revenue ton-miles.

Starting with the results for 2Q02 Week in Review will offer a separate Review and Outlook covering the North American rail operators. The focus will be on shortlines and the merchandise carload business – what happened in the quarter and YTD and what can be expected looking ahead. Watch for details at www.rblanchard.com and in this letter.

Roy Blanchard

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.

Impact of Stock Options on US Railroad Earnings for the Year Ended 12/31/2001

NSC	2001	2000	1999
Reported	$ 0.97	$ 0.45	$ 0.63
w options	$ 0.94	$ 0.39	$ 0.55
pct chg	-3.2%	-15.4%	-14.5%

UNP	2001	2000	1999
Reported	$ 3.77	$ 3.34	$ 3.22
w options	$ 3.69	$ 3.23	$ 3.01
pct chg	-2.2%	-3.4%	-7.0%

BNI	2001	2000	1999
Reported	$ 1.87	$ 2.36	$ 2.44
w options	$ 1.84	$ 2.25	$ 2.34
pct chg	-1.6%	-4.9%	-4.3%

CSX	2001	2000	1999
Reported	$ 1.38	$ 2.67	$ 0.09
w options	$ 1.32	$ 2.58	$ (0.11)
pct chg	-4.5%	-3.5%	NA

RRA	2001	2000	1999
Reported	$ 0.71	$ 0.60	$ 0.77
w options	$ 0.54	$ 0.41	$ 0.68
pct chg	-31.5%	-46.3%	-13.2%

GNWR	2001	2000	1999
Reported	$ 1.48	$ 1.38	$ 1.23
w options	$ 1.42	$ 1.28	$ 1.12
pct chg	-4.2%	-7.8%	-9.8%

Source: 10-Ks for 2001

WIR Extra! The Interchange scorecard for measuring class 1 on-time performance with respect to the ISA is ready for downloading at www.rblanchard.com. See link on home page.

Errata: There was a misprint in last week’s volume chart. Average daily volume for RRA is closer to 155,000 shares making daily volume more like to $1.5 mm than the $123,000 reported. Looks like I picked a slow day. Thanks, RRA, for your sharp eyes.