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The Railroad Week in Review 8/2/2002

The week got off to a roaring start as Monday's rally helped produce the best four-day percentage gain in the DJIA since 1933. Technicians were pleased to see the upside/downside ratio close at 11.28:1 (ten-to-one is both rare and significant). Better, the NYSE advance/decline ratio closed at 4.44 ups for every down. By Friday most of the gains were gone. Economic reports didn't help, with June factory orders off 2.4%, 70 BP below the consensus. Orders for non-durables fell 4.1%, about in line.

Among the Big Four US rails, CSX remained above the fray, UP and NS stayed with the index, and BNSF lagged a bit. CN, CP and KCS stayed with the Dow while FEC jumped 5%. Both GNWR and RRA reported this week (see below). GNWR was up 10% until it reported, sank to no gain, and then rose a tad on no news other than a rather decent quarter. Meanwhile, RRA quietly tracked the DJIA.

Florida East Coast as a railroad and real estate company does all right. These two businesses generated $61 mm sales and $18 mm operating income for 2Q02. Telecom and trucking were another story posting a $17 mm loss on $28 mm in revenues. For the quarter (six-month carload breakouts were not provided) cars and revenues were up 7% while intermodal sank 3% yoy.

The big winners were food and chems, revenues up 36% and 16% respectively with the new Tropicana juice trains (Sep 18 press release) a major contributor. Construction material, autos and paper revenues decreased. The good news is that FEC is building a carload business franchise now representing 63.5% of revenues, up from 61.2% yoy.

As for the telecom side, as we've noted before that's a work in progress. Expenses were up considerably in the quarter and half and below-the-line "other income," chiefly real estate sales, made the difference between net loss and net profit. The railroad and real estate operations are carrying FEC for now and both appear to be in good health.

Genesee & Wyoming (GNWR) posted a remarkable quarter driven largely by the astute acquisitions of the Emons and South Buffalo Properties. The former has been divided between the switching subsidiary (Yorkrail) and the Canada Group (Saint Lawrence & Atlantic). The Buffalo & Pittsburgh group gets the latter.

GNWR posted double-digit 2Q01 revenue and carload gains yoy in key commodity groups to bring in 30% more revenues on 28% more carloads; YTD it was 26% more revs on 24% more cars. Revenue per car is essentially unchanged. Same-railroad carloads were off 9% and 4% respectively for the quarter and half however the acquisitions more than offset the losses. (They were largely a function of coal stockpiles and the weather anyway.)

The Australian Rail Group equity contribution was up 9% in 2Q01 but slipped 4% in the half exclusive of the gain on last year's sale of GNWR's Australian positions. All-in, earnings increased 46% in the quarter and 11% in the half however the 40% increase in shares outstanding diminished the eps changes to +5% in the quarter and –21% in the half. Look for more detail in WIR's upcoming *Quarterly Reviews*.

RailAmerica's 2Q02 report is a good one as long as you disregard the non-core charges. Net second quarter income was up 82% to $7.6 mm from $4.2 mm yoy. North American rails generated $83 mm out of $115 mm total revenues (72%) while incurring only 66% of the expense. Same railroad cars were up 1.7% vs. a decline of 1.4% in the AAR's 2Q02 numbers. The marketing initiatives CEO Gary Marino spoke of during the conference call are paying off.

Marino said they are looking more to existing shortlines for potential acquisitions even as RRA plans to shed lines that don't come up to scratch. RRA targets the immediately accretive deal a la Park Sierra and States Rail. These two brought in $23 mm in new revenues, virtually the entire yoy gain. The OR shed 160 BP to 74.6 demonstrating the economies of scale are working.

Offshore it's a little different story -- sales of $32.5 mm, up 2% yoy. Continuing drought in Australia hampers grain movements and thus revenues available to the railroad. Copper shipments are up in Chile, though total revenues from that operation account for only about a sixth of the total international pie. Increased Australian RR operating expenses pushed the OR to 81.8, a full six points more than posted in 2Q02. Maintenance and depreciation appear to have been the biggest hit.

I&M Rail Link (IMRL) officially became the Iowa, Chicago, and Eastern Railroad at 0001 July 30 according to a note from DM&E's Kevin Schieffer. The next step is the integration of the DME and IMRL commercial and operating networks. Says Schieffer, "Once combined the resulting rail system will be roughly triple the size of the current DM&E system." It's been a long time coming and ought to prove well worth the wait. Congrats to all.

A Reuters item Wednesday reports some Members of Congress from the hustings say being limited to one railroad is hurting the competitive posture of their constituent country elevators. In No Dak, for example, it is claimed that 97% of 'em are served by only one railroad. They accuse the rails of "gouging" the little guy who has neither the stomach nor the resources for a lengthy STB appeal process.

For the record, No Dak has the BNSF, CP, Red River Valley & Western, Dakota Missouri Valley & Western, and the Northern Plains Railroad. In the eastern part of the state no railroad-served point is more than 50 miles from a rail served point on another railroad. And we all know what super-trucks on super highways have done to hurt country elevators. Can you say keep the rails in to keep the truck rates down?

One of our favorite financial writers is Wharton's Prof. Jeremy Siegel (*Stocks for the Long Run*, McGraw Hill, 1998). Every now and then Prof. Siegel shows up on the Op Ed page of the WSJ with some pointed observations and the July 25 commentary, "Stocks are Still an Oasis," is appropriate to the times. He begins by lamenting the loss of cash dividends and the increasing belief that "reported earnings are real and can be substituted for this cash return."

More specifically Prof. Siegel encourages greater attention to "core earnings," a measure of what's left in the till after everybody's been paid. Options expense, portfolio gains, restructuring charges are in; write-downs are out. Back in May Standard & Poors put out "Measures of Corporate Earnings" actually defining what's to be included as "core earnings."

For example, "Restructuring charges from on-going operations are generally defined as those expenses, such as employee layoffs, maintenance costs, or early lease terminations, that arise when a company decides to close plants or other facilities. Since these assets would have been used up in the process of creating operating revenues, charges for restructuring these assets should be included in the calculation of Core Earnings."

Something I've been wanting to do for some time is compare shortline carload changes yoy with their class 1 counterparts. I'm using RRA and GNWR as proxies for the whole industry for a couple of reasons. First, among the 500+ shortlines in my database these two own about 75. Second, the public companies' individual properties go from the very large (Buffalo & Pittsburgh, Indiana & Ohio) to the very small (San Pedro Southwestern, 3200 cpy on 78 miles).

The results (see spreadsheet) show shortline "same railroad" loadings so as not to skew yoy comps. From this it appears the shortline community may *not* be increasing carloads at a rate much faster than the larger roads. On the other hand, RRA's biggest interchange partners are UP (28% of carloads) and CN (20%) and these are the two strongest YTD carload performers. GNWR does not break out class 1 share of revenues, however it's still worthy of further thought as to the community as a whole. As usual, feedback is invited.

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.

Rail carload changes less intermodal
Same railroad for GNWR, RRA
Ranked by YTD railroad changes high to low

	By Quarters		YTD end
	1Q02	2Q02	2Q02*
AAR	-3.2%	-1.4%	-2.2%
UNP	0.6%	2.0%	1.2%
KCS	2.7%	-2.1%	0.5%
RRA	-2.1%	-0.4%	-1.6%
CN	-3.6%	-0.1%	-2.0%
CSX	-5.7%	-2.0%	-3.7%
NSC	-5.0%	-3.1%	-3.8%
BNSF	-4.8%	-4.7%	-4.6%
CP	-8.7%	-4.4%	-6.7%
GNWR	-4.3%	-9.3%	-6.8%

*Class 1s through July 6