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One of the value concepts I follow deals with free cash flow and how much there is of it per share, and the more the better. My definition of free cash flow is net income plus depreciation less capex, the reasoning being you have to replace what you wear out. For capex I'm taking the purchase of plant and equipment line straight from the cash flow statement.

What's left is essentially what Warren Buffett calls "owner earnings." (1) The argument is that companies must generate enough cash to replace the infrastructure consumed and still provide a return on investment. The attached chart compares the Big Six class 1 roads plus GNWR and RRA for the amount of owner earnings per share, the bigger the better. Please note, however, that the two shortline operators approach the matter from slightly different directions. The table shows both calculations.

Jack Hellman, Genesee CFO, writes, "I generally agree however we add the increase in deferred taxes to the cash flow analysis since it reflects our cash tax rate (as opposed to book taxes). This deferred tax number is important to us since we generally try to structure acquisitions as asset deals in order to benefit from accelerated depreciation schedules that reduce our cash tax rate."

At RailAmerica, Wayne August, AVP Investor Relations writes, "There are many ways to define cash flow. We here define it as EBITDA less CAPEX less interest expense, believing that this provides a clearer picture for us since there are many 'unusual/one-time' items below the line that impact net income one way or another." The point remains that however one measures it one must look to Owner Earnings as one indication of the health of the enterprise.

We've written before about the BNSF initiatives in the carload freight business. The summer 2002 issue of *RAILWAY*, the BNSF employee magazine, carries an excellent article on its Industrial Products (IP) group entitled, "Old Business, New Attitude." The three tenets according to Group VP Dave Garin are the Approach to Market, the Approach to the Customer, and the Approach to the Product.

In the IP marketplace a quarter of the rate quotes issued moved 80% of the goods, so rate simplification had to be Job Number One. Now comes market-based good flow analysis and network decisions based on capacity to meet shipper' goods flows. Customers say they want to deal with the same railroad representatives over time, and they want those faces to have all the supply-chain answers, not just by-the-move rates. We're talking relationship-building here.

Finally, not all carloads are created equal. John D. Rockefeller Sr. observed more than 100 years ago the more rail freight he could concentrate in one location the better a deal he could strike. Carload concentrations still count, and BNSF is simply saying focused network provides maximum customer value. Shortliners, concentrating loads in one place is *your* stock in trade, and BNSF is on record as wanting to build on it.

(1) Robert Hagstrom, *The Essential Buffett*, © 2001John Wiley & Sons

Rick Webb's WATCO shortline group (www.watcocompanies.com) certainly is. Its Timber Rock line was formed in 1998 as a 40-mile BNSF spin-off and just this week added another 100 track-miles in eastern Texas through a 10-year lease agreement with BNSF. Pete Rickershauser, BNSF VP for Network development says shortlines often can "provide service offerings closely tailored to their shippers' needs and we've found WATCO to be nimble and competent service providers." Exactly what Matt Rose, BNSF Chairman, was talking about in his ASLRRA address some months ago.

UP President Ike Evans called the other afternoon to chat about the link between Trip Plan Compliance and Customer Satisfaction (WIR 8/23). His message is that UP is driving its solid carload gains (an industry-leading 3.7% for 3Q02 to date) by instilling greater customer confidence in the product, thereby lessening the need to discount. He also said – and this is borne out by UP's half-page four-color ad in Monday's WSJ – that this 140-year old company is in reality a totally new company that has yet to hit its stride. First the merger meltdowns in the mid-1990s and now this downturn. Can you spell positioning for 2003-2005?

As we can see from success stories like the UP-CSXT Express Lane and the UP-NS Blue Streak the heat is on to build franchises in the high-end high yield product line. Morgan Stanley's Jim Valentine says in his September 3 report, "Now that the SP and CNW acquisitions have been fully integrated UP can sell network solutions in a service area that includes the faster-growing railroad-friendly freight markets in the US."

The trucking industry took two shots this week, first in an AP article about the individual trucker's travails and then on Tuesday when Consolidated Freightways (CF) filed for bankruptcy. The AP story quotes an ATA executive who says some 7,000 carriers with five or more trucks are no more; for smaller outfits the number of closures is in five figures.

CF went the bankruptcy route citing, among other things, substantial operating losses in the prior 18 months and the resulting impact on liquidity. For 2Q02 CF lost $123 mm on sales of $482 mm following a 1Q02 loss of $31 mm on $463 mm in sales. Competitors Roadway, Yellow Freight picked up the pieces not only in freight billings but also in stock price advances. The $2 bn of annual CF billings have got to go somewhere.

Department of Corrections: Re trackage rights vs. track ownership, both fellow pundit Larry Kaufman and NIT League's Ed Rastatter to me to task citing BNSF, UP and SP. What I should have said it that it works *to a point*, and that as distances and train sizes grow 31 cents a vehicle-mile gets expensive. Drop me a line for further explanation…. Re the demise of Conrail Shared Assets, Norfolk Southern's Jim McClellan and Steve Eisenach speaker-phoned me Tuesday to stress the point there is no basis to the rumor and that my remarks were on point. QED.

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.

Selected Class 1 and Shortline Railroad Owner Earnings, year ending 12/31/2001

Railroad	BNSF	CNI	CP	CSXT	NS	UP
All dollar amts but per-share in MMs		($C)	($C)			
Year ending	12/31/01	12/31/01	12/31/01	12/31/01	12/31/01	12/31/01
price at yr end	$ 28.980	$ 49.210	$ 20.310	$ 35.120	$ 18.670	$ 57.180
dill shares (mm)	390.70	201.00	158.90	212.40	385.20	271.90
Cash Flow						
net income (corporate)	$731.0	$1,040.0	$410.0	$293.0	$375.0	$966.0
Depreciation	$ 909.00	$ 565.00	$ 334.00	$ 613.00	$ 527.00	$ 1,126.00
Capex	$ (1,549.00)	$ (1,058.00)	$ (566.00)	$ (930.00)	$ (746.00)	$ (1,736.00)
Owner Earnings	$ 91.00	$ 547.00	$ 178.00	$ (24.00)	$ 156.00	$ 356.00
OE/share	$ 0.23	$ 2.72	$ 1.12	$ (0.11)	$ 0.40	$ 1.31

Railroad	GNWR	GNWR-A	RRA	RRA-A
All dollar amts but per-share in MMs				
Year ending	12/31/01	12/31/01	12/31/01	12/31/01
price at yr end	$ 21.00	$ 21.00	$ 14.60	$ 14.60
dill shares (mm)	12.90	12.90	25.40	25.40
Cash Flow				
net income (corporate)	$19.1	$19.1	$17.0	
Depreciation	$ 12.80	$ 12.80	$ 27.60	
EBITDA				$ 102.30
Interest				$ (52.50)
Deferred Taxes		$ 4.00		
Capex	$ (16.60)	$ (16.60)	$ (61.70)	$ (61.70)
Owner Earnings	$15.3	$19.3	-$17.1	-$11.9
OE/share	$ 1.19	$ 1.50	$ (0.67)	$ (0.47)

Source: Individual Railroad Financial Statements