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The Railroad Week in Review 10/25/2002

Railroad earnings week has been a generally upbeat story in spite of a soft economy, the West Coast Port follies, storms and droughts. Each of these is, as UP's Dick Davidson pointed out, a one-time event and from which the rail industry as a whole has emerged stronger. A particularly encouraging theme has been the continued success in "modal conversion," getting the rubber off the road. Best of all, a lot of it is going into carload freight, not just from road to ramp.

As with 2Q02 we'll present the overview of the conference calls here and leave the specifics of the carload changes and trends to the Quarterly Review. Recall three months ago we remarked that how well the 2Q Review was received would determine whether we'd do on for 3Q. In a word, it was a success. In fact one shortline holding company present remarked to me, "I take it everywhere I go." Onward…

Intermodal got top billing at Tuesday's BNSF conference call. CEO Matt Rose said transpacific container shipping will increase 60% over 10 years. In addition, the premium truckload business is on the cusp of a significant growth spurt – a $7 bn opportunity. Intermodal revenues per 1000 GTMs were 40% more than were industrial products and 72% more than ag.

Total revenues dipped 1% vs 3Q02 while expenses crept up two points pushing the OR to 81.8, up 3 points yoy. Carload revenue (ex-coal and intermodal) was off 9% while coal and intermodal revenues rose 3% and 7% respectively. Automotive alone was off 42% yoy due to the loss of GM, dragging the average down a bit. Operating income fell 16% while reduced interest and taxes and the aggressive share repurchase program held eps to an 11% decline.

That's the bad news. The good news is BNSF is running at a system average of 91.2% on time. Freight car and locomotive velocities in miles per day are back where they were before the 2001 dip and average train length is up to 114 cars, an all-time high. Non-productive crew starts fell to a record 14.9% while head counts continue to shrink and MGTM per employee is the best ever. Looking ahead 4Q earnings will be about the same, though improvements in positioning and productivity will serve BNSF stakeholders well as the economy regains its health.

Union Pacific's message is clearly that business growth is related to performance. And so it was that UP reported an all-time record net income for the third quarter of $437 million, or $1.63 per diluted share. This is compared to net income of $267 million, or $1.04 per diluted share, in the third quarter of 2001. Third quarter results included income gains from a transaction with the Utah Transit Authority, as well as a tax settlement. Excluding these items, quarterly earnings were $1.19 per diluted share – still a 14% increase over 3Q01.

Out on the railroad merchandise carloadings (everything but coal and intermodal) were up in every category. Intermodal was up 9% with coal the only negative. This was the best quarter ever hitting 190,000 loadings a week until the port effect hit, depressing levels to the 150,000 range. By now UP is back to the 180,000 level, closing in on the 3Q00 and 3Q01 levels. Trip plan compliance is a record 95% with industry pull and place at 85%, another all-time high.

Norfolk Southern posted a 27% jump in operating income on a 6% rise in revenues with expenses held to a 2% increase for an OR of 80.5 vs. 83.8 in 3Q01. Net income was up 59%. All five commodity groups posted gains for the first time since the CR integration. Merchandise carload revenues were up 6% on a 5% increase in volume. In other words, five-sixths of the revenue gains came from increased volumes – a fact that ought to be music to the ears of NS shortline connections. Coal was up a point and intermodal up 11%, however increased short-haul business in these two groups took a point each off the yoy revenue gains.

The Thoroughbred Operating Plan (TOP) continues to play an increasing role at NS. Recall the TOP is designed to get the right cars on the right trains and delivered to the right places at the time specified in the trip plan. Third quarter train performance improved to 84% on time vs 74% in 3Q02. The big changes were in multilevel (88% from 77%) and general merchandise (84% from 68%). We see blocking compliance (right car, right block, right train) at 95%+ and car hire down 12% even with the increased carload (and car-hire sensitive) business up.

CSX continues to grapple with an OR in the high 80s. Since 4Q00 revenues and carloads (an intermodal unit is a "carload" in this connotation) have hovered around the 1.8 bn level with operating income ranging from $182 mm (1Q01) to $293 mm (2Q02). Consequently, the OR remains stubbornly stuck north 0f 86, except for 2Q02 when it hit 84. For the present quarter railroad revenues were unchanged yoy while expenses were up a point. Lower interest and tax exposure contributed to a 27% increase in the net.

CSXT President Mike Ward spoke specifically about the effect of the two Amtrak derailments on operating results. Slow orders slowed not only passenger trains but also everything else. Consequently the hoped-for gains in system train speed, yard dwell, recrews and on-time destination arrivals did not materialize, adding an estimated $15 mm to the overall operating cost. Ward even took his own "Better is cheaper" mantra and turned it around for this quarter: "Worse costs more." My own view is that 2Q02 results better reflect what Ward's team can do and the operating metrics are going to be much improved going forward.

If there's a common thread running through these reports it's that good service begets good revenue. We are personally involved in car-scheduling projects with some clients who are shippers and others that are shortlines. In every case trip plan performance is bringing new carload business to the railroads. Moreover, this is modal conversion in the best sense. None of the goods ever hits the public highway.

At the NJ Shortline meeting this morning one of the members told how being able to measure performance was helping him win new business. It's a basic marketing tenet that quality is defined by the customer as measured against his expectations. Carload trip plans from origin are commitments made *before* the car turns a wheel, thus setting the expectation level. You get on a plane at ORD bound for DFW and your expectation is for an arrival at the published hour. The freight carload expectation *can* be that exact.

Due to time and space constraints we have to reserve comment on results from the remaining class 1s for next week. We'll have our report on the BNSF shortline meeting at that time as well.

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.

Commodity Carload Comps
Quarter ending 9/30/2002

Revenue and income in $millions

Metric		BNSF		CSX		NS		UP
Railroad revs (1)	$	2,308	$	1,786	$	1,598	$	2,850
Carload revs (2)	$	1,013	$	1,066	$	917	$	1,593
Pct carload		43.9%		59.7%		57.4%		55.9%
Mdse Carloads (000)		646		829		698		1,018
Rev/CL	$	1,568		1,286		1,314	$	1,565
Operating Income (3)	$	421	$	276	$	311	$	619
Other Income (3)	$	(7)	$	28	$	4	$	161
Net Income (3)	$	192	$	127	$	126	$	437
RR Operating Ratio		81.8%		87.3%		80.5%		78.3%
Net Margin (3)		8.3%		7.1%		7.9%		15.3%

(1) CN, CP in $Canadian
(2) Excludes coal, intermodal
(3) Corporate