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**The Railroad Week in Review**

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***"The future is not for us to decide. All we have to decide is what to do with the time that is given us." -- Gandalf***

So it's now time to put away the party hats, mistletoe, the dregs of Christmas past, and knuckle down. A lot of coal has passed under the bridge since last we looked. Perpend…

Fellow rail stock watcher Tom Murray reports in his most excellent monthly letter, *Rail Stock Watch*, that for the year 2002 "The Dow Jones and S&P rail indexes, and the median price of the stocks we follow, were all down between 2.6% and 3.6%. But on a relative basis, rail stocks didn't do badly at all, given that the DJIA was down by roughly 17% and the S&P 500 was off by 23%. Thus investors could at least feel that in 2002 rail stocks were a better neighborhood to live in than some of the alternatives."

Some specifics: NS and UP stock prices took top honors finishing the year up 9% and 5% respectively. I think NS got hammered unfairly early on and came back on a combination of good fundamentals against easy yoy comps. Union Pacific's gains come as the CNW and SP additions begin to show their values to an incredibly strong carload franchise.

Looking ahead, we continue to see intermodal a revenue leader with coal improving yoy due to increased yoy volumes. There is a growing sense that 2003 will be an improvement on 2002, and that the so-called "economically sensitive" merchandise carload business will do better. CSX (Exhibit 1) and NS appear to be priced right as they being to capitalize on the Conrail investment and both have healthy carload franchises.

Recall the price-earnings (PE) ratio theoretically reflects yoy earnings growth rate, so a PE-Growth rate ratio (PEG) of one indicates pricing to perfection. Anything under one is a Buy, under 0.5 a strong buy. Going the other way, the higher the PEG the more expensive the stock. Both eastern roads have PEGs under one and thus are good opportunities for price appreciation.

**D**M&E President Kevin Schieffer had a Merry Christmas thanks to a favorable ruling by the US Federal District Court in re a South Dakota eminent domain law passed in 1999. Evidently the SD law incorrectly tried to transfer federal regulatory power that lies with the STB away from that august organization and to the state Governor. Schieffer called the decision a "home run."

It was one of those classic cases where those against the project proposed the law and pushed it through the state government, as we've seen in similar NIMBY power-grab cases before. But the court found that "such power amounts to regulation of the railroads [by the Governor] and is prohibited." How ironic it is that Schieffer noted that the vast majority of elected officials throughout the state have in the past and continue to provide strong support for the project. Three cheers for the DM&E and its advocates for taking a strong stand against SD's clumsy move.

**E**d Burkhardt's RailWorld consortium appears to be ready to rock-and-roll with a loco fleet that is 100% GE. Opening day for the 850-mile Montreal Maine & Atlantic (MMA) system replacing the venerable Bangor & Aroostook (BAR) and connecting lines cobbled together by previous owner, Irons Road Railways. Says Burkhardt, the GE power is available and priced right. The previously announced Jan 1 start was, in Burkhardt's words, "too ambitious," and so it is that the closing date will be January 8, 2003, with the start-up to begin the following day.

The MMA includes the former BAR, Canadian American Railroad, Quebec Southern Railroad, Northern Vermont Railroad, and Logistics Management Systems. It's fairly well-known that railraods in northern New England have not fared particularly well over the past decade or so, and one of the reasons BAR went into bankruptcy was lack of revenue traffic. Indications are, however that the new owners have gone out to see the people and are encouraged. And that's the *really* good news.

**F**ollowing up on December's CSXT shortline meeting we've queried our list of some 200 CSXT shortlines to see how many actually have ISAs and of that number how many have ISA that work as they're supposed to. The good news is that so far everybody responding has a signed ISA and all these report car movement events to Train II. These mini-surveys as a rule generate about a 25% response rate. If you got one please send it in ASAP; if you're a CSXT connection and did not get a questionnaire (five short fill-in-the blanks items) let me know and you'll have one in the next e-mail.

**O**ne of our favorite tubs to thump has to do with scheduled operations -- doing the same thing every day. You've heard UP's Ike Evans talk about how consistency drives customer satisfaction. You've read BNSF's Dave Garin's remarks about the importance of carload networks. Still, the proof of the pudding is in the merchandise performance numbers. Exhibit 2 compares the traffic makeup of the Big Six and CN is the clear carload leader, outdistancing CP by nine points and UP, the largest US carrier in percentage of merchandise traffic, by 17 points.

Even more striking, my 2003 estimate for merchandise carloads per year per mile puts CN second only to CSX with a 20-point spread in operating ratio between them. We already know the CSX 87 OR is an aberration; think of what they could do with a few thousand fewer miles of railroad while reaping the rewards of the present push on the revenue and service plan venues. But CSX aside it still looks like the higher the merchandise percentage the lower the OR.

Shortline operators might well be watching these merchandise carload figures very closely to see where the best BD opportunities are likely to be. One caveat, though: earnings estimates reflect the entire revenue base, not just merchandise carloads. CN has gone rapidly from a moribund crown corporation to a maturing public company where earnings growth is a function more of the economy than of manipulating revenues and costs. NS and CSX, on the other hand, are at the beginning of the curve as the Conrail assimilation becomes complete.

The earnings stories do not change the relative importance of the carload business to the respective properties. But a low OR and consistent earnings growth combined with a healthy carload business is the best if both worlds.

**Renewal notices went out last week. If you think you're up for renewal and you didn't get one, drop me a note. Starting this month we're offering WIR-Plus: A full year of WIR plus four Quarterly Supplements for the base sub rate plus 3X the single-copy quarterly rate.**

***Roy Blanchard writes and consults on railroad commercial, financial and operating best practices for shortlines and shippers. Disclosure: Blanchard may from time to time hold long, short, debt or derivative positions in the companies mentioned here. A list of such holdings is available on request.***

Exhibit 1

**Looking Back**

| Road | Price 31-Dec | First Call Estimates>> 4Q02e | 4Q01 | Change | FY2002e | FY2001 | Change |
|---|---|---|---|---|---|---|---|
| BNSF | $ 28.53 | $ 0.52 | $ 0.57 | -8.8% | $ 1.99 | $ 2.08 | -4.3% |
| CN | $ 48.28 | $ 0.84 | $ 0.94 | -10.6% | $ 3.29 | $ 3.19 | 3.1% |
| CP | $ 19.50 | $ 0.47 | $ 0.47 | 0.0% | $ 1.63 | $ 1.50 | 8.7% |
| CSX | $ 35.05 | $ 0.57 | $ 0.48 | 18.8% | $ 2.10 | $ 1.55 | 35.5% |
| NS | $ 18.33 | $ 0.31 | $ 0.30 | 3.3% | $ 1.16 | $ 0.94 | 23.4% |
| UP | $ 57.00 | $ 1.10 | $ 1.06 | 3.8% | $ 4.44 | $ 3.57 | 24.4% |

**Looking Ahead**

| | 1Q03e | 1Q02a | Change | FY2003e | Change | PE03 | PEG03 |
|---|---|---|---|---|---|---|---|
| BNSF | $ 0.43 | $ 0.45 | -4.4% | $ 2.23 | 12.1% | 12.79 | 1.06 |
| CN | $ 0.77 | $ 0.72 | 6.9% | $ 3.43 | 4.3% | 14.08 | 3.31 |
| CP | $ 0.28 | $ 0.27 | 3.7% | $ 1.74 | 6.7% | 11.21 | 1.66 |
| CSX | $ 0.44 | $ 0.32 | 37.5% | $ 2.48 | 18.1% | 14.13 | 0.78 |
| NS | $ 0.27 | $ 0.22 | 22.7% | $ 1.41 | 21.6% | 13.00 | 0.60 |
| UP | $ 0.93 | $ 0.86 | 8.1% | $ 4.75 | 7.0% | 12.00 | 1.72 |

Exhibit 2

**Commodity Summary by Class 1 Railroad**
**YTD through Week 52 (12/21/2002)**

| Road | BNSF | CN | CP | CSX | NS | UP | AAR Pct* |
|---|---|---|---|---|---|---|---|
| Coal | 33.20 | 13.90 | 17.30 | 22.30 | 33.60 | 28.00 | 32.50 |
| Intermodal | 29.20 | 18.20 | 23.90 | 28.80 | 21.20 | 21.20 | 22.10 |
| sub total | 62.40 | 32.10 | 41.20 | 51.10 | 54.80 | 49.20 | 54.60 |
| Merchandise | 37.60 | 67.90 | 58.80 | 48.90 | 45.20 | 50.80 | 45.40 |
| Total | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Miles operated | 33,000 | 18,000 | 13,900 | 23,400 | 21,800 | 38,700 | NA |
| Est. Mdse CL ** | 2,533 | 2,431 | 1,077 | 3,341 | 2,775 | 4,008 | NA |
| Mdse CL/mile | 77 | 135 | 78 | 143 | 127 | 104 | NA |
| 3Q02 OR | 81.8 | 67.8 | 79.6 | 87.3 | 80.5 | 78.3 | NA |

* Percent of total class 1 carloads reported

**Estimated FY2002 based on 3QYTD non-coal, non-IM carloads, in thousands