The Blanchard Company
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The Railroad Week in Review
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Earnings Week begins in earnest next week with BNSF kicking off the proceedings Tuesday followed by CN and UP Wednesday. Then CP comes to town the following Tuesday with NS on Wednesday. CSX and KCS bring up the markers on Thursday. GWR has scheduled a conference call for Feb 13; neither FEC nor RRA have signed in. The table on page 3 lays out what's generally expected. There is no reported coverage for FEC. This is rather odd in itself because FEC is 2.5 times the GWR market cap and four times that of RRA. But I digress.

The big change for the quarter is CSX, up 19%. IMHO this is largely due to continued pressure on cost control and new business initiatives. For the year both CSX and arch-competitor NS will see double-digit increases as they finish working through the last of their Conrail follies. The UP gains are again a function of finally getting the merger synergies working for them.

I think the 2003 earnings outlook is encouraging. We're looking at double-digit increases on five of the nine properties. BNSF moves beyond over the poor coal and auto comps while CSX and NS continue to build on their Conrail franchises even as they refine operations elsewhere. Shortlines report much improved interchange reliability on both and both are zeroing in on predictable dock-to-dock transit times. The UP story continues.

In a Dec 20 press release RRA said the continuing drought in Australia would limit the 2003 net to the 80-85 cent range. Consequently the modest PE of eight times forward estimates seems rich on top of a projected 5% growth rate. Note too that both Canadian roads are sporting PEs of 12 against growth rates much less than that. At the other end of the spectrum GWR sees the 2003 net up 20% yoy making the 11 PE the cheapest of the lot.

In short, 2003 promises to be a watershed year for shortlines, especially those with extensive and healthy North American properties. BNSF has already gone public with its line sale program and I suspect there are others in the wings. RRA expects a 5-6% revenue increase in NA where three-quarters of total revenues come from. GWR added the Oregon Electric lease from BNSF in October (WIR 11/15/2002), worth another 2,000 cars a month while the Utah and Emons acquisitions are still maturing.

And that doesn't begin to count another 300 shortlines that continue to grow up and out. On the flip side one can reasonably expect there to be a fair number of shortlines going out of business in the next five years as they either lose their niches or don't make the mechanical, engineering, and systems investments needed to stay in the game.

Merchandise carload traffic remains a core business, never mind the intermodal intrigue or the constancy of coal. Reader response to this thread has brought some key insights to success in this necessarily fragmented business. First, the eliminate-the-locals theme. Increasingly shortlines preblock or even make whole trains for the class 1s -- IHB for BNSF at Blue Island, for example.

Second, keep the carload data current and the cars moving. A WIR reader in the chemicals business writes that waybills and cars don't always move together or cars shown as pulled are still in the plant. Out on the road yard dwell times lengthen when trains are annulled, especially during a holiday shut-down, and then yard are flushed to get everything out. Not good for his private fleet usage factor.

Third, keep the customer contact team constant. A grain merchandiser writes that successive and rapid changes in field contacts as well as HQ support personnel means that “a lot of time is spent on getting acquainted instead of on productive sales time.” Better, he says, to “not be moving people all the time so there is a level of understanding of how we operate and so we understand the constraints facing the railroad.” One road moves its reps every two years or so while another road hasn’t changed reps in the eight years my correspondent has been there.

Fourth, be sure interchange times match between. A shipper sees 17 days transit time dock to dock against a trip plan of 12. Turns out the originating shortline and the terminating class 1 have a day or two difference of opinion as to when interchange took place. That makes it even harder to drill down for root failure causes. Another shortline’s inbound cars are shown as interchanged when they pass an AEI-reader well in advance of the physical interchange point. If lunch happens between reader and shortline, guess who gets charged for the car hire. And it makes the shortline look to the customer like it’s lallygagging.

Genesee & Wyoming reported December North American carloads up 28.6% or 5.5% excluding the acquisitions of Emons (Feb) and Utah Ry (Aug). For the quarter cars were up 22% total and 1% without the acquisitions. All-in carloads for the year were up 18.7%. It is instructive to note that the yoy carload spreads don’t really start to expand until about two months into the relationship so that by July the 3,000-carload yoy spread in Feb had grown to 7,000. By December the spread was 9,000 cars with Utah.

RailAmerica’s December North American total carloads were up 31.4% and for the year up 25% overall. December same-store cars rose only 2.6% and less than a point YTD. Recall The Park Sierra and StatesRail transactions were concluded in Jan 2002 so starting this month the easy comps are gone. After the 30,000-carload jump Dec 2001 to Jan 2002 it’s been a steady 90,000 cars a month, plus or minus. One positive sign is 4Q02 was some 14,000 cars ahead of 1Q02, about 4.8%.

BNSF will keep its share repurchase program in high gear adding another 30 mm shares to the 116 mm shares already purchased, bringing the 12/31/2002 share count down another notch (see chart). Also BNSF will pay its regular dividend of 12 cents a share on April 1 to shareholders of record March 11. Now that may not seem like much, but based on Friday’s close of $26.67 that’s 1.80% a year – best of the rails and right in line with the S&P 500’s 1.76 average yield (and ever better if tax-free).

Kansas City Southern has started direct service to the Port of Mobile, AL via haulage and rights over the former IC through Jackson and Hattiesburg, MS. A new interchange with CSX at Mobile is an added plus. This agreement provides KCS customers with access to all facilities served by The Alabama State Docks and the Central Gulf Railroad. With access to the Port of Mobile, KCS now offers customers service to seven U.S. gulf ports, more than any other road.

Elsewhere, KCS named Larry Stevenson SVP for marketing and sales and Robert Cleator VP sales. These new appointments support a restructuring of the department, aimed at increasing its customer focus, streamlining its function and making it easier to do business with KCS. The marketing function will continue to operate along commodity lines, with all of them reporting to Stevenson. The account managers and directors will report to Cleator and he reports to Stevenson. Congratulations, guys.

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.

Railroad Market Capitalizations and earnings estimates

Ticker	BNI	CNI	CP	CSX	GWR	KSU	NSC	RRA	UNP
Exchange	NYSE	NYSE	NYSE	NYSE	NYSE	NYSE	NYSE	NYSE	NYSE
Price ($USD)	$ 26.86	$ 41.17	$ 20.20	$ 29.06	$ 20.89	$ 12.50	$ 19.63	$ 7.02	$ 60.19
Dil shares	382.4	203.1	159	213.5	17.6	60.1	388	32.8	276.5
Market Cap*	$ 10,271	$ 8,362	$ 3,212	$ 6,204	$ 368	$ 751	$ 7,616	$ 230	$ 16,643
Earnings	21-Jan	22-Jan	28-Jan	30-Jan	13-Feb	30-Jan	29-Jan		22-Jan
4Q01a	$ 0.57	$ 0.94	$ 0.47	$ 0.48	$ 0.35	$ 0.18	$ 0.30	$ 0.19	$ 1.06
4Q02e	$ 0.52	$ 0.84	$ 0.47	$ 0.57	$ 0.38	$ 0.16	$ 0.30	$ 0.19	$ 1.08
change	-8.8%	-10.6%	0.0%	18.8%	8.6%	-11.1%	0.0%	0.0%	1.9%
FY01	$ 2.08	$ 3.19	$ 1.50	$ 1.55	$ 1.49	$ 0.45	$ 0.94	$ 0.72	$ 3.77
FY02	$ 1.98	$ 3.29	$ 1.63	$ 2.09	$ 1.53	$ 0.79	$ 1.15	$ 0.79	$ 4.28
change	-4.8%	3.1%	8.7%	34.8%	2.7%	75.6%	22.3%	9.7%	13.5%
FY03e	$ 2.23	$ 3.43	$ 1.74	$ 2.48	$ 1.85	$ 0.84	$ 1.40	$ 0.83	$ 4.74
change	12.6%	4.3%	6.7%	18.7%	20.9%	6.3%	21.7%	5.1%	10.7%
# analysts	10	8	12	11	5	6	11	5	11
Fwd PE	12.04	12.00	11.61	11.72	11.29	14.88	14.02	8.46	12.70
Fwd PEG	0.95	2.82	1.72	0.63	0.54	2.35	0.64	1.67	1.18

* $USD mm

Source: First Call reported at yahoo.com