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The Railroad Week in Review
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A long-time shortline reader writes, "While I appreciate the overview on the Class I's, I definitely miss your former focus on shortlines. I know that you are expanding your horizons with the class 1s however don't forget us guys who subscribe to your Newsletter." Point taken. What I have been attempting to do throughout Earnings Week is to focus on the class 1 carload business and what's working -- CP's "same store" results, e.g.

This week's *Review* compares operating metrics of the class 1s – operating ratio (OR), carload revenue as a percentage of total revenue, revenue per merchandise carload, e.g. -- to show who's doing the most in the carload arena and thus the better shortline connections. The comparison (Table I) provides a glimpse of class 1 performance in terms of shortline implications going forward: the stronger the carload business the better the shortline prospects.

Market capitalization is useful because it lets you know the relative size and market clout of your friendly class 1 connections. Earnings per share drive stock price; debt load and returns are measures of financial health that in turn can color shortline relationships. Cash flow is important because, like Frank Zappa once said, money gives you options: more capex, buy back more shares, pay dividends. The FCF margin is a percent of revenue, not unlike net margin.

The Railway Statistical Data section is a series of metrics designed to show how well the assets are used in the production of revenues. The shortline implication is the more efficient your connection the more efficient you can be. The carload portion of total revenue and revenue per carload (ex-coal, intermodal) indicate the degree of focus on carload markets. Revenue ton-miles per employee and per gallon of fuel and the load-to-empty ratio are other asset-utilization flags.

Granted there will be differences of opinion – let me know where yours lie. And be sure to drop me a note if you need further detail on any of this. I'll cover the other class 1s and plus GWR and RRA following their earnings reports. The Fourth Quarter Review will cover the traffic base in detail by commodity revenue and carloads.

Fellow pundit Larry Kaufman sent this note: "As I've long believed, the Class 1s are demonstrating that once you get revenue up to a critical mass that justifies the capital structure they can both make money and provide better service. And, contrary to railroads' long-held belief, customers will pay for service."

Larry's right again. For so long the only way the RR could get the biz was on price. That created a culture that didn't know how to sell any other way. Bad news. In his 1987 book, *Thriving on Chaos*, management guru Tom Peters writes, "Sustainable market share comes from customer-perceived service quality vis a vis the competition." That means providing a product that stands apart from and is worth more than whatever the competition has.

As for price, it can never be a unique selling point: no matter how low my price, if you are my competitor and really want the biz you can name a lower one than mine. And once I'm out of the way you can start jacking up prices again. Rails selling on price simply could not compete with trucks on their own price-driven turf. Moreover, Peters points out that ROI runs highest for focused, differentiated firms with low market shares and for cost-leadership firms with high market share. The rails will never be the latter; better they focus on the former.

Regarding my comments on the Price Earnings/Growth metric as a stock evaluation tool (WIR 1/24) an investor writes, "You do not do RailAmerica (RRA) justice. The analysis is superficial at best. It is true that the growth this year is only 5% or so with Australia down huge. But droughts come and go. This one will too. All other things being equal, the company has earning power closer to $1.20. Tangible book is over $9.00 per share. If that is not cheap, I don't know what is.

"To me, well-managed short lines are good long-term investments. RRA has done a good job operating their RR and also cleaning up their balance sheet. There could be a refinancing that will lower interest costs significantly going forward. Also there are further divestiture potentials down the road." This is the kind of letter I like – full of facts and figures, not just opinions.

On the heels of that note comes news that RRA has put its 55% Chilean railroad interest on the block. Included is the 2,200-kilometer (1,400-mile) Ferronor Railroad and the 89-kilometer (57-mile) Potrerillos Railway. In 2002 the railroads moved approximately 120,000 carloads of iron ore, copper ore, limestone, chemicals and petroleum products for revenues of $22 mm, earning a little more than $6 mm before interest, taxes and depreciation, about 5% of RRA's total business. Credit Lyonnais is brokering the deal and the book should be out by the end of Feb.

Then on Thursday RRA said it plans to boost the disinvestment level to around $100 mm through 2004, taking debt-to-cap down to 50% from the present 63%. This fits with prior discussions with RRA about non-strategic shortline sales to enhance the portfolio of core assets. Thus far RRA has gotten a good price for the properties it has had on the block. Whether the $100 mm is attainable depends on the properties and the possibilities.

Deprescription has finally happened after what has seemed like years of jaw-boning, though it's not entirely clear to me that all and sundry really understand it. Pete Kleifgen, newly-tapped Chairman of Railcar Management Inc., called the other day and we touched on the matter. By way of review, the Jan 1 full implementation of deprescription means virtually all car hire rates on railroad-marked cars are open for negotiation.

For shortline operators it means making their own deals with car owners. This can be a bit daunting, especially if one isn't wired with the going rates. Here's where Kleifgen has the better mousetrap. RMI has developed the "Car Hire Marketplace," an independent source of information that provides an exchange of accurate and impartial car hire rate information. Moreover, it lets shortlines communicate bids and offers electronically with other railroads, car owners and Railinc.

Pete says for some short lines and all Class Is, this is top-of-mind today. UP is on board already. And IMHO any shortline wishing to go it alone it will find itself in the midst of a veritable snake pit. For the full story, go to www.railcarmgt.com . It's a worthwhile visit.

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.

Table I. Class I Results for the Year Ending 12/31/2002

Railroad	BNSF	CN	CP	CSXT	NS	UP
All dollar amts but per-share in MMs		($CDN)	($CDN)			
Year ending	**12/31/02**	**12/31/02**	**12/31/02**	**12/31/02**	**12/31/02**	**12/31/02**
Price at yr end ($US)	$ 26.01	$ 41.17	$ 20.20	$ 29.06	$ 19.63	$ 60.19
Diluted shares (mm)	376	202	159	214	388	278
Market cap ($US)	9,780	8,316	3,212	6,219	7,616	16,733
Revenues	8,979	6,110	3,665	8,252	6,270	12,491
Operating Expenses	7,323	4,240	2,809	7,025	5,112	10,167
Operating Income	1,656	1,870	856	1,227	1,158	2,324
Net income (corporate)	760	1,152	496	467	460	1,341
Earnings per share	$ 2.02	$ 5.70	$ 3.12	$ 2.18	$ 1.19	$ 4.82
Div yield	1.8%	1.6%	1.7%	1.4%	1.4%	1.5%
Debt/capital	45%	37%	46%	51%	52%	44%
ROE	9.6%	13.8%	14.6%	7.5%	7.1%	12.6%
ROA	2.9%	5.3%	5.1%	2.2%	2.3%	4.1%
ROIC	3.2%	5.7%	5.7%	2.3%	2.4%	4.1%
Cash Flow						
Ops cash flow	$ 2,106	$ 1,612	$ 784	$ 1,127	$ 803	$ 2,250
Capex	$ (1,459)	$ (938)	$ (559)	$ (1,080)	$ (689)	$ (1,887)
FCF before divs	$ 647	$ 674	$ 225	$ 47	$ 114	$ 363
FCF Margin	7.21%	11.03%	6.14%	0.57%	1.82%	2.91%
Railway Statistica Data						
Railroad Operating Ratio	81.6%	69.4%	76.6%	86.1%	81.5%	79.8%
Pct mdse carload revenue	45.0%	74.0%	58.6%	60.6%	58.2%	56.7%
Revenue/mile	$ 271	$ 343	$ 264	$ 307	$ 288	$ 289
Revenue per mdse carload	$ 1,601	$ 1,863	$ 1,971	$ 1,307	$ 1,323	$ 1,574
Revenue/employee	$ 228,957	$ 263,476	$ 227,414	$ 208,838	$ 219,330	$ 235,930
Revenue/MRTM	18.32	38.22	34.03	31.48	35.03	21.51
Revenue units/route mile	76.3	136.2	78.5	96.8	126.5	103.9
Revenue units/employee	64.4	104.7	67.6	96.8	96.4	84.9
MRTM/employee	12,501	6,894	6,683	6,635	6,262	10,967
MRTMs/gallon consumed	417	426	414	399	379	394
Gallons cons/MGTM	1.31	1.21	1.25	1.22	1.38	1.32
Load to empty ratio	54.7%	51.7%	51.8%	48.6%	52.2%	52.2%