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Don Phillips writes in *The Washington Post* for Feb 27 that STB Chairman Linda Morgan will resign her post April 8, nine months ahead of schedule. He writes, "Morgan said she believes that the railroad industry has emerged from the merger period better, because the companies learned to pay closer attention to their customers and to day-by-day operations." Ain't that the truth. The scheduled railroad, trip plans, guaranteed car supply, and market-based pricing are but a few of the benefits.

Chairman Morgan fears that unless the railroads can earn their cost of capital the network will shrink still further. Recall that one of her goals in holding off further mergers was to make sure no more infrastructure is lost. In the Conrail transaction, for example, those of use close to the process wished certain key links – seen redundant by previous owners – had been retained. The assumption was business was never coming back and the capacity was excess.

Happily, Morgan's sucessor, Roger Nober, similarly sees earning the cost of capital and seamless service as critical (WIR 2/22/2003). On the other hand NIT League President Ed Emmett worries that Chairman Morgan "seems to view railroad customers as a set group, instead of trying to inject the benefits of competition where appropriate."

One way to inject competition is to locate new facilities on shortlines connecting to two or more class 1s. Which is fine, until you get, as I did, this note from a state DOT rail planner: "More than half of our track miles are operated by short lines and more than 60% of the rail-served industries are served by short lines. One car out every five the Class Is handle is from business generated by the smaller railroads, but the Class Is don't seem to get it. They've actually worked against siting new industries on short lines -- even giving incentives to locate in another state."

RailAmerica (RRA) has done very well with the StatesRail and Park Sierra acquisitions closed in January 2002. North American revenues went up 36% on 25% more revenue units. Operating expenses for the year were up 34% while transportation expense including fuel, labor, car hire and maintenance was held to a 33% increase. GS&A was a minor nuisance, up 39%, though CFO Mike Howe said on the conference call it was largely due to the big acquisitions. From this I must conclude it will come down as a percent of revenues.

North American operating income was $21.5 mm for the quarter and $84.0 mm for the year representing increases of 48% and 41% respectively. The 4Q02 operating ratio shed 2.1 points to 74.3 and just under a point to 74.8 for the year. That substantial improvement puts RRA in the Number Two slot for operating efficiency, behind CN's 69.4. Of particular note to other shortline operators, RRA has gotten a limited OK to pass fuel surcharges onto its own customers. That sure beats eating increased fuel costs and could be a model for others.

If the good news is that North America accounts for 75% of RRA's total revenue, the bad news is that the 100-year drought in Australia so damaged the wheat crop that 4Q02 revenues skidded 17%. That against an 18% hike in ops expense pegged the OR at 127.2 and drove a $5.6 mm loss vs. last year's $2.7 mm operating profit. For the year operating income was $5.1 mm, down 77% yoy. The net effect was to take consolidated earnings down 18 cents a share.

Consolidated 4Q02 operating income was $12.7 mm, down 23% yoy and including charges relating to restructuring, asset sales, etc. For the year operating income drifted down 1% to 70.5 mm, again including the odd bits. As we've noted before, a lot happens "below the line" at RRA. Q4 net income was $1.9 mm and $5.1 mm in 2002 and 2001 respectively, off 63%. For 2002 and 2001 net income was $2.2 mm and $17.1 mm respectively, off 87% yoy. The increased number of shares outstanding yoy (largely attributable to the Jan 2002 acquisitions) helped push eps down 67% for the quarter and 90% for the year to six cents and seven cents for the Q and year.

There was no cash flow statement (why?). We know form the 10-K for 2001 RRA generated $55 mm in cash provided by operating activities. Net of sale proceeds RRA put $42 mm back into the property. During the call we got 2002 capex of $66 mm with $55 mm planned for 2003. RRA has about 8,000 route-miles of track to maintain in North America and at $3-5,000 per mile per year it would be nice to know where it's coming from.

Looking ahead RRA anticipates further gains in NA carloads and revenues, and given the record thus far with the two big acquisitions there's every reason to believe they will hold. The three biggest commodities -- forest products, agriculture and chemicals – account for more than half the carloads. As for Australia, it's up to the weather gods. Marino says that once the rains begin they expect most of the grain to move on RRA rails and the increases will be substantial, though perhaps not fully realized until 2004. Australian officials project grain loadings to jump from 9 mm tons in 2002-3 to 24 mm tons in 2004.

During the Q&A the proposed $100 mm in asset sales and subsequent paying down of debt got a lot of attention with Chile (WIR 2/8/2003) taking center stage. Marino hopes to realize $40-50 mm from the sale of RRA's 55% stake in the operation, implying an asset value of $73-91 mm for the Chilean operations. EBITDA in 2002 was $6.3 mm on $22.6 mm revs; RRA hopes to see $10 mm in EBITDA on $25 mm sales in 2003, a 40% operating margin. Is this sleeper a keeper?

Assuming the sale goes through the other $60 mm or so will come from line sales (not necessarily whole properties but the marginal portions thereof), real estate, and excess equipment. The challenge of course will be getting top dollar for non-core assets in this environment. The second challenge will be disposition of the gains.

Marino floated three choices: pay down debt, buy more railroads or buy back stock. Moody's December 2002 Railroad Outlook shows RRA with the highest debt-to-equity ratio and the lowest interest coverage ratio in their seven-railroad group. Putting the $100 mm against debt would bring RRA's debt-to-cap ratio down to about 50%, certainly more in line with its peers. One would also hope that the modest share repurchase ($5 mm max) is delayed until there is more clarity re Chile. Given management's projections and depending the offers for the Chilean assets, retaining the latter may even reduce the debt ratios.

This was a good conference call. The NA core carload business is heading in the right direction. It's going to rain sooner or later in Australia and RRA is positioning itself to be a major beneficiary of the recovery. There is a plan to shed non-producing assets in such a way as to reduce the revenue hit while taking a god bite out of debt. Let's watch.

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.