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The Railroad Week in Review
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Genesee & Wyoming's (GWR) presentation to the Credit Suisse First Boston was a fitting cap to the recently announced results for the quarter and year just ended. The theme of the panel was "Earning Your Cost of Capital? Why now? A look at rail economics." CEO Mort Fuller, following a brief and data-filled introduction to GWR, showed how and why GWR earns its cost of capital. The serious student may wish to turn to the conference replay at www.gwrr.com, but suffice to say what separates GWR is relating return-on-capital goals to individual business units. That separates out non-performing assets in a hurry. And gives one options to grow.

As to the financials, it is important to note that Genesee & Wyoming uses equity-based reporting whereas RailAmerica uses consolidated reporting. The difference is that GWR, because of ownership structure, separates out North American and off-shore results with the former above the line generating operating income and the latter leading to net income. RRA's consolidated basis puts all income above the line with the adjustments below the line. See WIR 5/11/2002

Thus GWR's $32 mm full year operating income is wholly from North America. Australia ($8.5 mm) and South America ($1.2 mm) fall below the line and when combined with interest expense, taxes, etc. drill down to net income of $25.6 mm, up 34% from 2001's 19.1 mm. For the quarter, net income doubled to $5.7 mm yoy. EPS for the Q rose 44% to 38 cents yet slid 4% for the year to $1.66, simply because the diluted share count was up 40% yoy.

Turning to North America core results, there were two acquisitions in 1Q02 so the yoy comps are skewed accordingly. In the fourth quarter, for example, the 26% yoy revenue growth was almost equally split between Emons and Utah with same railroad revenue growth minimal. Come 2Q03 these acquisitions will become part of the "same railroad" picture and will settle out.

GWR's strength lies in running five contiguous "regional railroads" plus a switching service as opposed to what one observer has called a "portfolio of shortlines." Merchandise carload revenues were up 26% for the year and 22% for the quarter and contract switching was up 25% and 20% respectively. For the year total revenues rose 21% while operating expenses were held to an 18% bump, generating a 39% increase in operating income and taking two points out of the OR to 84.7 for the year. Once again, key acquisitions made the difference.

Equity income from Australia (ARG) was even yoy, while South America's contribution was triple 2001's meager $400,000. In 2003, Australian results are expected to be less robust thanks in part to a poor grain year that is only partially mitigated by carry-over from last year's harvest. Also the expected early completion of the Alice Springs to Darwin line will decrease revenues somewhat. But, says GWR, "On the positive side are some new Australian commercial prospects and operational improvements." Of course, tapping former SP prez Mike Mohan to run the show down under won't hurt, either.

As for 2003 GWR says it has "positive fundamentals" in North America supported in part good same-railroad carload growth in December and January. It appears Emons, Utah and the recent Oregon acquisition from BNSF are performing to spec. And, Fuller again, "While we have less clarity than normal on how the year will unfold, on balance our outlook for GWI's core business in 2003 is positive. In addition, our balance sheet is strong and the acquisition environment is encouraging." Which is exactly where he began the CSFB remarks.

Enlarging on my Feb 22 note, Florida East Coast Corporate is beginning to look more like a real estate company and less like a railroad, if the 4Q02 and full year financials are any indication. Railway does $40+ mm a quarter in sales less $30+ mm a quarter in operating expense for a reliable $10+ a quarter in operating profit. Realty, on the other hand, includes rentals and property sales and is less consistent. Realty revenues of $78 mm in 4Q02 were nearly four times what they were in 4Q01. For the year total receipts were up 25% to more than $300 mm.

And so it was that income from continuing operations (railroad plus real estate) was $33 mm in 4Q02, four times last year's $8 mm. For the year continuing operations left $50 mm in the till on 12/31/2002, up 28% yoy. But, once you take into consideration gains and losses from discontinued operations, principally the epic EPIK venture, one gets $38 mm vs. ($69 mm) for the Q and ($108 mm) vs. ($61 mm) for the year.

Investors and pundits (this one most particularly) like consistency and distrust surprises. So when we read that for the year the railroad was up 4.4% in carloads and 6.1% in revenues we know at least that the *rail* segment is performing as it should.

Norfolk Southern recently hosted representatives of the financial analyst community at its Brosnan Forest conference center outside Charleston, SC. The slides and commentary are posted at www.nscorp.com, however a few observations are in order. First, the merchandise carload operating plan already has about 75% of all moves taking less time with arrivals according to plan. Metrics such as cars-on-line, yard dwells, and foreign car hire look better.

Second, car-days per load are down 8% and revenue per car-day is up 17% yoy. Backing this up is NS improved billing accuracy. Internet and EDI bills of lading now account for 98% of the total. Receivables are turning faster, too, with only 16% out over 30 days, a 30% improvement. Most important, the focus on process improvement keeps identifying new opportunities to do it better. That's good for shippers, shortlines, and shareholders alike.

The list of shortline operators keeps getting shorter. Fallen Flags of late include RailTex, Emons, StateRail, Park Sierra, Utah Railroad and Canada's RaiLink. US Steel shed a bunch of shortlines then reconsidered after some had gone their own ways. Bethlehem Steel's railroads are caught up in a bidding war for their parent. While we hear from some of the larger shortline groups that the time is ripe for acquisitions, surely they can't be talking about Class I spin-offs any more.

The Big Six are all under the gun to build revenues and margins. The average revenue per merchandise carload is a tad over $1300, never mind the higher-rated commodities moving in private equipment. Branch lines with traffic that pays its way will remain. But on the marginal lines, who's going to give up $250 or more in revenue to keep marginal traffic? That's one reason there isn't a lot of line sale chatter among Class Is. And such line sales as we *do* see will most likely be from one shortline operator to another. May we hear from those who will take the other side of this argument?

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