The Railroad Week in Review
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Now that the press of Earnings Week is past it's time to step back and reflect on what it all means. I've had particularly thoughtful notes from Tony Hatch, Jim Valentine, and Tom Wadewitz and passing along some of their thoughts could be worthwhile.

Tony Hatch, who toils for a select group of clients out of NYC's Lincoln Center environs, writes that to him the quarter was one of modest revenue growth overshadowed by cost control efforts that "were not able to carry increased sales through to the bottom line." I'll say. Among the Big Six only UP had a positive number, and that miniscule at best. Tony cites "six themes – some recurring, some emerging."

Tony ticks them off thus: Sluggish traffic ex-intermodal, expenses not under control, lowered "quality of earnings" thanks to below-the-line items, dividend increases, wobbles in service performance, and the relative strength of any putative 2H03 comeback. To which I can only add that the core carload business is what really brings home the bacon and until that's under control Tony's themes will be more recurring than emerging.

Jim Valentine and Chris Leshock (Morgan Stanley) picked up the service theme and wrote-down BNSF, CP, CSX and UP for "disappointing service metrics." The recurring thread deals with terminal dwell times and network train speeds four weeks into the third quarter. The question is raised whether the emphasis on cost control is cutting into the roads' ability to perform as advertised. Could be; anecdotal evidence to that effect abounds, at least here in the northeast.

On the shortline front a Bear Stearns note (Wadewitz) suggests that RRA's poor grain results in Australia dragged down 2Q earnings and that 2H03 isn't going to be much better. However, with the recent US acquisitions, plus the prospects of more to come in 2004, and the return of better grain yields Down Under the note concludes, "With the potential for a strong upturn in 04 EPS, we believe there is modest further upside for the stock."

Providence & Worcester (PWRR) yoy earnings turned positive in 2Q03 as the June 2002 arbitration award to Amtrak for $1.1 mm in retroactive trackage and siding fees (see table, WIR 8/16/2002) becomes history. Still, freight revenues were up a point at $6 mm as carload revenues fell a point and intermodal fees went up 22%, half from volume, half from price. Non-freight and "other" income fell thanks to no property transactions and fewer maintenance dept billings.

This time PWRR put track fees under operating expense where they belong, dropping 85% yoy as the Amtrak bulge in the python passes. Absent track fees expenses were unchanged yoy at $6.8 mm. From this PWRR takes a credit for "capitalized and recovered costs" causing a 2.5% yoy decrease in net expense to $5.6 mm this year and $5.7 mm last. Note that PWRR calculates its OR (87.6) on this adjusted expense line as a percent of the total freight, non-freight and other revenue lines. The classic method is to take what you spend creating and selling transportation and related services and state *that* as the OR (89.1). Land sales and such like go *below* the line.

The cash flow story is intriguing. Says the 10-Q, "During the first six months of 2003 the Company generated just $4,000 of cash from its operations. Total cash and equivalents decreased by $2.3 mm for the period. The principal utilization of cash during the period, other than for operations, was for expenditures for property and equipment, of which $1.3 mm was for additions and improvements to track structure, and for the payment of dividends." Four *thousand* you say? Can't wait to get my hands on the cash flow statement.

Genesee & Wyoming (GWR) and RailAmerica (RRA) posted July carloads this week and it's an informative picture of where the railroad business is heading. The AAR's August 7 press release says July US carload traffic fell 1.6% while intermodal grew 4.3%. There was a 25,637 net loss in US carloadings. Canada saw a net gain of 6,570 carloads, 2.3%, and intermodal was up 7.5%.

What I find intriguing is that both GWR and RRA saw gains in both total units handled and same store units. And since virtually everything that touches either one of these properties also touches a Class I road, one can only conclude that were it not for the shortline community the large railroad losses would be even larger.

GWR had double-digit percentage gains in coal, coke & ores, pulp and paper, minerals & stone, lumber and forest products, and metals. RRA had double-digit percentage gains in metals, chemicals, minerals, and petroleum products. And though it's difficult to get a strict apples-to-apples comparison because of differences in STCC reporting, some trends emerge.

In the combined AAR categories of coal, coke and ores, the Class Is were way up in coke, down slightly in coal, and down 18% in coke. RRA does not report coke but is net up in the other two; GWR is up 28% in the combined category. For the broad aggregates category (essentially all the STCC 14s) the AAR was up 5% *vs.* 12% for both shortline operators. Chemicals (STCC 28, 49 only, no pets) were up 5% for the Class Is and – get this – 19% and 36% respectively for RRA and GWR.

The main take-away here is that most of the lines operated by GWR and RRA are former Class I branch lines given up as not meeting viability thresholds. And yet these very same properties are bringing back revenue sources the trunk lines had passed over. Makes one wonder what the Big Six could do on their remaining lines if they lowered the bar and aggressively went after top-line dollars. Or have they cut costs so far that's no longer an option?

Canadian National hit a new 52-week high of $53.93 midweek as prices stay comfortably above the 50-day SMA line, representing a 16% gain yoy. CP has also had a nice run, up 14% yoy. Nice, you say. Until you recall the US dollar is now worth $1.40 Canadian, down from $C1.56 a year ago. So in *Canadian* dollars CN is up 4% and CP is up 3%. Maybe not the barn-burners the casual observer might have seen, but still ahead of their US counterparts.

UP a year ago went for $60 a ticket, same as today, though it's had forays between $64 and $51 in the past twelve-month. BNSF is down a tad at $28 from its 52-week high of $30 made last August. Bringing up the markers CSX lags the lot, down 12% for the TTM period. NS has fared only slightly better, off 10%, though it did get back to zero toward the end of May while CSX has never regained the nearly $37 high of a year ago. (Full disclosure: I bought CSX in the dip for $25 and NS for $18.)

Among the smaller caps FEC is the winner, up 20% as investors cheered the ending of the EPIK epoch. GWR is unchanged, RRA is down 15% and KCS (I'm short at $12) is off a third. Yes, the economy's to blame, but the dry van truck traffic I see on I-95, 80, 81, 76 (Penna Tpk) and 90 (NY Thruway) to name a few is worse than ever. What's wrong with this picture?