The Railroad Week in Review
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Last week I wrote, "BNSF experienced the biggest stock price changes over the third quarter and YTD through 9/30/2003. My take is they're doing a great job in carload yield and the IM pricing is more aggressive than one finds elsewhere." What, pray, is this all about?

It has to do with relative revenue per unit (RPU) between carload and intermodal. We've all heard the drill that intermodal margins are less than carload margins and that intermodal revenues help the top line more that the bottom line. Maybe there's another angle. Consider that the typical merchandise carload has to ride on three or more trains origin to destination to intermodal's one. Consider too that units and carloads are used interchangeably in most reports. As a result, the average intermodal RPU is a lot less than it is for carload freight.

However, an interesting thing occurs when one converts intermodal units to carload equivalents. Watch a double-stack train go by and count platforms. Have somebody else count the "voids," places where there could be a double stack but there is none. Do that with enough trains and you'll find intermodal trains average 1.7 boxes per platform. The results are in the table below.

Assume the carload RPU is what's required to meet the added handling and related costs of multiple train-rides per car. If so, then the closer the intermodal carload equivalent rates gets to the carload rate then the more profitable the intermodal business – no extra handling expense. BNSF shines. Not only does it have the highest intermodal carload equivalent RPU in $USD but also BNSF has the highest carload RPU, if only by $5 but still the highest.

This raises two questions. One, if BNSF can make 80% of the money per platform with a third or less handling does it not follow that intermodal does contribute significantly to operating income? Two, if intermodal can generate these margins on a simple FAK model, does it not follow that a simpler carload pricing model (one that is less costly to administer) can improve margins?

Can you say *retail*? Not that railroads are comparable to retail, however the success of Amazon and Wal-Mart comes in part from their judicious use of the value-price lever to keep customers coming back. Keeping costs down and passing savings on to customers calls for value and a non-complex pricing environment. The move to web-based carload freight pricing simply follows the FAK model for intermodal. Waiting days for a freight rate is hardly "non-complex."

Not to put too fine a point on it, BNSF for the second year in a row was named Carrier of the Year by FedEx Supply Chain Services. BNSF was one of only eight companies and the only railroad to have received this award. Criteria for the award included on-time service, safety, claims/damages, communication and freight bill accuracy. Not surprising. BNSF is ahead of the railroad industry web-enabled transaction curve. And it's not complex.

In a note to clients Morgan Stanley's Jim Valentine writes, "The US railroads and the UTU have reached agreement on healthcare cost-sharing provisions. If this agreement is ratified by the UTU, the major US railroads will likely benefit from $60 mm in healthcare cost sharing in 2004. Healthcare cost sharing in this agreement and others will help offset benefit inflation in 2003 and 2004, however, the current programs are likely to yield few incremental savings in 2005."

Valentine concludes by noting that labor expense is in the range of 40% of total operating expense (on some shortlines it's closer to a third). As anybody trying to meet a payroll knows, health and welfare costs have been zooming up at roughly 20% a year for some time. Thus controlling healthcare costs is a critical part of containing labor expense.

Tom Wadewitz from Bear Stearns writes that their outlook calls for "generally soft 3Q results for the rail group" on unexciting volumes, high fuel prices, and continued pressure on the expense side of the ledger. He continues, "None of the carriers stands out in terms of upside while CSX and NSC appear the most likely to have difficulty meeting current consensus expectations while BNSF realized the best volume growth of the group."

On the cost side, it is Tom's view that "increased maintenance activity, crew shortages and the mix of volumes drove deterioration in operational performance for most of the rails as shown by slower average train speed and increased terminal dwell. Bear Stearns also takes the position that "the rails are positioned for an acceleration in yoy EPS growth in 4Q03 as the auto production outlook is brighter, strength in grain volumes should provide a boost for the full quarter, and the intermodal comparison is very easy due to the West Coast port lockout last year."

UPS stock hit a new 52-week high Monday and closed just below a three and one-half year high at $67.10. Also this week UPS said it has taken a day out of the transit time between many of its most significant city pairs. An article in Tuesday's Phila *Inquirer* says "improvements in using railroads have allowed UPS to *guarantee* (emphasis added) that some of its packages would arrive a day earlier than under the previous schedules." Still, both UPS and Fed Ex have a long way to go to catch the likes JBHT and HUBG in stock performance – up 40% and 20% since July vs 5% for FDX and flat for UPS.

KCS on Wednesday accepted the STB decision to suspend the procedural schedule involving KCS' request to gain regulatory approval of the control of the Tex Mex, a wholly owned subsidiary of Mexrail. In its decision, the STB said, "The board will reinstate the procedural schedule at such time as KCS demonstrates that there is a reasonable likelihood that it will be able to acquire control of Tex Mex."

Schwab Capital Markets' *Morning Roundup* for Oct 9 cites International Paper, Georgia Pacific and Temple-Inland as "boring mundane stocks with a cyclical flavor" that have nonetheless achieved market leadership status. All three are trading right around support at the 50-day SMA line with positive trend-lines. Moreover, the 12-month charts show all three achieving or surpassing the highs reached last fall.

As regular WIR readers know, earnings estimates drive stock prices and sales forecasts drive the estimates. Paper and lumber make up about a third of the revenue base for both RRA and GWR, so an upturn in forest products has got to be positive for them, and by extension, the shortline industry as a whole. Actually capturing that larger share of forest products traffic, however, depends in part on market intelligence. Happily, there is a new tool that can help shortlines gain the competitive edge. Watch this space and www.rblanchard.com for details.

Table 1. Intermodal Carload equivalents

Rev ($mm)	carload	coal	intermodal
BNI	$ 1,002	$ 504	$ 757
CNI*	$ 1,055	$ 70	$ 289
CP*	$ 519	$ 118	$ 238
CSX	$ 1,151	$ 416	$ 314
KSU	$ 98	$ 22	$ 14
NSC	$ 944	$ 389	$ 300
UNP	$ 1,649	$ 601	$ 514

Units (thou)	carload	coal	intermodal	IM CL equiv
BNI	623	504	1,002	589.41
CNI	598	122	332	195.29
CP	271	93	274	161.18
CSX	864	418	565	332.35
KSU	119	46	76	44.71
NSC	708	420	608	357.65
UNP	1,029	537	753	442.94

RPU	carload	coal	intermodal	IM CL equiv	IME % CL
BNI	$ 1,608	$ 1,000	$ 755	$ 1,284	80%
CNI*	$ 1,764	$ 574	$ 870	$ 1,480	84%
CP*	$ 1,915	$ 1,269	$ 869	$ 1,477	77%
CSX	$ 1,332	$ 995	$ 556	$ 945	71%
KSU	$ 824	$ 478	$ 184	$ 313	38%
NSC	$ 1,333	$ 926	$ 493	$ 839	63%
UNP	$ 1,603	$ 1,119	$ 683	$ 1,160	72%

* In C$; US$1.00 = C$1.34