The Railroad Week in Review
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Regarding this earnings season just past, the rails as a group continue to disappoint, starting at the top line. Clearly there's a disconnect between what we're hearing from senior management in the earnings conference calls and what shortlines and shippers see in the field. The root cause, more often than not appears to be a disconnect between departments within the same company.

One railroad will say there are too many branch lines with not enough business to support 'em while at the same time certain market managers say the abandoned factory at the end of the branch might come back so we have to keep the line. Another railroad's operating group will say we have to cut costs but ignore the division manager with a bulletproof plan to combine train starts. Somebody else will say we have to increase revenues but will shoot down short-haul business because it doesn't fit the cost model developed mainly for long-haul business but applied across the board. IMHO the railroad to watch is the one where actions in the field mirror top management statements in front of the analysts.

It's not that there isn't freight to be moved out there. Trucking stocks seem to be doing very well, thank you. The DJ Trucking Index is up 25% to the Total Market Index, up 20%. The DJ Rail Index is up just 10% YTD. Everybody knows the biggest driver of share price is net income and that revenue is the biggest driver of net income. Quarterly changes in railroad revenues are posted in Tables 1 and 2. And in Table 3 I've posted some trucking yoy revenue changes.

These seven trucking firms generated an additional $300 mm in new revenue among them. That's 8.8%, more than twice the rate of increase than the best of the Class I railroads. To be sure, Yellow and Hunt for example are good rail intermodal customers, so the Class Is got a piece of the increase. Still, that increase represents an awful lot of dry van boxes. Now note that double-digit revenue increases came from the two shortline holding companies, RRA and GWR. This is what happens with local *involved* sales and operating teams working – for once – as teams. No reason the Class Is can't do a lot to encourage more of the same.

Here's my Class I formula, for what it's worth. Make the carload network mirror the intermodal model as closely as possible. Somebody else (i.e., not the Class I) makes the sale, provides the box, and gets that box to and from the ramp. The Class I railroad hooks and hauls. That's all there is to it. The carload mirror requires three changes in the present way of doing things.

First, no rail-direct customer should be more than one train ride from a core system serving yard. Second, all shortlines must go directly into serving yards so their cars can be classified immediately into core trains with no intermediate local. If there are multiple handlings between the dock and the serving yard let them be on shortlines as they can best eliminate the between-train lag. Third, moves developed by shortlines using non-Class I owned cars originating *and* terminating on shortlines require no Class I marketing input and so should ride FAK.

There's a new line in Table 1, "Revenue per Intermodal Carload Equivalent." We've touched on this before, but by way of review the aim is to put intermodal containers in terms of revenue carloads. The Class I financials all report "revenue carloads" with intermodal containers getting the same treatment as covered hoppers of plastics. I simply wanted to see how intermodal boxes equate to carloads.

Everybody seems pretty much agreed that with the mixes of double-stacks, single-stacks and trailers about 1.7 boxes per platform is about all one can expect. Thus I multiplied the intermodal RPU by 1.7 to come up with my carload equivalent revenue. The closer that number comes to the average carload RPU the better for two reasons. One, carload RPU assumes all handling costs are covered and there's a profit margin baked in. Two, because intermodal is point-to-point, there are no intermediate train-starts, and so, operationally, costs less to handle between end points.

CN does it best (never mind FX; it's all $C in this measure) followed by BNSF. Where the spreads are higher it seems to say either you're not charging enough vis a vis your peers or your service does not warrant a higher price. Either way, there's money to be made.

KCS redux. In preparing the spreadsheets for my Quarterly Review (published separately, see www.rblanchard.com) it struck me exactly how well KCS preserved its operating revenue gains on the top line through expenses to operating income on the bottom line. Quarterly operating income including switch fees, demurrage, etc. increased $7 mm or 5.3% yoy. Operating expenses decreased $1 mm or 1% yoy. Operating income rose to $14 mm from $6 mm as a result, taking six points out of the OR. Do it again in Q4 and the OR will be in the low 80s where it belongs.

Genesee & Wyoming's CFO Jack Hellman gave an excellent and refreshing account of his company at the BB&T Logistics Conference on Wednesday. His remarks and slides are available through a link at www.gwrr.com, but a few highlights are in order. Because his was not an audience already steeped in rail lore, Jack had to put the story in a pure investment context, which in itself led to a discussion of best management practices and the results attendant thereto.

Jack's prepared remarks took about 20 minutes and the PPT charts are on the web. He touches on acquisition strategies including capex exposure and target IRR, the North American and Australian businesses with outlooks for both, the importance of the "contiguous railroad" philosophy, the 18% CAGR since the IPO, and the rail business as an annuity. Go to the replay and see how it all fits; it's nicely done.

Over the past few weeks I've stepped up the pace of my letter writing to build WIR subscriptions among shortlines. Each letter cites a theme of Class I developments and trends that will impact shortlines over the next six months. The response has been instructive. The most interest comes from operators who are good students of the industry and who ask the best questions at shortline meetings. The least interest comes from operators of marginal lines who ask the fewest questions in open session and complain the most in private. And therein lies the lesson.

There are nearly 700 non-Class I railroad companies in my database, and that includes the S&Ts such as the BRC and the Conrail Shared Asset Operation. I have carload data for 450 of them and of these nearly half take in less than a $million in annual revenues based on $250 a car (25% of the average class 1 RPU). These guys dominate the shortline group that is most critical of the Class Is in private, that contributes least to the Good of the Order, and whose understanding of railroad economics is sadly lacking. WIR aims to promote dialog to increase that understanding, though the adage about horses to water often comes to mind.

Table 1.
Big Six Class I Commodity Carload Comps

Quarter ending 9/30/2003

Revenue and income in $millions

Metric	BNSF	CN	CP	CSX	NS	UP
Railroad revs (1)	$ 2,395	$ 1,413	$ 866	$ 1,823	$ 1,598	$ 2,956
YOY Pct. Change	3.8%	-6.0%	-1.4%	2.1%	0.0%	3.7%
Carload revs (2)	$ 1,067	$ 1,030	$ 523	$ 1,124	$ 911	$ 1,658
Pct carload	44.6%	72.9%	60.4%	61.7%	57.0%	56.1%
Pct Intermodal	32.9%	19.8%	27.3%	17.2%	19.7%	18.3%
Pct Coal	21.3%	5.7%	12.3%	21.1%	23.3%	21.2%
Mdse Carloads (000)	646	599	268	864	688	1,030
Rev/CL x coal, IM	$ 1,619	$ 1,720	$ 1,953	$ 1,301	$ 1,324	$ 1,610
Rev/IM CL equiv	$ 1,293	$ 1,474	$ 855	$ 943	$ 854	$ 1,185
IMCLE/avg CL rev	80%	86%	44%	73%	64%	74%
RR Operating Income	$ 430	$ 454	$ 209	$ 213	$ 311	$ 592
RR Operating Ratio	82.0%	67.9%	80.3%	88.3%	80.5%	80.0%

(1) CN, CP in $Canadian

(2) Excludes coal, intermodal

Table 2
Small Class I and Shortline Holding Company Commodity Carload Comps

Quarter ending 9/30/2003

Revenue and income in $millions

Metric	FEC	KCS	GNWR	RRA
Railroad revs (1)	$ 41.4	$ 146.3	$ 53.0	$ 80.2
YOY Pct. Change	5.3%	5.3%	16.0%	12.0%
Carload revs (2)	$ 26.0	$ 95.2	$ 35.3	$ 67.6
Pct carload	62.8%	65.1%	66.6%	84.3%
Mdse Carloads (000)	46.6	243.4	87.1	197.0
Rev/CL	$ 558	$ 391	$ 405	$ 343
Operating Income (3)	$ 1.3	$ 14.9	$ 9.2	$ 20.5
Other Income (3)	$ 2.2	$ (10.6)	$ 3.0	$ -
Net Income (3)	$ 1.0	$ 4.3	$ 7.2	$ 4.2
RR Operating Ratio	76.1%	89.8%	85.0%	na
Net Margin (3)	1.1%	2.9%	11.7%	4.6%

(1) Excludes off-shore railroad data

(2) Excludes coal, intermodal, bridge traffic

(3) Corporate

Table 3
Trucking Company 3Q revenue performance yoy
($millions)

Name	3Q02	3Q03	% change
Old Dominion	149.9	176.9	18.0%
Heartland	91.1	104.5	14.7%
Yellow Freight	682.5	770.7	12.9%
Werner	336.1	368.0	9.5%
Arkansas Best	375.4	402.7	7.3%
JB Hunt	582.7	621.6	6.7%
CNF	1230.1	1306.4	6.2%