The Railroad Week in Review
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Union Pacific was first out of the gate in the Earnings Reports Sweepstakes this week. For the first time in five years all six commodity groups reported revenue gains for both the quarter and full year. Also, for the first time, the corporate income statement is essentially the railroad income statement thanks to the Overnite IPO. Unfortunately, continued high fuel costs and some missteps in T&E hiring and training conspired to reduce operating income by nearly $60 mm. The operating ratio was 80.1, unchanged yoy; for the year it inched up 170 BP to 81.5, still a respectable number.

Fourth quarter freight revenues rose 6% on 4% greater volume and were up 4% on 1% more volume for the year, though about $100 mm came from fuel surcharges. Merchandise carloads were up 7% yoy in the quarter, approaching the 9% intermodal growth rate – the latter possibly a tad higher than normal due to last year's west coast port slow-down. And when you figure that the industrial prods RPU is 21% higher than the intermodal carload equivalent (intermodal RPU times 1.7 units per platform) that's good news.

Commenting on the strong volume and revenue performance, railroad President Ike Evans attributed the feat to "a consistent approach to yield strategy, leveraging assets for top-line growth, and a favorable environment for truckload conversions." In the Q&A Ike also noted the margins of new business are higher because better service begets higher prices.

Looking ahead, UP anticipates 2004 revenue growth in the 4-6% range – a couple or three points from the economy, a point from pricing, and the balance from conversions. Agriculture (with a special nod to Express Lane), coal, intermodal and industrial will be the likely leaders. Fuel expense will continue to be the downer, even as employee levels are brought up to snuff through better hiring and training practices.

RailAmerica (RRA) has a commitment to sell its 55% Chilean Railroad interest for $11 mm cash (less fees) and a $7 mm 6-1/2 year note to an affiliate of its Chilean partner, who will also assume "about $20 mm" of RRA debt. Thus the total value to RRA is $37-38 mm. We had suggested a range of $30-$40 mm (WIR 3/22/2003) based on EBITDA between $8 mm and $9 mm and multiples from 4x to 5x plus debt, crediting RRA with 55% of the enterprise value for every combination of variables.

I say "we" because I didn't come up with these numbers all by myself. I've done some shortline valuation work with Eric Meltzer of Philadelphia's Curtis Financial Group, an investment banking firm specializing in middle market analysis, and he did most of the heavy lifting in arriving at this range of estimates. The collaboration with Eric is particularly beneficial as it brings together his considerable financial analysis skills and the fruits of my shortline labors.

Recall that back in March RRA had predicted $10 mm in EBITDA. Some analysts took this to an enterprise value as high as $70 mm. Recall also that RRA said at the time the goal was to reduce corporate debt by $100 mm by the end of 2004. This deal then leaves about $60 mm to go less whatever else has been done in the meantime. Our understanding back in March was that RRA had real estate and other underutilized assets to go on the block. Eric and I know where about $50 mm of it is right now and we'd love to know if it's the same $50 mm RRA sees.

Elsewhere RRA December North American traffic (carloads plus intermodal units) was up 12.3% yoy and up 9.4% for the full year on a same-railroad basis. For the month of December, strong bridge traffic, agricultural & farm products, metals and metallic/non-metallic ores shipments were partially offset by lower auto and intermodal carloads. For the year ended December 31 2003, total North American carloads were up 3% yoy and up 1.7% yoy on a same-railroad basis. Note that for RRA "same railroad" excludes carloads associated with railroads, or portions of railroads, sold or acquired January 1, 2002.

In a real break-through CN and CSX now have instantaneous interline prices for carload shipments moving over their networks. The new tool, called "A+B Pricing," allows railroad account managers (not customers – yet; that comes later in 2004) to retrieve and combine CN's and CSXT's revenue requirements to quote market competitive interline prices in real time for any origin, destination and commodity on the two rail systems.

Says Jim Foote, CN's chief commercial officer, "This is a real step forward for the rail industry. Traditionally, the process of quoting interline prices has been manually intensive and time-consuming. In today's business environment, that's not acceptable. We needed to change to be more competitive." CSXT's Clarence Gooden, Foote's counterpart allows, "Because interline moves comprise more than half of our business, this innovation is anther important step in making our railroads more progressive in the industry, and more focused on our customers' needs than ever before." If any out there in Reader Land have tried it, let me know what you think.

DM&E says they got FRA approval of a $233 million RRIF loan for itself and its Iowa, Chicago & Eastern Railroad (IC&E) subsidiary. By way of review, DM&E is a 1,103-mile regional railroad that currently serves 130 companies. The IC&E is a wholly owned subsidiary of the DM&E that serves approximately 750 companies on a 1,403-mile system.

This is the first RRIF approval since the release of the National Transportation Systems Center's "Evaluation of the FRA's Railroad Rehabilitation and Improvement Financing Program." The report was commissioned in order to uncover the major problems with the RRIF program and propose solutions. See www.fra.dot.gov/downloads/RRdev/rrif_review_oct2003.pdf for the complete report.

Over the past couple weeks I've gotten the distinct impression that the line rationalization process will be accelerating at a number of Class Is. Nothing specific, mind you, but a number of common threads emerge. First, line dispo is very much a function of economic return and there are four choices: keep, shortline, abandon, or donate. And with the price of scrap steel now pushing $200 a ton, a mile of 100 RB rail could be worth $250,000 after pick-up cost, surely a consideration when one is looking at asset return.

Second, shortline options will be carefully doled out to the players with solid financials and with good Class I working relationships – don't call us; we'll call you. Third, sellers must be secure in the knowledge that the buyer won't try to flip the property in short order or to change the essential terms of the transaction after a couple of years. This will get lively; stay tuned.