The Railroad Week in Review
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"I learned that when you start charging people for their capital all sorts of good things happen." – Robert Goizueta, The Coca-Cola Co., attributed by Roger Lownstein in Buffett, The Making of a Capitalist, p.329

Lowenstein's book is loaded with goodies for railroad managers. The quote above drives home what John Lanigan, Chief commercial Officer at **BNSF,** said during the January conference call: Every commodity group (consumer, coal, aggregates, industrial products) will be expected to cover its cost of capital (WIR 1/30/2004). The implications boggle the mind.

Does that mean the ag product manager pays for owning and maintaining the controlled main-line turnouts leading into and out of a shuttle-loading facility? Or that the metals guy pays for a switch used for three loads a year out of a scrap dealer? On some railroads intermodal already pays its own way. Crews, power, fuel, yard costs – everything exclusively intermodal is in the intermodal product manager's budget. So too, one would like to think, with unit coal and grain trains. But Industrial products? Hardly. And that's wrong.

The response to the Contribution series (WIR 3/19) is most encouraging. A subscriber who owns a number of shortlines called the other day to enlarge on my earlier comments. Having spent some time collecting Class I railroad paychecks he is well aware of the "no such thing as bad revenue" syndrome seemingly so popular in some quarters, and well larded with incentives to keep it so.

On the ops side of the house, he says, shortline allowances are viewed as credits to ops expense and so are to be taken wherever possible. Thus the inevitable tug-of-war between marketing and ops. I'm advocating shortline fees as an ops credit as long as they actually lessen what ops is paying to get the work done.

Like the Class I manager who told me this week his cost per crew-start is down 15% without changing the size of the staff or number of crew starts. Getting rid of overtime and arbitraries did the trick and he stall has more to go. A shortline that can save a $million in non-productive crew costs can probably write its own ticket.

My friend concludes, "There is a diminishing delta between Class I and shortline ops costs. Thus it is incumbent on the shortline operator to show where he brings value. The Class Is are faced with a choice between selling surplus capacity and selective disengagement. Too often the Class I doesn't really see what the shortline adds. The ticket to success in this game is a *crisp* value-added message."

Any investor, whether a shortline owner, an individual stock portfolio investor, or even a shipper wanting to do business with fiscally strong carriers, ought to look at more than just share price changes. A good place to start is the quarterly yoy eps changes (WIR 4/9/2004). But there's more.

Recall during the Jan 31 conference call Matt Rose said he wanted to see **BNSF** revenues increasing at twice the rate of earnings per share. The first table compares eight names (Canadians omitted due to exchange rate complications) in 1Q04 yoy estimates and FY 2003 yoy actual. Note that Matt should make his goal though **NS** will win the prize for highest multiple. **RRA** gets the prize for FY 2003 yoy but below-the-line noise magnified a 14% operating earnings gain into an outsize eps gain.

The cautionary note is we're looking for consistent results, devoid of wide swings. Shareholder returns is where the buck stops. There were some stellar results last year as the rails took off in anticipation of a recovering economy starting in 1Q04. However those results have to be tempered by whether they can be repeated. The **UP** congestion and the **CSX** restructuring kinda took the bloom off both those roses with double-digit declines in estimated earnings for 1Q04.

RRA and **GWR** had the best price appreciation last year, however RRA started in the single digits. GWR has done better in maintaining the momentum. RRA is a company in change with the AUS properties on the block and now a change in leadership. Meanwhile, GWR keeps on doing what it does best. I also think NS and BNSF got dragged down with the group, though these two names have parted company with their respective competitors since Mar 31. And though **FEC** has continued its momentum into the new year, it's still a railroad (and a *fine* RR at that) plus a REIT.

April is Awards Month for shortlines and regional railroads. Pennsylvania's **Nittany & Bald Eagle** NBER), a member of the North Shore Railroad group, won the prestigious *Railway Age* "Shortline of the Year" award for its innovative short-haul moves. The North Shore (NSHR) family of shortlines also wins its second consecutive ASLRRA Marketing Award for its unique focus on short-haul opportunities on and among its own railroads.

A silent partner in much of this is **Norfolk Southern** for letting the North Shore railroads bridge these moves over short stretches of NS track to "connect the dots" between railroads. That NSHR is a good corporate citizen helps. NSHR was selected as one of the top "100 Best Businesses in Central Pennsylvania" by PA Business Central Newspaper and is a consistent winner of the ASLRRA's "Jake" award for safe operations.

The *Railway Age* "Regional Railroad of the Year" award goes to the **Wheeling & Lake Erie** for its innovative approach to the short-haul grain and wheat markets. Both stories are best appreciated by a perusal of the RA website, http://www.railwayage.com/B/feature1.html . Finally, the other two ASLRRA marketing awards go to the **Providence & Worcester** for developing a market for imported steam coal and to RRA's **San Juaquin Valley** for the revitalized "Sunset Subdivision" for revitalizing the perishables business once enjoyed by the SP and since lost to trucks.

During the week just past I had the opportunity to chat with the presidents of two Listed railroads. As usual the subject turned to shortlines in general and those that get it and those that don't in particular. The common thread between the two presidents is that the negative image painted by those that don't get it clouds the positive image of those that do. And it reinforces what I hear elsewhere.

The trait shared by that don't get it is that they are small (less than 6,000 loads a year), trade in commodity lanes that are highly truck competitive, and are poorly capitalized. If anybody needs a favorable image with the connecting Class I roads these are the ones. So why do they continue to bite the hands that feed them? What a great way to insure that marginal properties are – dare I say it? – marginalized. Better they look at the five award winners above to see how it's done.

Correction: A chap who saw SP/Houston at its worst writes that UP even in today's straits is hardly "SP redux" (WIR 4/9/2004). Exception noted. Any shipper or shortline comments?

Share Price Change vs. Revenue Change

Estimates Revenues in $millions

(see Matt Rose, WIR 1/31: Target EPS rate of change at 2x Revenue Rate of Change)

2004 ests	**BNSF**	**CSX**	**NS**	**UP**	**FEC**	**GWR***	**KCS**	**RRA**
1Q04 eps	$ 0.45	$ 0.28	$ 0.31	$ 0.62	$ 0.15	$ 0.34	$ 0.06	$ 0.19
1Q03 eps	$ 0.40	$ 0.20	$ 0.22	$ 0.57	$ 0.19	$ 0.21	$ 0.08	$ 0.20
Change	12.5%	40.0%	40.9%	8.8%	-21.1%	61.9%	-25.0%	-5.0%
1Q04 revs	$ 2,370	$ 1,960	$ 1,650	$ 2,850	$ 64	$ 82	$ 145	$ 91
1Q03 revs	$ 2,230	$ 2,020	$ 1,560	$ 3,080	$ 76	$ 59	$ 140	$ 107
Change	6.3%	-3.0%	5.8%	-7.5%	-16.5%	39.3%	3.6%	-15.3%
Multiple	1.99	(13.47)	7.09	(1.17)	1.28	1.57	(7.00)	0.33

*1Q04 Est Revs = eps*shares/TTM net margin

Source: First Call at yahoo.com

Canadians Omitted due to currency effects

EPS Change vs. Revenue Change YOY

	BNSF	**CSX**	**NS**	**UP**	**FEC**	**GWR**	**KCS**	**RRA**
FY03 eps	$ 2.10	$ 0.88	$ 1.37	$ 6.04	$ 1.17	$ 1.55	$ 0.90	$ 0.46
FY02 eps	$ 2.01	$ 2.09	$ 1.18	$ 5.05	$ (2.95)	$ 1.38	$ 1.68	$ 0.07
Change	4.5%	-57.9%	16.1%	19.6%	-139.7%	12.3%	-46.4%	557.1%
FY03 rev	$ 9,413	$ 7,793	$ 6,468	$ 11,551	$ 339	$ 245	$ 581	$ 358
FY02 rev	$ 8,979	$ 8,152	$ 6,270	$ 11,159	$ 301	$ 210	$ 566	$ 333
Change	4.8%	-4.4%	3.2%	3.5%	12.6%	16.7%	2.7%	7.5%
Multiple	0.93	13.15	5.10	5.58	(11.06)	0.74	(17.52)	74.21

Source: First Call at yahoo.com

Shareholder Total Returns FY 2003

Price	**BNSF**	**CSX**	**NS**	**UP**	**FEC**	**GWR**	**KCS**	**RRA**
12/31/03	$ 32.35	$ 35.94	$ 23.65	$ 69.84	$ 33.10	$ 31.50	$ 14.32	$ 11.80
12/31/02	$ 26.01	$ 28.31	$ 19.99	$ 59.87	$ 23.20	$ 20.35	$ 12.00	$ 7.17
Change	24.4%	27.0%	18.3%	16.7%	42.7%	54.8%	19.3%	64.6%
Divs 03	$ 0.54	$ 0.40	$ 0.32	$ 1.20	$ 0.16	$ -	$ -	$ -
FY 03	1.7%	1.1%	1.4%	1.7%	0.5%	0.0%	0.0%	0.0%
Total Ret	26.0%	28.1%	19.7%	18.4%	43.2%	54.8%	19.3%	64.6%

Shareholder returns 1Q04 ex-divs

Price	**BNSF**	**CSX**	**NS**	**UP**	**FEC**	**GWR***	**KCS**	**RRA**
3/31/03	$ 31.50	$ 30.29	$ 22.09	$ 59.82	$ 35.82	$ 24.70	$ 13.90	$ 12.05
12/31/03	$ 32.35	$ 35.94	$ 23.65	$ 69.84	$ 33.10	$ 21.00	$ 14.32	$ 11.80
Change	-2.6%	-15.7%	-6.6%	-14.3%	8.2%	17.6%	-2.9%	2.1%

Source: First Call at Yahoo.com; wsj.com

Canadians Omitted due to currency effects