The Railroad Week in Review
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Florida East Coast Industries (NYSE: FLA) has returned to its core rail (Florida East Coast) and real estate (Flagler Development Co.) businesses with a vengeance. First quarter rail revenues were up 10% and rail operating expense was up 6% yielding a 26% operating income jump. FEC is on track toward regaining its former reputation as an operating ratio leader, taking out 3 points yoy to 77.1%. Flagler operating income as off 20% on a 5% dip in revenues yet net earnings including gains from discontinued operations' asset sales was up 20%. Eps was up 19% on a slight increased in diluted shares outstanding. (See Table 1.)

Among railroads, FEC and NS are the only ones to show intermodal volume and revenue as separate from the same for merchandise carload. I like to break out intermodal because we're counting boxes, not carloads and we need a carload equivalent to arrive at a carload volume estimate. As noted before, 1.7 boxes per platform is a generally accepted industry average. This particularly apt for FEC as the revenue base is 41% intermodal and 59% carload (no coal). The intermodal carload equivalent revenue is 91% of the carload amount, the highest in the industry.

Crushed stone remains the Number One commodity accounting for 56% of sales and 66% of carloads making it a fairly low margin business. It works because it's the Wal-Mart model: a lot of merchandise turning very fast at low per-unit markups. Automotive was the only downer, following the industry rend (of the majors only NS was up and that by two points). The elegance of FEC's mainly point-to-point rail model, the low rail ops ratio, and the 1Q04 corporate 11% net margin have sped FLA's recovery from the telecom foray.

The Matt Rose award for increasing net income at twice the rate of revenue increase goes to **Genesee & Wyoming** (GWR). Net income for 1Q04 was $9.2 mm after preferred shares, up 75% from $5.2 mm yoy; diluted eps grew to $0.35 from $0.21, up 67%. Consolidated revenues (remember, GWR reports off-shore income below the line) increased 23% to $72 mm with operating income of $12 mm as operating expense rose only 20%.

North American carload revenues increased 27% to $44 mm with double-digit growth in all commodity lines but petrol prods and aggregates. Lumber and paper were up 49% and 29% respectively and represent a third of GWR's portfolio. Intermodal revenues, though less than 1% of the total, grew 55% on a mere 5% more units, pushing the RPU up 49%, and the carload equivalent (see Table 1.) to more than the average merchandise RPU, a first.

Something else you rarely see in shortlinedom is free cash flow, which GWR defines as cash from operations less "investing activities," mainly capex. North American Rail operations generated $12.8 mm in 1Q04 vs. 12.2 mm a year ago. More important, FCF as a percentage of revenue was 18%, actually exceeding the 13% net margin after preferred. And lest one think this is a one-time event, last year's FCF was 21% of revenues against a 9% net margin.

To recap, there were double-digit increases in revenue, operating income, net income, and diluted eps. Net margin and FCF margin were also double digits. Over the five-year period ending 12/31/2003 retained earnings and shareholder equity increased at CAGRs of 23% and 29% respectively. Debt-to-cap ex-Australia sits comfortably at 34% and every dollar in retained 2003 earnings generated $6.44 in market cap. Looks to me like GWR is doing pretty well by its shareholders.

The second **Conrail** Oversight hearing convened in DC this week with both David Goode and Mike Ward agreeing that the transaction has been a success and the industry is better off for it. As one who watched the slow and painful demise of the once-proud NYC and PRR systems I'd have to agree. After the Wreck of the Penn Central a strong Conrail emerged but it could not last as it evolved into a loads-east, empties-west railroad. It was split up between CSX and NS on 6/1/1999.

In his remarks before the Board Goode said the transaction has worked and there is no need to extend the formal regulatory oversight period. Ward told the Board, "We believe the five-year oversight period that followed the transaction has achieved its objectives. We are now at a time when additional oversight is unnecessary – and the ordinary authority of the STB is more than sufficient to ensure that the public good continues to be served."

Having watched this transaction from beginning to end (I was on retainer to NS for two years working on shortline matters) I must agree with both CEOs. But it must also be said that Conrail assembled a team of some of the best and the brightest in the business that was not afraid to innovate and left a legacy of market development, pricing, and operating practices that have morphed into more of same at both succeeding organizations. The Oversight is dead. Long live Conrail.

Canadian National held its annual shortline meting this week in the Chicago suburb of Oak Brook this past week and it was another winner. There was no trade show, there were no scheduled periods for shortline reps to discuss specific opportunities, and there was no train ride. Instead attendees were treated to a day and a half of unrelenting attention to the CN-shortline relationship.

For once operations took the limelight. The presentations couched best operating practices – e.g., car cycle time (load and empty), velocity, trip plan compliance, event reporting, etc. – in terms of yield, returns on investment and, yes, market share. The Guaranteed Car Order (GCO) program is the main driver as it ties empties to loads, propels shortline ISAs, and rewards local CN ops managers for making smart, economically sound decisions.

CN showed how the same tools can help shortline managers do likewise. They, like CN terminal managers, can look out 72 hours to see what's coming when. No reason the shortlines can't lock-and-load based on that advance info. Would that they did because shortlines touch more than $C1.3 mm of CN's annual revenue stream. Given the challenges faced by the truckers (new hours of service rules, congestion, high diesel fuel costs) rate spreads increasingly favor the rails. But we continue to lose customers for service failures.

I'd like to see CN look past the shortline interchange for trip plan compliance. As is, dock-to-dock works only for CN local points. Trip plans for shortline cars begin and end at the interchange. This will not do. Rail ops planners even more than customers need to include shortlines in their ever-tighter measures if they're ever going to get control of car cycle times and velocity.

The US contingent of the CN shortline community states the case exactly. These 29 properties touched 24% and 29% respectively of CN's revenues and carloads from US operations. Forest products, chemicals (petrol included), metals and minerals, and coal brought in about 80% of the revenues in nearly equal proportions. The general outlook for these commodity groups is positive; the rail outlook should be even stronger. It is the shortlines' to capture.

Table 1.

Other Class Is, Regional and Shortline Holding Companies
Quarter ending 3/31/2004
Revenue and income in $millions

Metric	FEC	KCS	GNWR	RRA
Railroad revs (1)	$ 47.6	$ 147.8	$ 72.4	$ 97.0
YOY Pct. Change	9.7%	5.4%	23.0%	12.3%
Carload revs (2)	$ 28.0	na	$ 43.5	na
Pct carload	58.7%	na	60.1%	na
Pct Intermodal	41.3%	na	0.8%	na
Pct Coal	0.0%	na	14.8%	na
Mdse Carloads (000)	49.2	-	105.8	207.8
Rev/CL	$ 568	na	$ 411	na
Rev/IM CL equiv	$ 515	na	$ 688	na
IMCLE/avg CL rev	91%	na	167%	na
Operating Income (3)	$ 10.7	$ 17.4	$ 11,560.0	$ 15.7
Other Income (3)	$ 2.7	$ (14.0)	$ 3,974.0	$ -
Net Income (3)	$ 8.3	$ 3.4	$ 9,165.0	$ 1.3
RR Operating Ratio	77.1%	88.2%	84.0%	80.8%
Net Margin (3)	11.6%	2.3%	12.7%	4.8%
Debt/capitalization (3)	29.5%	#DIV/0!	34.4%	48%

(1) Excludes off-shore railroad data
(2) Excludes coal, intermodal, bridge traffic
(3) Corporate

Note: "NA" means data not supplied with press releases.