The Railroad Week in Review
July 9, 2004
www.rblanchard.com
(215) 985-1110

Rail stocks got hammered along with everybody else on Thursday and bounced back on Friday as NS and BNSF both gained more than 3.5 percent on the day. However, there are lessons to be learned from the 3-month curves *before* Thursday in particular. Looking solely at the Big Four US rail stocks, excluding CN and CP due to foreign exchange effects, NS is handily ahead of the 20-, 50, and 200-day moving averages, with all three showing rising trends.

Next is BNSF, trading above all three until this week when it broke below the 20-day line but only briefly. Volume was way below average so there was no real conviction to the move. Here again each curve shows consistent upward movement. CSX and UP tell an entirely different story, however. The 200-day curves have been flat at $32 and $62 respectively since April. CSX's 20- and 50-day curves have been rising steadily, closing on the longer curve, however the $33 hit June 24 has not held. The 50-day curve is at about $31.50 and whether that provides real support is yet to be seen.

UP has disappointed. I thought (WIR 6/25) it would shortly cross the $60 resistance touched twice in six months but such has not happened. The 200-day curve has dipped slightly below $62 and given the recent $58 trading range getting to that level any time soon does not appear to be in the cards. If you did buy at the $56 resistance point, I would consider taking profits here. Why?

Because Earnings Week begins in earnest on July 20 and it will be a mixed bag. The AAR this week released 2Q03 and YTD traffic figures for the week ending July 2. Table 1 (attached) starts with the traffic volumes reported for 2Q03 and applies the AAR's volume changes to get an estimated revenue-unit count for the quarter just ended.

BNSF led the AAR pack, scoring double-digit gains in both carload and intermodal for the quarter, missing a full sweep by less than 2 points for YTD carloads. NS came next with double-digit intermodal gains for the quarter and YTD and slightly above average commodity carload gains for the quarter. Comparing BNSF and UP, the former's intermodal lead is significant ands is closing in on UP's commodity carload count. In the east, the NS intermodal lead is surprising because in the Conrail split it was assumed CSX would be the intermodal leader.

Now look back at stock price performance only this time in the context of the traffic volume scoreboard. BNSF and NS are ahead of the curve on carloads and ditto with respect to the moving averages. In a sideways market like this, you don't buy stocks to hold forever. You rent them as long as they behave.

Shippers and shortlines are telling me they see signs that some railroads are raising prices a *lot* not so much to meet market prices but to cover added costs of running a sloppy railroad. A chemical shipper says his rates are up in a service area where traffic volume is half what it was five years ago but the operating patterns haven't changed a jot. Another railroad took a 30% rate increase at the same time they degraded the service, adding car days to each cycle and effectively shrinking the fleet available for loading. This combo puts $4 mm in revenues at risk.

A shortline owner told me this morning his serving railroad priced itself out of a $5 mm revenue stream partly because cars that could make three round trips a month with a little creativity now make one if they're lucky. This combination of aggressive pricing and poor service has cost several shortlines more than 100 cars a month – cars worth $1000 each to the Class Is. Run the numbers: 50 shortlines times 100 cars a month times $1000 a car to the Class I times 12 months a year is a BIG number. At an OR of 80, maybe $12 mm in operating income. Pricing to the market is one thing; pricing to recover from egregious service lapses is quite another.

BNSF and **UP** are raising intermodal rates from the West Coast come August. The LA Times reported Friday that UP's John Bromley said the rates were "slightly higher." BNSF's Dick Russack was quoted as saying the increases went to eastbound trailers and containers. This is really a non-event. When the airplane is nearly full they stop selling the cheap seats because demand remains for first or at least a Y fare. The AAR traffic figures show BNSF full and getting fuller. My sources say much the same is going on at NS. Wall Street gets it. See above.

To its credit, Union Pacific has over the past nine months added some 2,500 T&E hires, put 700 conductors into the engineer certification program, and has brought forward the purchase of 500 new locomotives. By the end of 3Q04 another 1,250 new T&E hires will be ready to go out on the road.

They'll be kept very busy, I'm sure. As of July 2 UP had a record 324,000 cars on line, up 5.5% yoy. System train speed is down 2.3% yoy, and recall the UP rule of thumb that every one MPH change in velocity is worth 250 locomotives. Let's hope the added assets will get the car count down and the train speed up. Completing the bidirectional running through Iowa east of Dennison will be a big plus, eliminating the blockage as trains wait for each other to cross from the old CNW left-hand running rails. I'll try to get some pix when out there next month.

RailAmerica's Australia deal may have hit a snag. Lloyd's reports that the Victoria government wants to delay the transaction and change the lease arrangements. The wire notes that RRA has threatened legal action if the delay eats up too much time. It was just last week (WIR 7/2/2004) that the Australian Competition and Consumer Commission (ACCC) has approved the sale of the Company's Freight Australia operation to Pacific National. Now comes the State of Victoria to say not so fast.

One can understand RRA's position. They've done a respectable job of bringing down the debt/equity ratio to about 1.2 x from 3x not that long ago. The transaction is estimated to be worth about $US200 mm, roughly double what they paid for Freight Australia back in 1999.

Shares of trucking concern JB Hunt (JBHT) fell from a $38 high on Thurs to an intraday $32 low on Friday as BNSF served notice to arbitrate its revenue sharing agreement with JBHT. This is a legacy contract of far-reaching proportions as it was signed more than 10 years ago when the then-Santa Fe was an entirely different critter than today's high-speed, high-density BNSF. Ergo the pricing practices of 1994 are out of step. It will be instructive to see where it goes.

WIR for 7/2 had a sentence fragment that several astute readers flagged. In the commentary regarding the new CP-NS agreement I wrote, "The MMA and Vermont Rail…" and there it ended. What I meant to say is these two shortlines in particular stand to benefit from the added NS access to the south and west.

Table 1.

2Q04 and YTD 04 Traffic Volume Comps						
Revenue Units (000)						
	Second Quarter			YTD		
RR	**2003**	**AAR % Ch**	**2004e**	**2003**	**AAR % Ch**	**2004e**
BNSF						
Commodity	1127	10.9%	1250	2245	8.5%	2436
Intermodal	1002	12.9%	1131	1926	10.2%	2122
CN						
Commodity	720	7.4%	773	1450	4.0%	1508
Intermodal	332	-4.6%	317	640	-10.0%	576
CP						
Commodity	365	9.6%	400	714	6.9%	763
Intermodal	274	8.3%	297	518	12.4%	582
CSX						
Commodity	1282	4.0%	1333	2504	3.9%	2602
Intermodal	565	6.6%	602	1091	6.0%	1156
NS						
Commodity	708	5.7%	748	1383	3.8%	1436
Intermodal	608	18.0%	717	1186	14.2%	1354
UP						
Commodity	1565	2.8%	1609	3066	2.8%	3152
Intermodal	753	3.5%	779	1445	3.1%	1490
AAR						
Commodity		5.0%			4.2%	
Intermodal		11.8%			9.6%	

Source: Railroad Investor's Reports, AAR