The Railroad Week in Review
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CSX has announced its intention to lease its “B&O Cluster” of nearly 300 miles in MD and WV in two chunks. One is the 182-mile east-west line between Brooklyn Jct and Cumberland; the second runs south from Grafton to Cowan, 116 miles. CSX has asked eight shortline operators to bid in a tightly controlled “don’t call us, we’ll call you” process. To be selected a shortline operating company must have solid financials, a record for increasing carloads and revenue for Class I connections, a presence in the geographic area where the target lines are located, and an excellent working relationship with CSX.

With a little thought it’s not hard to see why CSX approaches the line rationalization task in this manner. Line sale announcements invariably draw supplicants the way bananas draw fruit flies. Worse, the usual wannabes all have acquaintances elsewhere in the selling organization that they knew in a prior life. And before you know it there are 20 bidders, a wholly unmanageable situation. Using this deliberative approach CSX is well launched to deliver on the 1200-mile target set publicly last December. It would not surprise me to see that much or more in 2005. If you’re a suitor you’ll know it.

Union Pacific says it will make some changes to its I-5 Corridor effective 8/1. Service Bulletin 2004-073 (see www.up.com/customers/bulletins) posted 7/13 suspends intermodal service in trailers from LATC to Seattle and all Seattle-LATC intermodal service, as well as intermodal service northbound from Portland to Seattle. Domestic container service from LATC to Brooklyn (Portland) will cease. Finally, service northbound from Oakland to Portland and Seattle in rail containers (EMP's and STXU's) will be suspended. UP will continue to provide service for steamship containers in these lanes.

Norfolk Southern has developed a whole new suite of operations management tools linking car distribution and train operations practically from whole cloth. Last week I was the guest of Debbie Butler, NS Vice President for Customer Service and her staff. There were three discussion topics in particular that are of vital importance to shortlines and shippers alike.

1. New car management practices that insure not only that the load gets to its destination in accordance with the initial Trip Plan, but also that empties requested for loading are not delayed in route or re-routed to other than the intended customer. A sub-set of this is the shortlines' ability to see what cars are coming to them even before an advance consist report is issued. The "pipeline report" includes not only loads but also empties ordered by customers on-line through "access NS" at www.nscorp.com.

2. Service Design tools that can reroute cars en route with the touch of a button where there is congestion or other impedance in the original route. (Traditionally this work takes a staff of 25 two weeks to run such what-if options.) Included are systems that allow the shortline to identify instantly where the terms of the ISA are missed along with appropriate remedial action.

3. Tools to help shortlines and shippers improve car cycle time, cut car hire cost, and -- with a little luck -- eliminate demurrage charges completely. For the past 30 years it's been a given that 75% of a car's life is under customer control: loading, unloading, CPd, storage. Cycle times have improved but customer delay is still the biggest cause for poor turns. NS has the tools to address

these failures. Faster turn times can actually reduce rates because the equipment cost is less. And if that isn't an incentive to turn cars faster I don't know what is.

Greenbrier (GBX) reported $6.4 mm in net earnings for its fiscal 3Q04 ended 5/31/2004. EPS was $.42 per diluted share, equal to net earnings for the entire first half of fiscal 2004 and double the fiscal 3Q03 net earnings. Revenues for fiscal 3Q04 grew to $225 mm, up 63% yoy, and up 35% from fiscal 2Q04. New railcar deliveries for the quarter were 3,600 units, up 125% from 1,600 units for the third quarter of fiscal 2003. Deliveries YTD were 7,800 units vs 4,400 at this time last year. GBS estimates they will deliver about 10,500 units in the FY.

Reflecting this growth GBX stock price doubled from $10 in May of 2003 to nearly $20 in Jan of 04. From Mar thru May it was range-bound between $16 and $18, breaking out to the upside in June and spiking to $23 intra-day recently on stronger than usual volume. Just three brokers follow GBX and they give it a BUY with targets north of $27. The consensus 2004 EPS is $1.18, a yoy triple, and $1.58 in fiscal 2005. Volumes are thin, so liquidity may be challenging.

Meridian Southern, a 55-mile shortline in southeastern Mississippi, has embarked on a $14 mm grant and loan program to upgrade and repair the former GM&O track between Meridian and Waynesboro. According to a press release, fixing the railroad "will preserve roughly 1,800 to 2,000 jobs and will open the area to a whole variety of industrial development opportunities." The line currently has a 10 mph speed limit and 71 bridges in need of repair.

Canadian National's 2Q04 performance was exceptional, so much so that the stock gapped up $1.25 or 3.5% to $43.75 at the open on Tuesday. Net income and diluted eps were up 35%. Operating income increased 32% on 14% more revenue and 6% more operating expense, pushing the OR down five points to 65.5 and proving once again you shave more points faster by increasing revenue than you do cutting expenses.

The story is in the commodity mix and yield. To begin, CN derives more revenue from merchandise carloads (ex-coal, ex-IM) than any other Big Six Class I, coal is a quarter of what it is elsewhere as a pct total RR revs, and IM at 17% of revs is among the lowest. This ought to tell even the dullest reader that CN is deeply involved in the gathering and distribution of individual carloads, the most complicated part of any rail network. But, properly run, highly profitable.

Keeping the rail network fluid and flexible is critical. Asked about capacity during the Q&A Harrison responded that there is capacity to spare and there is still room for 15-18% improvement in car fleet productivity. Locos are running about 1.1 HP per trailing ton where there is capacity for half a ton more. That's how train length in 2Q increased 9% with no more train starts. Car hire was down 17% yoy, however interchange difficulties with the lower 48 hurts turn times on CN equipment.

Looking ahead, CN sees 15% revenue growth in 2H04, implying operating and net income increases of about 30%. Recent surges in Comp and Benefits and Other expense were largely driven by the GLT and BCR acquisitions and so were one-time events. The flip side is both buys were immediately accretive to earnings and the effect will magnify going forward. And don't be surprised if the OR shortly breaks below 65 on solid revenue gains and miniscule expense upside.