The Railroad Week in Review
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This quarter I'm going to try something new for Earnings Week. The emphasis will be on business results while playing down the earnings aspects. Readers tell me the commercial and operating insights are what make WIR unique and that the "below the line stuff" is readily available elsewhere anyway. And since my investing style is more to the technical side than buy and hold, my stock commentary will run more toward trends and indicators than to earnings projections and target prices, which is where the analysts tend to go.

WIR's goal is to educate and entertain railroad users and managers. Ergo the thrust will run to indicators of how well the railroads are run and how shippers can take advantage of strengths and avoid the weaknesses. This week we'll cover half the roads reporting to date; the balance will come next week and those yet to report as they come. Here we go…

RailAmerica's North American 2Q04 rail operating income dipped 2% yoy to $18.7 mm from $19.0 mm as revenues rose 13% to $96.1 mm against a 17% increase in operating expenses to $77.5 mm pushing the OR up nearly three points to 80.6 from 77.7 a year ago. RRA, alone among the rails, neither reports carload information nor does it break out expenses by accounting functions (compensation, purchased services, materials, etc). Thus one is debarred from discerning what's driving what.

In the press release RRA did say there were higher fuel and casualty expenses, though these are buried in the "transportation" line on the income statement provided. As it was, transportation expense was up 26% yoy. RRA paid $1.26 a gallon for diesel fuel in the quarter vs. a buck even last year and it'll probably get worse as there it little opportunity to share in the Class I fuel surcharges. (Most of RRA's properties are paid per-car allowances out of Class I base revenues.) Car hire, MOW expense and depreciation were all up double-digits and accounted for a quarter of the dollar increase in expenses while transportation accounted for half the total increase.

Revenue detail is pretty sketchy, providing little beyond gross numbers. Since there is no carload detail, one must attempt to derive some inklings from the monthly carload reports, but it's tough. For instance, commodity comps over successive quarters would be a lot easer if RRA used the same commodity listing order. As is, they list in descending order by revenue units and every quarter it's different. Thus to get 2Q comps one must pick up the YTD numbers from the March carload report, re-sequence them to fit the 2Q04 YTD list and subtract the former from the latter. Would that RRA would look at the Class I formats and copy same. (The icing on the cake would be a printable web page with justified columns, but I digress.)

Quarterly revenue units including intermodal containers thus derived were up 8.4% while merch loads (ex-coal, IM, bridge) rose 11%. Double-digit gainers were chemicals (27%), ag and farm (24%), and ores (18%). Bridge traffic, essentially empty returns of loads moving to destination on Class Is, continues to be the Number One car count, 44,000 out of 303,000 revenue units. I once figured this traffic was worth about $110-120 per unit, so it really brings the average RPU down.

Yoy earnings for 2Q04 took a bath thanks largely to Gary Marino's severance package. RRA's continuing operations earned a penny a share vs. $0.20 a year ago. Excluding Marino's $5.6 mm (net of tax) hit each share would have earned 17 cents. Net income including discontinued ops was a nickel a share vs. 14 cents in 2Q03.

CSX opened the slide presentation with some sobering ops metrics and then delved deeply into what's being done to fix what's broken. Tony Ingram's slides can be accessed directly at www.csx.com and are highly recommended. The bad news is that yoy quarterly dwell time, cars-on-line and recrews were up while velocity, on-time originations and on-time arrivals were down. The good news is that CSX will add 155 more locos in August, field 1,400 new T&E employees this year, and that Phase I of the ONE Plan (CSX's answer to NS' highly successful Thoroughbred Operating Plan) is underway and on target.

It is appropriate to note the ONE Plan focuses on the batch networks – merchandise and auto – accounting for 90% of all car handling. See Tony's Slide 8. Corridors completed, under way or scheduled include Indy-St Louis, Midwest and auto, the Northeast (essentially Mid-Ohio to Richmond and Boston), and the I-95 Corridor/Southeast (mostly former SAL, ACL, L&N). As dwell times decrease and velocity increases the rate of change in crew and power productivity will accelerate so this whole integrated effort is to be roundly applauded.

Overall yield was up 2.4% yoy on 5.7% more revenues generated by 3.2% more volume. Coal revenue was up 6.3% on 2.2% more carloads for a 4% yield improvement. Intermodal yield took a haircut as "service challenges" and mix changes allowed only 2.9% more revenue on a 4% volume increase. Saving the best for last, merch revs increased 6.9% on increased demand (vols up 4.1%) and RPC up 2.7%. Within the group, every commodity but phosphates and ferts posted greater increases in revenue than in carloads. Now re-read the last sentence of the preceding paragraph and see what's possible.

In spite of the adverse performance metrics 2Q04 yoy revenues were up 6% to $2 bn and expenses increased by 4% to $1.7 bn (before the $15 mm restructuring charge) producing an 85.2 OR, down 1.1 points. Ops income went up by a respectable 14%, proving once again what's oft been said here: The best way to reduce the OR is to increase revenues faster than expenses.

On the financial score, CSX reported net earnings of $119 mm or 55 cents a share vs. $127 mm or 59 cents a share in 2003. The management restructuring process completed in the present quarter cost a nickel a share so on an apples-to apples basis CSX did OK. Given the improving economy and the reallocation of assets and processes, CSX will do even better in 2H04.

Union Pacific operating revenues topped $3 bn, a first for any quarter. It was the fourth consecutive quarter of record volumes and set a record for average RPU. Unfortunately, the 16% increase in operating expense so overshadowed the 5% revenue gain that operating income plummeted 38% and the OR gained eight points to 88 from 80 a year ago.

UP ascribed $93 mm of the expense hit to fuel price increase and another $75 mm to "service inefficiencies and velocity." These two, plus 18% more rent (mainly car hire) accounted for three-quarters of the $359 mm in yoy ops expense. The good news on fuel is they got 5% more revenue on 4% more fuel burn. The bad news is it cost 37% more because they were paying $1.16 a gallon vs. 88 cents in 2Q03.

On the revenue side it was a little better. Because of the "service inefficiencies" there wasn't a lot of room to raise rates. In fact, the 5% revenue increase was only 1% price; the rest was volume and mix (3%) and fuel surcharges (1%). Still, average RPU was up everywhere but coal, and that off but a point. Shortline operators in particular will be pleased to note that average carload (ex-coal and IM) RPU was up 4% thanks largely to the 7% bump in RPU for the industrial products group. (It might be worthwhile to ask at the shortline meeting breakout sessions how much of the rate increases came from fuel surcharges in your specific commodity lanes.)

Below the line eps came in at 60 cents vs. a buck-five in 2Q03, down 43%. Even a 13% decrease in interest expense and 52% less taxes weren't much help. Which leads back to my earlier remarks (WIR 7/9/2004) about UP's lackluster stock performance, seemingly stuck between $56 and $60. What UP reports as "Second Half Opportunities" may be the breakout keys. UP sees improved results driven by a "return to the operating plan [where have we heard that before?], continued strong carload growth and a great pricing environment." Let's watch.

BNSF, on the other hand, could tell an income story as well as a revenue and volume story. Revenues went up 17% to $2.6 bn on 11% more unit volume while expense increases were held to just under 16% taking the OR down 1.1 points to 80.7. Once again BNSF's fuel hedge program took it to the lowest price/gal of the rails written up to date (see summary attached). On the other hand, every expense line but equipment rents took a double-digit bump.

Operating income increased 23% to $508 mm. Merch revs rose 20% on 12% more loads and average RPU improved 7% powered by the 13% increase in ag and 6% for industrial products. Note that BNSF includes auto and carload consumer (perishables, e.g.) in its consumer group whereas I put them in the merch group for better comps with other roads. That said, intermodal and consumer products accounted for 39% of total revs.

I also put ag products in the merch group, and that's 16% of revenues. Industrial products (chems, forest products, metals, etc) get 24% and coal 21%. The summary chart attached puts BNSF's revenues from strictly intermodal at the head of the class and carload lags accordingly. However, note too that BNSF carload equivalent IM revenue is closest to the merch carload average meaning IM's a lot more profitable here. Generating 80% of the carload revenue with 20% of the crew starts per carload equivalent makes a lot of sense.

Carload traffic highlights include 122% and 71% grain revenue increases to the PNW and Gulf respectively, a 19% hike in domestic grain, and double-digit increases for all four IP groups. GTMs were up 13% yoy and revenue-unit-miles increased 11%. The downside was a slowing of the RR, dropping system on-time to 79% from 89% yoy. Car miles per day increased slightly to 200 and cars-on- line went up 6%, which seems to say cars are moving faster but spending more time between train-starts.

Of all the roads I cover BNSF has by far the most meaningful metrics in its presentations. It's all at www.bnsf.com and the astute student will take a look. You'll see how BNSF translates its 23% ops income increase into a 24% increase in eps.

Class I Commodity Carload Comps

Quarter ending 6/30/2004

Revenue and income in $millions

Metric	BNSF	CN	CSX	UP
Railroad revs (1)	$ 2,685	$ 1,665	$ 1,995	$ 3,029
YOY Pct. Change	17.0%	13.8%	5.7%	4.7%
Carload revs (2)	$ 1,203	$ 1,230	$ 1,227	$ 1,760
Pct carload	44.8%	73.9%	61.5%	58.1%
Pct Intermodal	32.8%	17.2%	16.2%	18.0%
Pct Coal	20.6%	4.8%	21.4%	19.7%
Mdse Carloads (000)	623	735	910	1,057
Rev/CL x coal, IM	$ 1,726	$ 1,673	$ 1,348	$ 1,665
Rev/IM CL equiv	$ 1,341	$ 1,553	$ 932	$ 1,201
IMCLE/avg CL rev (3)	78%	93%	69%	72%
RR Operating Income	$ 508	$ 575	$ 295	$ 359
YOY Pct. Change	23.3%	31.6%	13.9%	-38.4%
RR Operating Ratio	80.7%	65.5%	85.2%	88.1%
GTM/gallon diesel fuel	749	849	777	753
Fuel/gallon	$ 0.97	$ 0.96	$ 1.00	$ 1.16
YOY Pct. Change	8%	-6%	6%	32%

(1) CN in $Canadian

(2) Excludes coal, intermodal

(3) Intermodal carload equivalent revenue as percentage of average carload RPU