The Railroad Week in Review
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Florida East Coast Railway concluded the 2Q04 Earnings Season with a 13% yoy gain in operating income. Revenues including ancillary charges were up 11% against a 10% operating expense increase. The OR came down half a point to 74.7 as Comp & Benefits, Purchased Services, Materials, Property Taxes and Other all increased double-digits. Fuel was up 9% on 7% more volume using intermodal carload equivalents rather than box count.

Intermodal was the big gainer, up 20% in revs and 12% in units. Crushed stone, always a major play at FEC, saw revs up 13% on 10% more volume. In fact, four of seven commodity groups posted revenue increases and five of seven increased RPU. It's instructive to note that FEC's intermodal carload revenue equivalent (revenue per box times 1.7 average boxes per platform or carload equivalent) captures 90% of the average carload RPU, second only to GWR's 152%.

Continuing on the intermodal front, on June 22 FEC hit 500 consecutive days of failure-free service for UPS, FEC's largest intermodal customer and a record for UPS transportation partners. Further, specialty retailer Sports Authority has signed on with the joint FEC-NS "Hurricane Train" out of Atlanta into Southern Florida. And if that wasn't enough FEC won a bronze Harriman in May for its 2003 employee safety performance. Not bad for a 350-mile railroad.

Looking ahead CEO Robert Anestis said, "We are increasing the 2004 full year outlook to high-single and low double-digit growth for Railway revenue and operating income." Full-year 2003 railway revenues and operating income were $181 mm and $43 mm respectively. The outlook thus implies revenue in the $204 mm range and operating income around $46 mm and an OR of 77.3, 2.6 points worse than the 2Q04 number.

I'm using 7.5% as "high single-digits" and 12.5% as "low double-digits." Keep the operating expense increase to half the revenue increase and operating income jumps by 21% on the low end and 33% at the high end. This is exactly what NS and CN have done: taken modest revenue increases and piddling operating expense increases and used the leverage to create significant operating income gains.

RailAmerica's second-quarter carload commodity and revenue data is now available in the 10-Q, downloadable from www.railamerica.com. RRA does a good job breaking out commodity lines – paper from lumber, petrol from chems, e.g. – and that's particularly helpful in the shortline environment. Also, the 10-Q goes into some detail as to what's behind the yoy changes by commodity.

There are 14 lines from Ag & Farm to Other. Of these six saw double-digit revenue increases and of *these* the May 2003 Mobile Line segment purchased from BNSF figured in four: chems, metals, minerals and met/non-met ores. The fifth area of increase, ag & farm, was chiefly Kansas and Ohio grain thanks to easy yoy comps.

Which brings me to the subject of "same-railroad" results. Nice, but not necessary. The shortline owner has to assume a 10% per-year turn in the customer base. Since a shortline's customer base is by definition small the best way to cover customer rotation is to broaden the base. The last three RRA buys fit this definition well because they are add-ons to existing properties. Mobile is part of the AGR, Central Michigan augments that cluster, and the Crestline-Valpo ex-PRR main is great for the I&O cluster. With both CSX and BNSF actively shedding lines look for more of the same from RRA. Same store sales? Important for Gap or Wal-Mart investors perhaps. But last time I looked neither RRA nor GWR were bricks-and-mortar retail businesses.

Elsewhere RRA reports July North American carloads for July 2004 up 10% yoy to more than 100,000 units. Chemicals (the highest RPU) increased 28% while met/non-met ores, food products, minerals and petroleum were all up double-digits. Coal was up 20% partly from the recent Central Michigan Railroad purchase, continuing the acquisition theme above.

Bridge traffic at 17% of volume continues to be the largest slice of the pie. As we've noted before, bridge or "overhead" traffic used to be good business on railroads that connected two distant Class I roads by a shorter route. That worked when there were 50 or more Class Is. Now we're down to six majors in all of North America and everybody has a better way of going anywhere on their own without any overhead moves. It's fragile business, and for RRA at least, the lowest RPU in the franchise. To the extent that it's found money OK, as long as it doesn't take assets away from more lucrative businesses.

Inquiring WIR minds wanted to know why the "1818 III" investment fund managed by Brown Brothers Harriman & Co. (BBH) sold its interest in GWR on June 1. According to the BBH website, the 1818 Fund is a "private equity investment partnership organized to provide equity capital to well-managed companies being transformed by major change." Back in October 2000 GWR signed an agreement to receive from the Fund up to $25 mm for GWR convertible preferred stock. The stock had a conversion price of $23 a share based on a 15% premium to the then-current stock price of $20 (less than $5 split-adjusted today.)

BBH closed its position on 6/1/2004 selling 3.4 mm shares of common (the "converted" number) at $21.50 a share -- $73.1 mm or nearly three times the initial commitment. It's not that BBH lost interest; it just that the Fund did its work and it was time to cash out and fund other "major change" transformations. In fact, the top ten institutional investors still hold about 8 mm GWR shares. The total institutional and mutual fund investment in GWR amounts to 81% of the total 25 mm diluted shares outstanding in 2Q04. You can see it all on the Yahoo! Finance pages.

Clearly, there's money to be made in shortlinedom – if you do it right. Shortlines typically are paid on a revenue-sharing basis with their connecting Class Is and the handling fee runs 20-25% of the Class I's revenue on the specific move. The Big Six averaged $1,600 per merchandise carload in 2Q04, implying an average shortline allowance of $320 or so.

The Top Ten North American shortline operators – excluding Class I-owned S&Ts like the BRC, IHB or Conrail -- handle some 3.5 mm revenue loads a year worth $1.1 bn in sales. That's worth about $180 mm in operating income assuming an operating ratio of 85. (My recent shortline survey of shortlines of all sizes in all parts of the US yielded an average OR of 83.4.) To put this in context, CP's 2003 operating income was US$554 mm, 57% or US$317 mm of which came from merchandise carloads. Thus the Top Ten NA (ex-Mex) non-Class I operators run a merchandise carload business slightly more than half the size of CP's. See Table 2 for a Top Ten Who's Who.

My 2Q04 Statistical Review of the top ten publicly-traded railroad companies is ready. It's the only place you can get carload and revenue data by commodity in one place in one format. Single copes are $50 for WIR subscribers. Write rblanchard@rblanchard.com for details.

Table 1. Q2 Results for Shortline Holding Companies and Other Class Is

Small Class I and Shortline Holding Company Commodity Carload Comps

Quarter ending 6/30/2004

Revenue and income in $millions

Metric	FEC	KCS	GNWR	RRA
Railroad revs (1)	$ 50.1	$ 153.9	$ 74.1	$ 96.1
YOY Pct. Change	10.8%	5.2%	17.7%	12.7%
Carload revs (2)	$ 28.2	$ 103.3	$ 43.2	$ 72.8
Pct carload	56.3%	67.6%	58.3%	84.1%
Pct Intermodal	42.3%	10.1%	0.9%	1.0%
Pct Coal	0.0%	15.2%	16.3%	8.3%
Mdse Carloads (000)	48.9	122.1	106.5	210.1
Rev/CL	$ 576	$ 846	$ 406	$ 346
Rev/IM CL equiv	$ 521	$ 306	$ 617	$ 187
IMCLE/avg CL rev	90%	36%	152%	54%
Operating Income (3)	$ 11.9	$ 19.5	$ 13.6	$ 11.3
Other Income (3)	$ 5.1	$ (10.3)	$ 3.9	$ -
Net Income (3)	$ 8.4	$ 9.2	$ 10.7	$ 1.6
RR Operating Ratio	74.6%	84.9%	81.7%	80.6%
Net Margin (3)	11.9%	6.0%	14.4%	0.5%
Debt/capitalization (3)	29.0%	37%	34.4%	45.8%

(1) Excludes off-shore railroad data

(2) Excludes coal, intermodal, bridge traffic

(3) Corporate

Note: GWR Railroad Revenues include $18 mm in switching services, 25% of total.
Source: Individual railroad reports

Table 2. Top Ten Shortline Operators Ranked by Annual Revenue Carloads

Owner	Lines	miles	Annual Carloads
RailAmerica	46	8745	1,140,000
Genesee & Wyoming	23	2778	600,000
Transtar	4	367	500,000
Rail Management Co.	13	735	302,000
Washington Group	2	723	285,000
DME	2	2300	227,000
Watco	7	2834	200,000
Omnitrax	11	1500	107,000
Anacostia & Pacific	3	416	97,000
NA Rail Net	4	802	85,000
Total	**115**	**21,200**	**3,543,000**

Source: Publicly available documents, company websites, interviews;
Class I-owned S&Ts (BRC, IHB, e.g.), Industrial operators (Alcoa, e.g) excluded