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The Railroad Week in Review 1/19/2002

Both of the big publicly traded shortline holding companies reported carload figures for Dec 2001 and for the full year. Both have interests in South America and Australia, however we will restrict our discussion to their North American (US, Canada, Mexico) business for two reasons. First, because we can put it in the context of annual changes in class 1 traffic patterns. Second, because 49% of GNWR's carloads and 73% of RailAmerica's (RRA) are North American.

Variations in reporting formats make precise YOY comparisons a bit of a challenge. To get a full picture of 2001 we can annualize the GNWR results for 4Q01. Then we compare that to the full year 2000 as reported in the 10-K. Last year North American carloads were 76% of the total, however the recent acquisitions in Australia -- even when you discount carloads by the 50% interest GNWR does *not* own – drop the NA share to the 49% above.

RRA reports 1.2 mm carloads for the full 2001 year with North America carloads accounting for nearly 900,000, up 1.8%, roughly half the rate of increase seen by the class 1 roads in '01. Going forward, we can approximate the RRA carloads by class 1 per the breakout in the 10-K for 2000 (GNWR does not break out share by class 1).

We also know what sort of earnings increases to expect on the class 1s in FY 2002. As it happens, RRA does the most business with the class 1s expecting the best earnings increases. And since earnings are driven first by revenues and second by cost-cutting, we can get a sense of forward carloadings by applying yoy class 1 earnings estimates to the 2001 carloads reported by the shortlines. Ergo we can expect RRA carloads in North America to increase by 10-15% or so.

Moreover, the RRA acquisitions of StatesRail and the Park Sierra Group will further strengthen the portfolio. There are about a dozen pre-existing RRA properties that do not meet the 100 carload per mile per year generally accepted as the threshold of economic viability for shortlines. The addition of the dozen strong properties dilutes the impact of the weak ones, which we expect to see sold off fairly soon anyway.

Since we don't know how GNWR breaks out by class 1, and since half their business is based in Australia, it's hard to say what 2002 will look like. What can be said is that there are no weak performers in the GNWR portfolio in NA. Recall GNWR is organized around five contiguous systems plus a switching operation. A sixth system, the Louisiana & Delta, was rolled into the switching operation in 2001 partly because it did not meet certain minimum thresholds. The view from here is that if GNWR increased NA carloadings 11% yoy in '01, they ought to be able to do at least as well in '02.

Last week Morgan Stanley trotted out their fall "Freight Pulse" report taking the RRs to task for not meeting shippers' expectations in terms of consistency, reliability, and ease of doing business. The thought occurs that each of these attributes is as much a function of customer service as anything and as such ought to be a piece of cake for shortlines to address.

It's pretty well agreed the shortline edge in operational cost saving has gone away. Two-man crews, already depreciated 4-axle power, mechanized track maintenance of lowered FRA class ratings by branch, and so forth have done the job. But the one place the shortline shines is in customer service if only because the class 1 sales forces have been shrunken so. That being said, here is a chart with the class 1 shortcomings per Morgan Stanley paired off with shortline opportunities.

Shipper Opinion from MS Report (page)	Shortline Opportunity
Rail shippers more pessimistic about economy than others (1)	Validate sentiment with customers; show an interest in *their* futures.
Looking at other modes (1)	Find out which other modes and why
Slowing shipment speed (2)	How slow can they get? Will carload work?
Lower service levels inveigh against volume increases (3)	Shortlines give better service; work w class 1s to streamline and measure interchange and pipeline management.
Intermodal less attractive (3)	Fewer Intermodal train starts mean more room for mdse trains on the system. SL challenge is to fill 'em up.
Rail rates drive biz to trucks (9)	SLs work with class 1s to get price/service offering where it needs to be in order to prevent shift to truck
Captive traffic is overpriced and at risk (9)	Watch out for longer-term alternatives.
Five Measures give CN best marks (10)	SLs control shipper interface on their end. Measure effect their performance has on shipper perception.
Class 1 reduced rates to win business back (13)	Find ways to help class 1 get rates back up.
Class 1s preying on shippers (13)	Does this shoe fit on SL? Why? Fixes available?
Rail too difficult to work with (13)	Get specifics from your customers and fix what you can; what you can't get commitments from class 1 to fix. Watch demurrage patterns esp.
Rail too unpredictable (16)	Match SL service pattern to shipper need as far as possible; regularize class 1 interchange dates and times; get on Train-II to watch cars from origin to your customer's dock; become part of the trip plan.

Let me know what you think. Results here next week.

Roy Blanchard

Disclosure: Blanchard may from time to time hold long, short, or debt positions in the companies mentioned here. A list of such holdings is available on request.