The Blanchard Company
www.rblanchard.com

The Railroad Week in Review 2/9/2002

Tony Hatch, a good friend and an independent rail analyst in NYC, writes, "The rails had a very good quarter in trying circumstances, a well-known refrain this past year. Bulk was up (for how long?), industrial and consumer was down. Fuel comparisons, for the first time in a year, helped and overall expense control was almost uniformly terrific. None could predict the economy and hence revenues and earnings for 2002, beyond the vague hope of a second half turnaround. Service levels are solid and improving, fluidity is there; the rails are ready to show earnings out-performance in a rebounding economy."

Meanwhile, rail stock prices YTD favor the easy comps with NS and CSX up 15% and 7% respectively against a flat DJIA. Rail freight traffic at the end of Week Three was off 6% yoy with CSX and CP both off 11% while KCS was the only one in the black, up a point. Of course, one week does not a year make, though some selective industry watching may give us some clues.

We do not expect to see utility coal shipments to be anything like past periods as warm weather, cheap gas, and sizable stockpiles reduce the need for more. Auto will probably slow down once we're through with the incentives. Housing starts may help the lumber carriers but paper is anybody's guess given the downturn in advertising revenues. Steel and chemicals may have to wait for 2H01 to begin to look like their old selves. So, as Norfolk's Ike Prillaman pointed out (WIR 2/2/2002) it's time to focus on yield and make lemonade.

So where does one start? For the year our market basket of shortline commodity stocks is off about 2% across the board with the major hits being Ford (-14%) and GP (- 17%). On the plus side were Sun Oil and ConAgra, both up 3%. Small comfort in that, though, as others in their sectors are flat-liners. As options players know, the place to be in a flat market is in positions that will make money as long as the underlying doesn't do anything rash. In other words, you make money on consistency.

Ditto when selling rail freight services. Recall the chart of shipper complaints (see "Business Development Options" at www.rblanchard.com). There is a concession that high-priced spur-of-the-moment truck service may have less value than previously thought thus creating new carload opportunities. Two come immediately to mind: value-added supply chain support services and limiting demurrage exposure.

Take the new Modalgistics unit at Norfolk Southern (www.modalgistics.com). Once or twice a year a client asks me to help with a demurrage problem. Typically we find it's a question of better coordination between and among purchasing and sales at the client and the vendor's shipping department. Most recently Modalgistics' Director of Paper Sales Larry Rasche stepped up with some nifty ideas for improving product flow and ways to increase rail share of inbound material. And this in an industry that is flat to down for the year. Swapping demurrage fees for freight bills seems to make a lot of sense. Lemonade, anybody?

Value-added services like supply chain management absolutely require running a scheduled railroad and better returns on capital invested in railcars. We've heard repeatedly from the likes of CN's Paul Tellier and others that doing the same things the same way every day means you can move more freight with fewer cars. Good for the rails, not so good for the likes of Trinity (TRN), Greenbrier (GBX) and GATX (GMT). Of the three, only TRN has shown any stock price gain over two years, and that only in 4Q01. That may be short-lived, pun intended.

The October 2001 merger with Thrall Car may have helped the price rise, though the stock is off 21% from its 52-week high ($28) reached just a few weeks ago. TRN's 8-K filed December 28 indicated that charges related to the Thrall merger "are expected to be in the range of $50 to $65 million, or $0.75 to $0.97 per share" to be recorded in 4Q01. This is an increase from what was anticipated in the September 30 10-Q "in the range of $25 to $40 million or $0.37 to $0.59 per share." For the fiscal year ending 3/30/01 TRN lost $1.98 a share, down from a positive $4.18 yoy.

EPS for the June 01 and Sep 01 quarters were 25 cents and 21 cents respectively. The consensus estimate for the Dec 01 quarter is ($0.02) and $0.43 for the fiscal year ending Mar 02. Both estimates are sharply below the estimates of 90 days ago. Chart watchers were concerned when, right after the $28 high the moving averages crossed and rose above the closing price line, one indicator of a possible short. With TRN closing at $22 on Friday, the shorts at $28 did OK.

Dave Parkinson, founder of the ParkSierra rail group (Arizona & California, California Northern, Puget Sound & Pacific) sent round a note telling of the now-completed sale to RailAmerica. He writes, "These railroads now operate as part of the Pacific Corridor of RailAmerica under the supervision of SVP Tom Schlosser. Several of the former ParkSierra managers have been promoted to support Tom in his new role. I will continue as a consultant to Tom and RailAmerica for the next year."

This comes as good news for several reasons. One, I see RailAmerica continuing its practice of keeping on the best and the brightest at the roads they acquire. Two, customers can anticipate the same degree of attention and care they received from the previous owners. Three, the class 1s don't have to learn a new management team. Thanks for the note, Dave. Best wishes to all, and you can bet we'll be in touch.

The Library Company of Philadelphia will host an exhibition of William Rau Photographs taken for the Pennsylvania Railroad 100 years ago. Rau was the PRR's official photographer, complete with his own traveling studio cum locomotive. Needed it, too – he used an 18x22 view camera with glass plate negatives.

According to the announcement, "Rau made the albumen prints by direct contact and exposure of the glass negatives rather than by enlargement from smaller negatives. The result of this technique is a collection of photographs of remarkable depth, character, and detail. The exhibition will feature highlights of the collection, many of which were displayed at the PRR's pavilion at the World's Columbian Exposition in Chicago in 1893, shown in hotel lobbies and department stores, and reproduced in various PRR publications." The exhibit runs Mar 11-September 20 and the website is http://www.librarycompany.org/CE-Exhibit.htm

There's nothing like a fresh coat of paint to announce to the world that you're in business to stay and proud of it. Contrast the Santa Fe of the 60's with the PRR of the same period. Now comes CSXT with a fresh coat of paint and new look for its locomotives. The new design features a solid, deep blue locomotive body with gold nose, tail and trim (pictures at www.csx.com). To me it's a great improvement over the present paint scheme adopted more than 10 years ago. It was only fitting that CSXT President Mike Ward credit the employees for the idea, saying, "They told us that a new paint design on our locomotives would serve to unify our work force to meet our business objectives." Nice going.

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.