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The Railroad Week in Review 2/16/2001

RailAmerica Inc. (RRA) lowered its 2001 earnings-per-share expectations to the range of $0.70 to $0.75 from the previously stated $1 as certain railroad asset sales were delayed to 2002. RRA remains confident it can deliver $1.32 in 2002. The company had expected to complete the sale in the fourth quarter of 2001. A Thomson Financial/First Call survey of four analysts yielded a consensus estimate of $1.30 for 2002 on revenues of $500 mm. That translates to a net margin of 7% on total earnings of $37.5 mm on 27.5 mm shares (diluted) per the 10-Q of 9/30/2001.

According to the 10-K for the year ending 12/31/2000 RRA earned $9.0 mm from continuing operations, 50 cents a share on 18.2 mm shares from total sales of $358 mm 11.7 mm -- $0.60 a share – on total sales of $358 mm for a net margin under 3%. So even without the FY 2000 accretion of its new properties, and with the delay in selling off other non-performing assets, RRA is becoming a stronger property. This week's sell-off in stock price to under $10 from $14 thus remains that much more a mystery.

Genesee & Wyoming (GNWR) chalked up yoy January carload gains of 12.5% in North America (US, Canada, Mexico) and 16.3% in Australia. In North America (which is mainly US-driven) gains as a percent of total carloads were taken in metals, forest products, and automotive. Coal was unchanged while slight declines were experienced in paper, food, chemicals and petrol, pretty much reflecting the experience of the class 1s. Australia accounts for two-thirds of the total GNWR carloadings (but only half the revenue) and most of that is ore and grain. Needless to say both were up sharply.

Results for 2001 were posted Thursday morning and once again there were two sets of numbers – one with and one without the one-time items relating to the off-shore transactions. We shall focus on the latter to get a better idea of how GNWR really doing with its core business. Net income for the quarter was $4.8 mm up 41% yoy from $3.4 mm. On a per-share basis, again excluding the odd bits, earnings were 53 cents vs 48 cents yoy, up 10%.

For the year and including all special items for both years GNWR earned $19.1 mm vs $13.9 mm, up 37%, $2.22 a share vs $2.07 yoy, up 7%. To put it all in perspective, $10.2 mm of net income for 2001 came from North American operations with Australia contributing $8.5 mm and South America just $400,000. Zeroing in on the NA results, we find 4Q01 revenues up 8% to $44.4 mm yoy as a more favorable revenue-to-expense reduced the operating ratio to 86.7, an improvement of 270 BP. For the year, revenues rose 3% to $173.6 mm yoy. That doesn't look like much until you see operating expenses were reduced 15% and the resultant OR dropped to 87.2.

Looking ahead, GNWR expects to complete the EMON acquisition in 1Q02. The combination – based on the benchmarks spreadsheet at www.rblanchard.com -- ought to boost NA revenues to around $184 mm with an operating ratio in the mid-80s. All the metrics look good, from operating income per carload to revenue per mile and per locomotive. And for dessert, there will be a three-for-two stock split on Mar 14 for holders of record on Feb 28.

Earnings expectations for CSX and CP have been trimmed somewhat for 2002. The common thread is a much bigger reduction in near-quarter estimates with the full years 2002 and 2003 taking smaller hits. Over the past 60 days the CSX estimate for 1Q02 consensus has been trimmed 30% to 32 cents from 47 cents while the full year remains in the $2.30 range but shows signs of softening. Paper, chemicals, grain and coal appear to be the main culprits.

Further north, CP traffic lags expectations as grain and coal slide. Consensus estimates had been in the 32 cent (US) range for 1Q02 and $1.55 (US) for the year. Morgan Stanley is leading the pack taking seven cents off the Jan-Mar 02 period and a dime off the year. Stock growth comparisons aren't really fair, since CP only started trading on its own in Oct 2001. However, since then CP has barely budged from its $19 opening while CSX is up about 8% in the same period of time.

In another development, CP has bought Norfolk Southern's TYES (Train-Yard-Engine) software as part of a new suite of operating systems designed to increase CPR's operating efficiencies and reduce costs. By way of review TYES allows the user to process more car movement events with greater accuracy. Benefits include improved visibility, quicker reporting, and more timely information available for the customer all at lower cost to the user. CP has retained DMR Consulting to adapt TYES for the CP operating and business environment.

PennDOT has released another $6.1 mm in state capital budget funds to help finance needed infrastructure repairs on five rail-freight projects. They include $2.1 mm for ties and surfacing on the Allegheny Valley Rwy and $2.6 mm for the same thing on GNWR's Buffalo & Pittsburgh and Allegheny & Eastern units. CP's D&H unit gets $1.2 mm for rail, ties, surfacing and bridge work, and the Lackawaxen-Honesdale Shippers Association was awarded $250,000 for the purchase of a 24-mile rail line to maintain rail-freight service between Hawley and Honesdale.

The Foods Products sector in our Industry Watch market basket is off about 2% from where it started the year, though that's better than the S&P 500, down about 3%. But among our Industry Watch food product stocks, only ADM and General Mills are down whereas Hershey, Heinz, ConAgra and Tyson are all up. Rail commodities that will outperform in this environment include mainly those in the STCC 20 group.

In forest products, paper products have outperformed the broader index by about 10% YTD. Leaders in this group are Abitibi (+19%) and Domtar (+18%), while Jefferson Smurfit (-1%) and Bowater (-2%) bring up the markers. The S&P Company report says paper sales will be better in 2H02 as the economy firms boosting demand for white paper and packaging.

On the lumber side, continued strong housing starts appear to be the driver here as the home construction sector is up 20% YTD taking the DJ Forest Products sector with it, up 4%. The leaders are Willamette (+18%) and Weyerhauser (+12%) while GP (-23%) shows up dead last in the group. I think we can credit the fight over WLL for some of that. S&P says to expect wood products demand to soften in 2H02.

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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.