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The Railroad Week in Review 2/23/2001

Quote of the Week: *"The accounting issue is the flavor of the day. The market has attention-deficit disorder: it can only focus on one issue at a time. All the accountants and auditors are going to make sure the first quarter numbers are squeaky clean". Ed Yardini, Deutche Bank Alex.Brown in the WSJ-OnLine for Tuesday.*

Bill Bulkley, Staff Reporter for the Wall Street Journal, has some excellent observations about how to account for so-called "one-time items," offering some different ideas. The context is IBM's taking a $300 mm gain from asset sales to offset GS&A. As WIR readers know, we take a dim view of anything that misconstrues operating income and expense.

Bulkley notes that some accounting experts maintain that SG&A is an expense category and should be left alone. Others say many one-time items are in reality simply parts of doing business. In the railroad environment, I've seen companies put tax items that are regular operating expenses with the tax line between operating income and income. Others will offset car hire expense paid to other railroads with car hire received from other railroads.

In the first case, taxes paid on operating activities are operating expenses, and to put them "below the line" understates the operating ratio. In the second, car hire paid as a percent of freight revenue is an excellent measure of car velocity and equipment utilization. To use car hire receipts for off-line use of one's own cars to offset car hire paid misstates the case. The financials are, after all, not only something filed to satisfy the SEC but also something investors will want to use to measure performance. QED.

Freight carload figures for Week Six and YTD were no barn-burners. In fact, we saw some downgrades as a result. We are concerned that some rail stocks continue to sport unusually high PE multiples while others remain depressed. Morgan Stanley reports "economically-sensitive" traffic was off 4.5% despite positive forward-looking economic indicators and very easy comparisons with last year.

Writes fellow pundit Drew Robinson in NY, "Rail traffic continues to lag last year's uninspiring levels with just a few exceptions like autos. And these aren't tough comparisons as the shortfall vs. 1999 is even more pronounced. UP continues to do the least worst. This sour picture was forecast by the railroad execs here in New York a few weeks ago and in the stock market recently. It's fair to say the railroads aren't hiding any Enron-size bombshells on their balance sheets. Their problems are there for all to see. Which is a plus in this market." Drew's traffic charts at www.transmatch.com are quite revealing.

From South Dakota comes word that regional rail Dakota Minnesota & Eastern (DME, www.dmerail.com) will acquire the 1700-mile I&M Rail Link (IMRL, www.imrail.com). Recall IMRL is 2/3 owned by the Washington Rail Group (Southern Ry of British Columbia, Montana Rail Link) and 1/3 by Canadian Pacific. The deal gives DME direct access to gateways in the Twin Cities, Chicago, and Kansas City and more than 30 interchange points with all the class 1s and numerous shortlines.

DME President Kevin Schieffer says the properties will be managed as “sister companies “using the best of each and to respect differences where logical.” He properly notes that keeping the two names makes the total operation “responsive to employee ideas and concerns.” Of course, DME already has a pretty full plate with its Powder River Basin project cranking along nicely. And in these days of mergers and consolidations among class 1s it’s encouraging to see regionals combining to offer competitive alternatives.

The folks at CSX are definitely walking the talk when it comes to beating the bushes for new business. Literally. The recently launched Phoenix Project aims to put more freight cars on industry tracks that now generate only crumbs of cash. It’s a welcome change, as we’ve seen the rail industry turn its back on the single-car merchandise business in favor of shuttle trains and containers on flat cars. It works, too, generating more than $650,000 in new business in six months. The potential could be as much as $5 mm.

CSX has gone through its database of sidetrack agreements – some going back 65 years – and identified about 22,000 industry spurs on its 23,000-mile system. They matched up revenues and tracks and targeted those generating freight sales less than $25,000 – another 20 cars at the current CSXT average of $1,200 per merchandise load. And who’s taking the lead? Train crews! What a novel concept – who knows better than they where the business is and is not. And for follow-up, the Phoenix project sales force of five retired CSX sales pros extends the reach of the regular sales staff. With 36 hits for 70 solid leads, I’d say they’re working wonders.

Florida East Coast (NYSE: FLA) got hammered with a 4Q01 loss of $69.1 mm last week, due mainly to its EPIK fiber-optics venture, $67.8 mm. In 4Q00 FLA earned $5.8 mm. For the year, the company lost $61.4 mm vs a $25.8 mm profit in 2000. The railroad made money in 2001, albeit less of it -- $41.2 mm, off 5.7% on 2.5% less revenue. Real estate did surprisingly well, despite the economy, though revenues remain about 40% of what the RR contributes. The trucking arm was lost $6.3 mm on sales of $36.2 mm.

Still, it’s a pretty well-run railroad. The operating ratio lost a mere 90BP yoy, creeping up to 74.4, a pretty good number in anybody’s book. FEC racked up the second-highest operating profit and EBIDTA with FY 2000 the record-setter. Commodity gains were taken in aggregates (11%), food products (26%) and automotive (5%). Intermodal was off 5%.

Same Words, Different Meanings. The National Assn of Securities Dealers (NASD) has taken steps to demystify and decipher the various terms used to summarize research reports with a brief recommendation. One firm’s “underperform” is another firm’s “sell” recommendation. Another firm’s “market underperformer” is another’s “avoid” recommendation. The whole story may be gotten in a nutshell at www.nasd.com. Read ‘em and reap.

Roy Blanchard

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