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The Railroad Week in Review 3/30/2002

Big Six rail stocks eked out gains of 5-10% vs. the DJIA's 4% in 1Q02. Except for NS, up 30% on recovery from the Conrail mess and the promise of better operating ratios to come. To be sure, much of the fundamental performance improvement is already in the stock price – $24 is 20x the $1.19 estimate for '02 and 16x the '03 estimate. But then again, NS has always enjoyed a higher multiple thanks to its strong financial and operational reputation.

Speaking of which, the Thoroughbred Operating Program (TOP) now being unleashed on the railroad is taking out much of the random-event railroading that has plagued NS since July 1999. The view from here is that NS is doing this as a phased process starting with the big bites – core train operations, loco management, and yard dwells. From here the focus gets narrower, first to the yard and local jobs and then to the car itself. NS could well be giving CN a run for its money as a scheduled railroad leader by the end of the year. Any bets?

Meanwhile, the smaller class 1s and shortline holding companies have, with the exception of RailAmerica (RRA) outpaced the DJIA with honors to FEC up 21%. RRA came off a Jan high of 15 to close Thursday at $11, having slipped below resistance (the 200-day curve) at $12. The four analysts following RRA have reduced their rating to 2.25 (hold) from 1.75 (buy) as the 1Q02 estimate is off a penny yoy. For more on RRA's 2001 performance, see WIR 3/23/02.

Providence and Worcester income for the year 2001 was off 57% yoy, to $851,000 from $2.0 mm in FY 2000. Operating revenues for the year were $22.3 mm vs. $23.1 mm yoy, a decrease of $871,000, or $3.8%, but *other* income was cut in half, down to $1 mm – no property to sell. Intermodal billing was off 6% and conventional freight dipped 2% while demurrage fees and maintenance billing was off 22%. Operating expense was unchanged at $21.9 mm.

P&W says the decrease in container freight revenue comes mainly from the loss of a customer and depressed economic conditions. The decreased demurrage is good news. Net car hire on P&W runs 4% of revenues, a third of the typical shortline. But then, the 68,700 containers had to ride on something. I use and average of 1.6 boxes per platform – call it 43,000 carload equivalents. Also, a third of the conventional carload revenue is from chems, and that's got to be 99% "X" cars. Thus lowered demurrage says the carload side is being handled better.

Still, the 94 operating ratio is a concern. Run the numbers through the benchmark spreadsheet at www.rblanchard.com. P&W says many of the operating expenses are "relatively fixed" so the first place to look is sales and receivables. With $22 mm in operating expense it'll take $26 mm in sales to support a target OR of 85. One source maybe readily at hand. The $3 mm in receivables represents a 60-day collection period. Coincidentally the $1.7 mm in payables represents a 29-day aging. They collect too slow and pay too fast.

Cutting collection time to 30 days is worth a $million in sales; paying in 60 days takes almost $2 mm out of the expense side. Thus we have $20 mm in expense divided by $23 mm in sales for a new OR of 87. Ought to be worth a look, at least. Elsewhere, the returns are shy of what one would expect for an operation this size. Earnings are 3.6% of sales vs. the expected 8%, a mere

26 cents in sales is generated by each $1 in assets, and each dollar of equity supports just $1.29 in assets. Multiply the three and get a 1.3% return on equity vs. 8.9% on other small RRs.

Canadian National has made good on its promise to post the shortline breakout session notes on the web. Go to

www.cn.ca/companyinfo/shortlineinfo/en_AboutShortlineInformation.shtml

for a dozen PDF files covering Peter Marshall's opening remarks through product line presentations through Responsible Care and Safety. Perhaps the most far-reaching session has to do with the scheduled railroad and extending trip plans to shortline points.

A continuing complaint among rail users the "black hole" that exists between many shortlines and their Class I connections. Mack Barker's Service Integration session addressed this and related issues in terms of ISA's (or lack thereof), data flow to the customer, and operational matters. Solutions included formalized measurable ISAs, event data from the shortline, and having the CN local operating officers take ownership of meeting the ISAs. Without this, there can be no trip plans to shortline points. Ergo action is in order.

For its part CN has made a commitment to formalize a measurable ISA process and have and implementation plan in place by the time you read this on April 1. Data gaps that create "black holes" between shortline and CN will be identified along with what's needed to eliminate them. Lastly, CN will address local operating issues starting with the local switch list. An excellent starting place – often shortline crews finish their work after the clerks have gone home so cars on the interchange aren't on the next day's CN local crews' switch lists (not unique to CN).

Leasing company GATX (NYSE: GMT) received a favorable mention in Tuesday's *Barron's On Line* story, "Value Comes in Threes." The argument is a top-performing fund manager looks for three things: "the quality of the business, the track record of management and a company's ability to reinvest excess profits." His FBR Small Cab Value Fund (FBRVX) is up 58% yoy vs. the S&P's 4%. Pretty impressive. And GATX is one of his top ten holdings. Worth noting also is that GATX is one of the top dividend payers at 4.13% on the recent price of $31. The payout ratio is a generous 61% and the PE is under 15.

Annual Report season is upon us. Though we all try to stay abreast throughout the year, very often there are tidbits in the Annuals that we may have missed. A sampling: BNSF has trained more than 14,000 employees on its NetSimulator locomotive training program and other computer-based training. Canadian Pacific gives us the details on its programs is building short-haul trucker alliances even as it seeks to take business from the long-haul side. And Norfolk Southern provides graphic evidence of the significant (a third or better) reductions in transit times on six key lanes.

Now go cozy up with your stack of Annuals. And don't ignore the proxy statements.

Roy Blanchard

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