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Transparency in railroad traffic and financial reporting means the reader can see where the revenue is coming from, how it's being spent and what earnings are retained for another day. Transparency is important not only for financial review but also as a means to determine with whom one wishes to do business. The more up front the information the better; the more one must go digging for numbers the more one tends to ask, "What are they hiding?"

And so it is that WIR's *Third Quarter Review* puts every railroad's carload details and financial highlights in the same format with summary pages listing companies side-by-side. What's more, the *Review* grades each of the railroads reporting on the transparency of their stories. For example, most but not all provide carloads by commodity and revenue. I could get the carloads if I wanted to spend $2,000 a year on the AAR's Weekly Traffic Report series, so it's not like it's classified information. Onward…

Genesee & Wyoming (GWR) had 3Q02 operating income of $7.4 mm, up 44% yoy. Freight revenues including contract switching increased 26% to $53 mm while operating expenses were held to a 24% increase yoy. North American railroading is main force for GWR: net income after offshore and other below-the-line items was $6.7 mm, up 51% yoy. As for eps, 40 cents, up only 14% yoy because of the 36% hike in shares outstanding. Interest expense was a paltry $1.9 mm, handily covered 3.9 times by operating income.

Regular readers will recall I like to look at six-quarter trends to size up the direction of target companies. According to my calculations for the period April 1, 2001 through Sep 30, 2002 GWR net income rose 38% on 24% more operating income driven by 20% in revenue growth. By comparison, RailAmerica (RRA) grew the net 46% on 153% more operating income and 22% more revenues. There was a net loss in 2Q02, though. The charts on page 3 compare GWR with RRA for six quarters. Note the relative spreads between operating and net incomes.

The recent acquisitions – South Buffalo, Emons, Utah Ry, Oregon Electric (BNSF) – enhanced concentrations in metals, chemicals (incl petroleum), and forest products. In every case double-digit increases in carloads drove even greater percentage increases in revenues. Moreover revenue per car increased in these commodity groups while RPC drifted south in the lesser commodities.

Offshore, Australian Railroad Group (ARG) revenues increased 14% yoy but ops income was flat thanks mainly to old equipment inflicting $US1.5 mm in track damage. The Bolivian adventure brought home half-a-mill, up from $200,000 yoy. The view from here is that GWR has the fiscal strength and operating wherewithal to withstand the occasional shock and keep growing.

Kansas City Southern, like GWR, uses "equity accounting" for non-core results, making it that much easier to see how the principal business fares. That's a plus. But KCS loses transparency points for not providing commodity car counts or revenues in its public documents. (I got 'em later with a phone call).

KCS Railway (KCSR) revenues dipped 4.5% to $136.3 mm yoy due to commodity mix changes exacerbated by change-over difficulties as the new Management Control System (MCS) first mentioned three months ago (WIR 7/27/2002). KCSR thinks this may have cost $4.5 mm in lost revenues alone. The net effect was a 60% decline in operating profit to $8 mm from $20 mm yoy. Consolidated earnings came to $10.6 mm, $0.17 a share, including $5 mm from asset sales, about 6 cents a share, suggesting "real" earnings of $0.11 vs. $0.13 yoy. Here again one can readily see that KCSR – the core business – generates an operating income that falls pretty much intact to the bottom line with equity income reducing the effect of interest and taxes.

Looking ahead, the MCS changeover is largely complete and some adverse coal comps are past. Thus it is fair to say revenues will go up and operating costs down returning the OR to a more normal mid-80s from 3Q's aberrant 94. Know too that KCS through its 37% TFM rail interest now owns 46.6% of Grupo TFM, immediately accretive to KCS. Rail traffic on TFM is up 11% in the AAR's Week 43 after having seen gains of 8% and 10% in Q2 and Q3 respectively. That beats everybody else in the AAR's North American Railroad universe.

Florida East Coast will get out of the telecom business. As previously announced FEC got out of the long-haul trucking business, too. Now they can focus on what have always been the core businesses, railroads and rail estate. And well they should. More than two thirds of corporate EBITDA comes from the railroad and the rest from real estate.

Corporate lost $4.04 a share in 3Q02 thanks to the EPIK write-downs vs plus five cents in 3Q01. Railroad revenues were up 2% to $40 mm, expenses were down 1% to 30.3 mm, and the OR improved 2.5 points to 75.8. Merchandise carloads increased 5% with 6% more revenue however intermodal was off 3% by itself, cutting into the carload gains.

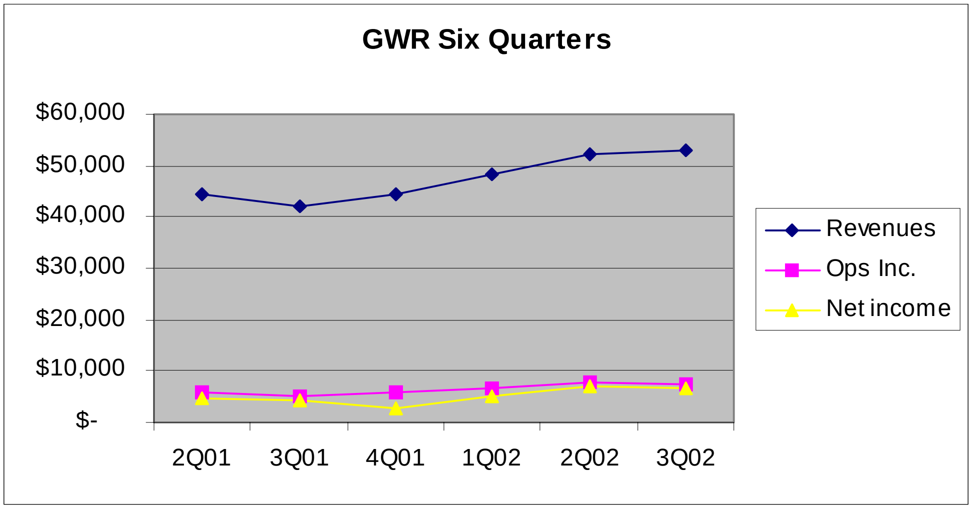
Revenue per carload (RPC) was up a mere point, indicating volume not pricing is the main factor. While RPC is already quite respectable given the distances involved, one would like to see some careful parsing of commodity sectors for value-based price increases. As BNSF has discovered, it's possible to increase rates faster with new business than old because the perception of value – they *did* switch from truck, didn't they? – is much greater.

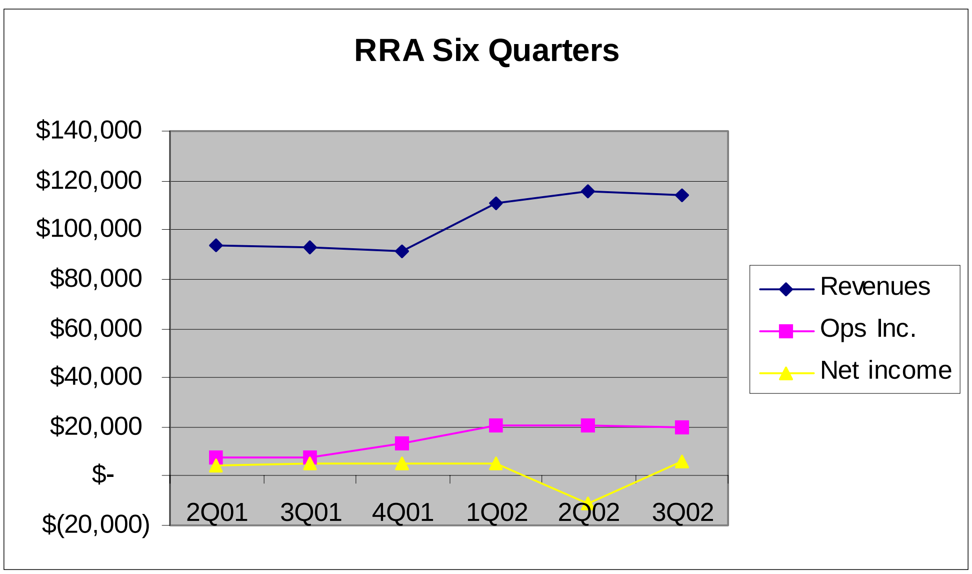
Trinity Industries (TRN) reported 3Q02 net income of $6.2 mm, down 22% yoy, on revenues of $387.6 mm, up 4%. YTD the per-share loss was trimmed to 18 cents from 60 cents yoy on slightly improved sales. For the full year TRN projects a loss in the 25-to-40 cent range. Meanwhile, GATX has ordered 1,000 cars a year over five years from TRN. This represents 2/3 of the 7,500-car buy GATX announced last month.

Railcar Management Inc. (RMI) this week tapped former States Rail CEO and shortline industry leader Pete Kleifgen as President and Director. He will take the lead in strategic planning, market expansion and growth opportunities, acquisitions and finance. I've known Pete for a good many years and he's the right guy for this slot IMHO. He's an excellent student of the industry, has impeccable contacts with the class 1s, and has met many a shortline payroll. Congrats, Pete!

Rail stocks largely held their own Friday as the broader markets fell on news that the UN Security Council unanimously approved the US resolution on Iraq. A note in forbes.com suggests that the "nonglamorous growth cyclicals specializing in transportation should benefit dramatically" and the small caps (GWR cited in particular) should outperform. Surprisingly, TRN and GBX held the course as well. Both have broken out above their 50-day SMAs.

Roy Blanchard provides railroad financial and operating performance measurements for shortlines and shippers. 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.


GWR Six Quarters
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$-
2Q01
3Q01
4Q01
1Q02
2Q02
3Q02
Revenues
Ops Inc.
Net income


RRA Six Quarters
$140,000
$120,000
$100,000
$80,000
$60,000
$40,000
$20,000
$-
$(20,000)
2Q01
3Q01
4Q01
1Q02
2Q02
3Q02
Revenues
Ops Inc.
Net income