

## The Railroad Week in Review

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**G**enesee & Wyoming (GWR) net income for 2Q03 came in at \$7.7 mm, up 3% yoy, though due to a 3% increase in diluted share count eps remained at \$0.49 for both quarters. Top line revenue figures for GWR include only North American rail activities plus the terminal contract switching business, \$62.9 mm vs. \$52.1 mm in 2002, up 21%. The Utah Railway acquisition accounted for half the increase and another \$million was from the start-up of a new rail line in Oregon. Same railroad revenue in the second quarter of 2003 increased 8.3% to \$4.4 mm, though a quarter of that was due to the Canadian-US dollar exchange rate.

NA operating expenses were held to a 19% increase yoy taking another point-plus out of the OR to a respectable 82.7. Comp and benefits take the largest bite at 35% of revenues, down from 37% yoy. Fuel expense rose 42% yoy however the larger revenue base held it to 7% of revenues, up a mere point. Merchandise carloads (no coal or intermodal) were up 13.7%, though mix changes held the carload revenue increase to 9.8%. Still, the same-store and carload revenue increases compare very well with the Big Six, none of which hit 4% in yoy top-line growth.

Offshore, Australia Rail Group generated US\$2.1 mm in equity income, down from US\$2.7 mm yoy as a result of what CEO Mort Fuller calls a "difficult grain year." Equity income from GWI's 22.9% indirect ownership of a Bolivian railroad, Empresa Ferroviaria Oriental, S.A., was US\$0.2 million in the second quarter of 2003 compared with US\$0.3 million in the second quarter of 2002. GWR has been mentioned as a possible suitor for TranzRail, but IMHO the US\$100 mm or so acquisition price might be better used elsewhere. The D&H, for example. Just look at a map and connect the dots.

**R**ailAmerica turned the 2Q02 loss of 33-cents a share into a positive 14-cent win for 2Q03. The 3% yoy gain in North American operating income was consumed by the continuing losses in Australia for a no-percent gain in yoy consolidated revenues, a 4% increase in consolidated expense, and a 17% decline in operating income. Recall last year there was a \$25.7 mm below-the-line hit, mainly due the debt restructuring.

Getting back to North America, total carloads based on an aggregation of the monthly reports (I don't have the quarterly carloads by commodity and revenue yet) were up 2.2%. Against the reported 5% revenue increase, a positive change in mix is implied. On the other hand, the 5% expense increase would seem to indicate the mix change was such that no economies of scale were realized.

According to the rather broad data given (expense not broken out by comp, material, fuel, etc) we can only tell transportation costs (crews, fuel, car hire, etc.) were up 4%, GS&A up 5% and Depreciation up 12%. One would like to see the first two come down a bit as COO Gary Spiegel & Co. start to see the regional efficiencies one might expect in an organization this size.

**K**ansas City Southern share prices continue to hold up a week after the firm announced a three-cent per share loss (5 cents before the preferred dividend) vs. a positive 27 cents (24 cents pre-preferred) in 2Q02. Evidently the \$2.3 mm loss from its TFM partner (vs. a \$13 mm profit in 2Q02) due to Mexican tax exposure has not dampened investor enthusiasm for the stock after the US core rail operations posted a 5.7% revenue increase.

Above-the-line operating income was \$14.2 mm, down 2% yoy on increased operating expense (up 5.9%), chiefly fuel (up 21.5%) and casualties/insurance (up 16.7%). Revenue per commodity carload increased 2% led by price and carload increases in the key commodity groups of food-related products (STCC 01, 20), lumber (STCC 24), and paper (STCC 26). The chem and petroleum group posted 9.3% declines in both volume and revenue.

Looking ahead, one analyst writes in a private note to clients, "Given the sharp swing in which deferred taxes reduced the TFM contribution we now assume zero impact from deferred taxes in 3Q and 4Q." The new numbers are about half what they were and even FY 2004 looks more like four bits than six. This being the case, one wonders how long the present \$12 stock price can last.

Florida East Coast increased rail revenues by 8.5% to \$45.2 mm, including \$2.7 mm in drayage fees now charged by the railroad since discontinuing its in-house truck line last year. Crushed stone for construction and road building continues to be the Number One carload revenue generator with half the total revenues and two-thirds of the volume. Only intermodal scores higher in revenue, \$14.9 mm to \$13.8 mm. The short-haul "Hurricane Service" in the ATL-MIA market has proven a winner, offsetting losses in haulage and LTL lanes.

Rail operating income was held to a 2.8% gain as operating expense were up 10.4% yoy, adding 135 basis points to the OR, now 75.4 – still an industry leader. Elsewhere the real estate arm brought in another \$28 mm in revenues and helping the corporate operating income line to an 18% increase to \$15.4 mm, of which \$11.1 mm came from the railroad. Shareholders must be relieved that the epic EPIK epoch is over. Per-share earnings for the quarter came in at 25 cents, up from a nickel in 2Q02.

As a group these four turned in some rather nice results compared with the Big Six. Using just the North American railroad revenues for RRA and GWR, the lowest revenue increase (RRA, 4.7%) was nearly a point better than the best Big Six revenue increase (BNSF, 3.9%). Operating income was up for three out of four vs. down for five out of six. Operating ratios however weren't much better, though, with only GWR taking out a point-plus. See the Table 1.

Lessons learned from this earnings season are several. First, there were modest revenue gains pretty much across the board, thanks in varying degrees to better pricing, better volumes, fuel surcharges and RCAF adjustments. Second, aside from the obvious fuel follies, labor and casualty costs have to be brought back in line.

Third, opportunities abound in transporting what we make and consume here in North America. Look at packaged food goods (STCC 20), forest products, and specialty chemicals. Fourth, a good way to get trucks off the interstates is to give the truckers what they want: 53' trailers (not containers) on reliable cut-off to availability schedules. These four, plus a modicum of economic improvement, might just make signal successes out of the upcoming quarters.

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**Table 1.**

<b>Small RR Commodity Carload Comps</b>				
<b>Revenue and income in \$millions</b>				
<b>Quarter ending 6/30/2003</b>				
<b>Metric</b>	<b>FEC</b>	<b>KCS</b>	<b>GNWR</b>	<b>RRA</b>
Railroad revs (1)	\$ 41.7	\$ 146.3	\$ 62.9	\$ 86.7
YOY Change	8.4%	5.7%	20.7%	4.7%
Carload revs (2)	\$ 26.8	\$ 97.7	\$ 36.9	\$ -
YOY Change	3.1%	3.4%	9.8%	na
Pct carload	64.3%	71.8%	58.7%	0.0%
Mdse Carloads (000)	47.4	118.5	92.2	-
Rev/CL	\$ 565	\$ 824	\$ 400	na
YOY Change	-0.8%	2.1%	-3.4%	na
RR Ops Income	\$ 11.1	\$ 14.2	\$ 10.9	\$ 17.0
YOY Change	2.8%	-2.1%	29.8%	3.2%
Interest Exp (3)	\$ (4.0)	\$ (11.7)	\$ (2.2)	\$ (9.7)
Net Income (3)	\$ 9.3	\$ (0.5)	\$ 7.7	\$ 4.6
RR Operating Ratio	75.4%	89.7%	82.7%	77.9%
YOY change in pts	1.35	0.23	(1.21)	0.32

(1) Includes non-freight revenue; GWR, RRA North America only

(2) Excludes coal, intermodal, bridge traffic

(3) Corporate