The Railroad Week in Review
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www.rblanchard.com
(215) 985-1110

This week was my Third Annual Shortline Review trip to Canadian National HQ in Montreal. The purpose, as it has been every year, was to review shortline trends past present and future with an eye toward incorporating them in the spring CN Shortline Meeting. The session alternates between Chicago and Montreal, and this year it's the Windy City's turn. Mark your calendars for Monday and Tuesday May 3 and 4. There's also golf on Sunday if you insist.

Every year the CN shortline group has significant progress to report on how the results and recommendations of the previous year's conference have been put to use, and this week was no exception. For the past year the focus has been car velocity and data quality with Chemin de fer de Quebec emerging as the Poster Child. CN pulled together a multi-discipline action team to identify the opportunities for process improvement and coordinate the findings with the shortlines.

There were three goals: decreasing shortline dwell time, improving data quality and bringing shortline customers into the CN's Guaranteed Car Order (GCO) Program. Embedded in the process was a measurement challenge the team met by putting put teeth in the ISAs. For example, there are cash penalties for failure to meet the metrics. The shortline gets tagged a nominal amount per day for holding cars beyond its allowed days. Similarly CN local managers pay a penalty for sending out unserviceable empties to meet the GCO commitments or for stuffing shortlines with cars they didn't ask for. The side benefit is that the financial incentives go far in assuring the measurement data is right and on time.

The scheme clearly has its roots in the IC. One of the first times I met Hunter Harrison he told me how the IC got five and later six turns a month with its grain trains. In addition to scheduling everything from trains to trackwork, IC paid a penalty to the customer if a train failed to perform as promised. The customer paid a penalty if the train wasn't ready to be pulled, loaded or empty, on schedule. And so it is on the CFQ lines. As a result, velocity is up 10% and dwell is down 15%. The question is now how to spread the word.

CN has 80 shortlines and the top 15 do 80% of the carloads. From the tone of this week's meeting one would have to conclude the smaller lines are the most resistant to the new reporting and GCO requirements. There are two reasons. First, the smaller properties typically operate on the fringes with one or two Class I locals between their interchange point and the serving yard. Being thus removed the incentives and benefits are less evident to the operator.

Second, the smaller lines operate on such thin margins that they often lack the financial resources to accelerate their own processes. A line running 100 miles over FRA class 1 track or worse will take an entire day to cover the distance before they ever do any productive work. A line that poor also operates on the margins with power, adding further to the potential for delay. (We won't even mention the D-word, another frequent occurrence.) Moreover, simply running trains is all-consuming, leaving little time or energy for financial planning or measurement.

The message writ large is that it's time for CN shortlines of all sizes to step up to the plate and take ownership of joint process improvement. Make the interchange work according to the rules, get the customers on-board with GCO, and improve the data transfer quality and timeliness. If you've already done it, go to the head of the class. You might even share with your peers in Chicago how you did it and the rewards you've reaped. And if you haven't embraced this change, come to Chicago and learn what you're missing.

As on the previous Montreal trips I spent the afternoon with Mike Farkouh, Greater Montreal Area Superintendent, at the Taschereau Transportation Center just west of *Centre Ville*. And again, the yoy improvements were obvious. The piles of stored international containers had dwindled down to 800 from more than 5,000 on the way to a target 350 boxes. To help keep the count down, no truck driver can get in the gate without a container destination, and the day isn't too far off when it will take a reservation for a specific train to get in the door.

The auto ramp has been completely redesigned and expanded. They can simultaneously unload three tracks of 25 cars each. Once the blocks are spotted a Trackmobile splits them into groups of five for unloading. Drivers then put the vehicles in "load lines" by dealer. The truck driver taking the load line loads 'em up and moves 'em out so Team Taschereau handles each vehicle once.

Farkouh's empire encompasses a flat switching yard, car repair facility, a diesel shop, a 300-spot bulk transfer facility, the five-track intermodal terminal and the auto ramp. The few vacant spots left are rapidly being filled up with dry bulk transloads (rock salt, cable spools, plate steel, e.g.). The beauty of it all is that everything is right there. When CN has a scheduled 10,000-ton train to a particular node it can be 5,000 tons intermodal, 2,500 tons auto and 2,500 merchandise – whatever's ready to go. Thus, says Farkouh CN keeps power, crews and freight cars balanced and fluid. And that's s one way to get to a 66 operating ratio.

Opening the **RailAmerica** conference call CEO Gary Marino said the strategic goals of selling non-core assets, increasing the emphasis on NA rail operations and getting the debt/equity ratio down to 1:1 are on target. Sale proceeds will go to debt reduction and funding acquisitions. Class I line sales will play a major role with new properties that are contiguous to owned lines and where resources can be spread across a larger base and earnings immediately accretive.

Consolidated 4Q03 revenue from continuing operations increased yoy 12% to $93.1 mm. RPU increased 8% to $280 with 11 of 14 commodity groups posting yoy increases led by double-digit gains in mets and ag. Excluding acquisitions in 2003, the revenue was up 7.1%. Quarterly operating expenses increased 15% yoy to $75.3 mm and operating income was essentially flat at $18.6 mm vs. $18.4 mm yoy. Backing out asset sales and restructuring costs in both years produces operating incomes in the $17.7 mm range for both quarters. At the end of the day RRA earned a nickel a share vs. six cents in 2002. See Table 1.

For the full year revenue from continuing operations increased 8% to $358.4 mm while expenses were held to a 6% increase, producing operating income up 14% to $74.9. Net income grew yoy to 14.7 mm from $2.1 mm on the cumulative effects of restructuring charges, income taxes, discontinued operations, etc. Management further estimates that the 2003 eps took a 19-cent hit due to the severe drought in Australia.

I've broken out the North American results in Table 2 and it's clear the quarter was expensive. The yoy changes in transportation and GS&A were double in the rate for the full year. Fuel was 35% hedged in 2003 to $1.01 a gallon vs. $0.87 in 2002. RRA cut the injury rate by a third to about 2.0, now half the shortline average. ROIC for the year was 9%, exceeding RRA's cost of capital, a feat managed by few railroads of any stripe this year.

Closing the loop, RRA does 18% of revs from CN, second only to UP at 28%. One would like to see RRA leading the pack in the CN shortline initiative. The time is right now that RRA is shed of Chile and shortly to be shed of Australia. Marino thinks they can do a buck a share in 2004 if they can hold the OR where it is now and fuel doesn't get away from them. Sounds reasonable.

Table 1. RailAmerica Income Statement

(Dollars in millons except per share)

Fourth Quarter 2003	Fourth Quarter 2002	Pct Chg		Full Year 2003	Full Year 2002	Pct Chg
$ 93.9	$ 83.6	12%	Revenues	$ 358.4	$ 333.3	8%
$ 75.3	$ 65.2	15%	Expenses	$ 283.5	$ 267.4	6%
$ 18.6	$ 18.4	1%	Ops Income	$ 74.9	$ 65.9	14%
$ (8.3)	$ (8.2)	1%	Interest Exp	$ (32.5)	$ (35.9)	-9%
$ 0.2	$ 0.2	0%	Other Exp	$ 0.1	$ (25.6)	-100%
$ (5.5)	$ (3.7)	49%	Income Tax Prov	$ (17.8)	$ (2.0)	nm
$ 5.0	$ 6.7	-25%	Net before Dis Ops	$ 24.7	$ 2.4	nm
$ (3.5)	$ (4.8)	-27%	Disctd Ops	$ (10.0)	$ (0.3)	nm
$ 1.5	$ 1.9	-21%	Net Income	$ 14.7	$ 2.1	nm
34.8	34.3	1%	Dil. Shares	34.3	32.6	5%
$ 0.04	$ 0.06	-22%	Dil. EPS*	$ 0.43	$ 0.06	nm
$ 0.05	$ 0.06		Dil EPS as reported*	$ 0.46	$ 0.07	nm
1.6%	2.3%		Net Margin	4.1%	0.6%	

Table 2. RailAmerica Railroad Operating Results for North America*

4Q03	4Q02	Pct Chg		CY 2003	CY 2002	Pct Chg
$ 93.8	$ 83.5	12%	Revenues	$ 358.0	$ 333.0	8%
$ 48.9	$ 42.9	14%	Transp	$ 183.8	$ 171.6	7%
$ 17.9	$ 16.1	11%	GS&A	$ 69.2	$ 65.7	5%
$ 6.3	$ 5.5	15%	Depreciation	$ 23.6	$ 21.7	9%
$ 73.1	$ 64.5	13%	Expenses	$ 276.6	$ 259.0	7%
$ 20.7	$ 19.0	9%	Ops Income	$ 81.4	$ 74.0	10%
77.9%	77.2%	6.86	Op Ratio*	77.3%	77.8%	(5.15)

* Change in points

A RailAmerica spokesperson says carload and revenue by commodity will by published in the 10-K.