The Railroad Week in Review
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"Our objective is to make our service more consistent, more reliable, and, therefore, more valuable." David Goode, CEO, Norfolk Southern, at Wednesday's earnings presentation in NYC.

Norfolk Southern led off this Earnings Season with a blowout quarter. Operating income rose 49.6% on an 8.4% revenue increase. Merchandise revenues increased 5.3% on just 4.2% more carloads, coal revenues were up 12% on 3% more volume and intermodal revenues shot up 14% on a 12% increase in units. Operating expense hardly budged, up 1.3% with diesel fuel, one of the biggest challenges in prior quarters, up 3% on a 6% consumption increase.

Absent last year's accounting change net income rose 86% to $158 mm from $85 mm yoy. Earnings per share was a near-double, to 40 cents from 22 cents in 1Q03. And David Goode got his wish: an OR beginning with a seven, 79.6. This was the best OR since the Conrail merger and handily bested 1Q03's 85.2. In his prepared remarks CFO Hank Wolf said comp and benefits were up 4%, however as a percentage of revenues dropped to 32% from 34%. Operating cash flow (cash from operations less capex less dividends) went up $143 mm and the dividend payout rose 19% to $37 mm.

Don Seale, SVP Marketing Services, provided some of the most detailed commodity data I've ever heard in an earnings presentation. NS is unique in that it posts the remarks on the website the day of the presentation and I'd recommend your bringing up that page as you read on. NS handled nearly 1.8 mm revenue units in the quarter, up 109,000 units yoy and every commodity group posted modestly higher RPUs. Yet cars-on-line (see the AAR website performance measures) never budged yoy. Average train speeds were up and terminal dwell times were down, enhancing velocity.

Don's main theme was matching prices to the value of the service provided. That 8.4% revenue increase was a function of a 1.8% improvement in RPU on 6.6% more revenue units carried. Merch RPU hit a record $1377 helped by paper, mets/construction, steel and automotive. Coal RPU was up 9% and intermodal up 6%, the latter due in no small part to volume increases of 22% with asset-based truckload carriers and 24% with the IMCs. Seale estimates that trucking hours of service changes and highway congestion helped bring in about $30 mm in truckload conversion revenues, about 2/3 intermodal and 1/3 carload.

The pace continues in April. Goode has said he wants annual revenues in the $billions beginning with a seven. The run rate with 1Q04's $1.7 bn is just shy of that. But given the fact that first quarters are typically slow quarters, an extra $100 mm per quarter over three quarters does not seem out of the pale. Wall Street seems to agree as the stock (NYSE: NSC) shot up 10% this week.

Canadian National Q1 operating income was up 5.6% excluding last year's accounting change thanks largely to expense control. Reported revenues were off 4% (up 4% adjusted for FX) while operating expenses dropped 7% yoy. Every line item came in lower – even fuel off 4% on a 2% greater burn. The OR came down 2.5 points yoy to 72.5. SVP Marketing & Sales Jim Foote said there were double-digit revenue increases yoy in mets/minerals and grains/ferts where each saw about a 5% loading increase. Only intermodal revenue was down, and that by 11% after FX.

The CAW strike took about $C24 mm out of net income (8 cents a share) but had a minimal impact on operating expenses, because the benefit of lower labor and fringe benefit expenses was mostly offset by increases in other expense categories. Intermodal revenues got hit hardest as, for example, CAW drivers chose not to deliver containers to CN ramps thus causing customers to seek other venues.

CEO Hunter Harrison in his opening remarks gave due credit to the 15,000 souls who stayed on the job minimizing the effect of the 4,500 who walked. That the merchandise groups all posted gains is proof of that pudding. The strike also pointed out which intermodal ramps were not up to scratch and that the RoadRailer business was not pulling its weight. All are expected to go the way of the dodo directly. Looks like less work for CAW members, if you ask me.

Looking ahead for 2004, the FX impacts will become less over time, the GLT transaction will close in a matter of weeks and the BCOL shortly thereafter, the strong pricing environment will remain, and a new operating plan Chicago-Memphis will make that railroad run better. Best of all, CN has at this moment the capacity to take on 20-25% more loadings without missing a beat.

March North American carloads for **Genesee & Wyoming** were up 17.3% yoy and 16.4% yoy for the quarter (Table 2). Excluding 4,105 carloads from three railroads acquired from Georgia- Pacific Corp., which GWR started operating January 1, 2004, North American traffic in March 2004 increased 8.7% and 7.2% for the quarter. Using the 2003 average RPU from the 4Q03 report it looks like NA freight revenues will be up 17%, about a point more than the unit volume increase. Four of the nine commodity groups reporting saw greater increases in revenues than units indicating better yield.

RailAmerica's North American carloads for March 2004 increased 10.5% yoy with most commodity groups posting double-digit increases (Table3). On a "same railroad" basis, March 2004 carloads increased 4.7% yoy. For the quarter NA loads went up 9.5% yoy overall and 4.3% yoy on a "same railroad" basis. Most merchandise commodity groups (ex-coal and intermodal) saw a greater increase in revenue than carloads based on average full-year RPU from 4Q03. Again using last quarter's RPU, three-month revenues were up 11.6% yoy, 210 BP more than the unit gain.

Retained Earnings is a little-noticed yet highly instructive line in the equity portion of the balance sheet. It is net earnings less dividends paid and tells the investor how much cash the company generates every year. It's really money in the bank and as such one like to see it grow over time because, as Frank Zappa once said, "Money gives you choices."

Moreover, there is a relationship between and among retained earnings, share price, and market capitalization. Table 4 shows how many dollars in market cap are represented by each dollar of retained earnings. Less than a dollar in market cap per dollar in retained earnings might be a sign that money in the bank isn't being used wisely.

There are four things a company can do with retained earnings: reinvest in the company, pay dividends, buy back shares or retire debt. Wharton's Jeremy Siegel writes in his seminal classic, *Stocks for the Long Run* (page 77), "In older firms [railroads, for example] disbursing cash or repurchasing shares often maximizes the value to shareholders." Now that dividends are taxed as ordinary income a steadily increasing dividend payout would be a healthy sign.

The accompanying table compares the US railroads' record on retained earnings and dividends for 2003. Also shown are the five-year trends in retained earnings growth and dollars in market cap per dollar in retained earnings. Put this chart next to last week's shareholder value charts and you'll see where the trends lie.

Consistent trailing results are the best indication that there will be consistent results going forward. Which of the lot will have the best shareholder returns over the next five years? Let me know what you think and we'll get something going here.

Table 1.
Big Six Class I Commodity Carload Comps
Quarter ending 3/31/2004
Revenue and income in $millions

Metric	CN	NS
Railroad revs (1)	$ 1,438	$ 1,693
YOY Pct. Change	-3.9%	8.5%
Carload revs (2)	$ 1,090	$ 967
Pct carload	75.8%	57.1%
Pct Intermodal	15.9%	19.4%
Pct Coal	4.9%	23.5%
Mdse Carloads (000)	619	703
Rev/CL x coal, IM	$ 1,761	$ 1,376
Rev/IM CL equiv	$ 1,485	$ 860
IMCLE/avg CL rev (3)	84%	63%
RR Operating Income	$ 395	$ 346
YOY Pct. Change	5.6%	49.8%
RR Operating Ratio	72.5%	79.6%
MGTM/gal diesel fuel	821	699

(1) CN, CP in $Canadian
(2) Excludes coal, intermodal
(3) Intermodal carload equivalent revenue as percentage of average carload RPU

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Table 2. GWR Revenue Carloads (thous.) US and Canada

March				Year-to-Date		
2004	2003	Pct Chg		2004	2003	Pct Chg
7.8	6.4	21.9%	Pulp & Paper	23.0	17.9	28.5%
2.8	2.9	-3.4%	Pet Prods	8.3	8.7	-4.6%
4.8	4.6	4.3%	Mins & stone	12.7	12.6	0.8%
6.6	4.2	57.1%	Lumber & FP	18.0	12.1	48.8%
6.3	5.3	18.9%	Metals	17.8	15.2	17.1%
2.7	2.1	28.6%	Chemicals	7.5	5.7	31.6%
4.5	3.1	45.2%	Farm & Food	11.5	8.3	38.6%
1.5	1.2	25.0%	Automotive	4.2	3.8	10.5%
1.2	0.8	50.0%	Other	2.9	2.5	16.0%
38.2	30.6	24.8%	Total	105.9	86.8	22.0%
14.8	14.4	2.8%	Coal Coke & Ores	44.0	42.0	4.8%
0.5	0.4	25.0%	Intermodal	1.4	1.3	7.7%
0.3	0.2		Mdse CL Equiv	0.8	0.8	

Table 3. RRA Revenue Carloads (thous.) US and Canada

March				Year-to-Date		
2004	2003	Pct Chg		2004	2003	Pct Chg
9.8	8.0	22.5%	Ag & Farm	26.5	22.2	19.4%
5.4	4.6	17.4%	Met/non-met ores	15.8	13.1	20.6%
11.3	11.1	1.8%	Lumber & For Prds	30.5	31.7	-3.8%
8.6	7.8	10.3%	Paper Prods	24.9	22.5	10.7%
9.3	7.5	24.0%	Chemicals	25.3	21.9	15.5%
8.5	7.9	7.6%	Metals	24.1	21	14.8%
4.5	3.9	15.4%	Minerals	12.1	11.4	6.1%
6.5	5.0	30.0%	Food Prods	18.4	14.8	24.3%
4.9	4.8	2.1%	Petroleum	13.6	13.5	0.7%
3.5	2.9	20.7%	Automotive	8.4	9.3	-9.7%
17.0	16.5	3.0%	RE Equip/bridge	50.1	43.1	16.2%
3.3	2.6	26.9%	Other	8.2	6.6	24.2%
92.6	82.6	12.1%	Total	257.9	231.1	11.6%
12.3	12.1	1.7%	Coal	35.2	34.7	1.4%
3.4	3.3	3.0%	Intermodal	8.6	9.7	-11.3%
2.0	1.9	3.0%	Mdse CL equiv	5.1	5.7	-11.3%

Table 4
Retained Earnings
Year ending 12/31/2003

Metric	FEC	KCS	GWR	RRA	BNSF	CSX	NSC	UNP
Net Income*	$ 43	$ 12	$ 27	$ 15	$ 816	$ 246	$ 535	$ 1,585
Divs declared	$ (60)	$ -	$ -	$ -	$ (201)	$ (86)	$ (117)	$ (234)
Retained Earnings	$ 517	$ 12	$ 27	$ 15	$ 615	$ 160	$ 418	$ 1,351
Prior Year	$ 500	$ 749	$ 103	$ 48	$ 5,625	$ 4,797	$ 5,694	$ 7,607
Net Retained Earnings	$ 558	$ 846	$ 131	$ 63	$ 6,240	$ 4,957	$ 6,112	$ 8,958
CAGR-5	-5.7%	-6.2%	22.7%	28.1%	10.8%	4.2%	3.3%	12.1%
SH Equity	$ 558	$ 964	$ 291	$ 372	$ 8,485	$ 6,453	$ 6,976	$ 12,354
Dil Shares (mm)	36.9	61.7	26.8	34.3	372.3	213.5	390	268
Equity/share	$ 15.14	$ 15.62	$ 10.87	$ 10.83	$ 22.79	$ 30.22	$ 17.89	$ 46.10
Price 12/31	$ 33.10	$ 14.32	$ 31.50	$ 11.80	$ 32.35	$ 35.94	$ 23.65	$ 69.84
Price/Book	2.19	0.92	2.90	1.09	1.42	1.19	1.32	1.52
Market Cap	$ 1,220	$ 884	$ 843	$ 405	$ 12,044	$ 7,673	$ 9,224	$ 18,717
MC/RE	$ 2.36	$ 1.04	$ 6.44	$ 6.46	$ 1.93	$ 1.55	$ 1.51	$ 2.09
5-yr avg	$ 1.92	$ 0.90	$ 4.28	$ 5.67	$ 2.31	$ 1.48	$ 1.33	$ 2.28

*After accounting changes