The Railroad Week in Review
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"We're using price to rationalize the business that is less attractive to us." – Rob Ritchie, Canadian Pacific CEO, April 25 Earnings Conference Call.

Burlington Northern Santa Fe reported $193 mm 1Q04 net income, up 30% yoy from $148 mm, $0.52 a share, also up 30% yoy, excluding the favorable effects of an accounting change in 1Q03. Operating income was up 19% on a 11% freight revenue increase and a 10% increase in operating expense. Every expense category was up double-digits ex-fuel, up a mere 0.36% (not a typo) though consumption rose 11% tempered by a 9% decrease in the average cost per gallon, $0.851 vs. $0.938 yoy after hedge. The OR came down one point to 83.3 from 84.3 a year ago.

Merchandise carload (everything but coal and IM) revenue grew 12% yoy on 9% more units and a 4% average RPU improvement. Ag (+22%) and industrial (+10%) were the big revenue drivers with perishables and dry box (+3%) and auto (-7%) trailing. Coal revenue was up 7% on 7% more loads; intermodal revs rose 12% on 8% greater volume. The mix remains much as it was last year – 46% merch carload, 31% intermodal, 21% coal and other (demurrage, ancillary charges, etc.) 2%.

Chief Operating Officer Carl Ice said first quarter car velocity was a record 196 miles a day. Through freight crew starts were up 10% yet the employee count was up only 1% and revenue units handled increased 8%. GTMs and unit miles per employee have improved at four-year CAGRs of 6% and 4% respectively. Finally, to stay ahead of the traffic growth curve T&E hiring rates and loco fleet expansion are running ahead of schedule.

Finally, the branchline rationalization program will result in about 2,500 miles being transferred this year. Rose gives the shortlines high marks for lowering BNSF capital exposure on the branches even as the small railroads access government rehab funds BNSF could never touch. Looking ahead to the balance of 2004, BNSF sees revenue growth in the 8-10% range with EPS running twice that. All but five of the 17 industrial products commodity groups saw record revenues in Q1 and the trends are likely to continue. Shortline operators would do well to look at Slide 17 and target their BD activities accordingly.

Canadian Pacific had a tough start in the first quarter with the worst avalanche in eight years, derailments and severe January weather conspiring to take about $C25 mm in ops income or a dime a share on the net. Reported freight revenues rose only 2% and total sales were up less than one percent. Reported net income dropped to 14 cents from 64 cents, 77%. But backing out disasters and foreign exchange (FX) impacts for both quarters produces a much-improved story and one that is a more accurate picture of what's *really* going on. Call it 36 cents vs. 23 cents, up 57% yoy.

Out on the railroad merchandise carloads (ex-coal, IM) were up 3% but revenue fell 4% and that took carload RPU down 7%. Coal loadings increased 17% but revenues were up only 10% causing a 5% fall in RPU. Similarly intermodal units increased 17% but revs grew by 12%, taking the RPU down 4%. Ops expense was up 1% yoy with significant savings in fuel (-6%), equipment rents (-12%) and purchased services (-7%) offset by comp & benefits and materials expense. Depreciation also rose 10%. And so it is that reported ops income was $116 mm, off 2% but again FX clouded performance by some $13 mm.

During the conference call Fred Green, EVP ops and marketing, showed how the adverse conditions Jan-Feb caused a drop of nearly 200,000 GTMs from late Jan through mid-Feb. That was the bad news. The good news was how fast they got it back with a 7% increase in train weight and 8% more GTMs per active employee Jan-Mar. In order to keep the momentum going and stay ahead of record volumes CP, like NS and BNSF in particular, has accelerated the hiring and training programs, pulling programs budgeted for 2005 into 2004.

The revenue planning model for the balance of this year calls for strong revenue growth in grain, coal, and fertilizers & sulfur assuming C$1.33 per US dollar. Revenue growth ex-FX ought to be in the 4-6% range. The fuel cost recovery program is alive and well with 90% of contracts covered and $10 mm recovered. The "up or out" program for marginal lanes will be aggressively pursued, meaning no more haggling for the last cwt, a theme we're already heard elsewhere.

CSX continued the pricing theme Wednesday. CEO Mike Ward opened the conference call saying, "Our goal is increased shareholder value through profitable revenue growth, modal conversions, and value pricing while we run our trains safely, reliably and efficiently. Our management restructuring is complete, our target has been met, and our goals are set." This was the eighth straight quarter of freight revenue gains, up 5% on merchandise (all ex-coal, IM) revs up 3%, coal up 9% and IM up 3%. Railroad operating income grew 21% as expenses were held to a 3% increase. The OR improved to 89.3, 140 BP better.

Diluted eps came in at $0.14, half the consensus, vs. $0.20 in 1Q02 excluding the one-time accounting change benefit of $0.26 a share. Embedded in the 14-cent figure is a 17-cent charge related to the corporate restructuring, so absent the charge eps would have been $0.31 a share up 53% yoy. During the earnings call CFO Oscar Munoz correctly noted the 11-cent eps gain is directly attributable to the enhanced surface transportation (railroad) results.

As you know, CSX has joined the ranks of railroads using the MultiModal ® service design tools and the new system has been tagged CSX-One. Says COO Tony Ingram, "We're going to roll it out in July for the core trains with near-term focus on safety and train originations, rebuilding the merch network, reducing car-handlings and cutting cycle time. That'll be done by Sep, we'll tweak it through Dec, and start on the local delivery system in 2005." Sound familiar?

Following the formal remarks somebody asked when the OR would hit 85. Ward, Ingram and Chief Commercial Officer Clarence Gooden all chimed in for the response. Ingram said consistent on-time departures are the best way to assure on-rime arrivals, a requirement for having all the pieces in the right place at the right time. Gooden said the pricing initiatives made possible by ops savings will lead to revenue growth. And Ward wrapped up saying that the productivity focus will create a safer workplace, driving every expense line item from comp and benefits to car hire to fuel to casualty and insurance. IMHO this is a pro team and we've got seats on the 50-yard line.

As expected, **Union Pacific** took a hit to operating income, down 15% as revenues rose 6% and ops expenses went up 9% adding 2.6 points to the OR, now 89.2. Fuel, materials, and purchased services/other were all up double digits. Absent the effects of an outrageous $36 mm crossing accident award in Arkansas the OR would have been 87.9. still up 1.4 points. Net income from continuing operations and before last year's accounting change was up 12% to $165 mm or 63 cents a share from 58 cents in 1Q03.

All commodity groups but auto were up with industrial products and ag both up 10%. Overall merchandise carload revenues increased 6% on 4% greater volume. Coal revenues and carloads were both up 4% while IM posted 9% higher revenues on 5% greater volume. Railroad President Jim Young said during the call that even with strong demand for UP services operating inefficiencies decrease the leverage needed to recognize higher rates. Somebody better tell the shippers, though. I'm getting reports of stiff rate increases in the most congested lanes while UP is selling on price on other parts of the system.

As to when the current congestion is likely to lessen, UP could offer no dates. However, even as increased carloadings have slowed system velocity UP is promoting more conductors to engine service and accelerating loco purchases. Three major congestion-relieving capital programs are running simultaneously: increasing double tracking El Paso-Colton from 30% to 60%, installing CTC east of Mo Jct. to Chicago, and increasing capacity on the MOP Chicago-Laredo.

Want proof congestion cascades? The 1Q04 recrew rate (percentage of crews that do not complete their assignments before running afoul of the 12-hour law) was up 75% over 1Q03 and UP has instituted transloads in Tucson and Montclair to keep cars out of Phoenix and Colton. As we've noted before, a one-mph increase in UP system train speed frees up 250 locomotives. They'll need that power because CEO Dick Davidson says the 2004 outlook calls for continued strong demand, unrelenting fuel price pressure, and the need to "leverage top line growth for bottom line improvement."

Kansas City Southern is, without a doubt, the toughest of the presenters when it comes to extracting key data. The slides are not downloadable, there is no print version of the press release, the tables are reversed with the latest numbers on the right, and the pure KCS railroad commodity carload and revenues are not available unless you ask for them. Combine that with the intricacies of their Mexican Standoff and it becomes a very difficult operation to understand, let alone communicate effectively to one's readers.

As near as I can figure out, 1Q04 KCS Railroad revenues increased 6%, operating expenses went down by 5% (a first among railroads), bumping up operating income smartly 15% to $24 mm and the OR sharply down nine points to 84. Though we don't have the numbers themselves, CEO Mike Haverty said all the commodity groups but chemicals and petroleum products were up yoy with only coal seeing a yoy revenue drop. This last was down 9%, though mostly a function of key generating stations being down for one reason or another.

EVP and COO Gerald Davies said the relatively new Management Control System has proved its worth in keeping a lid on ops costs even as volumes continue to accelerate. As we've seen elsewhere, truck conversions are on the uptick thanks to the hours-of-service limitations and congestion. KCS was nominated as the railroad with the most improved service quality in the biz by no less than *Logistics Today* magazine and the most recent Morgan-Stanley shipper survey. In sum, the KCS railroad is looking good and getting better.

Consolidated revenues increased 5% to $148 mm as expenses went south by 2% for a near tripling of operating income to $17 mm yoy. It's below the line that KCS (NYSE: KSU) gets complicated. Equity earnings in TFM fell 81% to $1.3 mm from $6.9 mm on weak auto volumes, high fuel prices, foreign exchange and other effects. KCS, like everybody else had an accounting credit last year, however discounting that net income fell 28% to $3.4 mm from $4.7 mm. Back out preferred shares and the common stick earned two cents (plain?) in 1q04 vs. seven cents in 1Q03.

RailAmerica's conference call told of North American Railroad operating revenues increasing 12% to $97 mm, ops expense up 16% on higher fuel, health, derailment, and casualty costs, and ops income down 3% to $18.6 mm with an OR of 80.8, respectable by any measure but still up three points yoy. Corporate revenues (why the difference what with Chile gone and AUS discontinued they did not say) rose 12%, expenses went up 17% and operating income headed south to the tune of 8%. Net income from continuing operations was off 21% and diluted eps for continuing operations was down 20%.

There wasn't much carload detail in the call, but last week's WIR chart will serve. North American merchandise carloads for 1Q04 increased 11% yoy. As noted last week, freight revenues would be up 11.6% yoy if we applied the average RPU from FY 2004. But since RRA does not provide this detail until just later we'll just have to wait.

Guidance for the full year is now $0.75-85, in line with First Call's $0.74, down from $0.89 three months ago. Caution is warranted because RRA still has more than a few under-performing properties based on annual carloads per mile of railroad operated and average RPU for the principal commodities of each line. We've long suspected RRA falls short of the $5000 per-mile-per-year maintenance average for shortlines to keep FRA class 2 (25 mph) track up to spec and the specific comment on derailment expense could be related.

Florida East Coast reported this week as well, however space and time limitations will prevent our getting to them here. GWR reports next week so in May's first WIR we'll wrap this quarter's earnings reports. I'll also run the GWR-RRA-FEC-KCS comp chart.

Retained Earnings redux. Last week we compared cumulative retained earnings over five years leading up to the 2003 numbers. This week let's kick it up a notch and look just at 2003 retained earnings and market cap. The argument is a $1.00 retained earnings increase should generate at least another market cap dollar. Conversely every $1.00 additional in market cap should be supported by a dollar in retained earnings.

In some industries stock buyers become so enthralled with a company's prospects they lose sight of its past record, pushing stock prices out of line with intrinsic values. This is one check. Another, more subjective check, is the continuity between and among years. A particularly bad year will hammer retained earnings (net income less dividends accrued) – KCS or CSX, e.g. Stock prices will lag the actual numbers so at year-end the market cap-retained earnings ratio will be out of whack.

On the other hand, GWR, BNSF and UP for example have consistent five-year trends of steadily increasing revenues, operating incomes, net incomes, retained earnings, and stock holder equity. As ever, the tables presented in WIR are designed to whet the appetite for more detail. Let me know what you think.

Upcoming Shortline Meetings: ***Canadian National***, Oak Brook Hills Resort, Oak Brook, IL, May 2-4, 2004, contact Mieka Ouelllette, Manager of Events, Mieka.Ouelette@cn.ca. ***Norfolk Southern,*** Hotel Roanoke, Roanoke VA, Contact John Kreaemer, AVP, john.kraemer@nscorp.com .

Table 1.

Big Six Class I Commodity Carload Comps

Quarter ending 3/31/2004

Revenue and income in $millions

Metric	BNSF	CN	CP	CSX	NS	UP
Railroad revs (1)	$ 2,490	$ 1,438	$ 886	$ 1,915	$ 1,693	$ 2,893
YOY Pct. Change	11.6%	-3.9%	0.8%	4.5%	8.5%	5.7%
Carload revs (2)	$ 1,149	$ 1,090	$ 492	$ 1,177	$ 967	$ 1,681
Pct carload	46.1%	75.8%	55.5%	61.5%	57.1%	58.1%
Pct Intermodal	31.3%	15.9%	28.8%	16.2%	19.4%	17.6%
Pct Coal	20.9%	4.9%	13.5%	21.1%	23.5%	20.3%
Mdse Carloads (000)	631	619	277	872	703	1,021
Rev/CL x coal, IM	$ 1,677	$ 1,761	$ 1,776	$ 1,350	$ 1,376	$ 1,646
Rev/IM CL equiv	$ 1,324	$ 1,485	$ 1,467	$ 960	$ 860	$ 1,196
IMCLE/avg CL rev (3)	79%	84%	83%	71%	63%	73%
RR Operating Income	$ 410	$ 395	$ 116	$ 204	$ 346	$ 314
YOY Pct. Change	18.5%	5.6%	-2.0%	20.7%	49.8%	-14.9%
RR Operating Ratio	83.3%	72.5%	86.9%	89.3%	79.6%	89.1%
GTM/gallon diesel fuel	736	821	769	725	699	724
Fuel/gallon (US$)	$ 0.85	$ 0.98	$ 1.06	$ 0.97	$ 0.83	$ 1.02
Debt/capitalization	45.1%	34.0%	49.4%	53.3%	49.1%	38.9%

(1) CN, CP in $Canadian

(2) Excludes coal, intermodal

(3) Intermodal carload equivalent revenue as percentage of average carload RPU

Note: This summary comes from my Quarterly Review that compares ten railroads' performance by commodity revenue and carloads plus Income Statement, Balance Sheet and Cash Flow Statement excerpts all in the same format making apples-to-apples comps a snap. Individual copies are $25 sent via e-mail in a PDF format suitable for binding.

Table 2

One-year Change in Mkt Cap vs. Retained Earnings

Metric	FEC	KCS	GWR	RRA	BNSF	CSX	NSC	UNP
Price 12/31/2002	$ 23.20	$ 12.00	$ 20.35	$ 7.17	$ 26.01	$ 28.31	$ 19.99	$ 59.87
Dil Shares (mm)	36.6	62.3	17.6	32.6	380.8	213.5	388.2	276.8
Market Cap 2002	$ 849	$ 748	$ 358	$ 234	$ 9,905	$ 6,044	$ 7,760	$ 16,572
Price 12/31/2003	$ 33.10	$ 14.32	$ 31.50	$ 11.80	$ 32.35	$ 35.94	$ 23.65	$ 69.84
Dil Shares (mm)	36.9	61.7	17.8	34.3	372.3	213.5	390	268
Market Cap 2003	$ 1,220	$ 884	$ 561	$ 405	$ 12,044	$ 7,673	$ 9,224	$ 18,717
Ch in Mkt Cap yoy	$ 371	$ 136	$ 203	$ 171	$ 2,139	$ 1,629	$ 1,463	$ 2,145
Retained Earnings 03	$ 517	$ 12	$ 27	$ 15	$ 615	$ 160	$ 418	$ 1,351
MC/RC 2003	$ 0.72	$ 11.14	$ 7.38	$ 11.67	$ 3.48	$ 10.18	$ 3.50	$ 1.59
5-yr avg	$ 1.92	$ 0.90	$ 3.50	$ 5.67	$ 2.31	$ 1.48	$ 1.33	$ 2.28