

Rail Earnings Summary 3rd Quarter 2010

CSX (reported October 12, 2010)

Price: \$57.26

- Reported ongoing earnings per share of \$1.14 after adding back a tax item, slightly besting analyst consensus expectations for earnings of \$1.04
- Generally seen as a very positive report for CSX, with high margins from both good cost control and strong pricing
 - Pricing improved 6.5%; yields were up 6%
 - Revenues increased 16.5%
 - Operating ratio of 69.1% was the company's best ever
- Productivity gains on the labor line: crew starts up just 6% while volumes were up 10% year over year
 - Expenses excluding fuel were up 6.4%, also lower than the volume increase
- Coal volumes and pricing are expected to remain stable and strong through the fourth quarter
- Analyst Opinion:
 - Tom Wadewitz of JP Morgan: Rating is Overweight (buy) with price target \$74
 - Ed Wolfe of Wolfe Research: Rating is Peer Perform (hold) with no price target
 - Chris Ceraso of Credit Suisse: Rating is Outperform (buy) with price target \$80
 - Scott Malat of Goldman Sachs: Rating is Sell with price target \$60

Union Pacific (reported October 21, 2010)

Price: \$85.26

- Reported earnings per share of \$1.56, beating analyst expectations for earnings of \$1.50
- Although quarterly results were very strong and topped analyst expectations, the stock price fell nevertheless as investors' expectations were not met
- Total yield growth was 6% on core pricing increases of 5.5%
 - Analysts expect continued strong pricing through 2011 as more contracts come up
- Cost side performance was extremely strong, with costs excluding fuel up just 7.2% compared to a 13.8% increase in volumes
- Volume growth in 2011 is expected to slow considerably; however, if strong pricing continues then the company has an opportunity to once again increase margins
- Operating ratio of 68.2% was a record for the company as strong operating leverage continued
- Revenues were up 20% which was generally in line with analyst expectations
- There could be more cost pressures coming up as more hiring and wage inflation as well as higher capital expenditures are expected going forward
- Analyst Opinion:
 - Tom Wadewitz of JP Morgan: Rating is Overweight (buy) with price target \$102
 - Ed Wolfe of Wolfe Research: Rating is Outperform (buy) with price target \$105
 - Chris Ceraso of Credit Suisse: Rating is Outperform with price target \$110
 - Scott Malat of Goldman Sachs: Rating is Neutral with price target \$95

Kansas City Southern (reported October 27, 2010)

Price: \$43.61

- Ongoing adjusted earnings per share of about \$.45 was in line with analyst expectations for earnings of \$.45
- Hurricane Alex impacted earnings by \$.14 per share; however, the company seems to have bounced back very quickly from the three-week outages through Mexico, and management's robust earnings guidance for the fourth quarter drove the stock price up
- Operating Ratio was 75%; however, excluding the impact of the hurricane it was 72%
 - This is a strong improvement for the company
- Operating leverage was strong as volumes increased 8.6% but headcount only increased by .6%
- Yields grew 5% as core pricing increased 5.5%
 - But pricing increases seem to be slowing, unlike at some of the other rails
- Revenue growth was 14% in the quarter
- Analysts feel that while KSU has a lot of upside potential in revenue growth and operating leverage, there is also a lot of potential downside from a slowdown in the North American economic recovery
- Analyst opinion:
 - Tom Wadewitz of JP Morgan: Rating is Overweight (buy) with price target \$54
 - Ed Wolfe of Wolfe Research: Rating is Peer Perform (hold)
 - Chris Ceraso of Credit Suisse: Rating is Outperform (buy) with price target \$58
 - Scott Malat of Goldman Sachs: Rating is Neutral with price target \$52

Canadian National (reported October 27, 2010)

Price: \$66.57

- Reported ongoing earnings per share of C\$1.19, which was slightly better than analyst consensus estimates for earnings of C\$1.14 per share
- Industry-high operating ratio improved to 60.7% in the quarter
- Volumes were up 18% and revenues were up 15%
- However, pricing performance was weaker with only a 3% improvement
- Performance was mostly in-line or slightly below analyst expectations; the slight earnings beat was mostly from below-the-line items such as tax rate, and higher than expected "other income" on the income statement (not from operating)
- Total yield declined by 3% in the quarter, mostly because of foreign currency impact (the US\$ weakness hurt yields substantially)
- Analysts suspect there is still some room for margin expansion as there remains excess capacity; however, with already-industry-leading margins, there is not as much room for growth here as at other carriers
- Analyst Opinion:
 - Tom Wadewitz of JP Morgan: Rating is Neutral with price target \$75
 - Ed Wolfe of Wolfe Research: Rating is Peer Perform (hold)
 - Chris Ceraso of Credit Suisse: Rating is Neutral with price target \$75
 - Scott Malat of Goldman Sachs: Rating is Neutral with price target \$71

Canadian Pacific Railway (reported October 28, 2010)

Price: \$65.64

- Reported earnings per share of C\$1.21, outperforming analyst expectations for earnings of C\$1.15 per share

- Although the earnings beat published estimates, strong performance from other rails that reported earlier led to raised expectations for many analysts and investors
- Margin performance was strong, increasing 2.3 percentage points over last year to 73.7%
- Revenues grew 15% on 13.8% volume growth and 1.1% yield growth
- Pricing should show improvement next year as regulated Canadian grain rates increased 7% on August 1
 - But pricing this quarter only increased 2%, which was on the low end of the rails
- Labor costs increased substantially more than other rails, as headcount went up 5% and costs rose 14%
 - However, other cost items seemed to do better than analyst expectations
- Higher pension costs will be a headwind against margin improvement in the fourth quarter and next year
- Analyst Opinion:
 - Tom Wadewitz of JP Morgan: Rating is Neutral with price target \$72
 - Ed Wolfe of Wolfe Research: Rating is Underperform (sell) with price target \$59
 - Chris Ceraso of Credit Suisse: Rating is Outperform (buy) with price target \$84
 - Scott Malat of Goldman Sachs: Rating is Buy with price target \$83

Norfolk Southern (reported October 28, 2010)

Price: \$61.35

- Reported earnings per share of \$1.19 compared to analyst expectations of \$1.09 per share; however, excluding many one-time items such as property sales, results were largely in line with expectations
- Similar to Canadian Pacific, Norfolk Southern likely faced raised investor expectations after seeing strong reports from so many other rails
- Coal volumes were very strong, up 14.6% in the quarter
 - But can this trend continue with cheap natural gas prices?
- Management refused to be transparent about pricing trends, leading analysts to suspect that pricing was not as strong as at some other rails
- Headcount was up 2.6%, compared to the 1% increases at competitors CSX and Union Pacific
 - Operating leverage was still strong; just not as strong as others
- Revenues were up 19% in the quarter on a 15.1% increase in volumes
 - Carload yield was up 3.4%
- Analyst Opinion:
 - Tom Wadewitz of JP Morgan: Rating is Overweight (buy) with price target \$74
 - Ed Wolfe of Wolfe Research: Rating is Outperform (buy) with price target \$64
 - Chris Ceraso of Credit Suisse: Rating is Outperform (buy) with price target \$77
 - Scott Malat of Goldman Sachs: Rating is Neutral with price target \$62