

The Blanchard Company
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The Railroad Week in Review 1/5/2002
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It's time for our annual look fore and aft at rail stock performance in 2001 and their relative potential for growth in 2002. Most of what follows is a combination of First Call, Zacks and Kentucky windage. As for the trailing 12 months, CN took the class 1 prize, up a whopping 60%, with the steepest rise post- Sep 11. NS and CSX both turned in 40% gains for the year, though easy comps from the depths of the Conrail morass were the biggest contributors.

BNSF and UP eked out slight gains while CP only got started in mid-Aug and ended the year slightly off the starting point. Both Rail America (now NYSE: RRA) and Genesee & Wyoming were up 75%. RRA had the soonest jump in May while GNWR picked up speed in the last two quarters. KCS was up 40% and it looks like the improved Mexican results helped there.

Looking ahead, my crystal ball is cloudy for GNWR and RRA because there are too few analysts following and we need to see how the late-year acquisitions work out. CSX, BNSF, and UP are likely to be the best growers in '02 thanks to portents for an improving economy and making great strides in scheduled operations system-wide. It looks like CN may need to take a breather following the 2001 surge and CP is finding its independent feet. As Mexico goes, so goes KCS, so there's no safe call there.

That being said, on Friday a news item from Reuters notes that transport stocks enjoyed a boost with CSX and NS strong in the rail sector. A convergence of economic indicators are seen by some that better times are around the corner and that now's the time to load up on transport stocks. Says Reuters, "Gains in transportation and shipping shares generally run ahead of any economic recovery by a span of about six months, as manufacturers slowly step up production -- and increase the need for the transportation of goods." That and 50 cents...

Suppliers did not have it nearly as good. GATX (NYSE: GMT) wins the down side, off 45% from its 52-week high of \$50 hit last Jan 2. This was the year in which GATX reinvented itself as a financial and leasing company, exiting the bulk terminal business, sold to Kinder-Morgan (NYSE: KMI). The transaction was completed in 3Q01 and then the stock price began to recover, up 15% thru 12/31 vs the DJIA up mere crumbs. Carbuilders and parts suppliers will continue to lag until the combination of rail traffic growth, fleet rationalization and increased equipment velocity mandate more newer, better cars. The bets are on that happening later rather than sooner.

Dan Machalaba writes (WSJ, 12/26) that grain shuttle trains on the class 1s are lowering transport costs and thus giving farmers a dime or more a bushel over the county elevator price. He says there are more than 140 shuttle loading points on UP and BNSF alone with many more in the works. That's good.

Not so good is the loss of business at the country elevators and the feeder railroads that serve them. A shortline operator in Montana tells me that the towns that grew up around branchline elevators are losing population even as the grain business leaves the railroad. County governments lament the increased road damage as farmers go to bigger trucks driving longer distances.

To be sure, the benefits of shuttle terminals on mainlines are substantial. But that does not mean the BNSF or UP are leaving the shortlines in the lurch. Jerry Johnson, AVP for shortlines at BNSF, says in a recent e-mail, "We have a handful of potential shuttle deals going with short lines in NE and KS and a few in operation. We load shuttles out of Salina KS with the Kansas & Oklahoma and out of Fergus Falls MN with Ottertail Valley. We run shuttles into a distribution facility in southwestern Kansas on the Cimarron Valley RR Other deals are in the works." In other words, shuttle terminals on shortlines are not out of the question – as long as the economics are there. County highway planners take note.

A few days after Christmas I had a bite of lunch with a good friend and sometime client who manages tens of millions of dollars worth of transportation services for a major chemical firm. I asked him, "What drives your decision to use truck or rail, assuming the commodity can go either way?" Said he, "That depends." The crux of the matter is neither rates nor timeliness, but rather the hassle-factor.

We already know that rail has many hidden costs that make a true apples-to-apples comparison a real challenge. My friend figures it cost him six times as much to administer a railcar as a truckload, from amortization of an expensive software program used only on rail moves to three full time staffers to monitor shipments, file statements of differences, and audit the add-ons. Never mind he has to maintain a fleet of leased equipment and the size of the fleet varies inversely with service reliability.

Shipments of less than 400 miles never go by rail, although the real break-even point varies by railroad. Even where he could have a thousand ten-car moves a year between the same short-haul O-D pairs, placing and pulling as blocks, it won't work because the carriers tell him one car or ten, costs are the same, so no breaks. Sure, it may cost the same to place or pull one car or a block of ten, but isn't the cost/revenue ratio better with blocks? If it were not, why would the class 1s be pushing shuttle trains? You can't have it both ways.

Canadian National's a new web page for car ordering, www.cn.ca/ebusiness/en_CarOrder.shtml is a welcome sight. With it one can list car requirements up to six months in advance, modify orders on line, and manage the cars against the orders. Of course, you have to register first, but that's a snap, too. It's all on the page. Give it a try and let WIR know it works.

RailAmerica is buying back its 12-7/8% senior debt of 2010 at the rate of \$1,085 per \$1,000 face value plus accrued and unpaid interest. There is about \$130 mm of this paper outstanding. The company tells me this tender offer was the first step of a debt refinancing process for RailAmerica. At this time RRA has yet to determine the exact method of refinancing, but is sufficiently confident at this time to put out this tender offer to start the process. Stay tuned for details; the entire press release is available at www.railamerica.com.

Roy Blanchard

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