

THE RAILROAD WEEK IN REVIEW

SEPTEMBER 30, 2005

Jim Bistline passed away recently. I only met him once, on the “welcome home” trip for the N&W 611 on her return to Roanoke after a total overhaul at the Southern’s Birmingham shops. Don Phillips knew Jim very well, and he penned this marvelous note on Jim’s passing:

A number of you have asked, “Who is Jim Bistline?” I won’t go into all the details. That would take a book. Jim was general counsel with the Southern Railway Company and then Norfolk Southern. He faced mandatory retirement from the Southern at age 65, but the railroad kept him on to run its growing steam locomotive excursion program. He had a ball.

Jim had a love for travel, and he covered the planet. He was rich, but the only reason anyone would know was that he loved to play the market. He loved to talk about it. But he never acted rich. It was a game, at which he was VERY good. Money meant nothing to him except for the games it could play and the fun things it could do. He gained one of the world’s great collections of railroad silver, dining ware plus bells, whistles, lanterns and other high-end stuff. Some of it is now headed to the Smithsonian, I hear, and to various museums and to a special Norfolk Southern display case, just waiting for it in railroad headquarters in Norfolk.

Jim was a lawyer when World War II Broke out, and he was suddenly an Army lawyer who, among many other things, commandeered a civilian DC3 at National Airport (to the cheers of the bumped passengers...attitudes on patriotism were different then) to fly to Chicago to seize Montgomery Ward. Roosevelt was angry that the company allowed a strike to shut down operations, and he sent Jim and a DC3-load of soldiers to Chicago to nationalize the company and draft the striking workers. The workers gladly returned to work for Uncle Sam. They were angry with management, not Roosevelt.

He was a junior prosecutor at the Nazi war crime trials, etc., etc.... I’ll stop here. Buy me a drink sometimes [which I did on Thurs – rhb] and I’ll tell you this and other stories [and he did -- rhb]. In the end, Jim was well aware he had little time, and he even joked about it. When he rallied on Monday, he said he was a little angry because he was prepared to die and this sudden burst of energy interfered with his plans. We laughed, and so did he. But he really meant it. What a life.... Don

Meanwhile Don is being kept quite busy, as most of you know, in the service of *International Herald Tribune*. Here are excerpts recent column* on what the US may have to teach the rest of the world about the rail freight business. “North American railroads are basically freight railroads designed to haul long. Passenger trains in North /America are little more than an annoyance for private-enterprise freight railroads, something forced onto their tracks by government pressure.”

* <http://www.iht.com/articles/2005/09/21/business/transcol22.php>

He goes on to say that for most government-owned rails in Europe freight is an afterthought though the EU is going to force freight on the nationalized systems. “The idea is that highways are terribly overcrowded and only railroads can handle the growing crush of heavy freight traffic.” Wow! What a concept! Here in Phila the R5 Paoli local runs half empty while the parallel Schuylkill Expressway – an oxymoron if there ever was one – is jammed to a stand-still. And regular gas is now \$3.25.

“Among other things, the EU has forced railroads to make space on their tracks for competing private freight haulers. This must be done by the end of the year, but the French railroads had to do so earlier in a deal that allowed a one-time government payment to shore up the freight system.” Similarly, we

in the provincial US need to “shore up” Amtrak so that equipment doesn’t fail on the road and slow down the host freight roads.

“North America, Russia and China are the biggest rail freight haulers in the world today, not only because of their size but also because they share a level of dedication that is lacking in Europe. The question is now whether Europe will join them.” And whether the US will join the rest of the world in making rail passenger service cheap, convenient and clean. Right now, it is none of the above.

Shortlines, too, have been busy warding off the effects of the dynamic duo of Rita-Katrina. Watco shut down its Timber Rock Railroad (TIBR) in anticipation of the storm. The railroad employs 76 people itself and another 173 members of the Watco family work on properties in the path of the storm. All locations in the Houston Metra Area were closed, including Greens Port Industrial Park and multiple switching and mechanical repair operations.

Watco is one of the most people-oriented shortline operations around and Rita put that caring the test. Keith LaCaze, COO, Gulf Region, was one of the last to leave the TIBR office in Silsbee. Said he, “Our employees have left for safer locations, along with their families. We want to make sure everyone reaches safety and we will do our best to make contact with them afterwards.”

Tim Lundberg, Watco’s Human Resources Manager, agreed the focus needed to be on the safety of the employees. “We have a detailed list of employees who live in the affected areas and have instructed them to contact us as soon as they can after the hurricane passes. We want to make sure everyone is safe and accounted for. As we make contact with employees we will also be determining when we can safely resume operations in the Gulf,” he said. Those who were able to make contact with one of the affected employees were asked to alert Lundberg. Now *that’s* staying ahead of things.

Coal is back with a vengeance at Norfolk Southern. A week ago NS President (and CEO effective Nov 1) Wick Moorman addressed the Center for Energy and Economic Development at White Sulphur Springs and showed some very interesting slides, [www.nscorp.com>>investors>>executive speeches](http://www.nscorp.com>>investors>>executive%20speeches)). Didja know, for example, that NS coal tonnage was up yoy in each of the last six consecutive quarters? Wick’s sample goes back to 1Q00 and there’s nothing like it anyplace.

Says he, “This doesn’t look like a flash-in-the-pan phenomenon that is here today, gone tomorrow. We think this is more like a long-term trend that has enduring value. It bodes well for the future of coal and Norfolk Southern. Volumes have not only surpassed production estimates for the first six months of this year but also are ahead of national metrics for production of electricity and steel.”

The implications for shortlines and the merch carload business are most encouraging. Coal consumption is expected to increase 36% from now through 2025, from 1.1 bn tons to 1.5 bn tons a year. Moving this increasing over the rails has to fit with the projected increase in everything else, and it’ll take improved service performance, better asset utilization and more capacity.

That’s one reason NS is aggressively hiring T&E emps, adding locos and adding track capacity. Just yesterday, for example, I took an excursion train over the new NS triple track between Harrisburg and Altoona where you can run in either direction on any of three mains. We rode over the Nittany & Bald Eagle’s coal shortcut between Tyrone and Lock Haven PA. And we saw where NS has installed bi-directional running on the former Reading double track line east of Harrisburg.

Clearly all this capacity improvement is going to benefit the carload product. NS has said it still has capacity for more merch traffic and shortline managers can quickly determine the best-yielding

commodity lanes. Take what BNSF's Jerry Johnson calls a "supplier mentality" when approaching the Class Is with new commodity lanes and everybody wins.

Shortline sales between shortlines are heating up. Twice in two months I've run one-paragraph notices in the ASLRRRA's *Views & News* announcing shortline transactions where I am assisting the sellers. Each time in a matter of hours I've had responses numbering in the teens. Responders have included not only the usual suspects but also owners of smaller albeit *successful* shortlines looking to expand their holdings.

Having been over the years on both sides of the transaction, I'm trying to make the due-diligence materials look like what I'd want to see if I were the buyer. The consensus is we've all seen too many books that are under-whelming and leave more questions than answers. To all would-be sellers, let me offer a few suggestions.

Make it transparent. Make the income statements take the form of what you see from the Class Is. Show operating and non-operating revenues backed up by a schedule of customers, carloads and revenues in milepost sequence. Break out each expense line in excruciating detail – number of emps, job assignments and pay scales with burden, car hire vs. leases, separate maintenance of locos and cars from MOW equipment, include depreciation, and show what's in GS&A and provide a separate line for the insurance bill.

On the balance sheet, include an exhibit detailing PPE. Show accounts receivable and payable as well as current portion of long term debt. It's amazing how often buyers have to go mining for these details and they ought not to have to ask. Don't skip the cash flow statement, either. Sellers like to hide the fact that they've been under-investing in track, so take the cash flow statement with you when you do the hi-rail trip. If there's a large capex number and the track is all FRA class 1 or excepted, you need to know where the money went. Or if the track is a solid FRA class 2 and capex in minuscule, you need to know where the money came from.

Finally, EBITDA is key and if a buyer can't get to it he'll have a hard time putting a value on your railroad. Buyers will pay up for good properties – just look at the premiums paid in recent transactions.

And for buyers? Even if all the detail is there, you don't want to get into a bidding war. If the seller tells you the other guy is offering seven times EBITDA and you see only five, say "mazel tov" and walk. One property I saw was so bad the only way to justify seven times was to tear up a lot of light density mileage and sell the rail, which itself was worth two times. Caveat emptor.

Next Week: Lexington Group annual meeting in Harrisburg PA sparks lively debate, includes spectacular train ride behind Bennett Levin's restored E-8s.

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