ROY BLANCHARD

Annual short line conference confirms that times are good

It's a great time to be a player in the game

A trip to the American Short Line and Regional Railroad Association's annual meeting in Baltimore last April gave me a good picture of what's going on in the industry.

Jack Koraleski, executive vice president and chief commercial officer at Union Pacific, manages the largest merchandise carload network in North America and is an articulate spokesman on the topic of the single-carload freight. He set the tone for the event with these words: "The railroad business has never looked better."

In calendar 2006, Koraleski said, shortline railroads participated in 14 percent of UP's total revenue volume unitXXXhuh? and shared in 20 percent of total revenues. Put that in context and you'll see that UP short line connections handled roughly 1.4 million units worth some $3.1 billion in revenue. Since the average shortline share of Class I revenue runs about 20- to 25 percent, one can conclude that total shortline receipts from UP alone were worth more than $600 million. In aggregate the "Big Six" North American Class I railroads rang up total 2006 revenues of $62 billion on 43 million loads. The shortline share runs about the same on each so it's clear the short lines carry a heavy load. The take home lesson is that the more shortlines know about their Class I partners' business objectives, the stronger the partnership. And each of the four US Class I railroad chief commercial officers addressing the 1,500-plus shortline and supplier representatives had pretty much the same message: The outlook for continued rail volume increases has never been better, and the door is open for even more short line participation.

Wall Street is beginning to take notice. The February 2007 purchase of RailAmerica by Fortress Investment Group was what many insiders view as the first of several such private capital ventures into shortline railroading. Joe Adams, managing director at Fortress, said that the $1.1 billion purchase price paid for RailAmerica reflects what his group sees as the rail industry's growth potential from increased commodities shipments and the many constraints on trucking from fuel costs to hours-of-service limitations to highway congestion. Besides, Adams said, few new rail routes are being built because the barriers to entry in the business are so high.

Looking ahead for RailAmerica, Fortress has no plans for divestiture, and the company expects to recover the premium paid (12 times earnings before interest, tax, and amortization) vs. an industry average closer to seven or eight) by better asset utilization and low-cost capital infusions, Adams said. As if to drive the point home, not three weeks later Fortress announced its intention to acquire Florida East Coast Railway.

What seems to be happening is that the investment community is beginning to recognize the excellence that abounds in the short line industry. As we've noted before, many top-notch short line operators are in the business. And both the shortline association and *Railway Age* make it a point at every annual meeting to cite several for significant achievement.

This year's association awards went to Pinsley's Arkansas Midland; Bob and Annie Bryant's Bucking Branch in Virginia; and RailAmerica's New England Central, formerly the Central Vermont. *Railway Age* presented its "Shortline of the Year" awards to R.J. Corman's West Virginia Lines and to Florida East Coast.

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The common thread among these five winners is the ability to get out and hustle for new business, and I think the Corman story says it best. The line in question is the former Chesapeake & Ohio branch to a coal mine at Pax from the mainline connection at Thurmond in the New River Gorge. Corman rebuilt 16 miles of railroad — four of which had been abandoned — to the 286,000-lbs. standard in three months, including the rehabilitation of an 1,100-foot tunnel. The net result is some 10,000 annual loads to domestic metallurgical and utility coal users.

Still, with all theses positive short line notes, there are myriad external forces at work that could derail the short lines' progress. Association President Rich Timmons cited five biggies in his "Ask the President" session: the threat of railroad re-regulation brought on by special interests from labor to utilities; increased pressure from the federal Transportation Security Administration on perceived risks; many aspects of hazmats from car design to insurance; the December 2007 expiration of the tax credit now in use by nearly 300 shortlines; and an intensified Federal Railroad Administration review of operating practices and regulations.

In an effort to bring many of these matters — as well as financial and commercial concerns — to closer member scrutiny, the association offered 42 sessions featuring presenters knowledgeable in subjects ranging from bridge maintenance to equipment leasing to the Federal Employer Liability Act, the tax credit program, evaluation of a sales lead, FRA relations, and tech advances.

By the end of the conference short line railroaders in every discipline had many new tools to do what Koraleski had talked about: participate in the growing demand for rail services, invest for growth as well as the best returns on capital, and do everything faster and at lower cost. The opportunities are there, as the award winners showed; the money is there as Adams and others proved; and the challenges are surmountable. Bottom line: It's a great time to be in the shortline and regional railroad business.

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