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The Railroad Week in Review 3/3/2001

No fights erupted after last week's invitation. But there was a goodly number of very constructive responses. A friend who owns shortlines in the Carolinas writes that an active industrial development campaign backed up by an aggressive transload program can add value and business. He notes that local government and connecting class 1 support are essential for the first. Knowledge of the service area beyond trackside is invaluable for the second.

The Albany (OR) lumber transload on GNWR's Portland & Western is a perfect example. The local entrepreneur and the railroad teamed up to build the facility (picture following) in true JIT fashion. Trucks arrive and the entire load can be on the car in 20 minutes. Though these are 286,000 lb cars, they are generally loaded to about 100 tons as the green fir can gain or lose weight according to the weather.

The beauty of the relationship is that now mills with no direct access to rail can enjoy the competitive efficiencies of rail to reach the LA and Phoenix markets. It's as Norfolk Southern's Jim McClellan told the shortline group assembled in San Diego recently: "The trick is to match the go-everywhere ability of truck. Lets face a simple reality -- getting someone already wedded to truck to convert to rail is very, very difficult. So the goal is to utilize transload. I continue to think that one of the real growth opportunities for shortlines is to think of their gathering and distribution functions in broader terms than just a railcar."

Taking a slightly different tack, Rail Development Corp's Henry Posner writes, "The strength of the Short Line industry [is its] focus on retail customers, however, there are weaknesses. The first weakness is that the cost advantage of Short Lines has substantially reduced by new class 1 efficiencies. Second, the fact that mergers mean that there are fewer Class 1s and that they're bigger means that any individual Short Line is less significant to that Class 1's success."

To which I can only add that we see the loss of cost advantage where class 1 branch line trains are working with two men and all the trackwork is mechanized. As previously reported here, the trend is to let FRA track class deteriorate to what's realty needed to support the service. Worse yet, I suspect that the combined revenue contributions of half of shortline connections amount to less than three percent of the total class 1 revenue derived from shortlines. And that's ten percent of the total revs, plus or minus depending on the class 1. Three percent of ten percent? C'mon.

Still, many smaller lines that might be classed as "marginal" can take steps to make themselves less so. A good friend writes from Central Pennsylvania, "I own a short line that has been in business for almost half a century and has never handled 4,000 cars a year. We are still competitive in the marketplace despite incredibly lousy service from the class 1s, beginning with the PRR.

"Small volume does not necessary equal bad business. I send maybe 10 packages a year by UPS and I get the same prompt, courteous and economical service that a distributor handing them 10,000 shipments a day gets. If the big railroads ever stop shooting themselves in the foot they will have no trouble enjoying a profitable relationship with the small independent railroads they connect to."

Concludes Posner, “I believe that the US shortline market will continue to be relatively transparent and therefore highly competitive. Success in this business will focus more on the process than the customer.” Which comes back to the remarks of Jim McClellan and the actions of roads like the Portland & Western.

Trinity Industries (NYSE: TRN; www.trin.net) makes rail cars, river barges, freight car parts and accessories, highway construction products, ready-mix concrete and aggregates, highway construction products (bans and barriers, e.g.), and special purpose storage tanks. TRN also has its own leasing company. In FY 2000 (ending 3/31/2000) the Railcar Group rang up 53% of total sales and 48% of operating income.

Freight car parts contribute another 15% of total sales and 21% of total operating income with the balance of sales and operating income spead evenly throughout the rest of the company. Thus it’s safe to say TRN is primarily in the railroad supply business and therein hangs the tale. WIR readers know that railroads now own about 40% of the 1.3 mm freight cars in North American circulation and that percentage is declining. Conversely leasing companies own more and the rate of growth has been helped by lousy railroad performance.

Here’s the rub. As the rails get their arms around scheduled service and better asset management, you can move just as many tons of freight with fewer cars and locomotives. Combine that with a slowing economy and it’s not hard to see why TRN’s railcar deliveries in 3Q01 were 3500 units, down from 5900 units YTY. Trinity sold 42% of their railcar deliveries to the in-house leasing company. Historically TRN has leased around 6-8% of the railcars produced.

For nine months ending 12/31/00 TRN lost $34.7 mm on sales of $1.5 bn vs. a profit of $131.6 mm on sales of $2.1 bn a year ago. Even adding back the $117.5 mm in special charges, the adjusted net is off 37% on a 28% decrease in sales YTY. S&P figures revenues for the FY ending 3/31/01 will be off 30% YTY and the decline will continue through the coming FY as production stabilizes at a quarterly projection of around 3700 units. Next week, we’ll take a look at Greenbrier Industries (NYSE: GBX; www.gbrx.com).

Elsewhere in Supplierland, RailWorks Corporation (Nasdaq: RWKS), a relative newcomer to the scene, says it has bid successfully on more than $100 mm in new projects. The backlog now stands at a record $970 mm…Specialty track and car component maker ABC-Naco (Nasdaq: ABCR) has been placed on Ratings Watch Negative by Fitch, Chicago. The agency cites weak operating results during 2000, reduced liquidity and poor interest coverage – less than twice EBITDA.

If you own Wisconsin Central stock the proxy material for the proposed CN transaction will arrive shortly. Stockholders meet April 4, 2001. If the deal passes (and my bet is it will) stockholders will be entitled to $17.15 per ticket.

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Disclosure: Blanchard may from time to time hold long, short, or debt positions in the companies mentioned here. A list of such holdings is available on request.

Portland & Western (GNWR) lumber transload in Albany, Oregon, loading outbound fir studs for points south and southeast. (2/17/2001)

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