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The Railroad Week in Review 6/9/2001

A good friend in the supply chain business, one who keeps me honest and on my toes, on occasion takes exception to some of my remarks in WIR and is not shy about it (I could use more like him -- hint). Regarding my BNSF train ride story, he writes, "While the BNSF (former Santa Fe) intermodal service is very impressive, you appear to have fallen into the same historical trap as the railroad industry. It's like driving a car while only looking in the rearview mirror.

"First, while 2,000 mile lengths of haul are nice to have, it's important to remember that most data indicate that two-thirds of the domestic truck/container freight market is in the under 1,000 mile length of haul. So having a lock on one-third of the market is nice but where's the room for growth? (And we all know how Wall Street loves growth.)

"Second, the Chicago-L.A. lane is the historical market. It's a market where intermodal already has a 90% market share, with growth opportunities limited to the rate of growth in the overall economy. The great untapped potential for intermodal (and railroads) is between the Southeast and the West Coast. While Chicago was a major distribution center historically, the real growth over the past 40 years has been in Atlanta and Memphis over the past 20 years.

"Yet, railroads have missed both opportunities. I think this is called marketing myopia. What concerns Wall Street is the fact that BNSF (and the rest of the industry) seems to be heavily investing in the status quo but ignoring opportunities for real growth. Ironically, the Santa Fe missed an opportunity to get a great direct route into Memphis in the early 1980s by purchasing the old Rock Island Choctaw Route, from Amarillo, TX to Memphis.

"BNSF does seem to have a great understanding of the value of on-line distribution or transload facilities. The number of facilities located in the Alliance area is no accident. The old Santa Fe was very aggressive in this area due to the lack of on-line industry. Here's one example where necessity was the mother of invention. This transload capability was later put to good use by BNSF during the UP-SP merger problems."

The long-awaited opening of the new upstate-NY salt mine on the original Genesee & Wyoming has finally occurred. The mine is owned and operated by American Rock Salt and replaces the original salt mine that collapsed and was subsequently closed in 1995. From the G&W's founding in 1899 until the mine's collapse nearly 100 years later, the original salt mine was the single largest customer of the railroad, a property of Genesee & Wyoming, Inc.

The new mine is the first rock salt mine built in the United States in over 40 years. At annual projected production levels of 2.5 mm tons, the mine is estimated to have approximately 80 years of reserves in 10,000 acres of mineral rights. The primary use of the salt is for the de-icing of roads throughout the Northeast and the railroad expects a run rate of 1,200 carloads a month using a fleet of 600 new cars built by Trinity (NYSE: TRN) and owned by American Rock Salt.

RailAmerica, Inc. (Nasdaq: RAIL) reports that May same railroad carloadings (including intermodal units) increased 6% to 105,154 vs. May 2000. Year-to-date, same railroad carloadings for 2001 increased 6% to 515,577. Totals include RailTex's railroad properties in both periods and exclude carloads associated with railroads sold by the Company during 2000. North American carloads rose 8% to 76,747 for the month and 4% YTD. International same railroad increased 1% to 28,407 for the month of May and 9% to 138,101 YTD.

Speaking before the Merrill Lynch Global Transportation Leaders Conference last week CSX's John Snow said, "The earning power of CSX will increasingly be revealed. Our service is of more value than we are getting paid for it. We see a world where rates will have to go up." Precisely, and as service improves it is meet and right they should go up. Recall that in 1Q01 CSX raised prices selectively on certain rail lines (WIR 4/28)

Naturally Snow did not offer any specifics on pricing or timing. We already know, however, what CSX is doing to improve asset utilization and productivity to push the OR down another notch or two. A needed step, given the soft economy in the CSXT service area. Said Snow, "We see very weak demand across virtually all our lines of business. The only bright spot that we have is coal, which represents about 30 percent of CSX's total revenues." Coal volume was up 10 percent in the first quarter YOY as many utility companies turned to coal as an energy source rather than the more expensive natural gas.

Union Pacific's Dick Davidson echoed these sentiments in his remarks at he Merrill confab, noting that the long-term demand for coal "has been quite profitable for Union Pacific" and is likely to remain so for the same reason cited by Snow. Davidson said UP "is becoming less certain that we'll see a significant recovery in the second half and fuel costs continue to be a challenge." Diesel fuel cost UP 95 cents a gallon last week vs. an average 85 cents in 2Q01.

Steps are being taken to bump sales with little increase in cost, always good for the OR. UP has about a 95% on-time performance rating for its Express Lane service with CSX and will expand that to additional markets. Selective price increases could be a percent or two. The I-5 Corridor has added two daily trains and has garnered an 85% reliability rating. And a new auto parts transport service helps customers coordinate movement of auto parts from Canada to Mexico, now 75% truck. Finally, UP has plans to enhance its present 60% rail market share in Mexico.

Rail stocks were essentially unchanged last week, with only CN and CSX showing slight bumps of 4% and 2% respectively. Everybody else pretty much stayed where they began the week. The view from here is that it'll be a sideways market at least until 2Q earnings estimates are revised in late June. One play might be to buy July or August calls at the money perhaps financed in part by selling June calls at the same strike.

Last week WIR reported that Minnesota Power will not go ahead with a plan to build an alternative railroad line to serve its Grand Rapids generating station. It now appears that estimated construction costs were around $10 mm a mile for the proposed DM&E access. While this may be good news for BNSF it's really a classic case of how to use the threat of rail competition to leverage the incumbent carrier. Makes one wonder how BNSF would have priced the coal had the second railroad already been there.

Roy Blanchard

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