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The STB on Monday released its revised rules on mergers. By way of review, when the process began we wrote, "The Board said the new rules would substantially increase the burden on applicants to demonstrate that a proposed transaction is in the public interest. Among other things, these new rules would require merger applicants to demonstrate that the transaction would enhance competition and mitigate potential negative impacts resulting from service disruptions." (WIR 10/17/2000). Whether the burden has been increased is subject to interpretation.

Writing in *Traffic World*, Frank Wilner calls the rules "relatively tame," noting that "The operative word is 'may' because the new rules read as guidelines, with the STB avoiding absolutes such as 'must" and instead providing suggestions as to how future merger applicants should proceed." The *New York Times'* Anthony DePalma adds that some shippers don't think the new regs are enough to correct imbalances in the status quo. One even feared the railroads "would continue down the same track of providing unreliable service and unreasonable rates to captive customers."

The Overview to new STB rules says the "new rules and policy statement do not reflect an anti-merger bias, [yet] we do plan to take a more skeptical, 'show me' attitude toward claims of merger benefits and toward claims that no transitional service problems would occur." On the other hand, the STB notes – correctly, we think -- "Rail investors generally have not believed that the investment in additional rail lines to create two- or three-railroad service to most locations or shippers would prove sufficiently profitable to warrant the investment."

So where does that leave us? The STB believes "applicants should identify additional measures for use in case anticipated public benefits should fail to materialize in a timely manner." In other words, if truck traffic does not decrease or if carload service suffers, the STB thinks the applicants *should* have a contingency plan. It does not say they absolutely *must* have a contingency plan for the merger to be approved.

There is a fair amount of ink given to "enhanced competition," yet the Board concedes, "to assure a balance in favor of the public interest, merger applications *should* [emphasis added] include provisions for enhanced competition [which] can be enhanced in many ways. The focus of such a plan *could* be placed on enhancing intramodal (rail-to-rail) competition, for example, by the granting of trackage rights, the establishment of shared or joint access areas, the removal of paper and steel barriers, and other techniques that would enhance railroad-to-railroad competition."

Again, should and could. Soft words that sound nice yet leave a lot of wiggle room. As Morgan Stanley's Jim Valentine writes, "The new rules will put up few obstacles to prevent future transactions." And that may be OK for now. The mood among the class 1 CEOs I've spoken with in the last two months is not one particularly in favor of new mergers, rules or no rules. There are many things that can be done with alliances short of outright merger, and we've written abundantly on that topic already.

And even though CN/WC has been deemed a "minor transaction" and not subject to these rules, and KCS has been excused from this proceeding, we see a clear trend to what one wag calls "Rugby Railroading." Simply described, it's moving the ball (car) forward in everything one does. Class 1s talk of dispatching segments of shortlines if it'll move the ball (car) faster. The BNSF-KCS handoff north of Alliance works very nicely, thank you. The UP/CSX "Express Lane" is another seamless – and growing – corridor. See also BNSF trip report (WIR 5/26).

The Decision says shortline interests "are a key component of merger review." Accordingly, "applicants *must* (aha!) address anticipated effects" on shortlines, name the benefits that will accrue as a result of the proposed merger, and "develop remedies for anticipated harms to the public interest." The Board prefers public-sector solutions to problems that arise yet concludes that "the jury is still out" on the success of the Railway Industry Agreement (RIA) struck between large and small railroads.

That may be changing. The class 1 CEOs have told Wall Street new business must be won from the highways, not competing RRs, and shortlines have shown an uncanny ability to do just that. Yet shortlines must be careful not to push the RIA's limits too far. Some of the applications we've seen were blatant encroachments on the incumbent's franchise. Though few in number, actions like these poison the well for the legitimate applications. Care is advised.

If you can stand it, scroll through the STB decision at www.stb.dot.gov. Then you can decide for yourself whether "new rules substantially increase the burden on applicants to demonstrate that a proposed transaction would be in the public interest." There's no rush, though. It's doubtful there will be any significant merger action until around 2004. What I would watch for instead is growth and combination in the class 2 and class 3 railroad arena as first generation shortliners exit the business and class 1s further streamline route structures.

Freight car building is not a good business to be in today. New car order rates are running at about a third of what they were two years ago, and at about one-half of normal railcar fleet replacement levels of 50,000 cars per year. Consequently Greenbrier (NYSE: GBX) is further downsizing its work force and slowing new railcar production in response to continued softness in the railroad supply market in North America. For the fiscal year GBX anticipates results to range from around break-even to a small loss from operations.

Meanwhile, competitor Trinity Industries (NYSE: TRN) has announced it sees little improvement in the North American rail market. TRN has told analysts to expect net income in fiscal 2002 will be comparable to fiscal 2001 net income (before unusual charges) of $36.5 million, or $0.97 per share. For the year, stock prices of both are about where they began, though TRN has recovered from an April trough where it was down as much as 30%.

It's a double-whammy. Carload traffic is depressed, so fewer cars are needed for loading. At the same time, individual car utilization rates are up, meaning more turns per car and fewer cars needed in the fleet. Recall the recent NS announcement to get rid of 12,000 freight cars. Smaller fleets, faster turns, bad for the builders.

Roy Blanchard

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