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The Railroad Week in Review 6/23/2001

Last WIR contained some remarks that were critical of the way a few shortlines have approached the Railway Industry Agreement (RIA) between the large and small railroads. “Though few in number,” I wrote, “actions like these poison the well for the legitimate applications. Care is advised.” Strong words, I allow, however at times strong words have a cleansing effect.

The cleansing effect in this case came in the form of a most constructive call from Alice Saylor, VP and General Counsel of the American Short Line and Regional Railroad Assn. Said she, “The Association wants to keep everybody on a level playing field. To that end we have worked with the class 1s to develop an application form to be used by shortlines contemplating use of the RIA to further their commercial objectives.” I’ve seen the form, and it’s good. It links clearly to the provisions of the RIA and requires the applicant to set down exactly what’s proposed and why. You can have the form faxed to you by calling the ASLRRA at (202) 628-4500.

Writing in *International Railway Journal*, Editor David Briginshaw presents some vital observations regarding last October’s fatal derailment at Hatfield on the London-Edinburgh line. It’s apparently a story of missed cues and lack of follow-up within the Railtrack organization. “Despite the necessary work being given priority status, [the flawed rail] was either overlooked through human error or deliberately overlooked on several occasions. Railtrack was reluctant to close the line temporarily as it would have had to pay the train operators compensation.

“The ultimate cost of the Hatfield crash will put those errors and short-sighted cost-cutting into harsh perspective. Railtrack believes the cost will amount to £580 mm ($US 870 mm), but experts suggest the final figure could be closer to £680 mm ($US $1 bn).” So much for separating ownership of the track from ownership of the trains that use them. What about trackage rights, you say? In that case owner A uses them as well as tenant B. In the UK, owner A never runs trains over its own tracks and makes its money by charging B a toll. No tracks, no tolls. QED.

Kansas City Southern has scrapped plans to go ahead with its previously announced stock and convertible bond offerings. In a statement released Tuesday, Chairman and President Mike Haverty said, “Even though the indication of interest far exceeded the size of both of our previously announced stock and mandatory convertible unit offerings, we do not believe the current stock price properly reflects the valuation of the Company. Therefore, pursuing these offerings is not in the best interest of our current shareholders."

Meanwhile, the *Shreveport Times* ran a story calling KCS a “prime merger target,” to which the railroad replied, “There are no talks underway with anyone about selling KCS at this time and none are anticipated.” KCS argues that the STB decision to exempt the carrier from the new merger rules “does not suggest that KCS is in play, and to the contrary, simply recognizes that KCS is much smaller than the remaining Class I railroads and should therefore be treated differently.” Doth the lady protest too much? We’ll see. But KSU is up a buck for the week, so somebody must approve.

Short-sellers of rail stocks are running for cover. From May 15 through June 15 the number of short shares outstanding on NS dropped a whopping 51%, followed by UP down 24%, CSX down 17% and BNSF down 14%, CN and KCS ran the other way as short interest increased 28% and 115% respectively. CP doubled, though remaining under a day to cover -- the ratio of shares short to shares long is pretty small. For more on this, go to www.shortinterest.com.

So-called "industrial stocks," what's left after you take away the techs, consumer cyclicals, etc., are enjoying some nice increases. It could be argued investors fleeing techs in particular are looking for safe havens and all that money is flowing from a large number of stocks to a much smaller number of issues. That may be one reason why the rails are doing OK relative to the market. Beware the fundamentals, though. Earnings for 2Q01 will be out in a month.

At a time when railroad industry suppliers are faced with enough trouble keeping the order books full, the last thing they need is labor problems. Enter ABC Rail (Nasdaq: ABCR) in a dispute with its unionized employees at its Sahagun, Hidalgo, Mexico Facility. The labor contract expired May 30, 2001, and the employees have not worked since then. Clearly any settlement must reflect reality and the currently depressed rail supply market situation.

The severity of the current economic downturn, particularly for new freight cars, has placed extreme cost pressure on all rail products suppliers. Though ABCR will increase production at its other facilities in order to fill customer orders, the effects of this work stoppage will not help operating results.

Shares closed Friday at $1.09, down from $6 YTD and in a 52-week trading range of $8.25 to as low as 60 cents. The Street had this company as a Buy two years ago but dropped it to a sell a year ago and it's been there ever since. With annual sales of $629 mm, negative 3.9% return on assets and negative 2.8% ROE, this is not a happening place. One would hope the souls on strike in Mexico are getting the union leadership they deserve and will be back on the job soon.

CSX has expanded its on-dock intermodal service in Savannah by as much as 30% at the Garden City Terminal. In addition, the Georgia Port Authority has plans for the construction of an eighth container berth at the Garden City Terminal. Four new high-speed container cranes have been ordered to support operations at the new berth. In 2001, CSXI expects to handle in excess of 70,000 loads of freight in Savannah, including a 25% increase in its international volumes.

Being able to load directly from ship to railcar (and vice versa) saves time, money, handling, and diesel fuel. In my humble opinion, there's not enough ship-to-rail going on. Even where there is track on the dock adjacent to the berth (Philadelphia, New Orleans come to mind) it's not used much if ever. Seems to me container ships could be loaded in destination sequence and even break-bulk (coiled steel rolls, copper plates, e.g.) could then be off-loaded straight onto the cars. What I'd like to know is why it's not done. Drop me a note for next week if you have an idea.

Roy Blanchard

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.