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The Railroad Week in Review 10/13/2001

Railroads went on a self-imposed "red-alert" status when the Allied strikes began last Sunday against the bad guys in Afghan, and some hazmat shipments were put on hold until Wednesday. The AAR said there would be increased security for some types of cargo, putting in place additional operation and protective measures under five critical action teams – information technology, infrastructure, operations, hazmat, and military.

The AAR correctly warned that a terrorist action against railroads could have ruinous consequences for the railroad industry itself. Insurance carriers have already notified freight railroads that liability premiums may be increased substantially and some coverage may be eliminated when renewals come up.

Nearer term, hazmat shipments are getting a lot of attention. Even if the hold goes in again analysts reckon earnings impact will probably be minimal, as these shipments are a small part of the total chemicals market. Higher costs resulting from the tighter security measures will most likely be reflected in higher rates to rail users.

Canadian National completed the WC transaction on Tuesday and began a phased integration of the companies' operations. Wisconsin Central now becomes CN's Wisconsin Central Division. One of the early benefits of the CN/WC integration will be improved connections and diminished empty backhauls. This ought to be a plus for asset utilization, offer faster transit times and reduce costs. Meanwhile, WC stockholders got $17.15 per share in cash, a nice bump for those of us who early on saw WC for the value it represented.

September US rail carloadings declined 2.4% yoy and 2.5% for 3Q01 vs a year ago. According to the AAR, for Sep only coal and aggregates were up, 2.0% and 7.6% respectively. Most everything else was off, led by nonmetallic ores (14.4%), automotive (11.3%), metallic ores (10.2%), and grain (9.4%). For 3Q01 it was pretty much the same story. Intermodal was off 1.7% in Sep and 2.3% for the quarter.

As a result, we don't expect a lot of good news at the upcoming earnings conferences. Except for small gains in March and April, U.S. rail traffic has been down each month this year. YTD carloads are off 1.5% yoy, with just five of the 19 major commodity categories tracked by the AAR showed any yoy gains through Sep. The big hits were met ores (15.7%), automotive (8.7%) and chems (5.6%). YTD intermodal was off 2.7%.

Timely data transfer between shortlines and class 1s and beneficial owners is getting better. This week RailAmerica and RAILINC joined forces to bridge the gap. Under terms of the agreement, RAILINC bought an exclusive license for RailAmerica's proprietary International Networking and Freight Operations System (INFO), which will allow RAILINC to web-enable the INFO system. The resulting web-enabled system cuts the railroad's data warehousing costs, speeds customer access to shipment information, and reduces manual data entry across the board.

Once web-enabled, INFO will be re-branded as Command, a module of the RailSync(TM) suite of short line products. To enable commercial access by short line carriers, RAILINC will host Command on an Application Service Provider (ASP) basis. According to RAILINC, Command is designed to support yard, train and industrial rail operations with EDI and TRAIN-II messaging, internal event reporting, standing track inventory, substantial reporting tools and links to back-end systems to provide financial and operational management information. See www.railinc.com for nuts and bolts.

It comes at an opportune time as reporting requirements are becoming more stringent to meet truck shipment info availability. Until now, shortlines have either had to build their own systems or purchase costly add-ons to existing systems to be customer-visible. This looks like a good step to eliminating the informational black hole between many shortline stations and the class 1 interchange track.

RailAmerica made the Forbes "200 best small companies in America" list for the second consecutive year. RAIL ranked 85th based on total sales, sales growth, EPS and ROE. In its rankings RAIL was 7th and 9th in 5-year average return on equity and 12-month return on equity, respectively. This year's 85th place ranking is a nice bump from last year's 103rd place ranking.

Quick notes: Morgan Stanley initiates CP Rail coverage with an Outperform rating and $21 price target. Believes the recent spinoff of 5 subsidiaries will unlock further value in the shares….CSX has paid the city of Baltimore $373,573 to cover some of the costs of the July derailment in the tunnel…. Technicals bearish for all rails but neutral for BNI, GNWR with some short possibilities…. Investors who opted to take the CP holders (NYSE: HCH) rather than the individual spin-off stocks gained 12% on the week on small volume, closing at $36.40.

Britain's RailTrack reached the end of the line this week as the government refused a plea for more funding -- $1 bn in Dec 2001 and anther $1.5 bn in Mar 2002. The company, which owns and maintains the physical track and related structures in the UK, is already in hock to the tune of $5 bn. The government said enough, asking the high court to appoint an administrator.

Accordingly Railtrack was declared insolvent and Ernst & Young named administrator. The WSJ says this action will accomplish two things. It will be "the first step in turning track maintenance and construction over to a nonprofit trust, which would allow substantial government control and permit profits to be plowed back into the rail network." And it will result in significant losses for its Railtrack shareholders.

Meanwhile, London's Financial times (www.ft.com) has set up a chat room on the topic. A sampler: "That [the government] should take this opportunity, without warning, to seize the assets of the company, is precipitate and unwarranted…To leave the shareholders penniless is an exercise in political cynicism, of the sort which one hopes had vanished with the Berlin Wall." And, "The financial structure imposed at the time of privatisation was always flawed…If it were allowed to charge access fees that gave an adequate return on this asset base, it would have had no problem in funding maintenance and upgrades." The education to be gained from this site far outweighs what one may get by reading the pundits. Including this one.

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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.