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The Railroad Week in Review 12/8/2001

Economic activity may be picking up. The November NAPM index rose 10% to 44.5 from October's 39.5, with a rise in new orders to 48.8. But before you get out your party hats recall that steel remains depressed and we really don't know how much the financing incentives pushed auto production into 4Q01 from 1H02. Still rail traffic is up slightly YOY, albeit on easy comps. Of the six North American rails, UP and CSX seem to have the strongest merchandise carload businesses, positioning them well for any manufacturing increases.

The rail sector continues to outpace the averages, up 16% YTD vs. the 13% drop in the S&P 500. The suspicion is, however, that much of this is dot-com money looking for a home as institutional investors seek safe havens for cash as they exit non-performing sectors. Rails traditionally trade at price multiples in the low teens, however, and with the group now poised a shade under 12 there may be room for growth in some of the less-richly priced issues – BNSF, UP, CP, e.g. Traffic data at www.railmatch.com bears some of this out. For the current week, these three are in the lead. For the four-week rolling average BNSF is in the No. 3 position.

Shortlines have clearly jumped to warp-speed with CSXT. Whereas the relationship between shortlines and CSXT has always been cordial and supportive, it has now moved to a more intellectual level if the tenor of this week's Shortline Meeting in Jax is any indication. I think the idea of a shipper panel was brilliant, and to have four major transportation buyers lay all their modal selection cards on the table was educational, to say the least.

All are rail users, and it was not all sweetness and light. One guy had closed a plant because rail went away and was moving away from rail at another. Another uses truck for half his supply and distribution. A third was concerned about shortlines' "critical mass of interchange to the trunk railroads." The final panelist exhorted shortliners to get out and meet the people, stressing the political value of the shortlines to the class 1s.

CSXT presenters then used this framework to detail the ways they expect to embrace shortline initiatives even as they laid out their own commercial, financial and operational goals for 2002 and beyond. Chief Commercial Officer Mike Giftos noted the shortline contribution to the $130 mm in truck conversion revenues (WIR 11/27/2001). Bill Flynn, SVP Merchandise showed how to find shippers' financial decision-makers to push changes in supply chain practices. A panel of marketing VPs delved into the shortline role in enhancing CSXT results in everything from emerging market sales to product performance. And that was all the first morning.

The second morning kicked off with a detailed look operational performance measures, ably conducted by Frank Pursley, SVP-Service Design. To begin, CSXT average train size now runs 80+ cars thanks to 30% fewer annulments and 25% fewer extras. Asset utilization clearly benefits as an hour saved in yard dwell time frees up 1000 cars and a one MPH train speed increase saves 75 locos, numbers much like we've seen on other railroads.

The message writ large for the shortlines is that a scheduled RR reduces variability at interchange. Right now 109 of 190 shortlines have signed ISAs, which CSXT wants to keep active and measurable. To be sure there were those shortlines where interchange performance in the field falls short of the mark, however a visit to the service design desk at the Trade Show was a good first step toward resolution. In sum, the feeling among shortlines attending seemed to be that the CSXT carload business is alive and well and getting better. And CSXT feels strongly that the shortlines have an important role.

The Surprise of the Week award goes to Genesee & Wyoming (GNWR) and Emons Transportation (EMON) for their merger announcement. Actually, GNWR is to acquire EMON for $18.5 mm in cash and the assumption of some $10.9 mm in EMON debt, net of cash. The cash payment is for the outstanding EMON shares at $2.50, a 63% premium on the previous close. The transaction represents a sale price of 1.6 times revenues and 6.9 times EBITDA.

GNWR says in a press release it expects to reduce Emons' operating expenses by approximately a $million chiefly by absorbing its costs related to being a public company as well as other administrative functions. GNWR also says it more savings will be realized by combining the EMON operations in New England and Canada with its present rail operations in Quebec. The acquisition is expected to be accretive to earnings in its first year.

In a related development GNWR announced it plans to make a public offering of two million shares of Class A Common Stock. Certain selling stockholders will add 200,000 shares to the offering. In addition, GNWR and the selling stockholders have granted the underwriters an option to purchase up to an additional 330,000 shares of its Class A Common Stock to cover over-allotments, if any. When available, copies of the preliminary prospectus relating to the offering may be obtained from the NYC office of Credit Suisse First Boston.

Pennsylvania's Keystone State Railroad Association (KSRRA) began its Legislative Outreach Forum with a Wednesday lunch at Philadelphia's Down Town Club. The first of a series of such meetings to be held throughout the state, the gathering delved into the state of the railroad industry in Pennsylvania, the effects of heightened security and insurance requirements, and how reduced funding will curtail infrastructure support under the Rail Freight Assistance Program.

KSRRA Executive Director Phil McFarren highlighted the key elements of The Pennsylvania Railroad Industry White Paper in three areas: security, stability, and solvency. Recent changes in shortline railroad insurance practices could be devastating what with fewer insurers, increased premium costs, and larger deductibles. Security implies not only protection of the physical plant but also improved shipment tracking, especially on shortlines.

Solvency affects railroads and shippers as reduced sales levels come at the very time the cost of doing business is going up. McFarren closed by saying the Penn DOT Strategic Rail Plan is now in discussion and input is invited. Other states and shortlines please take note.

Short takes: A friend at Florida East Coast writes, "We purchased CANAC's Beltpak product and have it installed on three GP-38's for use on five yard jobs in Bowden and have started training in Miami. For every Remote Control Job we get a crew reduction from 3 to 2." And get more men to put out on revenue-producing road trains in the bargain.

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