The Blanchard Company

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Ever since the October Shortline Meeting BNSF has included the shortlines in the weekly safety memo. The most recent note from Sharon Haywood says in part, "Due to the tremendous success of the WorkSafe campaign BNSF has extended the campaign and briefings will be issued through the week of December 16. Attached is the job safety briefing on Wearing Seatbelts. In addition to this briefing, five more briefings are attached, reflecting five of our most common injury types through last December.

Recall that one message writ large at the meeting was the willingness of BNSF to share corporate resources and information with shippers and shortlines (WIR 11/3/2001). The first item on anybody's checklist is "Do we have a safety plan?" and the last is always "Did we do what we set out to do safely?" Providing these safety briefings to the shortlines is a service of the first water.

There was some insightful feedback to my remarks on car supply and matching fleet size to the loads available. One of the perpetual problems is having too many desirable cars stashed where those who want them can't get them. A chap who manages 35,000 annual carloads for an eastern shortline writes, "Our shortline leases a fair number of various types of cars, the most common being boxcars. Reason? Very simple -- since the class 1s have all but abandoned the boxcar we have to get the equipment to capture the business.

"They are not willing to supply the equipment, especially if it is specialized. Most of the class 1s have sold off fleets of boxcars-particularly RBL type cars. I believe that shortlines are keeping the boxcars business alive. Are we niche players in a declining market? Maybe, but if we can make a buck at it, we will. The fact that shortlines can make money at this business and the big guys cannot speaks volumes about the flexibility and savvy of shortlines.

"Other car types handle low value commodities that building new cars for is not feasible. We lease several old covered grain hoppers for [local] coal service. Revenues and rates for this material do not support investment in new assets to handle this traffic. Most cars that wind up in this service are at the end of their service life. Wringing a little profit of some railroad traffic that otherwise we would not handle.

"I agree that there is little incentive to build new cars when fleets of old ones are still out there, but if the railroads can decrease dwell time and offer a better product (and make more money at it to boot) the demand for new cars will adjust itself. And, the clock is ticking on the old ones." Putting this in the context of the recent CSXT and BNSF shortline meetings, it does appear there is room for further dialog. Your comments are eagerly solicited.

Couple of weeks ago I ventured to the UP offices in Omaha, largely at the kind invitation of Warren Wilson, Dean of Shortline Relations for that august company. We met with Jim Hartwig's car management group on getting the right kinds of empties (system and private) in the right numbers to the places they're most needed. We touched on network design, safety, trip planning, operational best practices, and performance measurements. For dessert we went out on the road to see it all work.

To begin, the UP shortline split is pretty much 50-50 between UP line spin-offs and "original" shortlines. Shortlines generated 17% of total $10.7 billion in FY 2000 UP freight revenues, or $1.8 billion. With a population of some 200 shortlines we're talking an average of $9 mm per shortline. And not all of it stays home. Slightly more than half UP's carloads originate or terminate in the east, evenly split between CSXT and NS.

Woody Sutton, VP – Manifest Products, talked about how the waybill triggers the trip plan, essentially a dock-to-dock car schedule, which is in turn built on a scheduled train network made up of through freights of all kinds plus the local freights and yard jobs. Once defined, that network schedules dock-to-dock transit times. Ideally the customer starts the waybill process on line at myuprr.com and the serving shortline gets a copy. The trip plan clock starts when the car is pulled. (To see the actual UP performance measures, go to www.rblanchard.com/resources.)

In the relatively new "Express Lane" perishables service, nearly half of all origins are on shortlines, and the data and cars move together. Fresno, Hinkle, and Pocatello all send blocks to North Platte, and there sorted to 80-car trains or blocks to Selkirk, Waycross, Willard, Atlanta and Jacksonville. The explosive growth of this service shows what's possible between shortline and class 1 once service variables are removed.

Now that I've had a few days to look more closely at GNWR+EMON, I've revised my price/EBITDA to 5.1 times, right in the ballpark with the 6 times RAIL paid for StatesRail and Park Sierra. Similarly, price/sales looks more like 1.2 times vs. 1.6 times paid by RAIL for both properties. As promised in last week's cover note, I've run the combined EMON results plus the GNWR North American results using the Blanchard Benchmarks at www.rblanchard.com.

Revenues, expenses, operating income and net income are TTM figures from the 10-Ks and 10-Qs. I also added the South Buffalo TTM revenues less the coke and reduced the SBRY car count accordingly. I assumed SBRY had a shortline average 85 OR and a 10% net margin. Locos and miles were added to the GNWR base. Balance Sheets and Cash Flow statements came from the most recent 10Ks. GNWR starting debt is as of 12/31/00 plus the $29.3 mm EMON purchase price and the $36.4 mm paid for the South Buffalo in Oct.

What you get is a $217 mm (sales) operation with an 86.8 operating ratio and a 10.9% net margin. This is a straight sum-of-the parts exercise, though I reduced operating expenses by the $1.0 mm GS&A savings at EMON per the press release. (It could be more once the expenses related to running a public company are combined.) My pro forma shows a 13% gain in eps right out of the box.

The most recent fiscal year North American car counts, revenues and expenses – adjusted by SBRY as above – give us a 2,400-mile railroad handling 500,000 annual carloads at an operating ratio in the low 80s. Compared to my benchmark shortline pro formas the combined property generates 80% more carloads per mile and twice the revenue per mile, however only 10% more carloads per loco and 13% more carloads per employee, indicating some changes may be in order in these areas. But that's a small nit to pick in what looks like a good deal.

Roy Blanchard

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