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The Railroad Week in Review 5/11/2002

Providence & Worcester says it lost $313K in 1Q02 due to a 2.6% revenue drop to $4.9 mm, $122K of which was net container revenue. The company blames the balance on the loss of a customer as well as New England's still soft economy meaning less business overall. A year ago P&W lost a scant $191K. A year ago the OR was 105.4; for the quarter just ended it was 109. 1 due to a 3.5% increase in ops exp.

The company allows as how the expense hike was due to increased track maintenance costs and expenses relating to arbitration proceedings with Amtrak. As we know, Q1 is always tough for PWX as much of its carload revenue comes from the Fresh Pond rock trains, usually quiet in the winter months. Moreover, the intermodal business runs on thin margins and being surrounded by CSX ramps does not help. Seems to me the move is to build the top line carload revenue building on its proven base of forest products, chemicals, and food and ag.

Class 1 carloads for Week 17 (4/27/2002) rose 1.6%. Containers continued their rise in popularity, up 12% while trailers were off 3%. Coal didn't do much but the economically sensitive merchandise carload sector was off 1.6%. YTD totals are off 2.2% with double-digit declines in primary forest products and coke. Coal was off 4.6% and intermodal held its own. Holding their own were lumber, autos, and metallic ores.

What's wrong with this picture is the volume growing in the lowest margin business. The carload business continues to lag because the much-vaunted "scheduled railroad" just isn't there yet. We hear managers talk about on-time performance but it's mainly about performance between terminals, not point of origin to ultimate destination. Happily, that's changing, however slowly,

RailAmerica (RRA) posted April carloadings this week. Total loads, including intermodal units, rose 22% over April 2001 and 17% YTD vs. 2001, including recent acquisitions StatesRail and Park Sierra. On a "same railroad" basis, April 2002 carloads were up 4.5% however YTD down 1% yoy.

In North America April carloads including acquisitions were up 27% and 22% YTD vs. the 2001 numbers. Absent acquisitions April carloads were up 3% (mainly minerals and
2% ytd. Chief contributors were grain and minerals in Australia and iron and copper ore shipments in Chile.

Last week we noted that revenue increases for both Rail America and Genesee & Wyoming were chiefly the results of acquisition whereas same-railroad sales were not much changed yoy. Considering the debt levels in the industry, one might ask how long this seller's market for rail lines will continue.

Fellow pundit Larry Kaufman writes, "I recall at the NS shortline meeting in 1997 sitting with [a shortline owner] and having him explain why he would never take his company public. Once public, he said, you are in the world of Wall Street expectations and the only real way to increase the top line significantly is by acquiring more short line properties.

“That causes the prices to be bid up and then you're really in the soup (my paraphrase). He vowed to go fishing in northern Minnesota before he'd put his company in that position. This way he buys properties at the right price when they become available and can focus on operating them properly.”

Also last week I printed a chart from the “Briefings” page of wsj.com comparing results of GNWR and RRA. However, after further review, I have a sense that the comparison was not exactly apples-to-apples. The reason is that GNWR uses the “equity method” of accounting and RRA does not.

I’ve done some checking (do a google search on “equity method” to follow my tracks) and it seems a company owning 20-50% of another company is generally required to use the equity method but a company with a 51% interest will usually consolidate. GNWR owns 50% of ARG so uses the equity method. RRA has a 55% interest in Chile so *all* of Chile's debt, under GAAP, is included with the balance sheet LTD.

If GNWR consolidated rather than using the equity method then the entire $263 mm in ARG debt load would be added to the GNWR reported debt of $56 mm for total debt of $319 mm or 1.71 times equity vs. 1.91X for RRA. The fact of the matter remains, however, that ARG is owned 50% by GNWR and 50% by its joint venture partner Wesfarmers and the Board of Directors has three Directors each.

Going one step further, GNWR appoints the CEO of the railroad, while Wesfarmers appoints the CFO. Thus from an accounting perspective this 50-50 management and Board split means GNWR does not *control* the venture and therefore must report it using the equity method of accounting under GAAP. So the better “apples to apples” leverage consolidates GNWR+ARG and then compares debt as a percentage of total capitalization. The attached table tells us the relative leverage of the two is about the same.

Writing in Traffic World columnist John Gallagher notes that BNSF and UP have started charging $25 per car per day for storing empty private cars on railroad-owner tracks. The STB at first did not want to get involved but it’s beginning to look like the Board may not have the option. At issue is when a car cases to be “in use” and when the strict storage label applies. Shortlines storing cars for leasing companies and shippers may want to make sure they have a clear understanding.

The American Shortline and Regional Railroad Assn (ASLRRA) this week made available a request form for waivers under the 1998 Railroad Industry Agreement (RIA) and it may be downloaded from www.aslrra.org. Informal private conversations with several shortline operators tells me this bit of support is timely. However, if I may be permitted one small quibble, the on-line form is a PDF file (like WIR) and you either have to print it out and fill it in by hand or make a word-processor file to complete on line. Be that as it may, it’s a good move.

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.

Comparing RailAmerica and Genesee & Wyoming leverage positions as of 12/31/2001

($Millions)	**G&W 12/31/01**	**RRA 12/31/01**
Cash & Equivs*	$ 39	$ 60
G&W debt	$ 56	
ARG Debt	$ 263	
Total debt	$ 319	$ 422
Debt net of cash	$ 280	$ 362
Equity	$ 186	$ 221
Preferred stock	$ 24	$ -
Current Minority Interest	$ 3	$ -
Minority Interest	$ 56	$ 51
Total Cap	$ 549	$ 634
Debt/Cap	58.1%	66.6%

* Includes ARG