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The Railroad Week in Review 6/29/2002

Rail stocks got clobbered midweek and nobody seems to know why. One suggestion was that Fed Ex is expected to miss the whisper number of 54 cents by a dime (never mind the fact the previous quarter was a record-breaker) and so that brush tarred *all* transp stocks. Not smart.

We've noted before that as rails get better at meeting delivery commitments shippers' perceived needs for right away every day are gradually giving way to being more realistic about the high cost of right away. It's the difference between planning a Saturday night stay two weeks in advance and spur-of-the moment first class.

Then on Friday the DJIA snatched defeat from the jaws of victory, closing down 27 points (0.6%) after having been up more than 100 mid-afternoon. For the week, most US class 1 rails edged slightly higher. UP was the exception losing a buck to close Friday at $63, off 1.6% for the week.

FEC was a winner this week, up 13% possibly on the EPIK restructuring (see below) and KCS racked up another 5%. North of the border CP was up 6% and CN up 5%. Small Cap rails RRA and GNWR were up nearly 10% and one percent, respectively. Possibly last week's well-received NYSE event helped the former.

CSX had its annual analyst conference and train ride Tues and Wed. Jim Valentine was along and he thinks we've seen the end of the estimate downgrades and that at $34 CSX is fairly priced. However, the stated $8+ bn revenue goal by 2004 could be a stretch given the modest showing in revenue gains YTD. For 2001 CSX reported rail and intermodal revenues of $7.2 bn and is looking at reducing debt to 50% of equity and an OR below 80 – ten points – by 2004.

The good news to carload shippers and shortlines is that CSX hopes to achieve its revenue growth mostly on the merchandise side and most of that through modal conversion from truck. The bad news is that could be tough. Recall that in Valentine's recent *Freight Pulse III* shippers tend to vote with their feet rather than pay higher rates and that CSX was not one of the top performers. Still, lofty goals are good. Let's watch how they do it (slides at www.csx.com).

Kelowna Pacific, a relatively new shortline spin-off from Canadian National, has been tapped by CN for an assistance package to build a truck-rail transfer facility in Winfield, BC. In addition, CN will help the shortline rehab the track structure to accommodate the non-standard 286,000-pound cars. It should be noted that this is not the first time CN has stepped to the plate to upgrade a line to 286. However it's something we'd like to see more of, especially with the shortlines' carload growth rate now running double that of the class 1s.

Meanwhile, I am mystified by the continuing rise in share prices for Trinity. S&P says TRN needs to build 8,000 cars a year to break even. The outlook for this year is 5,000 cars, down 55% yoy. The current S&P outlook is for a loss in 2002 and two bits a share profit in 2003, putting the PE at 80 based on $20 a share, something we haven's seen since the dot-bomb days. Could it be shorts are covering to find better downdrafts elsewhere?

Railcars generated 39% of sales in 2001, followed by the construction group (32%) and the barge group (11%). The caveat is that when cars are delivered to TRN's own leasing the unit the profits are less because of an accounting rule. The leasing side of the house in turn generates about 7% of total revenues and had 22,000 cars as of 12/31/2001, 94% of which were leased out.

Florida East Coast is in for some changes. In a press release Wednesday FEC said it is selling the 56-acre Buena Vista yard in Miami for $34.5 mm. Also on the block is seven acres in downtown Miami, asking $16.3 mm. Both are expected to close in 2002. Earlier FEC said it was hiring Morgan Stanley to do a "strategic review" of its EPIK telecom subsidiary. CEO Robert Anestis cited industry overcapacity and consolidation as the reason "to explore transactional alternatives for EPIK," though a transaction could be for less than book value. Judging buy the stock price jump this week Wall Street doesn't seem to care.

Demurrage, they say, is a necessary evil. I have long disagreed, and maintain that in the scheduled freight railroad environment supply chain managers can order to fill and never see a demurrage bill, and that contracts ought to include car usage commitments. Of course, we're not there yet, making inventory control that much more difficult. For example, I just sampled three months of shipments for a client and found for every three departure days there was one arrival day. Yet demurrage bills are outta sight because he can't unload all those cars within the two days free time. The system is broke.

A partial fix comes in the form of the demurrage page at www.shipcsx.com. The screen gives you date offered, placed and pulled so you can see whether the charge is incurred before, during, or after unloading. And knowing what's "broke" makes remedial action that much easier. Matching up CP dates with origin dates yields flags transit time variability beyond customer control.

If you'll go to www.rblanchard.com and do a search on "demurrage" you'll get about 50 hits. The common thread among them all is that any demurrage bill is a railroad marketing opportunity – a sign that something's broke. As long as the car is placed, loaded or unloaded promptly, and released back to the railroad there would be no demurrage. Thanks, CSX, for a nifty tool.

Perhaps the best Amtrak commentary we've seen comes from Larry DeYoung citing a PBS commentary. Excerpts: "The problem is we're too big of a country to have the [Amtrak] kind of train system. Think of the places where trains are fast and efficient, like Japan and Europe, smaller countries with major population centers. The key to having a viable train network is linking big cities with fast, reliable trains.

"Places in the U.S. where trains make sense: between major cities in Florida and big cities in California; between Houston and Dallas; and places where there's a high concentration of people who want to get from center city to center city quickly, without doing the airport shuffle. Congress must begin looking at Amtrak as a kind of airline that deserves more public financing for part of its existence. Europe's "crack" trains, like the Eurostar and TGV, don't make a profit. They get people from point A to B in comfort, efficiently. But we can't expect it while also demanding that Amtrak serve everyone and make a profit, too."

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Roy Blanchard provides railroad financial and operating performance measurements for shortlines and shippers. 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.