The Railroad Week in Review
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As Claude Raines would have it, we're shocked – *shocked!!* – that the NZ government, "the Crown," as it calls itself, would *re*-nationalize that country's railroad at a time when privatization is the trend everywhere else. The plan, subject to shareholder approval, provides for the Crown to acquire a 35% interest in TRH in the form of a $NZ 75.8 mm new share offering at about NZ 67 cents per and elect three of the seven directors on the TRH board.

The Government would also buy back the rail track, associated land lease, yards, terminals and control systems from TRH for $NZ1.00 (58 cents US) and other land, property and leases surplus to TRH requirements for about $NZ50 mm, subject to final valuations. The Government is making a payment to TRH of $NZ44 mm in mid-June as a deposit on rail network and assets it will acquire from TRH. If the proposed transaction is not approved by TRH shareholders, this deposit will be repayable with interest on 30 June 2004.

Further, TRH would place its rail network operations activities into a separate company to be purchased, owned and operated by the Crown and pay a track access charge to the Government-owned track network operating company. The track access charge for the first nine months of operation through June, 2004 would be fixed at $NZ41.2 mm.

So TRH takes in $NZ 76 mm in new shares, plus a $NZ44 mm deposit for infrastructure and assets, plus $NZ50 mm for "surplus" property and leases, total $NZ170 mm. And TRH pays out $41 mm for track access over the next nine months, net $NZ130 mm. It also says here The Crown track network operating company intends to invest an incremental $NZ100 mm over five years on projects to upgrade track network operations and safety standards. This is much needed as reports reaching this desk note the lack of any real capex in track or locos in many years.

Consider that new locos cost $NZ2mm apiece and they haven't bought any in years. By way of comparison, shortline track costs upwards of $US5,000 ($NZ8,620) per mile per year to keep track in shape for 25 mph ops. TRH has more than 2,500 route miles with 149 tunnels and 2,100 tunnels, catenary *and* diesel operations (why they keep the catenary at all is a mystery). Gotta be more than $US5,000 a mile. Again by way of comparison, NS in 2002 capitalized $US530 mm for track over 22,000 route miles or $US24,000 per route mile. At that rate the proposed Government program of $NZ20 mm a year ($US11.6 mm) will do 483 miles.

In this regard, a friend in finance writes, "The taxpayers of NZ will be on the hook for it. Let's face it, if the Crown owns it, it's going to be their responsibility to keep it in shape. If I ran TRH, I would agree to $100 mm capex over five years, *subject to keeping the track up to some minimum acceptable speed standard*. In other words, I'd be after an unlimited shot at the Crown's pocketbook. And, I bet it's what they get. Once TRH gets that monkey off its back, funding a few locos won't be such a big deal, especially since they can be financed over time."

Recall the offers from both RailAmerica (RRA) and Toll were for $NZ0.75 per share *with no dilution* plus taking on more than $NZ100 mm in short-term debt. RRA may have backed out partly because of the cool TRH reception to RRA's condition that no more assets are sold. Recall also that an RRA goal was to rebuild the carload business that TRH has taken down (WIR 5/31).

Then on Friday Toll stepped to the fore again with an offer worth $NZ200 mm vs. the original $NZ158 mm bid. The government offer on the table sits at $NZ226, roughly $NZ1.00 per share, including proceeds from property sales less the modest capex commitment. Analysts were not convinced by Toll's latest, saying it will take something more like $NZ1.20 a share for Toll to succeed. The folks who bought TRH at $NZ4.00 five years ago must be rolling in the aisles.

So why is WIR spending so much ink on this off-shore property? Because rail economics are the same everywhere, and it takes well managed and maintained assets to make money in this business. It's beginning to look like the TRH rail side is a fixer-upper if only because rail assets were sold off and downgraded to make room for the Aretare ferry lease and pure cash flow to pay down the debt. What the government sold to Ed Burkhardt & Co in 1993 for the equivalent of $NZ1.49 a share was sold for $NZ4.00 a share to TRH following CN's 2001 acquisition of WC and its holdings. And the top bid before Friday was NZ seventy-five *cents*?

Genesee & Wyoming (GWR) and RailAmerica (RRA) posted May 2003 and YTD carloadings. Looking only at North America (US, Canada, Mex.), the former is up double digits for the month and YTD while the latter is about even with last year. The difference is the timing of mergers. GWR's comps have yet to catch up with its 2H02 acquisitions while RRA's comps tally the most recent additions the property. Absent the new property gains GWR's same-railroad record is about the same as its rival's absent the May increase in coal.

Meanwhile, you've read here that the rate of increase for YTD merchandise carloadings among shortlines has been running double that of the "whole railroad" for NS and CSX. The AAR figures show commodity carloads (including coal) through May flat to down a smidge, with only NS above one percent on the plus side. Yet GWR and RRA, pretty good proxies for the shortline community, do half their business with the western roads. Are shortline gains covering class 1 losses?

The message writ large here is that shortlines continue to out-class their class 1 counterparts in wooing and winning new business. The message to class 1 railroad stake-holders is that shortlines, already touching about of a fifth of total merchandise carloads, offer a better means to growing this line of business, especially on the feeder network.

The trunk railroads acknowledge the fewer car handlings the better, viz. intermodal and unit trains. BNSF's Matt Rose spoke specifically about shortlines as hub-and-spoke feeders. Even the most marginal of shortlines handles 80 loads a week in one place. The average shortline, excluding the S&T's, runs something closer to 400 cars a week through the interchange. That's a decent customer in anybody's book.

Yet the trend is toward fewer class 1 branch line sales to shortlines. It's true that low-yield shippers at the ends of high-cost branches are being converted to truck-transload. Shippers on "black hole" shortlines are switching to truck and class 1 transloads. This is not good news.

But look what happened to TRH as they tried to substitute truck for carload, eliminate branch lines, and put everything they could in intermodal boxes ("fixed capacity point-to-point trains," p.4, 2002 Annual Report). If the shortline can protect the revenue stream, eliminate capex, free up expensive power, be e-connected, and preserve the asset then we're all better off.