The Railroad Week in Review
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Providence & Worcester, though not one of the top ten traded rail operators we follow here, has offered up a second quarter 10-Q that is instructive none the less. What I've done is downloaded the Benchmark format from www.rblanchard.com/resources and substituted 2Q03 results for the shortline averages and 2Q04 results for the sample shortline.

Total revenues were up 4.2% to $6.6 mm on a 7.4% decrease in revenue units handled but with a 12.5% increase in RPU, though operating expense per carload increased 17.6%, indicating lower unit yields. Operating expense went up 4.2% as well, adding four points to the OR, now 94.8, an industry high. Assuming the employee and loco counts have not changed since the 10-K for last year revenue per mile operated including Amtrak rights, revenue per employee and revenue per loco unit all increased 4%.

The high operating ratio pushed 2Q04 net income down to $222,000 from $389,000 a year ago. Thus the low net margin (3.3%), low sales-to-asset ratio (seven cents of sales per dollar of assets), and limited leverage (assets/equity = $1.32) combine to push ROE down below one percent. The view from here is they pay too well. Comp & benefits continue to consume more than half the revenue base. Everything else being equal, slicing C&B to a third of revs (more in line with other rails) could drop the OR to 80 or better. That would be a big help here.

Kansas City Southern has struck an understanding with Mexican transportation company Grupo TMM to buy the latter's controlling interest in Mexrail, which in turn owns the Tex-Mex, the Corpus Christi-Laredo property KCS uses to connect with Transportacion Ferroviaria Mexicana, TMM's rail subsidiary. KCS thus gets a competitive advantage in the cross-border transportation market since KCS tracks end outside Houston and they get to Corpus on UP rights.

Under the agreement, KCS must also buy the remaining 49 percent of Mexrail by the end of October 2005, though KCS has the option to buy at any time between now and then. Recall that KCS had previously submitted an STB application to control Tex Mex, but that proceeding was suspended by the STB in October 2003 following TFM's repurchase of the Mexrail shares from KCS under the terms of the April 2003 agreement.

KCS has requested the STB to reinstate the procedural schedule and agrees to comply with all prior STB rulings concerning the International Bridge between Laredo and Nuevo Laredo, and to operate the Bridge under the terms of the applicable agreements and protocols. KCS still owns a 39% interest in TFM in hopes of buying TFM and merging the two into its Nafta Rail venture. [TMM, TFM, Mexrail, Tex-Mex…They're so intertwined it's like a Verdi opera. Pass the libretto, *per piacere*.]

RailAmerica is in the news again this week. First, the other shoe has dropped in Australia as State of Victoria will after all grant its consent to the acquisition of Freight Australia by Pacific National. The Australian Competition and Consumer Commission approved the transaction on July 2, 2004. Completion of the transaction is expected to take place in the third quarter of 2004. The proceeds will go mainly to reduce debt, which is as it should be.

Closer to home, RRA continues its connect-the-dots expansion program with a proposal to buy the 107-mile CSX Midland Division between Cincinnati and Columbus. This is yet one more piece of the former B&O to leave Class I ownership. The line will be operated as part of the Indiana & Ohio (first independent, then RailTex, now RRA). They look for annual volumes of about 18,000 carloads of agricultural & farm products, chemicals, and paper products.

Continuing the Who's Who thread of the top shortline operators in the US and Canada, counting carloads is one thing, scoring on traffic density is quite another. One useful measure is revenue carloads per route-mile of track operated. Table 1 not only adds that metric to last week's Top Ten list but also adds the next ten ranked by carloads and ranks all carloads per mile per year.

The Rule of One Hundred (see www.rblanchard.com) holds that a shortline railroad ought to budget roughly $5000 per year per main-line track mile for routine maintenance. Thus Omnitrax, for example, can be expected to have a track budget in the neighborhood of $7.5 mm a year. We've said elsewhere that shortlines get 20-25% of the connecting class I's RPU, averaging $300. Omnitrax probably takes in something like $32 mm a year in handling fees. Total track expense thus comes to 23% of revenues, 11.5% if they capitalize half of it. Not unreasonable.

Now factor in as well the ASLRRA's estimate (see Rich Timmons' 3/6/2004 testimony at www.aslrra.org) that the shortline community needs a capital infusion of around $7 bn to fix all the track and bridges to make everybody 286-compatible. That august organization figures shortlines operate 50,000 miles of track, so we're looking at that $7 bn spread out at the rate of $140,000 a mile, a truly stupefying number.

What this suggests is that shortline operators, backers and potential buyers need to take a long, hard look at infrastructure needs in their due diligence and capital planning. Granted, not all shortlines need 286 capacity throughout – there's a big difference between the odd 120-ton center-beam and 100-car grain trains. Also, some former class I branch lines got spun off because they were neither 286-compliant nor was there any need to make them so at the time of sale. In most of the cases I've come across the economics of those branches has not changed and if they're in that $7 bn number that's wrong. A word to the wise.

AAR rail traffic figures for July are in and it's helpful to compare Class I performance with that of RRA and GWR, my shortline proxies. Table 2 matches up the AAR July carload changes by commodity with the shortlines' July carloads. There are a couple of places where the shortline line items don't match the AAR line exactly, but you get the picture.

And that is the shortlines are building the traffic base at a faster rate than are the class Is. Yes, they're starting from a lower base. UP handled a million merch carloads in 2Q04 to RRA's 200,000 and a 2% increase at UP would be a 20% increase for RRA. But large changes on a smaller base will ultimately drive larger point changes in operating income and – one would hope – shareholder value.

Something else I'd like to know is to what extent are shortline carload gains masking class I carload losses? Not long ago I posited to a class I shortline manager that the yoy increase in shortline carloads interchanged with the class I was greater than the yoy change in carcount at the class I. Were shortline gains covering class I losses? We never finished the conversation.

Table 1.

Shortline Holding Cos

Excludes Industrial Owners, ALCOA, e.g.

Owner	Lines	miles	Annual Carloads	CPMPY
Transtar	4	367	500,000	1362
Rail Management Co.	13	735	302,000	411
Washington Group	2	723	285,000	394
Anacostia & Pacific	3	416	97,000	233
Genesee & Wyoming	23	2778	600,000	216
Pinsley	6	200	43,000	215
Gulf & Ohio	9	276	46,000	167
Ohio Central	7	516	71,000	138
North Shore	8	266	35,000	132
RailAmerica	46	8745	1,140,000	130
Rio Grande Pacific	3	484	57,000	118
NA Rail Net	4	802	85,000	106
DME	2	2300	227,000	99
RJCorman	7	222	20,000	90
Abernathy	5	121	9,509	79
Pioneer	7	331	25,000	76
Omnitrax	11	1500	107,000	71
Watco	7	2834	200,000	71
CAGY	4	370	12,000	32
Farmrail	3	493	14,500	29

Table 2.

July Carloads Commodity Carloads including coal, ex-IM YOY changes AAR Commodity Group	All Class I	RRA	GWR
Grain	-5.8%		
Other Farm Products	4.2%		
Ag & Farm		-10.8%	
Farm & Food			18.9%
Metallic Ores	6.8%		
Met/non-met ores		27.8%	
Coal	2.2%	19.8%	
Coal, coke, ores			25.5%
Crushed Stone, Sand	-6.4%		
Nonmetallic Minerals	14.7%		
Minerals & Stone			0.7%
Grain Mill Products	-7.7%		
Food & Kindred Prods	-5.8%		
Food Products		15.0%	
Primary Forest Prods	-8.5%		
Lumber & Wood	3.7%		
Lumber & For Prods		9.6%	37.2%
Pulp & Paper	1.8%		19.0%
Chemicals	2.5%	27.9%	17.2%
Petroleum	3.0%	17.7%	
Stone, Clay, Glass	-0.5%	16.3%	
Coke	16.2%		
Metals	9.3%	-5.6%	41.7%
Motor Vehicles	-8.9%	-47.3%	20.0%
Waste & Scrap	5.7%		
Other	-1.4%	20.3%	106.4%
Bridge		20.4%	
Total Carload	0.8%		22.5%
x-coal	-0.3%		
intermodal	7.2%	-6.2%	51.5%
total vols	3.3%	10.4%	23.7%