THE RAILROAD WEEK IN REVIEW
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RailAmerica (RRA) August 2004 carloads (no more Chile or Australia) exceeded the 100,000 mark, up 12% yoy. On a "same railroad" basis – without the newly- acquired Chicago Fort Wayne & Eastern Central Michigan -- August 2004 were up 5% and still past the century mark. Shipments in ten out of fourteen commodity groups increased, while only agricultural & farm shipments, autos, intermodal, and metals declined.

Total carloads YTD through August were up 10% yoy On a "same railroad" basis, YTD carloads were up 4.4% to three-quarters of a million units. It appears to me that RRA is accerating its rate of carload growth even as its connecting railroads accelerate their growth rates. According to the 10-K for 2003 two-thirds of RRA's revenue comes from the three Class Is with the highest concentrations of carload business – CN, CSX and UP. Selective, smart and accretive acquisitions can only help.

I listened to the recent RailAmerica presentation at the Morgan Keegan Equity Conference and it was quite worthwhile. CEO Charlie Swinburn carried the ball for the first half and was most candid. He said RRA has "consciously disinvested from overseas operations and is avoiding any aggressive revenue-based acquisition program." He made repeated references to how much different this approach is from what it used to be with a shift from "bold and ambitious" revenue growth to "selective and accretive" growth to maximize return on the properties they already own.

He then drilled down on the accretive benefits of Central Michigan and Indiana deals as examples of what to expect from here on. Each brings about 3% new top-line revs, offers opportunities to combine functions -- sales, accounting, mechanical, engineering, etc. This "cluster strategy," said Swinburn, is indicative of "what we're trying to do elsewhere." Backing him up, CFO Mike Howe said that even as he acknowledges an "active acquisition market" but "we're being selective."

No real surprises in the financials. RRA has upped 2004 estimates to $385 mm revs on 1.2 mm carloads. Full year FCF estimated at $16 mm, eps 64-70 cents before 16 cent charge for Marino's retirement package. Howe said they see North American 2004 capex of about $52 mm including $45 mm on track and infrastructure, upgrading to 286 as they go.

If all goes as planned they'll finally get below the 50% debt/cap mark as the Australian proceeds after senior debt will be in the range of $124 mm. True, they need $150 mm to cover tender of sub debt, but they'll make up balance from their 4.5% revolver. Said Howe with a bit of a laugh, "That's a lot better than 12%."

Mom and Pop shortlines at risk (WIR 9/10/2004) created no where near the stir I had expected. True, one chap remarked that if shortline carloads are up double-digits they must be doing OK. Not necessarily. Recall that 35% of all shortlines are owned by the top 20 operators and by definition are not "mom-and-pops." Another industry pro reminded me that the small railroads started the shortline phenomenon and therefore must be accorded a place. Not if they can't pay their own way. But that was about it.

Then there's the matter of commodity lanes. RMI has just introduced a new shortline traffic statistics service, the RailConnect Index. Until now there has been no independent and reliable source of short line traffic data, yet shortlines represent approximately 29% North American rail route mileage and account for 9% percent of all freight revenue.

The RailConnect Index collects data from some 40% or non-Class I rails and covers about half lf all the cars they handle. The Index includes traffic summaries of 13 commodity groups that are most utilized by the shipping community including chemicals, coal, intermodal, grain, metals, motor vehicles, aggregates, and paper products. The RailConnect Index is available weekly for distribution and publication to industry analysts and will be available to RailConnect customers free of charge.

With this tool we can really see where and short-haul, low-rated commodity lanes are cluttering up the increasing long-haul, high-density core routes of high-value commodities. The sample report I saw showed YTD shortline carloads through 7/31/2004 were 47% grain, ores, paper, mets, aggregates and waste – not exactly your high-speed RPU items. Which implies a terrific opportunity to take costs out of these lanes through more efficient management of the assets employed in their service.

It was BNSF's John Lannigan who said it first (WIR 1/30/2004): "We expect each commodity group to meet its own cost of capital." In today's world the successful shortlines are the ones that can partner with their connecting Class Is providing seamless service for profitable long-distance commodities in economically rational volumes.

As we near the end of the third quarter companies begin to preannounce yoy earnings ups and downs. Rail operators will be encouraged by the number of industries where Augusts's positive pre-announcements outnumbered the negative. They include industrials, energy, basic materials, and utilities. What's more, the negative August 2003 pre-announcements outnumbered the positives.

But there's something sinister going on here. Increased government meddling and regulation of everything from health care to OSHA to a legal system run amok have pushed manufacturing costs in some areas to the point that moving off-shore is the only alternative. The plastics for toys and shoes once shipped in covered hoppers now goes to China in containers that are then filled with goods coming back. There is still freight to move, only in different forms.

What's sinister is that as manufacturing jobs move off-shore due to governmental policy the number of government workers increases because regulations need regulators. That's one reason why I suspect AFSCME membership is up while union membership in basic industries is down. Take Philadelphia. Manufacturing has been R-U-N-N-O-F-T while city government has ballooned beyond all reason. Carload freight is no more. The Reading and Pennsylvania, both Philadelphia institutions, are fallen flags. But Big Labor remains a powerful force here. It's just that its membership doesn't make things any more.

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