THE RAILROAD WEEK IN REVIEW
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"We move enough wheat to provide every man, woman and child a fresh loaf of bread six days a week." – Union Pacific CEO Jim Young

Well, it needed saying and who better to say it than UP's Jim Young and Watco's Rick Webb. The occasion was the House Subcommittee on Railroads, Pipelines, and Hazardous Materials hearings on January 28 in DC. Young kicked off his remarks giving some striking examples of the railroads' importance to the economy – moving enough coal to provide half the country's energy needs, enough lumber (before the downturn) to build three houses every minute every day and enough cement to pave 45 miles of new highway every day. And more.

He then spoke in terms the number of railroad jobs, the 40 cents of every revenue dollar to keep the plant up to the task of moving all these goods, the railroad safety record and the environmental benefits of rail over competing modes. However, the tone turns dark: the steep drop in volume means equipment parked, railroaders furloughed and capex cut.

Young closes by urging the government to "embrace policies that enhance the ability of the freight railroads to attract private investment dollars." He also said that Congress should "enact an investment tax credit for new rail capacity" and fund public-private partnerships for projects such as CREATE. I urge you to read Young's remarks posted on the UP website.

Speaking from the shortline viewpoint, Watco CEO Rick Webb described the feeder-line nature of the shortline network, how its growth was spurred along by the regulatory changes of the Staggers Act, and cleverly related the short line percentage of total rail mileage in Florida (39 percent), home of subcommittee Members Brown and Mica. The short lines' first-mile-last-mile strength is not always well understood by those not close to the railroad business, and Webb did us all a great service by walking the Members through it.

Of course, no discussion of the government-short line relationship would be complete without mention of the rehabilitation tax credit extension and the RRIF loan program; Webb provides a great summary of the benefits of both. He wraps by saying, "We got a lot of help from our customers, our own people and good government policies" and then attaches six and a half pages of customer testimonials on the benefits of the Rehabilitation Tax Credit. See and hear Webb's remarks at http://www.watcocompanies.com/news/news.htm .

The so-called "stimulus" bill has drawn some cogent comment from observers of the railway scene. Larry Kaufman writes, "In the House bill once again transportation is dealt with as public works, not as the means of stimulating American commerce and mobility. The stimulus deals with infrastructure spending and not on fundamentals." Kaufman goes on to note Transportation Secretary LaHood's non-record on transportation policy issues and suggests that what's really needed is a schedule of truck user fees based on the allocable cost of the highways they use.

Another reader who has been involved in railroad law for more than twenty years writes, "Even with lots of talk about federal infrastructure spending and stimulus, there is nothing directly for rail freight in any of the bills on the hill. Instead, the money looks like it will be funneled through the states to railroads. We have learned recently that the money goes through FHWA and then to the state DOT and then to the railroad. Each step in the process adds administrative and bureaucratic requirements making the money very difficult and time consuming to access as opposed to money that goes directly from the state coffers to the railroad or the federal coffers to the railroad. There are historic preservation reviews, environmental scoping, bidding requirements, in short, the entire litany of federal regulatory requirements that makes obtaining the funding inefficient and calculated to not have the ‘quick jolt’ that President Obama has promised.”

And from the ASLRRA comes a fact sheet on “Why Include Short Railroad Infrastructure in a Stimulus Bill.” The paper makes the important point that “eliminating deferred maintenance is a particular challenge because short lines serve smaller customers that do not ship the large volumes needed to generate the extra revenue needed for capital investment.” There follows a six-point list of how shortline projects are “shovel-ready, serving the goals of the Act and a four-point list of ways to fund shortline capital projects.

As is, the bill strongly smacks of “from each according to ability, to each according to need.” I am appalled, and, though I am not a political person, have written my senator, Arlen Specter, thus: “As one of your constituents, I will be deeply disappointed if the stimulus package currently under consideration in the Senate is passed. It contains massive expansions of social action programs that would not be able to be passed without the urgency of the economic stimulus issue.

“The government does not add value to the economy. It redistributes assets, and rarely to the most productive sectors. Reducing the crushing burden of payroll, income, and profitability taxes from individuals and from businesses large and small is the best way to release the power of American ingenuity to restore the economy.”

Continuing the earlier thread of parallels between the present auto bailout and the railroads pre-Staggers, Larry Kaufman writes, “The railroads as they existed pre-4R and Staggers Acts, required an almost total restructuring [because] existing institutions and especially the bankruptcy laws could not cope with the crisis. The government [thus] created USRA and charged it with ripping out and discarding that which needed ripping out and restructuring what was left into a viable business.

“Railroads pre-deregulation were known for the arrogance toward customers (shippers, never even called ‘customers’), suppliers, labor, and the communities where they did business -- much as Detroit is perceived today. Labor agreements were restructured and work rules were changed radically - remember full-crew laws? Whether railroads were as arrogant as was said is of no consequence because it was the perception and perception becomes reality.

“One final thought for now: Detroit today, like the railroads of the 1970s, is in survival mode. When one is in survival mode, one cannot or does not develop the plans that require more than immediacy to be carried out. Strategic planning is a luxury they cannot afford. Look at today’s railroads, though. They have considerably better relations with all the above stakeholders, are relatively financially healthy, are reinvesting in improved service and increasing capacity and no Class 1 has entered bankruptcy since the Milwaukee in 1977.

“Perfect? Not by a long shot, but as one who was in the industry pre-Penn Central (I broke the PC bankruptcy story in *Business Week*) I know how bad things were and how much better they are today. Perhaps Detroit won’t achieve Nirvana, but the solution to Detroit’s agony just may lie in the solution that was adopted for the railroads. Note: Railroads are facing a serious re-regulation threat, but it is good to keep in mind that it comes from a minority of customers and when push comes to shove, most Members of Congress are sufficiently illiterate when it comes to economics that there is a good chance they can be scared away from doing something truly stupid.”

The Kansas City Southern earnings call is always an enigma -- a puzzle, something mysterious or inexplicable, or a riddle, as Wikipedia would have it. Whereas every other Class I without exception provides a balance sheet, a cash flow statement and supplementing operating data in its handouts, KCS never does. Moreover, we like to know how the reporting railroad is faring in the all-important fuel management department: gross ton-miles, and number of gallons consumed to give us cost per gallon and GTMs per gallon. Revenue ton-miles also help, as the ratio of RTMs per GTMs is a measure of how full the railroad is running. What is KCS hiding?

Up until not so long ago KCS was really two railroads -- KCS US and KSC Mexico. Now we're told they're running as one large regional railroad rather than two separate railroads, one north and one south of the border. If CP and CN can report US and Canadian operations as one railroad, so should KCS as well. Granted, KCS provides car counts and revenue by commodity. But we need fuel consumption and the other financials as well. I shouldn't have to make a special request every quarter.

There. That's off my chest. Moving on to fourth quarter results, KSC like everybody else went into the quarter with respectable revenue and volume numbers only to get clobbered in the last eight weeks. Train speed was up and dwell times were down, but it wasn't enough to keep the operating ratio from adding two points as revenue dropped eight percent and ops expense dropped only five percent, pushing ops income down 16 percent.

Below the line, KCS is a mess, faced with such annoyances as foreign exchange losses, preferred dividends, equity earnings from affiliations, and so forth. There was no share count reduction either, so earnings-per-share dropped 27 percent. Usually, we see the noise below the line driving a larger gain in net earnings than in ops earnings but such is not the case with KCS.

Meanwhile, out on the railroad, quarterly revenues were off in every commodity group save ag & minerals plus intermodal. Revenue units were off in every commodity group, pulling the entire railroad down eight percent in year-over-year quarterly volumes. Pricing didn't help, either, as system RPU was up mere crumbs: point oh-six percent.

Still, KCS gets full credit for keeping its business development activities on track, and, as I have written repeatedly here and elsewhere, the railroad that prepares for a better tomorrow today stands a better chance of living to see tomorrow than a property that sits on its hands looking for handouts. Go to the pipeline slide (30) in the presentation and see how much new business KCS has realized and is yet to come. I wouldn't count KCS out by any means. Now if only we could see the rest of the financials and some fuel data...

Funds sought. A well-established west-coast short line seeks investors for a small debt offering in the $30-50,000 range. Bonds are offered in $5,000 increments, callable and convertible at the discretion of the issuer, with a four percent coupon. If interested, drop me a line. Disclaimer: I have no financial interest in the property nor am I being compensated in any way for this announcement.