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The Railroad Week in Review 1/6/2001

The market giveth and the market taketh away. Wednesday's surprise 50-BP rate cut by Greenspan & Co. sparked a huge rally, but it did not make the downward pressure on earnings go away. Then there was Friday. The rails kept most of their earlier gains, possibly because there are those who see transports as a leading indicator. Maybe there's an argument for a railroad traffic turnaround as lower Fed rates help the manufacturing sector.

Surely some help is needed. The National Assn of Purchasing Managers (NAPM) said December was the fourth consecutive month of shrinking manufacturing activity. Their index dropped to 43.7 in Dec from 47.7 in Nov and was a sharper drop than had been expected, hitting a low not seen since 1991.

There is a bright side, especially for the railroad carload business. *Smart Money* published an interview with inveterate stock bull Abby Joseph Cohen in which she maintains "Stocks of basic-materials manufacturers, chemical companies, housing-related companies and select retailers are all poised to rise."

That's the good news. Yet we must temper it with the knowledge that two things need to happen if the rails are to escape further loss of market share and improve asset yield: they truly match the service to the need and start to charge accordingly. We still see railroad market managers cutting prices to keep business on their own rails almost at any cost, and the only loss they will tolerate is to truck. Perish the thought of it going to Railroad B if Railroad A can't meet customer spec. Maybe it ought go to the other guy if only to keep it on rails. Then at least they guy who gives it up today stands a better chance of getting it back tomorrow.

As if to anticpate this week's activity, a friend writes, "As a long time shortline operator, let me offer some New Year's Resolutions for the railroad industry:

"1. No more holiday shut downs. Sure, we can cut back on the holidays, but must we shut down everything? While the rails got rusty on New Years Day, I watched several towboats moving up and down the Tennessee River - and they ain't exactly hauling high value freight. Figure up the $billions of asset value times the number of holidays laying idle.

"2. No more issuing press releases that make the railroad look bad. Why do we proudly proclaim that train speeds are up from 17 mph to 21 mph? Just say that system velocity has increased 30%. Touting 17 or 21 mph sounds pure horse-and-buggy to anyone except a railroader. And coast-to-coast "express" service in "only" nine days?

"3. Talk to each other. Along the lines of item no. 2, a certain railroad issued a press release when heavy snow hit Chicago, saying among other things that they were dealing with the problem through "heightened communications with other carriers". Why can we have "heightened communications" *every* day? And not just at Chicago either. Eastern carriers should be contracting with western carriers to preblock trains for eastern destinations, and vice versa.

"Maybe you should ask WIR readers to each submit one New Year's Resolution for the Rail Industry and see what you get." OK, good friend, I'm asking.

Railroad equipment supplier ABC-NACO (Nasdaq:ABCR) expects to report a fourth quarter loss of about 55 cents per share before a restructuring charge. The previous Street estimate was minus 18 cents. Projected 4Q00 revenue for the fourth quarter is expected to come in under $120 mm vs. 3Q00 revenues of $131 mm. According to a press release significant orders were cut back, canceled or pushed into the first and second quarters of next year.

Many ABCR customers feel the pinch of a slowing economy as freight car builders have closed plants and shut down production lines as the year-end demand for new freight cars softened dramatically. ABCR adds that the economic slowdown has not affected its Rail Services and Systems (trackwork) and Flow and Specialty Products (valve housings and related castings) segments, which are less cyclical and have a higher component of repair, maintenance and replacement work.

By way of comparison the S&P Railroad Equipment "peer group" includes car builder Greenbrier (NYSE: GBX) and component supplier Wabtec (NYSE: WAB), the merged former Westinghouse Airbrake and MotivePower companies. Carbuilder Trinity Industries (NYSE: TRN) is lumped in with "Diversified Manufacturing - aerospace, transportation, defense, and so keeps company with Honeywell and United Tech.

The outlook for this Gang of Four is hardly robust, with single digit growth rates if any projected for 2001. The five year consensus is for 13% growth at ABCR and WAB, 8% at the car builders. PEs for 2001 are such that GBX and WAB are a tad under one (fair value) and the other two more richly priced. The message here is that the predicted economic slowdown will take a toll on car builders and repair parts suppliers, as fewer cars are needed to do the lower volume of work on the freight railroads.

BNSF has begun posting weekly carload and intermodal units at www.bnsf.com/investors. The PDF chart provides YTY comparisons by the week, QTD and YTD with percent changes for all three. The weekly reporting period spans each Sunday through Saturday. Intermodal units are classified as containers or trailers and carload units are classified by commodity, according to the Standard Commodity Code used by the rail industry.

The story for 2000 is virtually one of no change in bottom line, though intermodal was up 6.5% full year. Most of the major commodities were off for the year, with many big drops occurring in Week 52 -- forest products cut nearly in half, e.g.

RailAmerica on Thursday confirmed sale of two more US rail properties for a total of $6.4 mm. The 52-mile South Central Tennessee (SCTR) was purchased from the Kyle group in 1994 at which time it did 3,700 cars a year over light rail first laid in the 1880s. According to the RAIL website, SCTR now averages 3600 cars a year, so it’s not been a strong performer. The other line sale was a 72-mile line segment in Illinois. Buyers were not disclosed, however this brings total RAIL divestitures to $120 mm, 20% more than the goal announced a year ago.

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