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The Railroad Week in Review 10/18/2002

Eastern region members of the American Short Line & Regional Railroad Assn (ASLRRA) were treated to what was, by all accounts, probably the best regional meeting in years. I think newly-appointed ASLRRA President Rich Timmons summed it up best. In his opening remarks he said the focus must be on "promoting the shortline brand" to customers, communities, class 1 connections and Congress.

How right he is. And to start promoting the brand the program was chock-full of useful information from marketing case histories to better personnel management to the shortlines' role in Homeland Security. Two panel discussions that bore particularly relevant fruit were on deprescription and business development. Concerning the former, Al DeGregorio, Car Hire & Deprescription Consulting, said that of more than 300,000 cars yet to be deprescribed more than half bear shortline marks. G E Capital's Dick Kloster predicted that 45,000 cars a year for the next 25 years will have to be added to the fleet to replace older cars falling out the bottom.

That's assuming boxcar demand stays where it is and – IMHO -- that's arguable. Unless, of course, cycle times and the customer perceptions of reliability improve markedly. The good news is that panelist Jim Snyder, VP Car Management at CSXT, thinks they can, citing five opportunities to do so. They range from more thorough car cleaning to national pools. (If you want copies of any of these presentations, drop me an e-mail.)

Tuesday morning ASLRRA's Matt Reilly chaired the BD panel and Finger Lakes President Mike Smith stole the show. He pointed out that 90% of all freight moves 500 miles or less yet the railroads focus on the other ten percent. Smith cited short-haul moves of beer, steel and paper that have proven quite worthwhile. Interestingly, a quick show of hands demonstrated that a clear majority of the shortlines in the room enjoy short-hauls. Some, it turns out, never leave the shortline railroad at all. What a great way to improve asset yield, pricing, and service design!

Which leads me to the results of my recent questionnaire regarding YTD shortline carload volume changes. The response was on the whole encouraging. To all those who took the time and effort to respond, a heartfelt thanks. Each of you will receive a FREE copy of my Third Quarter Review, due out in the second week of November.

The data in Chart 1 represents some 60 different properties ranging from the very small to the rather respectable in terms of volumes and mileage. The trends are pretty much as expected, though the individual percent changes may need some explanation. Our sample is up 7.3% vs. 1.1% for the class 1s including intermodal, negative 1.2% excluding intermodal.

As for the numbers, one must disregard the wide swings at the top and bottom of the table as they represent small changes on very small base levels. It *is* significant to note that there was appreciable growth in the low-rated commodities like paper and aggregates. Recall that low-contribution branch lines were generally among the first to be sold off by the class 1s. We see shortline paper and aggregates well up against the class 1s' meager results but the grain problems hit the shortlines harder than the class 1s, if only because a large number of my respondents are in that business.

At the other end of the scale, branch lines with strong chemical, high-rated packaged foods, and automotive franchises were less likely to be sold, leaving those industries concentrated on the core systems. Granted, this sample represents about a quarter of the AAR non-switch-and-terminal class 2 and 3 carriers. But looking at the names on my list I'm not sure it would get much better with a wider sample.

If anything, this serves to confirm the impression that shortlines volumes tend toward the lower-rated carload traffic where margins are low and car costs are high relative to the goods being shipped. If this is indeed the case, then shortline operators and class 1s alike must, if they are to preserve this essential feeder network, focus on increasing yields. The place to start is getting yields up by offering greater transportation value. Folks like Mike Smith are leading the way.

Recall last week I wrote that there may be a relationship between profitability and the carload business, citing an analyst friend who opined that "good revenue should lead to good earnings and thus stock price performance." Now comes an item at CBS market watch wherein 3Q estimates of six rails out of ten followed are downgraded. Only NS and UP are "still expecting solid reports." These are the two with the highest carload-to-intermodal traffic volumes.

RailAmerica's December 2000 sale of the TP&W West End to A&K has been undone by the STB. Recall RRA first bought the TP&W ($13.4 mm sales, 59,000 carloads) in Sep 1999 for $18 mm. When RailTex came under RRA's umbrella in Jan 2000 RRA began selectively disposing of properties to reduce debt. Pioneer Rail offered to buy the 72-mile TP&W segment from Peoria to La Harpe to keep its eastern options open.

By Dec 2000 the deal was still not done and so RRA turned instead to an A&K affiliate. On Jan 4 2001 RRA issued a press release on another line sale, adding "In an unrelated transaction, the Company sold a 72-mile rail line segment in Illinois." RRA did not, however, sell the mile of track between the A&K property and Pioneer, retaining for TP&W the common carrier responsibility on that mile. Pioneer complained that this added time and expense to what was to be a through route for its Keokuk Jct. Ry (KJRY). And so it was that in March 2002 Pioneer filed its objections with the STB and asked that the Board revoke the exemptions that supported the original transaction between RRA and A&K.

In its October 17 decision the STB wrote "There are several aspects of the transactions that, both individually and cumulatively, indicate that Respondents [A&K] acquired the La Harpe Line for the purpose of salvaging it. We agree with KJRY that the purchase was intentionally structured in such a way as to make operating the La Harpe Line unprofitable, so as to facilitate abandonment of the Line, which in turn would permit A&K to salvage the materials from the Line."

The Board in is summary concludes that the line had indeed been "wrongly purchased for the purpose of abandoning and salvaging it." The Board notes the exemption process is designed to keep lines open and "[w]e will not allow our class exemption processes to be abused by sales of active rail lines to persons whose intent is to degrade, abandon, and salvage those lines."

Roy Blanchard provides railroad financial and operating performance measurements for shortlines and shippers. Disclosure: Blanchard may from time to time hold long, short, or debt positions in the companies mentioned here. A list of such holdings is available on request.

Chart 1. AAR commodity group carload volume changes YTD 2002

AAR Commod Group	STCC	Class 1s YTD*	Shortlines Avg**
Waste & Scrap	40, 48	0.0%	405.6%
All Other		-10.2%	255.8%
Nonmetallic Minerals	other 14	6.5%	163.6%
Pulp & Paper	26	-2.0%	86.5%
Coal	11	-3.6%	64.4%
Crushed Stone, Sand	142, 144	0.9%	33.6%
Grain Mill Products	204, 20923	3.2%	27.9%
Petroleum	291	-0.1%	14.1%
Stone, Clay, Glass	32	1.4%	7.7%
Chemicals	28, 49	2.0%	2.9%
Lumber & Wood	other 24	4.1%	2.0%
Coke	29911,3,4	-12.9%	-3.7%
Other Farm Products	all other 01	8.6%	-5.4%
Primary Forest Prods	241	-10.7%	-20.1%
Grain	0113, 01144	-2.8%	-29.8%
Food & Kindred Prods	other 20	-1.2%	-46.7%
Motor Vehicles	371, 41118	3.9%	-213.0%
Metals	33, 34	-0.2%	-421.0%
Metallic Ores	10	13.1%	-545.1%
Total Volume		1.1%	7.3%

*Through Sep 14, 2002 vs same period 2001

** Nearest period for available data, 62 railroads reporting