THE RAILROAD WEEK IN REVIEW

JUNE 24, 2005

Property you own may no longer be yours to have and to hold. The Supreme Court on Thursday ruled 5-4 that local governments may seize private property for economic development and that said local governments may transfer land so seized to private investors for “projects promising to bring jobs or commerce” according to the *Wall Street Journal*. Over on CNN, the thread is “cities have wide power to bulldoze residences for projects such as shopping malls and hotel complexes to generate tax revenue.” In other words, with the stroke of a pen we’ve gone from a nation of private property owners to a nation of serfs, except that the property owner is no longer the lord of the manor – it’s now the local government.

All of this comes as a result of a dispute in New London, Conn, where Hizzoner and others in power decided it would be nice to have a downtown “riverwalk” replete with hotel and other amenities. When some homeowners balked the city condemned their property, shifting title to developers, and now the Supremes have upheld that action. Here in Philadelphia, where we already have developers razing properties under the ruse of Mayor Street’s “Neighborhood Transformation Initiative,” the implications are particularly onerous.

There is a continuing FBI investigation into the “pay to play” culture in which heavy political contributors are awarded no-bid contracts for city work. Picture this unlovely scenario: a developer who is also a contributor says he wants to “develop” property along the east bank of the Schuylkill River presently owned by CSX. Since there’s already a public tiff about access to an existing “river walk” separated from the neighborhood by the tracks, here’s an easy out for the city: condemn CSX’ property citing New London as precedent. Similar situations exist in New London where Providence & Worcester has tracks along the water and in New Orleans with the New Orleans Public Belt.

According to both the WSJ and CNN (talk about strange bed-fellows) Justice Sandra Day O’Conner delivered a “blistering dissent,” writing that “cities should not have unlimited authority to uproot families, even if they are provided compensation, simply to accommodate wealthy developers.” Moreover, she continues, “The specter of condemnation hangs over all property. Nothing is to prevent the state from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory.”

And Justice Clarence Thomas in his dissent noted that “today's decision is simply the latest in a string of our cases construing the public use clause to be a virtual nullity, without the slightest nod to its original meaning.” The Philadelphia *Inquirer* quotes Thomas further: “Urban renewal projects have long been associated with the displacement of blacks.”

If there’s any bright side, the *Christian Science Monitor* reports that eight state supreme courts have barred such action -- Arkansas, Florida, Illinois, Kentucky, Maine, Michigan, South Carolina, and Washington. On the other hand, six say that forcing transfer of land from one private owner to another “for public use” is OK -- Kansas, Maryland, Minnesota, New York, North Dakota, and Connecticut. How very odd that five of the six states that endorse taking from the poor to give to the rich are blue states.

What worries me particularly is the number of shortline railroads occupying what could be valuable land were it not for their presence. The idea of federal interstate commerce trumping local interests is already under fire in a number of cities and the step from that to this is small. In a telephone interview

Friday morning ASLRRA president Rich Timmons told me, “The threat to shortlines is real. The Big Guys with big mainlines and big trains can show a ‘public benefit,’ but what about the little guy running a dozen miles through suburbia? We’re going to take a very close look at the implications.”

Good move, Rich. The way it’s going anybody who wants to be re-elected need only form a Committee for the Re-election of Activist Politicians (CRAP), seize all the property his campaign contributors want, and have another free four-year ride. Never mind government of, for and by the people. Except insofar as they’re *his* people.

Class I railroads line sales have slowed to a crawl. Only BNSF and CSX among all Class Is have any line divestiture programs at all, but they’re leases, not sales. UP and NS have said flatly their route structures are about where they need to be and except for the odd dribs and drabs there will be little change in branch line operations. Both Canadian roads are mum.

Yet but the shortline seller’s market remains, and GWR has certainly been the lead buyer. Excluding a couple of Class I leases GWR has picked up five properties Oct 2001 through 2005 YTD: South Buffalo, Emons Transportation, Utah RR, the Georgia Pacific Railroads, and Earl Durden’s Rail Management Corp. Each time the price-sales premium got a little richer, escalating from a 1.1 (Emons) to 3.8 (RMC). In the process GWR acquired revenues of some $149 mm for about $421 mm including debt for an average price-sales ratio of 2.8 times.

EBITDA is harder to compute because we don’t have all the data on all the transactions. However, where we do have data, it’s safe to say GWR paid from 4.9 to 7.6 times. How can they do it? Leverage, sez I, and then-CFO Jack Hellman’s remarks at the Sep 2004 Morgan Keegan conference show how they did it with South Buffalo. GWR paid 6.8 x EBITDA going in and within two months worked that back to 4.7 times. I’ll wager that before the dust settles RMC will be back below six.

Speaking of car-counts, we have to be careful comparing GWR and RRA (see Table 1). The former does not include its Rail Link subsidiary whereas the latter includes all of their 40+ properties. But the fact remains that both enjoyed traffic surges in Mar only to see some fall-off in Apr-May (total volumes, not “same store”). YTD shortline volumes (WIR 6/17) were up 12.5%, including of course GWR and RRA, but also including rapid-growers like Watco, up 25% YTD including acquisitions according to its President, Rick Webb, in a telephone interview.

Larry Kaufman writes in *Rail Business*, “Most experts believe the Administration really intends to kill Amtrak once and for all. Mineta talks of creating competition for rail passenger operations, but there is no commitment to provide sufficient financial assistance to the states that would end up paying for passenger service.

“Transportation generally has been free of partisan squabbling. There are no Democrat or Republican transportation philosophies. To most members of Congress, transportation is more a public works pork barrel than a subject that justifies serious thought and legislative consideration. Given Mineta’s depth of experience and knowledge, he should be transportation’s principal advocate – to the country and inside the government. While it is true that no cabinet secretary makes policy for his area of responsibility any longer, Mineta seems to accept that he is reduced to being an advocate of programs handed down from the White House Office of Management and Budget.”

The AAR’s just-released “Rail Transportation of Chemicals” is a 66-page study covering all aspects of the topic from modal share to tonnage and revenue by type. Moreover, the waybill sample upon which the report is based includes all US railroads, not just Class Is. Carloads originating in Canada and Mexico and terminating in the US are included; carloads going the other way are not.

The report cites American Chemistry Council (ACC) data showing trucks handle more than half of all chems with the balance split between water and rail. That said, two-thirds of all shipments move less than 250 miles so the high truck share is not surprising. In 2004 STCC 28 accounted for 9% of all Class I tonnage and 12% of gross revenues. However, revenue-per-ton-mile in constant dollars has hardly budged in 20 years while inflation-adjusted RPTM is down 40% in the same period.

Hazmats account for about 1.7 mm loads a year, small potatoes against the 14.5 mm merchandise (ex-coal, IM) loads handled by the Big Six in 2004. Trucks and rails had about the same number of hazmat ton-miles yet according to the AAR highway haulers account for 16% more hazmat incidents than rails. For gruesome proof, consider that 1981-2003 truck-related hazmat incidents killed 278 souls to the rails' ten.

Now comes Delaware Senator Joe Biden with a bill that would require rerouting of hazmats around "high threat corridors," referring to rail cars as "rolling weapons of mass destruction." Under his proposed bill, S. 1256, high-threat corridors will include areas that "terrorists may be particularly likely to attack," and that any city not so designated may petition the government for inclusion. Surely fits with a remark overheard at the recent NS shortline conference: "As railroaders our biggest threat is longer the regulatory environment, it's the legislative branch."

Rail stocks got clobbered Thursday as crude oil touched $60 a barrel. YTD it has not been a pretty picture for rail stocks as CNI and UNP have paced the Dow flat to down, with CP and BNI up 2%, CSX and KSU up 8-12% and NSC down 12%. GWR and FLA have bracketed the Dow and RRA is off 10%. Near-term, however, tech watcher have raised FLA and CSX to "long" from "neutral" citing improving technical indicators, never mind the fact that CSX dropped 3% from Monday's open to Friday's close.

Long CSX is tough because CSX has been so resistant to change. Average train speeds and yard dwells at 19 MPH and 30 hours compare with 22 MPH and 22 hours at NS with both companies operating in essentially the same service area. So why had people been bidding up CSX and not NS? A lot of it may have to do with the fact that the ten analysts covering CSX estimate strong double-digit 2Q05, 3Q05 and CY05 earnings gains at significant multiples to the industry.

But with the year half over and CSX traffic volumes about where they were a year ago through Week 24 (June 18), it's hard to see where it will come from. Core yards at Russell KY, Louisville and Cincinnati still report dwell times in excess of 40 hours and that's got to hurt. Here in Philadelphia, we continue to see merchandise trains parked for hours at a time on the former B&O main in the heart of town. And customers in New England and Ohio report uneven transit times eating into car supply and supply chain management. Let's hope the One Plan gets traction soon.

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Table 1.

GWR vs RRA Revenue Units

2005 by month, YTD

	2004	2004	2005	2005	Change	Change	2005
RRA	**month**	**YTD**	**month**	**YTD**	**Month**	**YTD**	**ch MTM**
Jan	97,821	97,821	105,508	105,508	7.9%	7.9%	
Feb	95,506	193,327	106,256	211,764	11.3%	9.5%	0.7%
Mar	108,214	301,541	118,115	329,879	9.1%	9.4%	11.2%
Apr	102,035	403,576	111,993	441,872	9.8%	9.5%	-5.2%
May	99,407	502,983	109,648	551,520	10.3%	9.6%	-2.1%
GWR							
Jan	48,462	48,462	52,705	52,705	8.8%	8.8%	
Feb	49,291	97,753	53,316	106,021	8.2%	8.5%	1.2%
Mar	53,455	151,208	58,765	164,786	9.9%	9.0%	10.2%
Apr	53,586	204,794	57,787	222,573	7.8%	8.7%	-1.7%
May	53,464	258,258	56,919	279,492	6.5%	8.2%	-1.5%