

Rails: Current Favorites of Wall Street

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We too are bullish on rails, but with more contingent qualifications than were indicated in this morning's *Wall Street Journal* article: "Boom Times on the Tracks..." This writer is the beneficiary of past employment, retirement income, and investment in rail industry shares; in good times and bad.....and Oh, how bleak were some of those times, recalling the 1970 Penn Central bankruptcy, the collapse of other northeastern railroads, passenger deficits, etc. We have made it a point to buy rail stocks since the early eighties, and those stocks have served us well, albeit with the usual ups and downs. Our modest portfolio includes all the major North American railroads.....not enough to make a blip on any road's list of major shareholders. In short, we are "*believers*"!

That said, the writer of today's nice WSJ piece clearly did not bother to take a virtual tour of West Virginia, Eastern Kentucky and Southwest Virginia. Not everything is rosy in railroading, especially in the Appalachian coal fields. Just yesterday, the Journal had a special section on energy. If their charts were accurate, one would do well to note the decline of coal used in the generation of domestic electricity, down from 52% of total fuels used for that purpose in 2000 to 38% in 2012. While no one expects coal to be entirely replaced by natural gas in domestic power production, coal's share is certainly going south very rapidly, and with it a lot of good rail revenue. Also to be acknowledged is the positive potential for coal exports; however, with coal representing more than 40% of U.S. freight rail tonnage, there is clearly a big adjustment coming in rail freight revenue sources, especially for the two big eastern roads, CSX and NS.

On a more positive note, the transportation world is changing, sometimes remarkably so. Consider the headline: "FedEx Customers Flee Next-Day" [WSJ 3/21/13]. Another article notes that commercial aviation flights are down 13% from six years ago [WSJ 3/22/13.]. When all the lobbying is done, pro and con, there will likely be a "price put on carbon" at some point in the future. On balance, that bodes well for the rail mode of transportation, but how is the freight rail industry going to seize that opportunity? Cross country double stack trains are only part of the answer.

We believe it will require a radical rethinking of rail in both the public sector as well as among the private Class I railroads. Virginia is already dabbling in the promotion of freight railroads as an alternative to highway. In partnership with the private railroads, the public sector must step up its involvement, in many ways. Not all actions necessarily require financial hand-outs. As things stand now public policy, at all levels of government, deliberately or inadvertently, tends to favor use of highway transportation.

An old railroad operating rule used to read: “*In case of doubt or uncertainty, the safe course must be taken*”. That’s wise in the prevention of accidents. It can be fatal in developing business strategy. We also have some appreciation for the dilemma faced by CEOs. It’s hard to “bet the farm” when life is good. All Virginians have a big stake in the future of the Commonwealth’s railroads. We’re rooting for rail! # # # # #