RAIL FREIGHT IN NEW YORK CITY:
A Global View

Transportation Research Forum
New York City
6 May 2002

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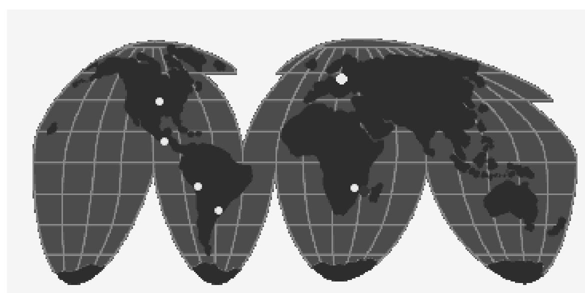
I am truly honored to be here today as I know so many of you in the audience. I would like to give you my personal opinions about New York, which are also the official positions of Railroad Development Corporation (RDC). The agenda today is therefore to provide some background on RDC; the U.S. short line industry; the overseas rail privatization industry; case studies concerning overseas railways and New York City; and to draw some conclusions.

Let me first apologize for the extremely pretentious title of this presentation. I really tried to think up something that would be less pretentious. The idea is not to pompously shove any out-of-town opinions down anyone's throat; but rather to raise people's consciousness as to how rail freight in New York stacks up against the world on the other side of the Hudson River and also the world on the other side of the Atlantic Ocean.

Background on RDC



RDC is a small company and one could say that we are probably among the least successful of the short line companies, at least in the USA. We are a privately held company and, while we have not been particularly successful in the USA, we have found a niche for ourselves in what we describe as Emerging Corridors in Emerging Markets – rail privatizations with related businesses like ports, etc. in smaller countries, and in particular developing countries. All of our businesses are joint ventures, so nothing is "The RDC Show". Our businesses always include local participation.

We are a company with five and a half employees and we are active on four continents. Historically in the track department of the Class 1s, the rule of thumb was "one man, one mile." In our case, it is 1.375 people per continent. Needless to say, we are not a highly centralized, control-oriented organization. And we are operating in some very interesting parts of the world – Argentina, Guatemala, Peru, Estonia, Malawi, and later on this year, Mozambique.

USA Short Line Trends - Transactions

Let's discuss the short line industry in the USA, and in particular why RDC has not been competitive in this business. Basically the competition in the railroad acquisition business is not trucks, but rather other buyers. Historically there have been dozens of bidders, all of whom are Innovative, Aggressive, Market-Driven, Successful Entrepreneurs, and the only question is, "Who is going to offer the highest price?" The result has been that acquisition prices have been very high even in today's slightly depressed market. It has been for the most part a controlled auction process where the Class 1s or even downsizing short line companies have sold to the bidder who will pay the most cash for these deals. So while the labor costs may go down, they are substituted for by high debt costs in order to finance the acquisition price. We haven't seen this practice changing in recent years; there has been some consolidation among the short line companies but there is always somebody who wants to enter the market for the first time with their vision of Innovative, Aggressive, Market-Driven, Successful Entrepreneurial Short Line Railroading.

USA Short Line Trends - Structural

Let's discuss where the short line industry is headed. From a structural perspective we need to consider what short lines still bring to the table, one of which is that short lines are far more effective at marketing, especially to carload customers, than the Class 1s; the Class 1s will be the first ones to acknowledge this. The Class 1s have virtually eliminated their marketing departments and rely heavily on short lines for clusters of single carload traffic. Therefore the short line industry is getting stronger due to consolidation among short line companies i.e. RailAmerica, Genesee & Wyoming, etc. which bring efficiencies to the table in terms of having shared office functions, shared mechanical functions, etc.

However, there are fundamental weaknesses in the short line industry. First of all, with labor shortages evolving it is no longer the case that Class 1s' labor costs are higher than the short lines'. Short lines have to pay higher wages just to avoid having their employees hired back by the Class 1s. Secondly, mergers are not happening; therefore, the Class 1s do not need to rely on the short lines for political support. Finally, as the Class 1s have gotten bigger, any individual short line has gotten relatively smaller. Many of the Class 1s have doubled in size due to mergers, but if you are a single short line, it means you are half as important as you were before, relatively speaking.

As stated before, the need for political support for mergers is past. There are still lots of people out there looking to buy, thus the competition is quite fierce. Interestingly, a recent trend is that while the public sector has historically been asked to finance the vision of short line entrepreneurs, now the public sector is being asked to finance the vision of Class 1s because now all of a sudden the Class 1s have found that they compete with trucks and that's not fair.

Overseas Trends – Structural

The overseas business as we see it is basically rail privatization in Latin America, Africa and the Former Soviet Union. In the overseas business the competition is usually trucks as opposed to other railroads. For example, the Iowa Interstate is one of four railroads from Chicago and Omaha; but in the countries in which we operate, we are the only railroad. In Guatemala, we are the railroad "monopoly", but the only problem is that the railroad was abandoned for three years; therefore, by definition there were no customers to monopolize. But at least in Guatemala we compete with trucks rather than other bidders.

The overseas environment is a high cost environment, which leaves plenty of room for improvement, and this is a positive. In general, as long as the price is not too high, there is no fundamental reason why overseas railways cannot be as profitable as domestic railroads. As long as the price is right, every deal is a good deal.

But in the overseas environment there are substantial negatives. There is a high risk in predicting revenue, especially where railways have not run for years. And in Open Access countries like the UK, I think people underestimated how bad Open Access was. What emerged in Open Access countries is that nobody can make a profit because if you ever develop a significant amount of traffic, you can bet that someone will show up and try to take that business away from you. The Brits are very happy with this model and they think it is a classic example of Dynamic Thrusting Private Sector Management. But if you are an investor in that environment, it has been a disaster. I believe that outside of the UK, people have generally come to the conclusion that Open Access is a fatally flawed model.

In terms of financing these deals, it is extremely difficult to finance in a country that has never had a private sector railway. You basically have to start from scratch in terms of working with the local financial markets.

Finally, overseas railways by definition are in another country, so you need to be prepared to bridge not only the gap of distance but also the gap of culture. Cultural gaps are the single biggest reason that these businesses have been difficult to manage. Unless you are prepared to become part of the local culture, you will not be successful. You are not going to make a railway work by trying to turn your employees into Americans, especially if all you do is send a few Americans over for one or two years.

By the way, an interesting factor in doing business in Africa is that the competitors for these concessions are usually the national railways of South Africa or the national railways of France. I stand before you to confess that RDC does not have as much money as the government of South Africa nor the government of France. So when RDC sees this type of competition emerging, we are very quick to redirect our efforts.

Case Study 1 – Overseas Examples

These case studies will show the extremes that exist in terms of the types of deals that are out there. Pictured on the left is our main line in Guatemala. Contrast this with Estonia (pictured right) which is Big-Time, Soviet-Style Railroading. The Former Soviet network has 25% of the planet's rail traffic, and in fact, had 50% of the planet's rail traffic before the collapse of the Soviet Union in the early 1990s.

	GUATEMALA	ESTONIA
TONS 2001	110,000	40,000,000
LINES OF BUSINESS	ATLANTIC: CONTAINERS, STEEL MEXICO: ? FIBER OPTICS: ?	OIL, FERTILIZER, METALS
PURCHASE PRICE	$0, PLUS 10% OF REVENUE	$60 MILLION FOR 64%
FINANCING	LOCAL CAPITAL MARKETS	STRATEGIC INVESTORS INTERNATIONAL CAPITAL MARKETS, IFC

The Guatemala railway is running a little over 100,000 tons per year; Estonia is handling about 40 million tons per year. Forty million tons is close to some of the smaller Class 1s in the USA, however this is a relatively small railroad which is basically a transit corridor from the Russian border to the Baltic Sea.

In Guatemala one of the interesting aspects of the business, which is why it may have proven to be a rational business decision, was that we got other things along with the railroad – fiber optics opportunities, and port facilities on both the Atlantic and the Pacific. And the best part of the deal was that the purchase price was zero. We got an abandoned railroad in exchange for fixing it up and sharing 10% of the revenue with the government. We took all of the risk but we also get all of the profit, if there ever is any profit. Another interesting aspect is that we financed the equity in the local capital markets. So this is not an American company in Guatemala – it is a joint venture with American and Guatemalan shareholders. We have 50 local investors who are our fellow shareholders.

In Estonia, it is a big operation but it is highly dependent on one commodity – oil products, which are running very strong right now out of Russia to the Baltics. The purchase price for 64% of the company's stock was US$60 million; the government retains 36%. Compared to the economics of some of the deals we've seen in the USA, it was a good price. In this particular case, we own the rail assets, namely the track and the rolling stock; it is not a concession where we rent the assets; we actually own them. RDC is a small participant with Ed Burkhardt's company, Rail World, as well as international investors and the IFC.

Case Study 2 – Domestic Examples

Let's contrast the previous Case Study with domestic examples. Originally we viewed the train going through the garbage dump in Guatemala (pictured left); there are places in the USA where that happens too, i.e. New York. This is a Conrail locomotive on the Bay Ridge line (pictured right), obviously photographed when I ran it quite a few years ago, but I can assure you that it looks more or less the same today.

GUATEMALA

NEW YORK

	OAK POINT LINK	65TH STREET YARD
TONS 2001	0 INCREMENTAL	0
LINES OF BUSINESS	DETOUR FOR BRONX, LI ACCESS	ORIGINAL: INTERMODAL PROPOSED: TRANSLOAD
PURCHASE PRICE	$180 MILLION	$20 MILLION CIRCA 1982
FINANCING	PUBLIC	PUBLIC

The biggest freight infrastructure project in New York City in the last several decades is the Oak Point Link, which essentially created a detour route as another way to get into Oak Point. Look at the price tag – US$180 million – financed by the public. But the most important point is the tonnage that this $180 million generated – ZERO. Note also the 65th Street Intermodal Yard, which when we were railroading on the Bay Ridge line in the early 1980s, was built as a state-of-the-art intermodal terminal – 90-foot track centers, high mast lighting, welded rail – you could yard a stack train without even having to make a setover. The only problem was that the stack train had to come off a car float or down the Bay Ridge line, where there is a major clearance problem called the East New York Tunnel. These are examples of the public sector run amuck.

Case Study Comparison

To make the comparisons even more graphic, look at Estonia -- US$60 million for 64%. Let's therefore say it was US$100 million to buy 100% of Estonian Railways which is handling 40 million tons. Or you can flush US$180 million into the Harlem River for the Oak Point Link, to accomplish nothing. This is the difference and this is why I am here today.

	GUATEMALA	ESTONIA	OAK POINT LINK	65TH STREET YARD
TONS 2001	110,000	40,000,000	0 Incremental	0
LINES OF BUSINESS	Atlantic – Containers, Steel Mexico – ? Fiber Optics – ?	Oil Fertilizer Metals	Detour for Bronx, LI Access	Original: Intermodal Proposed: Transload
PURCHASE PRICE	$0, plus 10% of revenue	$60 million for 64%	$180 million	$20 million circa 1982
FINANCING	Local Capital Markets	Strategic Investors, Int'l Capital Markets, IFC	Public	Public

Conclusions

So, to conclude…the overseas market will continue to be relatively opaque; and there are not a lot of buyers driving the prices up. However, it is a very risky market because it is far away, there are logistical gaps, etc. And to reemphasize culture, success in this business will depend mostly on the ability to understand the country – as opposed to understanding railways – and a high tolerance for risk.

Domestically, at least on the other side of the Hudson River, the market will continue to be relatively competitive in the USA. There will be buyers for every deal; the price will continue to be relatively high. Therefore success will depend more on the process, in other words – how to play the game – than on the customer. A classic example: offer a higher price than anyone else; take over; then go to your state government to take over your track budget because, after all it's infrastructure and it's not fair to have to compete with trucks; so let's have the State pay for our vision. Finally, financing for these deals is prospectively driven more by politics than economics. Now the Class 1s are going to the government and saying, "We just found out that we're competing with trucks. And we've got to pay for the premium that we paid for Conrail, so could you please take over our track budget?"

Now, to focus on New York City: as long as the primary focus is on building infrastructure as opposed to creating transportation, the impact on the market will be minimal, if anything. The inconsistent policies of the past and the present therefore create the following equation:

CONSTRUCTION OF RAIL TUNNEL TO BROOKLYN	+	FORCING NYCH OUT OF BUSINESS	=	ROAD TO NOWHERE

Let's assume that New York does build a rail tunnel to Brooklyn, which I understand will be something like US$2 billion, and at the same time succeeds in its current efforts to force the New York Cross Harbor out of business; where will this tunnel go? I presume it will go to Brooklyn, where there are actual rail customers and carload traffic. The result created will be the opposite of the New York Central. The New York Central was "The Road to the Future" – this, my friends, is the Road to Nowhere.

I would like to close with something I received earlier this week. As many of know, May 1st is May Day. Because of our close relationship with the former Soviet people, one of them has sent us this fraternal greeting, which I have been told translates as follows: **"The Oak Point Link – Glorious Manifestation of the Hand of the State."'**

Thank you.