What you don't know can cost you
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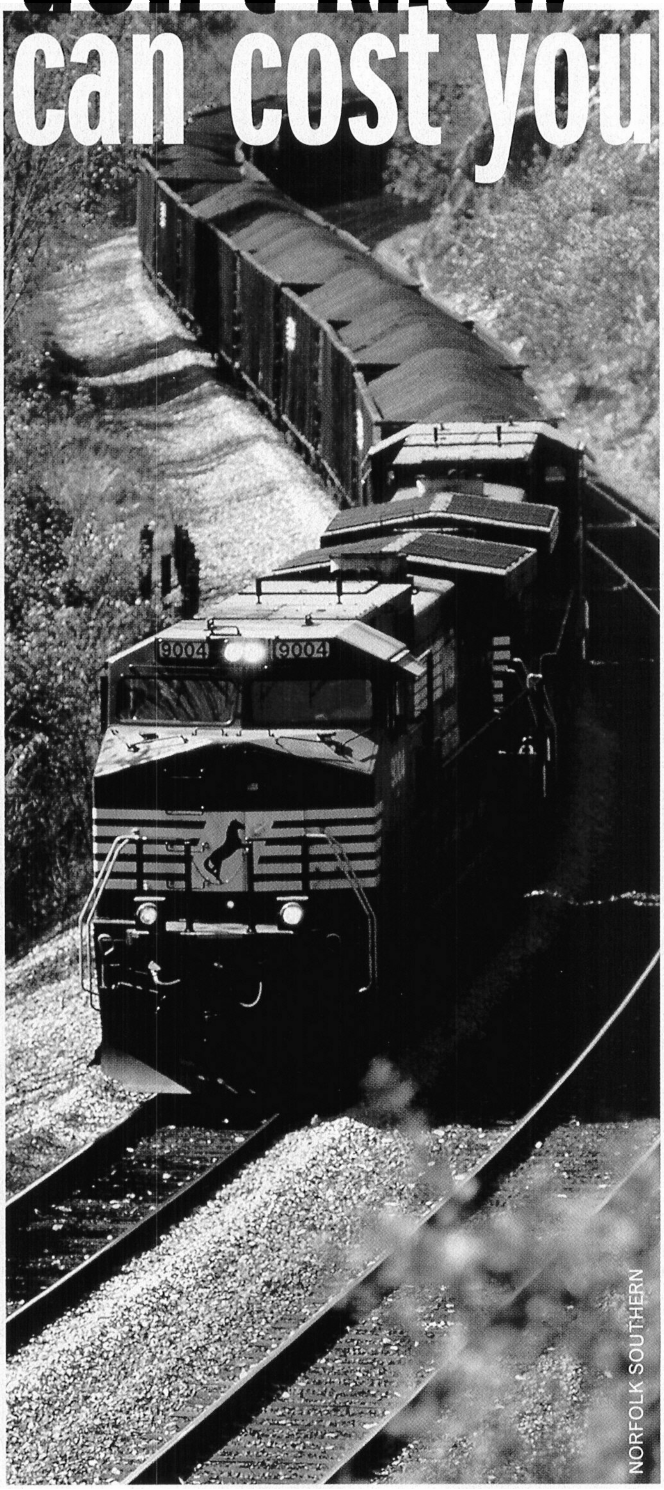
Equipment financing in 2005

What you don't know can cost you



NORFOLK SOUTHERN

One of the great mysteries of the past couple of "low-interest-rate-environment" years has been the seeming lack of interest, until recently, of North America's Class I railroads in reflecting while car and locomotive prices were low, interest rates were low, and the government was offering so-called "Bonus Depreciation" as an incentive to invest in new equipment. Sure, some railroads bought equipment, but by and large these purchases were driven by multi-year strategies, modest fleet additions and retirements, and a variety of other non-strategic reasons.

Given the size of the market, few roads seemed to be stepping up and saying: "Wow, here is a chance to get the best pricing, the best long term financing, and the best depreciation deal in years. We need and use our locomotives and railcars for 25 to 35 years. Let's take advantage of this situation!"

Cover photo by Bruce Harmon

To be truthful, we do know that there were a lot of other things on the Class I's minds during the last few years. Things such as a concern about overall borrowing levels after having leveraged themselves up with railroad acquisitions. There also were significant operational issues to be dealt with as well as rationalization programs involving existing and merged fleets. Finally, the seemingly limitless appetite of operating lessors for new equipment probably gave some railroads the comfort they needed not to jump into the market for new equipment themselves. Frankly, we were surprised that so few companies took advantage of these opportunities.

Who were the big winners in the new equipment markets in the last few years? Union Pacific and other roads that invested heavily in new locomotives and got both price and performance as well as excellent financing to boot. Operating lessors like CIT and GATX who bought "right" and are now in a position to profit from their risk-taking in markets where car prices and rental rates are up and rising. TTX, which regularly "stays the course" and buys with the future in mind. Industrials and shippers who jumped in and bought unit train sets for their needs when prices were low.

Were you among the winners? More important, with interest rates on the rise, do you have a plan for equipment acquisition for 2005?

As of this writing, the new-car building industry is "sold out" (more or less) through most of 2005. Things are a little more murky for the locomotive OEMs, but second-half 2005 looks to be tight even if the first half is not sold out. And no one is predicting a decline in interest rates in the new year. So what plan should you have?

Here are some tips that we'd advise every user of railcar and locomotives follow as we approach 2005:

■ Try not to jump into the new railcar market today unless you see a dip in orders or an unexpected opening in production lines already sold out. Remember, the new car market went from slack and hurting to hot and explosive in a matter of weeks. If and when the process reverses itself, things will not change so quickly in reverse, but buying opportunities will eventually arise. On the other hand, railroads that can justify acquiring new high-horsepower locomotives from EMD and GE may, depending on developments, be staring at purchase opportunities as new "launch" customers for these new EPA compliant models. Or if the loco market is seen as slack (we don't think it will be) at the beginning of 2005, be prepared to step up if a pricing advantage is seen to exist in your favor at some point.

■ Pay a lot of attention to your "short game." This means keeping operating leases to three years or shorter wherever possible. (We're not advocating putting all your eggs in one basket and not staggering renewals, but if you have a chance to go short for an appropriate percentage of your fleeting needs, do so. Better days rent-wise are likely at some point in 2005.)

■ Understand the difference between what you actually may need and what you could use in the way of rolling stock. Having a manageable surplus that you can sublease to others until you need the equipment may make sense.

■ Use your creditworthiness to your advantage! This means that if you are a shipper or industrial who is rated investment grade by the rating agencies, consider owning your own equipment and using your lower borrowing or leasing costs to create a market advantage for yourself. If you do decide to jump into the market, begin talking to potential financing parties as soon as possible. While there will be positive as well as negative factors impacting the market for bank lease financing in 2005, talking to as many lessors as soon as possible is always a good move. If you haven't the time to do this, hire an advisor who does.

■ Finally, if you do nothing else in respect to your equipment situation in 2005, at least consider your options and game plan, and have someone run some "what ifs?" Don't be a victim in 2005.

—Tony Kruglinski, Financial Editor

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