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HD **'White elephant' of rail comes of age**

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News Feature

The Adelaide to Darwin freight line is Genesee's jewel, writes Stephen Cauchi.

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It was a proud nation-building moment, the biggest project of its kind since the Snowy Mountains scheme was finished in 1974. When the first train from Adelaide arrived in Darwin in January 2004 - with the prime minister John Howard in the driver's cab - it was the realisation of a 150-year dream: a north-south transcontinental railway. Via its connection with Darwin port, the line was to be Australia's gateway to the lucrative markets of Asia, one that would transform trade to the region by slashing travel times.

From the day the first sod was dug in 2001, however, the railway's critics predicted it would not attract enough business. The $1.3 **billion** line was built and operated by private operator FreightLink, but it took $800 **million** in federal and state government subsidies to get the project started.

Interstate trucking and coastal shipping operators predicted a white elephant. Memorably, Patrick boss Chris Corrigan said returns on the line would be "smaller than a tick's testicles". Unfortunately, Corrigan's doubts proved justified.

FreightLink made profits but the **company** was heavily indebted by the line's construction. Investors were not satisfied and in May 2008 the **company** was put up for **sale**. In June 2010 it was purchased by American operator Genesee and Wyoming, which had entered Australia in 1997 with the **purchase** of freight lines in South Australia.

Genesee has turned the line's fortunes around and is now set for expansion.

In January, the **company** celebrated the 10th anniversary of the line's opening with a function at its Darwin terminal. Guests, including Northern Territory Chief Minister Adam Giles and former deputy prime minister and rail aficionado Tim Fischer, were told the railway shifted 5.9 **million** tonnes of containers a year - up 65 per cent since 2004. In addition to these six-weekly 1.8-kilometre-long container trains, 24 weekly trains on the line carry 3 **million** tonnes of manganese and **iron ore** from NT mines to Darwin port. More mines and trains are in the pipeline.

In February the microscope turned to the performance of the US parent **company**. Analysts' reviews were positive and there was much talk of growth, either above-rail (rail services on open access lines) or below-rail (ownership of track).

The **company** also runs a regional freight network in South Australia and freight trains on the open-access interstate network, putting it a distant third in terms of Australian rail freight, behind Aurizon and Asciano. But the Adelaide-Darwin line is Genesee's jewel in the crown: the only privately owned intercity main line in Australia, and a transcontinental one at that. The others have been owned by the federal government's Australian Rail Track Corporation (ARTC) since 1997.

"We think the FreightLink acquisition was very good for Genesee and Wyoming and that it performed better than expected," said US-based Wells Fargo analyst Anthony Gallo. He said the company had drastically lifted its share of the lucrative containers and metallic ores market, with the less lucrative agriculture, minerals and stone freight down in the mix.

"Genesee has continued to invest in track and high horsepower locomotives in the Australian market," Gallo said. "Overall, I think it is very pleased with the acquisition and the prospects for future growth in those markets."

Genesee and Wyoming's business is focused mostly on American regional railways but it also runs trains in Canada, the Netherlands and Belgium in addition to Australia. Of the company's global revenue of $US1.57 billion, about 20 per cent comes from Australia.

As measured by operating ratio (operating expenses as a percentage of revenue), it is the Australian sector of Genesee that is the best-performing, noted an analysts' report from Maryland investment banking firm Stifel. The Australian segment improved to 70 per cent in 2013. The American and European segment, thanks to unseasonably cold weather and an increase in fuel consumption, worsened to 77 per cent. Stifel anticipated that Australia would remain the best-performing sector in 2014 with an operating ratio falling to 69 per cent.

"Genesee is a high-quality growth story," Stephens analyst Justin Long told US magazine Barrons in January. "The management team is extremely strong, with a great track record of completing deals and integrating acquisitions." In the same article, Eagle Asset Management portfolio manager Matt McGeary echoed that sentiment, calling the growth outlook for Genesee "very strong".

Company chief executive Jack Hellmann told analysts, "We are actively engaged in multiple acquisition and business development projects in both North America and Australia.There is a pipeline [of Australian projects] and it's active."

Greg Pauline, managing director of Genesee's Australian operations, said: "We have the strongest growth of any of the [Genesee] regions over the last three or four years. We've got a very supportive [parent company] who's looking for us to sensibly grow in both intermodal [container] and organic bulk customers. And also below-rail acquisition.

"One of the main reasons I joined the business was to look at the really sensible, profitable growth opportunities in other states."

The Pilbara mining railways are definitely on Genesee's radar, Pauline said. "We're looking at one opportunity now, ." The company is also interested in expanding business on the national open-access rail network. "We're looking at a few opportunities to provide our services to other customers in New South Wales, Queensland and Western Australia right now, and that's mostly around bulk commodities."

Despite being the most prestigious asset in Genesee's Australian portfolio, the Northern Territory line only contributes about a third of the company's revenue, with the open-access business and the Whyalla network accounting for the rest, according to Pauline. But it is an asset the company was glad to acquire.

"There were some troubled early days," he said of the FreightLink era. "It was great that it was built, but in some of these infrastructure projects it's often the first or second buyer who gets the sort of deal that makes sense. Then you can actually sweat those assets and make money."

Besides shipping containers from Adelaide, the NT railway also ships manganese from Bootu Creek and iron ore from Frances Creek. More mines look set to come on board, the leading candidate being Sherwin Iron, which is developing a big mine 600 kilometres south of Darwin.

Genesee is also looking to move Asian freight south from Darwin and move produce from the long-rumoured Ord River food bowl. The Adelaide-Darwin Ghan passenger train pays Genesee to use the track.

Australia's 8500-kilometre interstate railway is an obvious below-rail target.

"There's been some speculation that ARTC might be divested to the private sector," Pauline said. "Those sorts of opportunities would interest us. Clearly that would be a very very large transaction so we'd need to look at how we'd respond to something like that."

Expansion plans are dependent on the strength of the resources sector. Jack Hellmann hinted strongly during the earnings call discussion that a Chinese slowdown, or a collapse in the resource sector, would bring Genesee's Australian plans to a halt. "There were projects a couple of years ago that I had thought would come to fruition but did not because of the slowdown in **China**," he said.

"In terms of the existing business, the one variable to watch is the price of **iron ore** ... if it fell $US40 there could be some concern on a sustained basis."

There are other caution signals on the line ahead. In December 2011, a Genesee train derailed and spilt 1200 tonnes of toxic **copper** concentrate into the Edith River, north of Katherine. Last December, another train derailed at Union Reef, about 200 kilometres south of Darwin. The latter derailment, plus another in Alabama, cost the **company** $US3.5 **million** and was cited by analysts as one reason for a disappointing 2013 fourth quarter. The declining Australian and Canadian dollars cost the **company** another $US2 **million**.

Regardless, one of Australia's two transcontinental railways will remain in American hands. The **company** has spent heavily on track upgrades and $50 **million** on new locomotives for the tough 53-hour trip across the brutal Australian interior. "The railway has been transformed," Hellmann told business magazine Territory Q. "When we bought it the line was on its knees. Now it's thriving," he said.

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