

Via Rail puts Global Railway firmly on the track

Meanwhile, RailPower Technologies, which also refurbishes locomotives, could be nearing the end of the line

By Laurel de Yturralde

Christmas came early for investors in **Global Railway Industries Ltd.** (GBI-TSX, \$4.60). Dec. 11, 2007, with the ink barely dry on its latest and largest new acquisition, the company announced a \$100 million-plus contract with Via Rail.

These two events will have a profound impact on the company's fortunes in 2008 and for years to come. Global Railway is now one of the elite integrated rail service companies in North America and is achieving the critical mass necessary to attract new institutional investors.

Canadian Allied Diesel (CAD), in Lachine, Quebec, rebuilds locomotives, passenger, commuter and freight rail cars. With the acquisition of CAD, Nov. 14, 2007, Global Railway becomes the largest re-manufacturer of locomotives in Canada and one of North America's major players.

The purchase will double Global's annual revenues to over \$65 million in 2008 and will add to cash flows and profits immediately. The growth potential for CAD is huge. As the only independently owned re-manufacturing facility in Canada, CAD has an advantage obtaining Canadian contracts, especially if government funding is involved.

Currently running only one shift per day, CAD has the physical capacity to increase production multiple times, and there is a good supply of skilled railroad labor available in the area.

CAD also houses one of only two locomotive emission-testing sites in North America and should soon capitalize on new high-margin revenue streams from emission-testing services. Global paid \$22 million for CAD assets, including \$12.5 million net working capital. The company is using \$8 million of its own cash for the purchase and funding the rest out of a new \$32 million credit facility.

Via Rail Canada received Canadian government funding in October, 2007, to upgrade its passenger rail services. Part of the total \$691.9 million fund was earmarked for re-



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building Via's aging fleet of locomotives and cars, to increase fuel efficiency and meet new emissions standards. In December, 2007, Via Rail announced Global Railway would be its "first partner following the government's investment." The \$101.5 million, five-year contract is one of the largest passenger rail-infrastructure-investment programs in recent Canadian history and calls for CAD to rebuild 70 per cent of Via's locomotive fleet.

CAD was always a strong contender, having provided the only F-40 prototype to Via over the past year. Still, observers were pleasantly surprised by the magnitude of the order. Work is to begin immediately, with the first locomotives expected to be delivered in March 2009.

Over nine years and a series of acquisitions, Global has grown into a well-diversified rail product-and-service company. Four separate operating facilities focus on highly profitable niche markets, with few direct competitors and growing demand from customers in the rail freight and transit industries. Now with CAD on board, Global will be supplying components equally to all three major railway-expenditure categories: locomotive, rail car, and track and signal.

Historically, Global has enjoyed high margins, strong cash flows and growing profits, without undue dilution (16.1 million fully diluted shares outstanding). The strong Canadian dollar certainly had a negative impact on Global's 2007 financial results. But in spite of receiving 88 per cent of its revenue in U.S. dollars, Global still reported

year-to-date (nine month) revenue growth of almost nine per cent and earnings were up 21 per cent to \$2.9 million or \$0.19 per share. With CAD and the Via order, Global will go forward with a close to 50-50 Canadian-U.S. dollar revenue balance, an enviable natural currency hedge. The company's balance sheet before the purchase of CAD was pristine, with a cash position of \$9.3 million, zero debt and a working capital ratio of 6.5 to one.

The rail supply market is a sweet place to be. Capital expenditures to renew rail infrastructure and refurbish rail cars and locomotives continue to rise. A recent report commissioned for the American Association of Railroads estimates a total \$148 billion in infrastructure investment will be required between now and 2035.

In Canada, two-thirds of all freight moves by rail, and demand for rail services will increase as trade with Asian markets continues to flourish; investment in infrastructure must continue to meet growing demand.

There is a "green" element here as well. The Canadian Railway association says rail "is the key to significantly reducing greenhouse gas emissions... trucks use as much as six times more energy to transport a tonne of freight one kilometre than a train." Increasing fuel prices are a major problem for the railways. A rebuilt locomotive provides "as new" environmentally friendly reliability at 40 per cent of the cost of a new locomotive.

Growth opportunities

Global Railway has numerous opportunities for extraordinary fu-

ture growth, both organically and through acquisition. CAD and Via guarantee revenue and earnings growth over the next several years and Global's three other divisions face increasing customer demand. CAD also provides sales and supply synergies with Global's Prime Steel and Bach Simpson divisions, which supply components used in rebuilds. Total revenue could reach as high as \$100 million in 2009, as units are delivered to Via. The bulk of revenue from the Via contract will be realized in 2010-12.

Locomotive and railcar re-manufacturing is a very dynamic industry of late. The credibility lent by the Via order leaves Global well positioned to compete for other rebuild opportunities.

Global is currently bidding on upcoming, major refurbishment tenders including programs for 93 Via Rail LRC passenger cars, 15,000 Government of Canada grain cars and 25 GO Transit PH-59 locomotives, just to name a few.

On acquisitions track

One of the best future-revenue opportunities for CAD is in North American yard locomotives. Over the next five years, 7,000 yard locomotives must be refurbished to meet environmental requirements, providing a \$5.6 billion opportunity. Global may well announce additional multimillion-dollar orders over the next several years.

In a recent BNN interview, president and CEO Terry McManaman said "consolidation is Global's main reason for being." Railway supply is a highly fragmented industry with very few suitors and over 1,000 opportunities to choose from. The CAD acquisition clearly demonstrates management's ability to cherry pick accretive, synergistic candidates at attractive multiples, and CAD itself provides an expanded platform for making future synergistic acquisitions. Investors can expect the company to continue exploring acquisition opportunities, with potential for sudden rapid growth.

The priority and challenge in 2008 will be a smooth integration of CAD and commencement of the Via Rail contract. To this end, Global is focusing on people, retaining

98 per cent of CAD's current employees. CAD's president and senior managers have extensive experience in the rail and locomotive industries and will further strengthen Global's management team.

Both a value and a growth play, the stock has yet to respond to all the company's good news and appears undervalued, even by conservative estimates. Analysts at Clarus Securities and M/Partners have "buy" recommendations out, with 12-month targets of \$7 and \$7.75 respectively. Earnings estimates for 2008 range from \$0.39 to \$0.45 per fully diluted share.

In contrast, **RailPower Technologies Corp.** (P-TSX, \$0.52) has to date been a major disappointment to investors. RailPower also rebuilds locomotives, transforming aging switchers into modern multi-gen sets or hybrids.

Union Pacific recently purchased 98 refurbished locomotives from RailPower and reports that compared to older trains "these ultra-low emission switch locomotives reduce nitrogen oxide and particulate matter emissions by 54 percent to 63 percent, while using about 30 percent less fuel."

Customers appear to like the technology, but RailPower has thus far been unable to generate a profit. Nine month revenue in 2007 reached \$95.9 million, but gross margins were minus \$12.8 million with net losses a whopping \$54.6 million.

If not for a \$35-million private-placement lifeline just tossed by Ontario Teachers Pension Plan Board, RailPower could have faced an insolvency crisis early in 2008. With the new financing, RailPower may have enough time to redeem itself.

Some analysts believe RailPower will be acquired by a bigger company with deep pockets. RailPower already has 94.7 million fully diluted shares outstanding and full conversion of the Teacher's debenture would generate an additional 116.6 million shares. At this time the risk level seems too high for most investors.

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