A Plan For All Seasons

While most of the leasing industry was flattened by recession, sound thinking and deft maneuvers catapulted BRAE Corp. to the top of the INC. 100

BY BRUCE G. POSNER

Just days before the initial public offering of BRAE Corp. (#1) in May 1979, an article in Barron's hoisted a bright red flag for the thousands of people who had invested in boxcars or in companies that

leased them to the nation's railroads. While nobody quarreled with the fact that BRAE and a handful of other companies were thriving in their leasing activities because of an acute rail-car shortage in the midst of an expanding economy, the article suggested that, for rather basic reasons, prospects might not be so attractive during an economic slowdown. As demand for lumber, metals, and consumer products tumbled, the article cautioned, many of the new rail cars would sit idle, earning little rental income to service their debt.

As it turned out, the recession did wreak financial havoc on several major players in the boxcar-leasing market; some of the more highly leveraged companies were forced to seek refuge under federal bankruptcy laws. But despite the travails of its industry brethren, San Francisco-based BRAE weathered the storm without any life-threatening consequences. By aggressively combining internal growth and new ventures with a series of major acquisitions in the piggy-back trailer, trucking, and offshore marine services areas, BRAE's revenues grew from $282,000 in the fiscal year ended March 31, 1978, to $251.2 million on March 31, 1982, a gain of 88,970%. Such a growth rate would be remarkable even for a red-hot technology company: The five-year sales growth rate of Apple Computer Inc.(#5) when it topped last year's INC. 100 was 43,154%. For a transportation services company operating in a period of economic decline, calling the accomplishment phenomenal might be an understatement.

BRAE's success is a direct result of the creative approaches taken by president and chief executive officer William J. Texido, formerly an executive

with Itel Corp. and IBM. While it was no secret in the 1970s that the U.S. rail system had too few good boxcars to meet the needs of shippers, BRAE's approach to the opportunity differed from that of its competitors. Instead of purchasing its own short lines (generally, railroads with less than 100 miles of track) to serve as home bases for hundreds of roving boxcars, and instead of leasing cars to short lines that lacked significant outbound traffic, BRAE minimized its risks by offering to lease cars only to a select group of about 40 short lines owned by major industrial shippers, such as Weyerhaeuser, Georgia Pacific, and Champion International.

The leases themselves were designed for maximum protection. Thousands of new boxcars joined the national fleet each year, a result of attractive daily rates set by the Interstate Commerce Commission ($25 per car, per day of use) and other government incentives designed to encourage rail-car investment. Texido says, "You had to conclude there'd be a surplus at some point in the business cycle." In exchange for a 15-year commitment to load BRAE's cars first, the targeted customers were offered brand new boxcars to ship in, but only enough cars to meet about half of their needs, giving BRAE a generous cushion against major declines in shipments.

A key advantage for the shippers is that they aren't required to take on any new debt in obtaining the new cars. BRAE owns a custom-built fleet of about 5,000 rail cars, costing about $40,000 each, financed through 15-year, fixed-rate borrowings from insurance companies and banks collateralized by

the leases and the cars. Moreover, BRAE has been an innovator in equipment management. It insures and maintains the cars, tracks their daily use on a computer, and collects revenues due its customers from all the other railroads using the equipment. Such services are also performed for another 6,000 rail cars that BRAE either partly owns, or manages for a fee for PACCAR Inc. and Ford Motor Credit Co. They are leased to such large companies as Cargill Inc. and Consolidated Foods Corp.

The essential structure of BRAE's rail-car business was developed by Texido, now 47, during the mid-1970s when he assembled a nearly identical operation for his former employer, Itel, the go-go San Francisco leasing company whose headquarters are in the same Embarcadero Center complex as BRAE's. To shape Itel's business plan, which would later be the pattern for BRAE's, Texido recalls, "I spent two weeks traveling around the U.S. talking to everybody who knew anything about short-line railroads. Then I came home and shut the door and asked, 'What does this mean?" Texido left Itel in 1977, lured by the challenge of putting together his own company and backed by a $10 million war chest put up by a group that included financial heavyweight Dan W. Lufkin and ex-president of Transamerica Corp. Edward L. Scarff.

In the late 1970s BRAE fought head-to-head with Itel for equipment leases with many of the same customers and over the purchase of a short line in Wisconsin, a skirmish that Itel won. But whereas Itel (which has recently completed its reorganization under Chapter 11) invested some of its capital

in owning a few railroads, Texido's initial interest in that approach quickly faded. Not only were short lines with substantial out-going cargo expensive, he says, but "you could get as much control over the loadings, which is what I really wanted, through leases that stipulated they had to load our cars first."

A similar emphasis on maximizing control over shipments while keeping its own capital investment as low as possible has marked BRAE's increasing diversification into the piggyback trailer business. Based on trailers that can be easily shifted from trucks to rail cars and then back to trucks for the quickest and most economic form of long-haul transportation, a company in the piggyback business stood to benefit greatly from deregulated rail-freight rates that began to take effect in 1980.

BRAE's earliest entry into piggyback was through a venture it funded for $500,000 in 1979, leasing refrigerated trailers to move lettuce and other produce from the West Coast to eastern markets. But Texido didn't stop there. To enhance the new operation's ability to find westbound cargo for its empty trailers once they delivered the produce, BRAE formed a joint venture with National Piggyback Services Inc. of Indianapolis, one of the nation's largest shippers' agents. With more than 40 terminals around the United States and hundreds of thousands of trailer loadings per year, "no matter where we dropped an empty, they could fill it," says Texido. By the end of 1980, BRAE had purchased National Piggyback, whose annual revenues of about $90 million were three times those of the company's rail-

car business. Typically, shippers' agents operate with very thin profit margins, so despite National's size, it was hardly a coveted acquisition target – except for a company in BRAE's position.

Unlike the rail operation, in which BRAE has an ownership interest in most of the equipment and from which it gets millions of dollars worth of tax benefits each year, the bulk of the piggyback trailers are simply managed by BRAE for corporations and other investors, thus limiting the amount of BRAE's capital investment. But while the financial structure of BRAE's piggyback business may differ, the key to operational success, in light of a glut of empty trailers in many eastern markets, is very much the same. "If you can control a shipper's agent, then you've controlled a lot of loadings," Texido notes. "You could assure high utilization and a high return."

To consolidate its position in the market even further, BRAE recently formed a joint venture with a Wisconsin trailer manufacturer to produce piggyback trailers, and it has also purchased a nationwide trucking company. "Even though it's primarily a service-oriented transportation company, BRAE hasn't been afraid to get its hands dirty by owning and manufacturing equipment," comments Michael Walker, a securities analyst at Alex. Brown & Sons of Baltimore. "They're making money on practically everything but the railroad's charge for hauling the freight car."

Lately, BRAE's interest in continued diversification has been leading it into new nonrail areas. In 1982, the company bought a Houston-based business

that specializes in transporting oil-well drilling personnel and supplies to and from offshore rigs. And in February it announced plans to buy American Sign & Indicator Corp. of Spokane, Wash., which specializes in building, marketing, leasing, and maintaining electronic message systems, such as sports scoreboards, airport flight information boards, and time and temperature displays.

Already, BRAE has found major benefits in its diversification beyond rail-car leasing, where the recession lowered the company's boxcar usage from more than 90% to around 60%. Cautious buyers prefer the smaller loads piggyback trailers deliver when money is tight, and so, says Texido, "the piggyback business has turned out to be counter-cyclical to the rail-car business." But the rail-car business hasn't been an albatross, either. Thanks to the way BRAE's leases were structured, "our utilization rate has remained at least 30% higher than any competitor's," he claims. "They still generate cash. And they'll be a significant recovery play."

What has provided BRAE with its edge from the beginning has been an ability to spot gaps in the markets it understands and to move cleverly and rapidly to fill them. "They've been very successful at achieving vertical integration," says Justin Mazzon, an analyst at Davis, Skaggs & Co., stockbrokers in San Francisco.

Such aggressiveness isn't surprising if one considers the competitive ardor of Texido. Only a few months after leaving Itel, he hauled his former employer

into court, charging the company with unfair competitive practices – including maintaining exclusive leases with some of BRAE's prime prospects, leases that Texido himself had negotiated while at Itel. "I tried to put as much in there as I could to protect the business when I was there. And we tied customers up 30 ways to Sunday," he admits. "But once I was running BRAE, it was not in our interest to be excluded from the market." An out-of-court settlement established BRAE's right to compete. Since then, the company hasn't been excluded from any market it has cared to enter.

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