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THE WALL STREET
TRANSCRIPT
Questioning Market Leaders For Long Term Investors

Trailer Bridge, Inc. (TRBR)

JOHN D. MCCOWN is Chairman & CEO of Trailer Bridge, Inc. Mr. McCown has been with Trailer Bridge since it was founded in 1992 by transportation pioneer Malcom McLean, most widely known as the inventor of container shipping. Mr. McCown worked closely with Mr. McLean from the early 1980's until Mr. McLean's death in May, 2001. Prior to his involvement in the maritime field, Mr. McCown was a corporate loan officer for a New York City bank. He has an undergraduate business degree from Louisiana State University and an MBA from Harvard Business School

Trailer Bridge, Inc.

TWST: Could you tell us a bit about what Trailer Bridge does?

Mr. McCown: We are an integrated marine and trucking company that moves full load freight between all points in the Mainland and Puerto Rico utilizing our own vessels, tractors and 53-foot equipment.

TWST: Why Puerto Rico?

Mr. McCown: When we started over ten years ago, Puerto Rico was the market where we thought our system would have the most advantages versus competitors. Puerto Rico is part of the US and its domestic marine trade is covered by something called the Jones Act. It is a large $750 million revenue market restricted to US flag carrier's operating vessels built in the US. We have numerous tangible competitive advantages based on the different hard assets we use to move freight.

TWST: Why 53-foot equipment?

Mr. McCown: It has 50% more inside cubic space than the 40' containers used most by our competitors. They're 32% longer, 19% higher and 6% wider. More inside cube is always more efficient. That's underscored by the fact that the domestic truckload industry has been built exclusively around 53's for more than a dozen years. There is no such thing as a domestic truckload carrier operating something as inefficient as 40-foot equipment. The freight that moves to Puerto Rico is effectively just like domestic freight so we decided to build our system around that efficient size. If there was an actual 1,121-mile bridge between the Mainland and Puerto Rico, all the freight would move in 53-foot equipment. That's the derivation of the name Trailer Bridge. Our system lets shippers move freight between inland points and Puerto Rico in the same efficient manner it has long moved domestically.

TWST: What are the other advantages and disadvantages of your system?

Mr. McCown: We have a different business model built around big tugs and barges rather than self-propelled vessels. We're slower at sea but tug barge combinations are much more cost efficient. This arises from a number of factors. Tugs have less than one-third the crew size of self-propelled vessels. Fuel consumed per unit mile is less than half due to slower speeds. The capital cost to build a new barge is less than 10% of a similar size self-propelled vessel and the maintenance and dry-docking costs are much lower due to the simple design and lack of machinery on barges.

Importantly, barges lend themselves better to moving the larger equipment size, both due to vessel design and cargo accessibility.

The larger equipment results in stevedoring and terminal cost efficiencies, but where those efficiencies really come into play is in the inland move within the US. In our business, most freight starts at an interior point in the US some 500-600 miles away from Jacksonville, our Mainland port. On that first leg, it moves just like that freight would move domestically. When you are talking about moving it over the road, moving 50% more freight obviously has a whole host of different economics because the cost of the pulling a trailer or van, whether it's 20 feet or 40 feet or 53 feet, is going to be roughly the same amount per mile.

TWST: Is it unusual to provide both marine and land transportation?

Mr. McCown: Yes. We're an asset-based carrier with big investments in vessels, equipment and tractors. In the Puerto Rico lane, that integration gives us cost benefits. Because we're built around the same equipment size used by all domestic truckload carriers, our land transportation has similar economics. One reason you don't see such integration by typical marine carriers is because they are built around 40-foot containers. That equipment size just doesn't work in a land operation. In addition to the cost benefits we see from being integrated, there are also service benefits. On the inland leg, we can often make up the one and a half day slower sea transit time due to no third party involvement and our competitors often use slower rail service. When they use rail, there are three different companies that handle the load even before it is put on their vessel. First is a third party trucker to pickup and deliver to the rail terminal, then the railroad company and then the third party trucker to pickup and deliver to the port. These hand-offs between companies add time and costs. Besides the service benefits from our seamless system, a growing number of our customers appreciate the security aspects of knowing that we are in control of their load the entire journey.

TWST: Do both of these businesses complement each other?

Mr. McCown: We believe they do. The Puerto Rico trade is very imbalanced, like most island economies. The marine freight moving in to the island is more than three times as much as the freight moving out. If we only relied on Puerto Rico business to keep our 200 tractors utilized, by definition we'd only have at best about 66% loaded miles even if southbound and northbound loads matched up in terms of time and place, which they don't. But we still need to get our equipment to interior points for customers to use. That's where our domestic freight, what we call our "connect-the-dots" freight, comes in place. For a lot of domestic customers in Florida and South Georgia, we handle their domestic freight requirements just as any typical truckload carrier would. That gives us the backhaul to more efficiently move our equipment into the lanes where we are picking up Puerto Rico freight. Our tractor loaded mile utilization is in the low 80's, meaning that our domestic business sharply reduces the incidence of moving empty equipment. The cost of moving an empty piece of equipment from Jacksonville to the Midwest is above the average vessel cost per unit, so a domestic revenue load that mitigates that cost is one of the most effective things we can do. So for us it's a wonderful compliment. We are the only marine carrier that has fully integrated into the trucking side by actually owning and operating our own tractors the way we do. But in this particular market, it works very well for us.

TWST: Tell us more about this market. How has the economy affected your business?

Mr. McCown: Much more important than the economy has been the affect of a specific cycle that is now finally unwinding. When I spoke to *The Wall Street Transcript* a year and a half ago, we talked about the onerous competitive conditions and rate war that had been going on for a while.

Since that period of time, unfortunately, it went from a rate war to a war of attrition, driven by 30% excess deployed capacity in the market. This led to hyper-competitive conditions much worse than anybody would have thought even 18 months ago. The largest carrier, a company called Navieras, went into chapter 11 bankruptcy in March 2001. It stayed in bankruptcy and continued to operate up until about two and a half months ago.

The net effect of this is that all five carriers were losing increasing amounts. The cumulative loss in 2001 is estimated at a staggering $175 million or some 23% of revenue in the sector of $750 million. The losses among all carriers were just extraordinary, driven by this overcapacity situation. As this ruinous competitive environment dragged on, everybody hunkered down and took steps to maximize their staying power in a market that wasn't going to improve until someone totally withdrew. For us, that meant discontinuing a northeast service. All of our 2002 interim figures show a significant reduction in our previous loss due to that and other steps we took at the end of last year. Meanwhile, all of the publicly available information from the Navieras bankruptcy pointed to growing, extraordinary operating losses through the continued operation of the trade's highest cost carrier.

The Navieras vessels were finally removed from the lane at the beginning of the summer as the case converted to liquidation under chapter 7 bankruptcy. The significant administrative insolvency and further disclosures in the Navieras bankruptcy case indicate that it continued to be operated well beyond what was reasonable, extending the financial trauma both of its own creditors and the other carriers. The net effect of the Navieras withdrawal is that there is now 20% less vessel capacity in the lane. This is a very recent event. It is hard to overstate the ultimate impact of this event.

TWST: What will be the effect of this event?

Mr. McCown: This overcapacity has been the root cause of our and others poor recent results. In my view, this recent event has three legs that really come together to form a very nice upward pointing triangle for the remaining carriers. First, the reduction in capacity is equal to two-thirds of the excess market capacity that was in the trade – i.e., 30%. So it's a major contraction of supply. Second, there are clear barriers to entry, with a general lack of availability of additional US flag vessels, and the Jones Act, which is the law that precludes the entry of foreign flag vessels. So that's going to act as a constraint on additional capacity. Third, the demand side of the equation is consistent and is driven by what 4 million American citizens consume in their daily lives. So it's not a situation like the airlines where the demand is also volatile. The demand for marine freight in the Puerto Rican market has been fairly consistent and long term can be expected to grow one and a half or two percent a year. Adding to the woes of the lane in the last year was an unusual 1% reduction in southbound marine freight volume believed largely due to reduced Puerto Rico government spending. Indications are that this spending will start to increase shortly, particularly in the important construction sector, so overall marine freight volume is expected to show positive growth near term.

So getting back to what I said earlier, you can't overstate the ultimate impact of this event. It really is a basic realignment of supply and demand that is going to benefit all participants going forward, both in terms of asset utilization and yield.

TWST: Are you getting better asset utilization?

Mr. McCown: Yes, we are. Our vessel utilization figures are up. That trend, as well as the trend in our bookings and inquiries, is encouraging. We recently released our second quarter financial results but the impact of this market-changing event didn't really show up in those results. It occurred late in the quarter and it also occurred during the seasonally slow summer period. While the volume effect of this event is what we will see first, not all of that is going to be as front-end loaded as you might think and it will be phased in over time for a whole series of seasonal and contractual and competitive issues. The fourth quarter of this year will be a better indication than the third quarter of the volume effect for us. Increases in volume are almost as good for us as increases in rates. Based on our business model, some two-thirds of additional revenue driven by volume increases goes to our bottom line, and obviously increases in rate go to the bottom line 100%.

TWST: What about prices? Are you seeing increases?

Mr. McCown: Our own southbound rates are about 25% less now than they were six years ago, which means that they would have to come up 33% just to be where they were then. That's an indication of the sort of hyper-competitive activity that previously occurred in this market which is now, with this capacity reduction, very much in the past. We think that most of the other carriers has experienced similar rate compression over that period and their compression wasn't mitigated by the per unit cost reductions that Trailer Bridge achieved.

As vessel utilization increases, pricing power is returning to the carriers. Most freight moves under confidential one and two year contracts so the ultimate effect of benefits from rate increases will extend well beyond benefits from volume increases. Certain categories of freight that generally move under tariff rates, however, have already seen long overdue increases. Our tariff rate on used cars, a very important niche for us, has increased 30% since the beginning of July and is holding. More recently, we increased our tariff rates on NIT's – for Not In Trailer, our designation for things like bulldozers, buses, etc. – by 11% and it is holding. Much of that business moves under tariff. There have been a number of individual contracts that have come up and we're pleased with some of the increases we are seeking and receiving. As we take on customers that we haven't previously dealt with, obviously they will start off at rates that reflect some of these new market realities.

It's clear that a 20% capacity reduction in what is effectively a closed loop will increase the pricing power of the carriers. Due to the severe and sustained financial trauma experienced by all the remaining carriers these last few years, I anticipate that everyone will seek meaningful rate increases as contracts are renewed.

TWST: In light of all that, what type of guidance are you giving right now?

Mr. McCown: We said on our conference call just a couple of days ago that we anticipate a bottom line profit in the second half of 2002. That is of course a sharp change for a company that had a $30 million loss in 2001. Even with the sharp improvement that we had in the first six months of this year, we still had a bottom line loss of $2.5 million. For the first half, our vessel capacity utilization southbound was only approximately 75%. We believe that we will be profitable at the bottom line in the second half. Most of the improvement should come from volume increases. I am going to leave it at that right now.

Major changes have already occurred in this market, and they are going to have a lasting impact on this sector and on our own results. We are much more certain in terms of the absolute benefit that we will ultimately see than the timing of that benefit.

TWST: What message would you like to give Wall Street at this time?

Mr. McCown: I think that the one underlying message to shareholders and potential shareholders – and this is the same underlying theme that I think has driven change in the Puerto Rico lane and will continue to drive it – is that we are a company with fundamentally different and superior hard assets. Hard, tangible assets have been and will continue to be the main differentiator in terms of relative success in most freight businesses. In our sector, the tug barge model built around 53 foot equipment in an integrated marine and trucking operation is superior to higher cost, self-propelled vessels.

It's also a straightforward advantage to grasp because it is a difference that I think somebody can see when he or she looks at our assets. If somebody physically inspected our assets and our processes and compared them with a similar inspection of the assets and processes of competitors, they would immediately see firsthand how and why we are able to move freight more efficiently. Moving freight isn't a black box; it is done with hard assets that are fairly easy to get your mind around. This tangibility of our business, at least in terms of understanding enough to make your own judgment, should be well received by people who are weary of non-understandable companies in the ether zone. An analogy I use is another big box situation. When someone walks into Home Depot and walks around, they can see for themselves the scale economies that give Home Depot much better underlying costs than the local hardware store. I think the same sorts of advantages are apparent in any sort of systematic comparison between Trailer Bridge and self-propelled vessel competitors.

Another underlying point is the replicability of our assets. We have among all US flag carriers the youngest fleet in terms of vessel age. The average age of our fleet is six years. Also, our newest vessels are more cost efficient. So those things come together to underscore the replicability of our business model in other markets.

Today, we are totally focused on the Puerto Rico market and do not anticipate any initiatives in other markets until Puerto Rico gets sorted out. But the cycle is now on the upswing. Once we start to make the profits that we fully expect we will be making in Puerto Rico, we'll be able to turn to expanding in other markets with what we know is a fundamentally superior business model.

TWST: What are the other markets you envision participating in?

Mr. McCown: The two other main Jones Act liner markets, Hawaii and Alaska, represent $800 million and $500 million markets, respectively. Like Puerto Rico, they are outbound markets with similar freight mixes. We believe a lower-cost system built around 53-foot equipment has some applicability in those markets. More importantly, we've had customers of ours tell us the same thing. Its encouraging to me, as I meet with various customers, to hear them ask "When are you going to start 53 foot service to such and such?". I think that down the road, new Jones Act lanes will develop for which our present vessels are uniquely qualified to serve.

Cuba is a major future opportunity for us. We were in Cuba last year meeting with various officials to learn more about this large potential market and its freight infrastructure. We already have a license from the US government to legally move freight to Cuba. We are participating in an upcoming exhibition in Havana and will of course follow political developments closely. If and when our government fully and openly embraces trade with Cuba, many anticipate that the initial wave of shipments will be government impelled assistance, or Cuba's version of the Marshall Plan. Should that occur, there would be automatic requirements that 50% move US flag. That is the segment of the large potential Cuba trade that we are focused on. No US flag carrier is in a better position to efficiently handle that freight than Trailer Bridge.

The Dominican Republic and other short sea markets in the Caribbean and the Gulf are also on our radar screen following the return of profitable operations in Puerto Rico.

I envision that we will be a US flag carrier in whatever marine market we go into, even where US flag isn't required, because that puts us in a niche where we believe we will benefit at the top-line and have superior costs compared to other US flag participants. As an American company, it is also appropriate that all our vessels fly the US flag.

We now have two patents related to our Vehicle Transport Module, a unique piece of equipment for moving cars. It is also now being tested in a non-marine application that could lead to additional opportunities for Trailer Bridge. We have a patent pending on the innovative system built around our newest vessels.

Trailer Bridge is capable of significant expansion prior to the need to build additional vessels. Beyond the sharp potential revenue increases from higher utilization and higher rates on the four vessels presently deployed, there are three vessels presently laid-up. Depending on the deployment, placing those three vessels into service would increase Trailer Bridge's effective capacity by up to 79%.

TWST: In light of what has happened with regard to corporate governance, what message would you like to give to your shareholders?

Mr. McCown: We have a nine-person board and an officer group that takes their responsibilities to shareholders seriously and professionally. Holders of a large majority of the company's outstanding shares are directly represented on the board and their interests are in synch with all shareholders. In addition, insiders have made open market purchases of the company's stock in each of the last 49 months. These purchases, totaling over 350,000 shares or more than 10% of the public float, underscore the commonality of interest between insiders and shareholders. I believe our board, our management and our more informed shareholders are all focused on the big picture and realize the conditions have now come together for us to move towards goals that will benefit all shareholders. The analogy that I use is that of a garden hose, where the spigot has been turned on full-blast, if you will. We know the water is going to come out of the other end, we just don't know precisely when. But all of the indications are that everything is moving very nicely in that direction and we're all working hard to do everything we can to maximize the resulting flow.

TWST: Thank you. (WT)

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