

# Midwest Association of Rail Shippers



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## Recovery Challenges in 2010

Airfreight, Surface, and Marine Transportation Research

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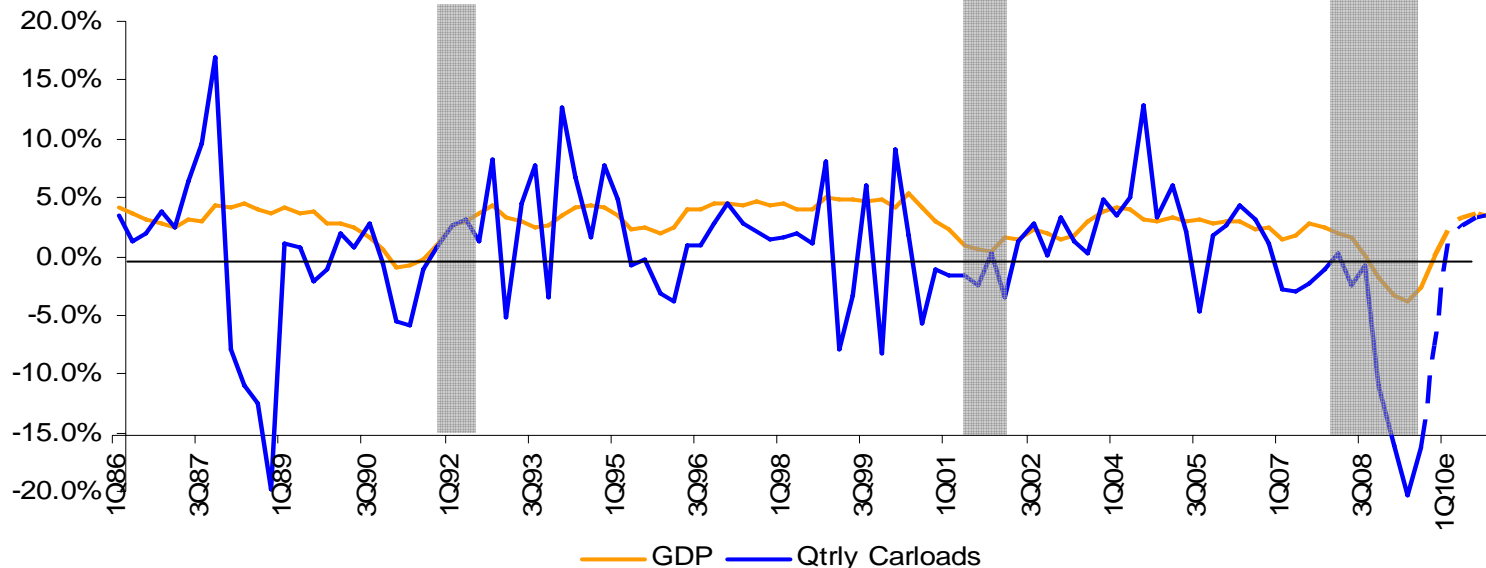
Refer to important disclosures on page 27-32. Analyst Certification on page 26.

## Leading the way to recovery

- Economic update
- Truck, Port, and Airfreight volumes moving to first derivative growth
- Rail carloadings turning positive - focus on where they trend in 1Q10
- Pricing renaissance moves into latter stages - “inflation plus”
- Rails proved to be more variable than anticipated (look to incremental mrgn)
- Capex above maintenance levels
- Legislative review
- Returns on invested capital still below cost of capital levels
- Stock performance - recent, past out-performance, and ahead of turns
  - Outperformed S&P 500 for 10 consecutive years
  - Trading at top end of historical ranges - indicating rebound potential
  - Typically early cycle investment

# Economic update

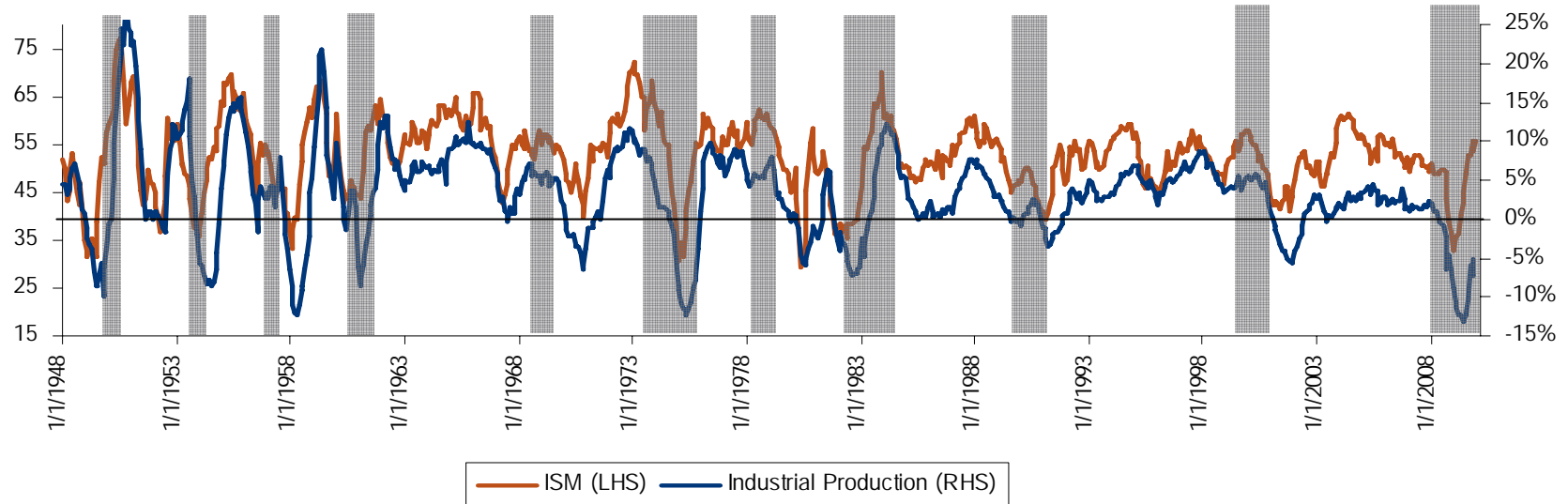
- Normal cycle - Truckload, Rails, Airfreight...
- GDP and rail carloadings move toward growth
  - Typically 3 quarters after bottom reach positive growth
  - Following past 10 post-war recessions, average GDP growth rate was 5.4%
  - After 2 worst recent recessions (1973-75, 1982-83), post-growth rate was 6.2%
  - We target ~3.5% carload growth on average



# Economic update

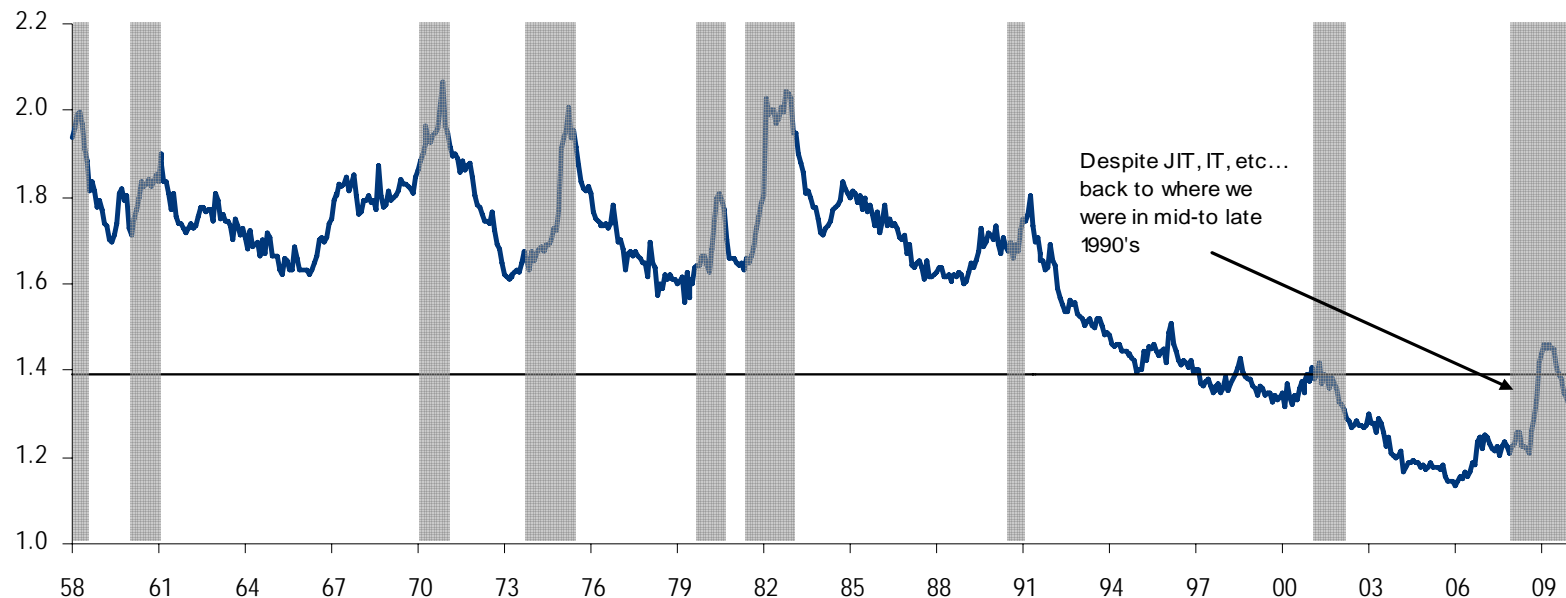
- ISM leads Industrial Production

- Carloadings: 1/3 Industrial, 1/3 retail, 1/3 weather
- ISM at 55, showing upside gaps, such as in ISM employment index, typically strong signal



## Economic update

- Inventory to Sales ratcheted up despite de-stocking to some of the lowest inventory levels on record, as sales dissipated faster
- Reversed course and moving back down as % of sales as sales improve and inventories remain lean
  - Still fear to rebuild inventories
  - Thus, express freight doing well



# Truck, Port, & Airfreight data are moving toward growth

- Truck Tonnage moving out of depths

- Truck tonnage declines have decelerated for the past 6 months, traditionally signals an improving economy by 9 months.

- We have entered an extended period of easier compares

- ~5.7 million trucks; 500,000+ registered companies with DOT

- 45% of cos own only 1 truck, 82% own fewer than 20

- Notable bankruptcies:

- November - McKelvey and Sitton
- Dec/Jan - Arrow (1,400 trucks) and Carlen (105 trucks)

## Adjusted Truck Tonnage

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
JAN	121.2	117.1	112.2	117.4	104.6
FEB	116.3	115.2	113.2	117.4	106.2
MAR	112.9	112.3	113.8	115.5	101.4
APR	116.2	114.9	112.2	114.2	99.2
MAY	114.2	114.9	110.6	114.9	102.3
JUN	113.4	114.1	110.4	115.6	99.8
JUL	115.0	115.1	110.5	113.8	102.0
AUG	114.1	108.9	110.1	112.6	104.1
SEP	114.9	114.4	111.4	112.0	103.8
OCT	115.5	112.5	111.5	109.3	103.6
NOV	117.5	109.4	112.7	110.3	106.4
DEC	116.9	115.0	116.2	101.7	

## Year-Over-Year

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
JAN	9.4%	-3.4%	-4.2%	4.6%	-10.8%
FEB	2.7%	-1.0%	-1.7%	3.7%	-9.5%
MAR	0.6%	-0.5%	1.3%	1.5%	-12.2%
APR	2.4%	-1.2%	-2.3%	1.8%	-13.2%
MAY	0.5%	0.6%	-3.8%	3.9%	-11.0%
JUN	0.5%	0.6%	-3.3%	4.7%	-13.6%
JUL	0.8%	0.0%	-3.9%	3.0%	-10.4%
AUG	1.6%	-4.5%	1.0%	2.3%	-7.5%
SEP	2.1%	-0.4%	-2.6%	0.6%	-7.3%
OCT	2.1%	-2.5%	-0.9%	-2.0%	-5.2%
NOV	3.4%	-6.9%	3.0%	-2.1%	-3.5%
DEC	<u>3.1%</u>	<u>-1.6%</u>	<u>1.1%</u>	<u>-12.5%</u>	
Average	2.4%	-1.7%	-1.4%	0.8%	-9.5%

Source: ATA and BofA Merrill Lynch Global Research

# Truck, Port, & Airfreight data are moving toward growth

- Port Volumes and Air Cargo also moving out of depths
- Ports move from -20% in June to down -1% in November
- Airfreight ended 15 months of declines, posting its first growth in November.

## TOP 9 of 10 US Ports (78% of total)

<u>2008</u>	Loaded <u>TEUS</u>	Y-O-Y <u>Change</u>	<u>2009</u>	Loaded <u>TEUS</u>	Y-O-Y <u>Change</u>
Jan	1,931,530	1.8%	Jan	1,588,858	-17.7%
Feb	1,999,740	7.1%	Feb	1,394,419	-30.3%
Mar	1,968,106	-0.1%	Mar	1,632,669	-17.0%
Apr	2,054,207	4.2%	Apr	1,658,426	-19.3%
May	2,115,539	2.0%	May	1,745,064	-17.5%
Jun	2,116,158	-2.4%	Jun	1,695,858	-19.9%
Jul	2,130,554	0.4%	Jul	1,793,458	-15.8%
Aug	2,162,394	-0.9%	Aug	1,881,981	-13.0%
Sep	2,079,526	-5.3%	Sep	1,826,608	-12.2%
Oct	2,064,256	-5.7%	Oct	1,922,168	-6.9%
Nov	1,823,793	-13.9%	Nov	1,480,916	-1.4%
<u>Dec</u>	<u>1,608,817</u>	<u>-20.6%</u>	<u>Dec</u>	<u>---</u>	<u>---</u>
<b>Total</b>	<b>24,054,622</b>	<b>-2.9%</b>	<b>2009 YTD</b>	<b>18,620,425</b>	<b>-15.8%</b>

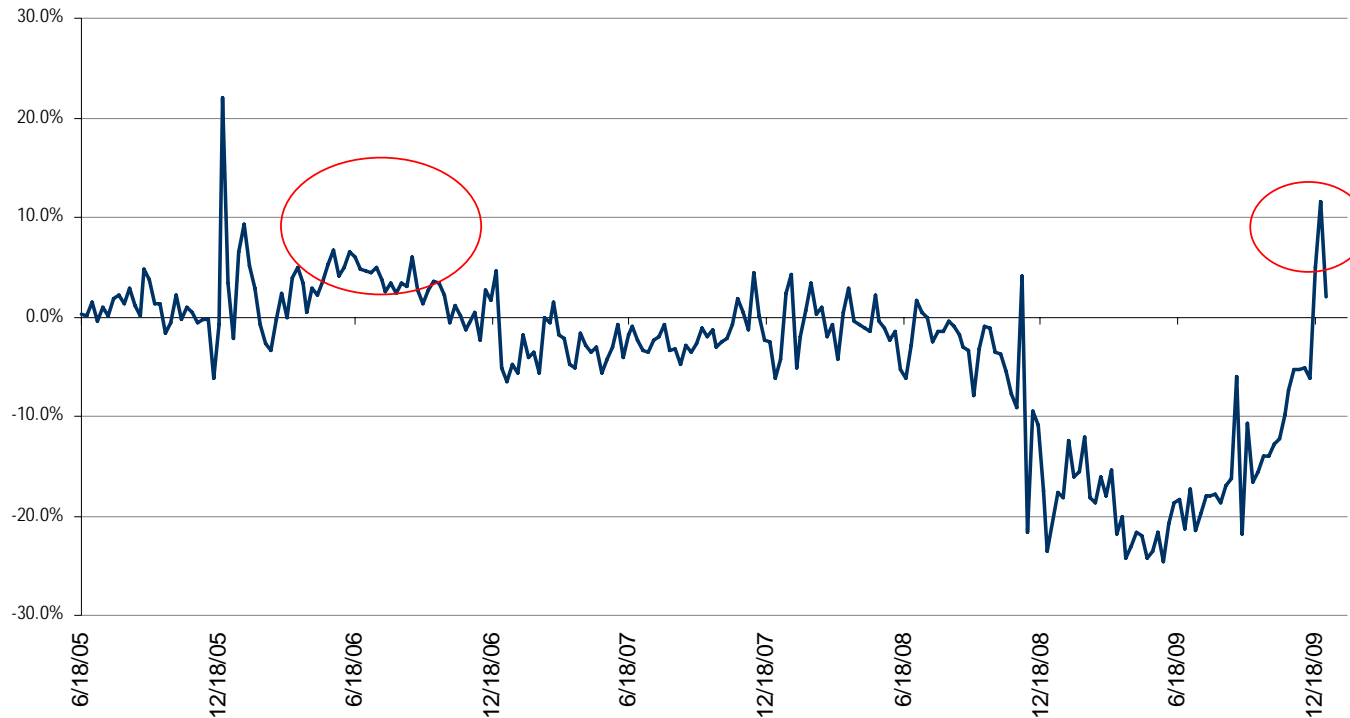
Source: Ports of LA, LB, Charleston, Savannah, Oakland, Houston, Seattle, Tacoma, Department of Transportation, New York. Top 9 of 10 US Ports - 78% of All US Ports.

## Airfreight Tonnage (% change)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
JAN	12.2%	1.7%	(7.9%)	6.9%	0.6%	6.7%	1.2%	2.1%	6.0%	(21.2%)
FEB	15.8%	(5.8%)	(8.5%)	4.4%	9.3%	(1.3%)	2.1%	0.7%	6.0%	(21.1%)
MAR	12.5%	(4.7%)	(7.2%)	2.5%	6.6%	3.5%	6.0%	(2.0%)	(1.1%)	(20.8%)
APR	8.9%	(8.6%)	0.2%	1.9%	6.9%	0.3%	5.4%	(2.0%)	8.2%	(21.5%)
MAY	9.1%	(5.7%)	0.5%	(2.8%)	7.5%	(3.8%)	9.9%	2.1%	1.5%	(20.0%)
JUN	7.9%	(9.6%)	1.8%	(4.6%)	10.1%	2.4%	6.3%	(0.3%)	(2.9%)	(15.0%)
JUL	2.7%	(9.6%)	5.3%	0.9%	6.7%	(1.7%)	4.7%	1.8%	2.9%	(13.3%)
AUG	9.6%	(10.4%)	2.6%	(2.6%)	5.6%	1.6%	9.7%	1.8%	(6.6%)	(11.8%)
SEP	4.0%	(25.3%)	19.9%	(0.4%)	11.1%	2.7%	3.8%	0.0%	(7.0%)	(3.0%)
OCT	3.7%	(24.5%)	19.0%	(6.1%)	7.2%	0.2%	0.7%	2.8%	(6.2%)	(1.2%)
NOV	5.6%	(15.7%)	14.2%	(4.2%)	7.9%	3.5%	2.8%	3.5%	(17.1%)	7.0%
DEC	<u>(4.7%)</u>	<u>(16.7%)</u>	<u>8.4%</u>	<u>4.7%</u>	<u>11.4%</u>	<u>1.8%</u>	<u>(2.3%)</u>	<u>3.1%</u>	<u>(16.9%)</u>	
<b>Full Year</b>	<b>8.1%</b>	<b>(11.5%)</b>	<b>4.6%</b>	<b>(0.2%)</b>	<b>7.6%</b>	<b>1.3%</b>	<b>4.1%</b>	<b>1.1%</b>	<b>(3.1%)</b>	<b>(13.1%)</b>
								<b>YTD</b>		

## Rail carloads posting growth

- Rail carloadings posting year-over-year positive growth for a few sequential weeks for the first time since Fall 2006

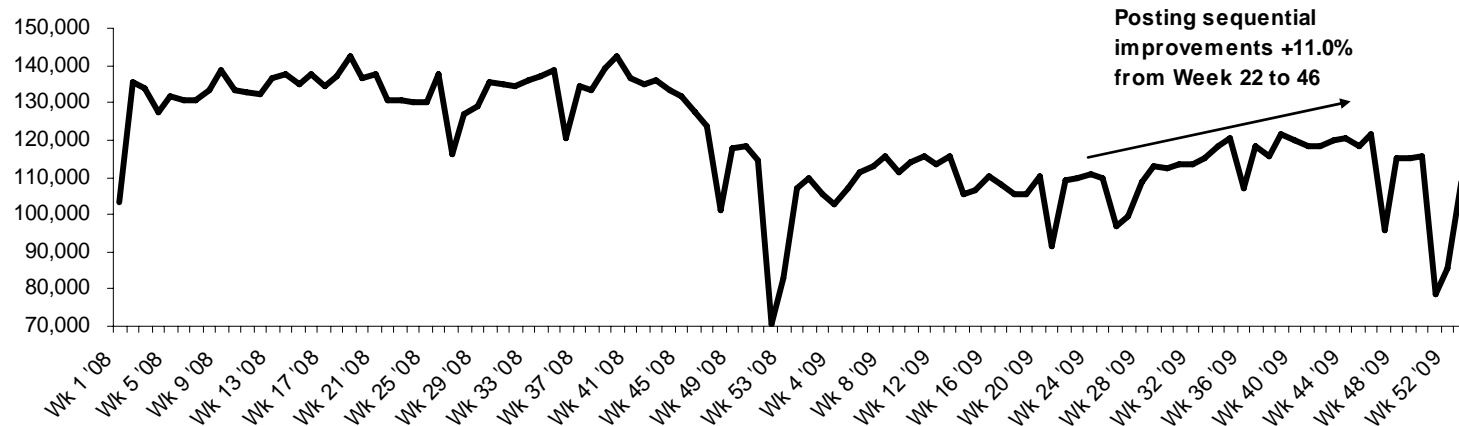


Source: American Association of Railroads

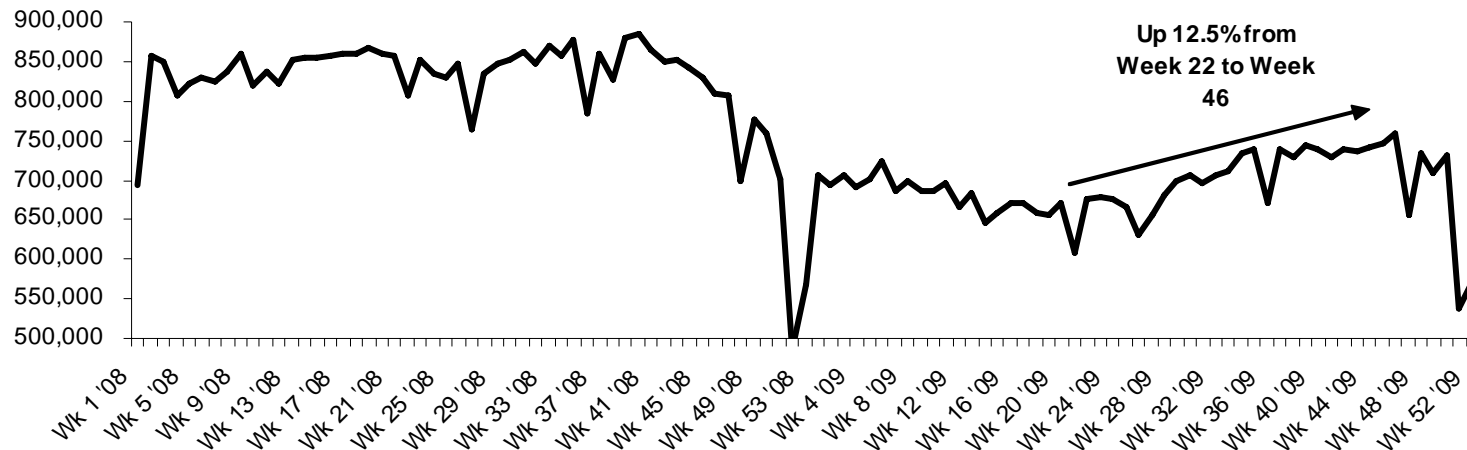
# Rail absolute trends look strong

- Rail volume improvement is widespread

**CSX**

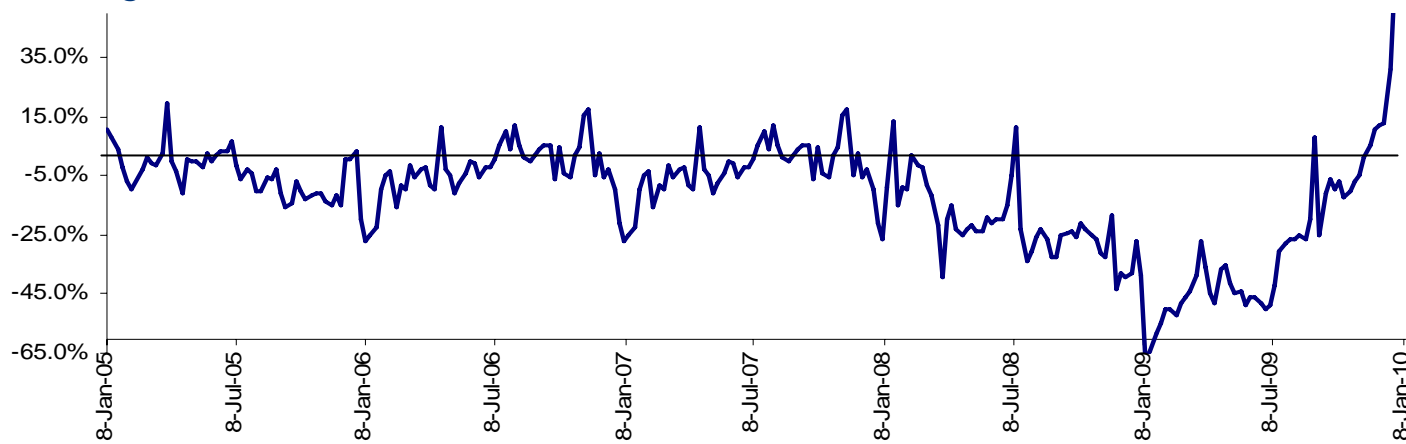


**Total**

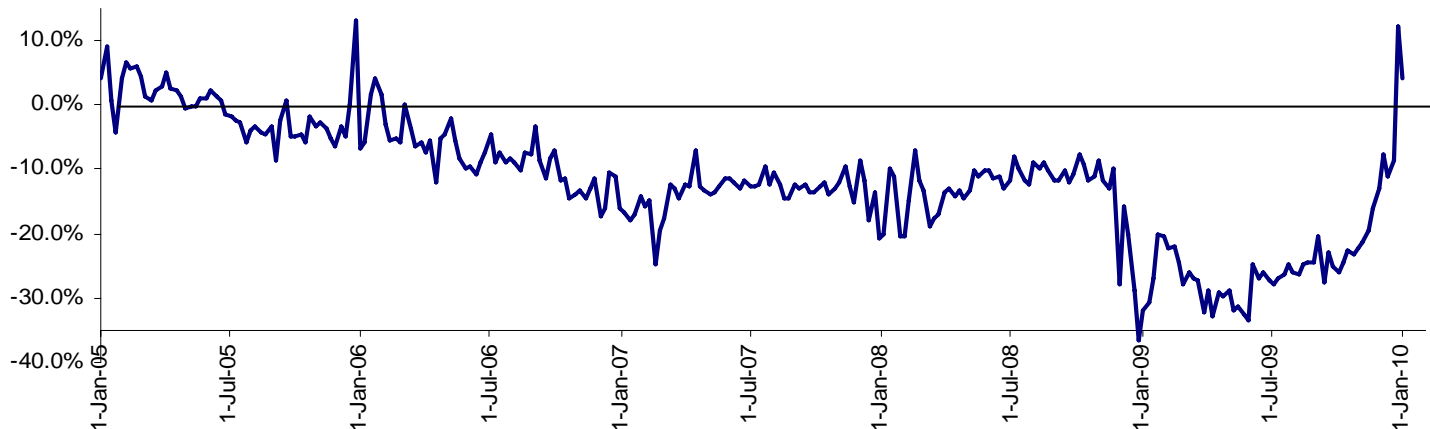


## Growth across commodities

- Autos post accelerating growth for 12 consecutive weeks, 8 of which are positive growth

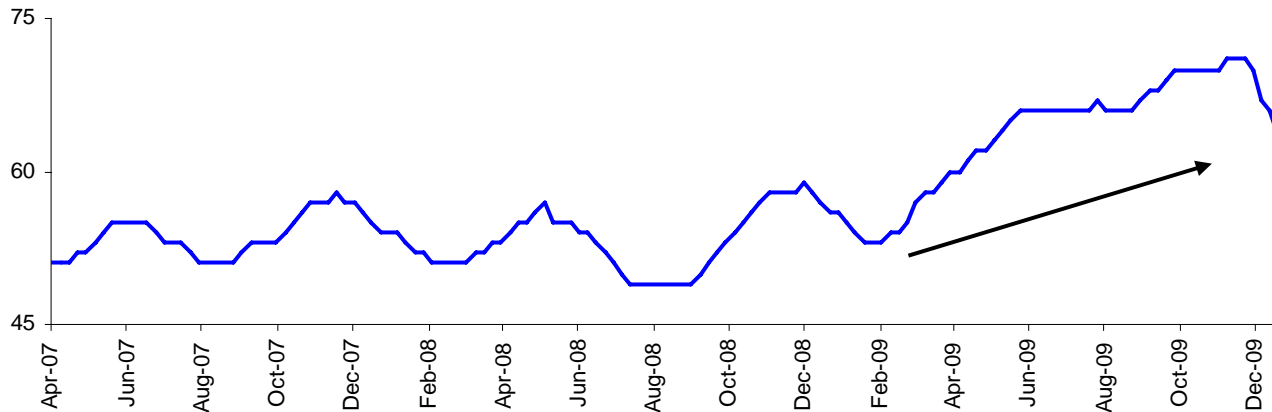
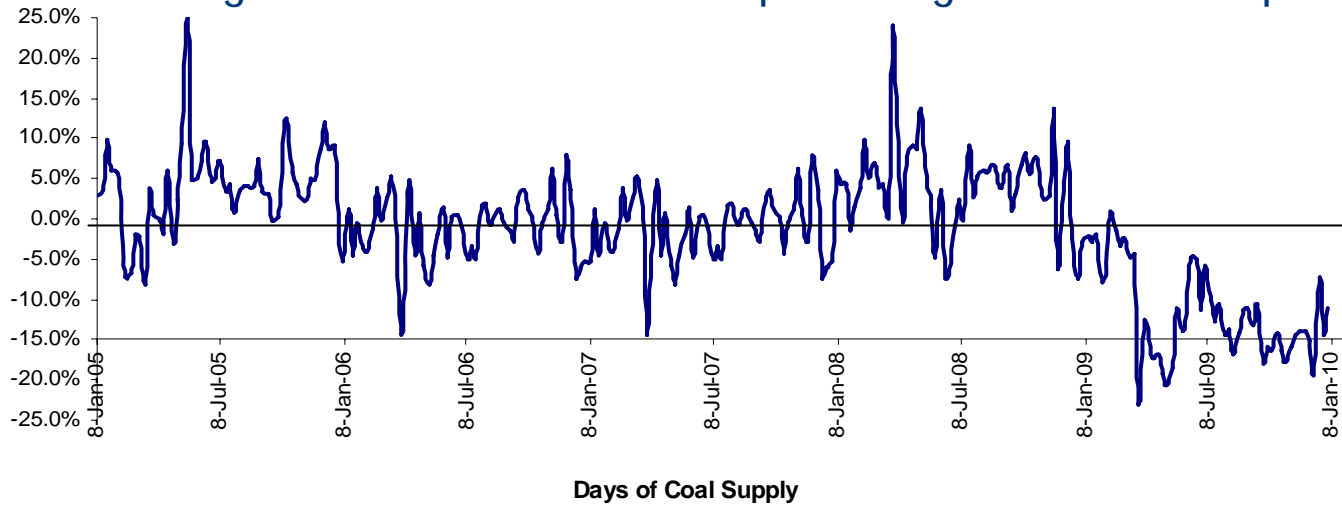


- Forest Products just ended 202 consecutive weeks of negative growth (since 4<sup>th</sup> week of 2006, now 2 consecutive upticks). Averaged -15% over 4 years.



# Growth across commodities

- Coal was a concern with record inventories
  - along comes needed cold snap and high Natural Gas prices



## Rails said we needed severe cold...

- Retail team likes to highlight cold weather/heating days.
- Not a meteorologist, but a skier. So just love the snow cover. Just left a Blizzard in VT with 18 inches.



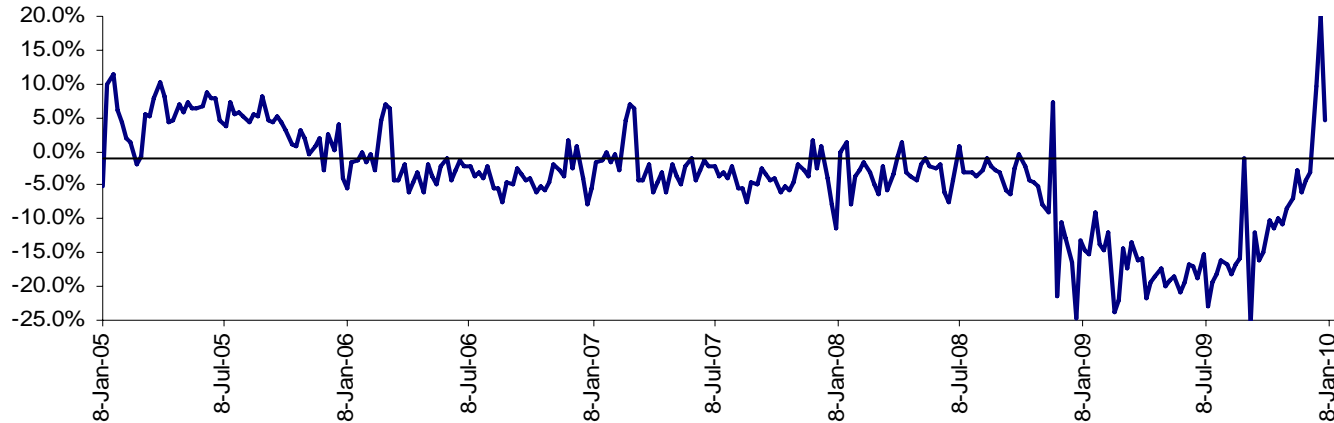
### WINTER WEATHER OUTLOOK

Regionally, the West will turn colder and stormier with very heavy snowfall for even the Southwest of the U.S. More heavy rain for Texas and the Southeast will bring more threats for flooding which is likely to become widespread and severe this Spring. The next nationwide cold snap is likely the front half of February through Valentine's Day and President's Day weekend which could also be quite snowy with the continued threat for East Coast snow storms.

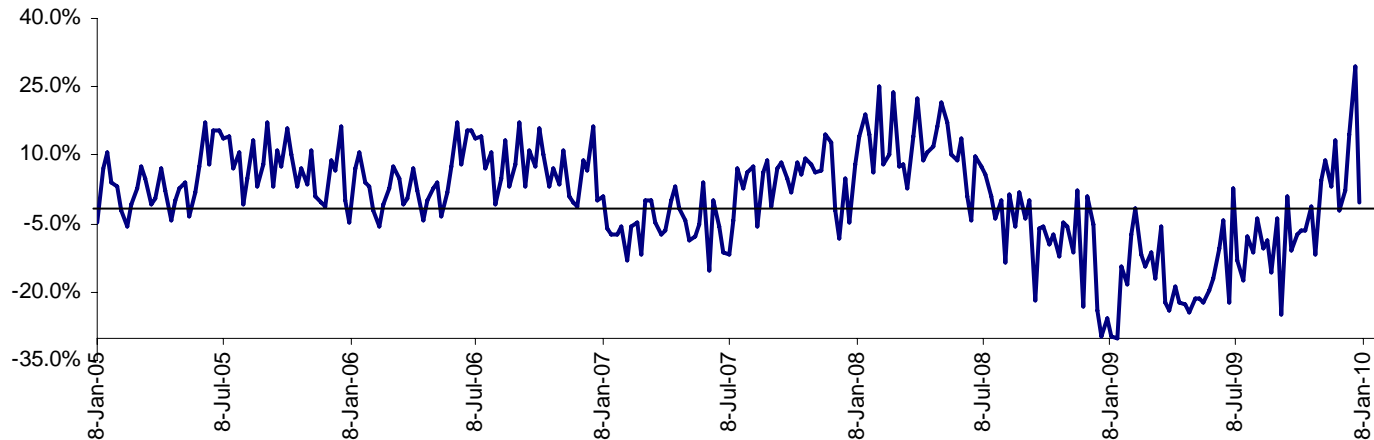
Source: Weather Trends International

# Growth across commodities

- Intermodal - containers posting growth



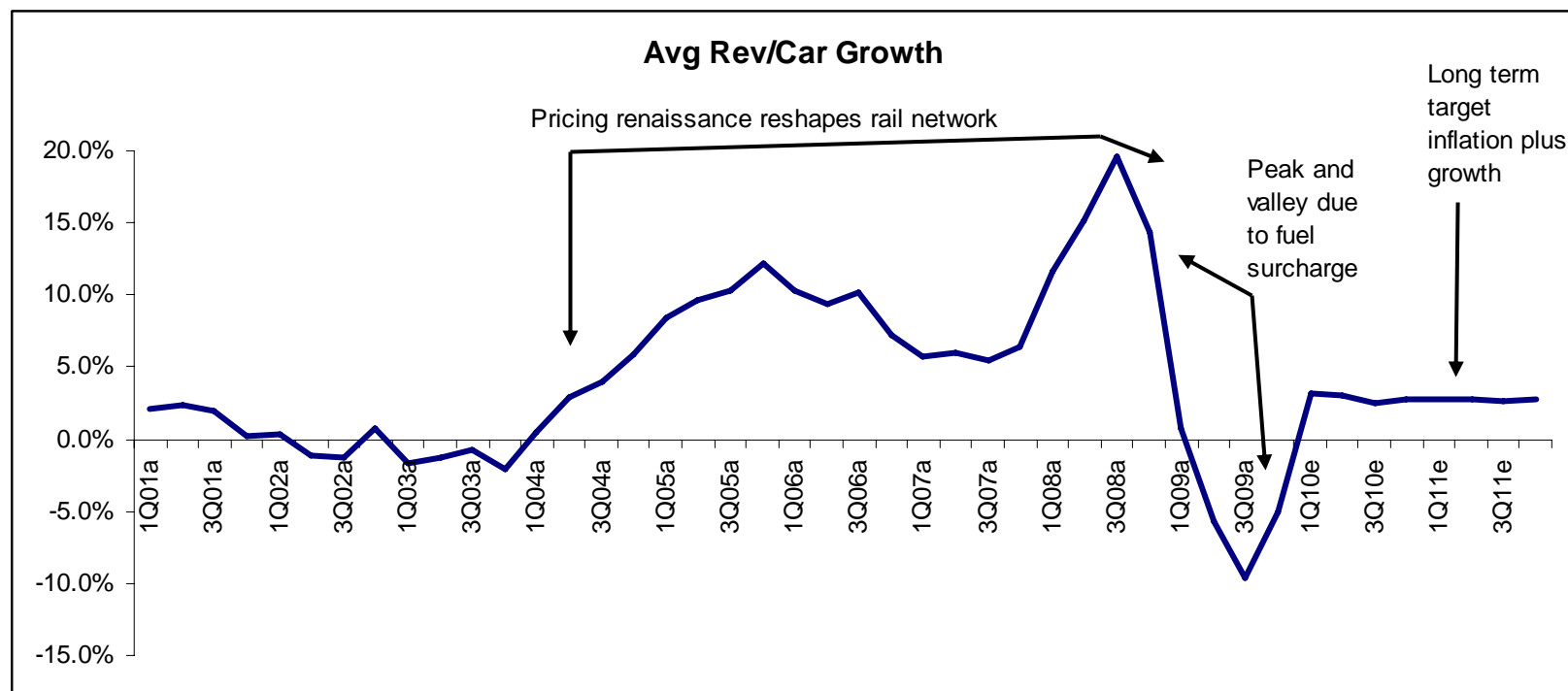
- Grain - still room to go with delayed harvest due to Fall rains



# Pricing renaissance moves into latter stages - "inflation plus"

- Pricing commentary

- Pricing renaissance that began in 2004 continues
- However, expect future pricing increases at rail cost inflation plus (+100-200 bps)
- Need to achieve proper returns in order to reinvest



# Rails proved to be more variable than anticipated

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- To soften the downturn, rails focused on reducing equipment
  - Parked >20% locomotives
  - Parked >20% cars (and returned leased cars and locomotives)
  - Furloughed employees
  
- Additionally, focused on structural cost potential
  - Closed yards (CSX hump yard in Buffalo, NY)
  - Enhanced operations (BNSF new operating yard plan)
  - Increased train lengths (CSX by 13%, KSU by 13%)
  - Posted improved service levels (near record velocity, dwell time)

## Pulled assets out quickly

- At peak, locomotives, cars, and employees were down 15%-30%
- Between 10%-35% of the parked equipment is back on line
- Still have assets to bring back on line - leading to incremental margin oppty

		Cars Stored	Locomotives Stored	Workers Furloughed
<b>BNI</b>	1Q09	43,000	900*	2,500
	2Q09			3,000
	3Q09	28,800	900	2,800
*200 were taken off lease ~4,000 locos active currently				
<b>CP</b>	1Q09	16,000	540	2,400
	3Q09	n/a	n/a	n/a
<b>CSX</b>	1Q09	30,000	500	2,400
	3Q09	26,100	640	1,600
<b>KSU</b>	1Q09	6,000	=36% of fleet	
		5,300	=26% of fleet	
<b>NSC</b>	Peak (May)	35,000	700	
	3Q09	22,000	380	
<b>UNP</b>	Peak	71,000	1,900	5,300
	3Q09	50,000	1,700	4,100

# Structural changes provides oppty

- Operational changes should provide incremental margin opportunity

## CSX moved quickly to park extra assets

**10/30/2009**

T&E Employees furloughed	1,562
<i>% of total</i>	14%
Locomotives stored	613
<i>% of total</i>	17%
Freight cars stored	24,170
<i>% of total</i>	30%

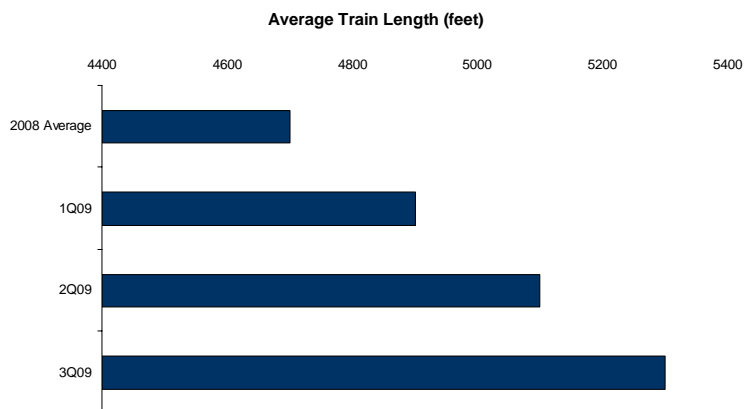
Source: CSX

## CSX productivity gains drive costs lower

		2008	2009	% Improvement
Short-term Variable Costs	- Fuel			
	- Car Hire			
	- Unit Train Crews	\$2,216	\$1,289	42%
Long-term Variable Costs	- Third Party Services			
	- Terminal Operations			
	- Scheduled Network Crews	1,659	1,416	15%
Fixed and Indirect Costs	- Yard and Local Crews			
	- Locomotives and Freight Cars			
	- Depreciation			
	- Track Maintenance	2,630	2,314	12%
	- Pension and Property Taxes			
	- General and Administrative			
	- Technology and Other			
<b>Total Operating Expenses</b>		<b>\$6,505</b>	<b>\$5,019</b>	<b>23%</b>

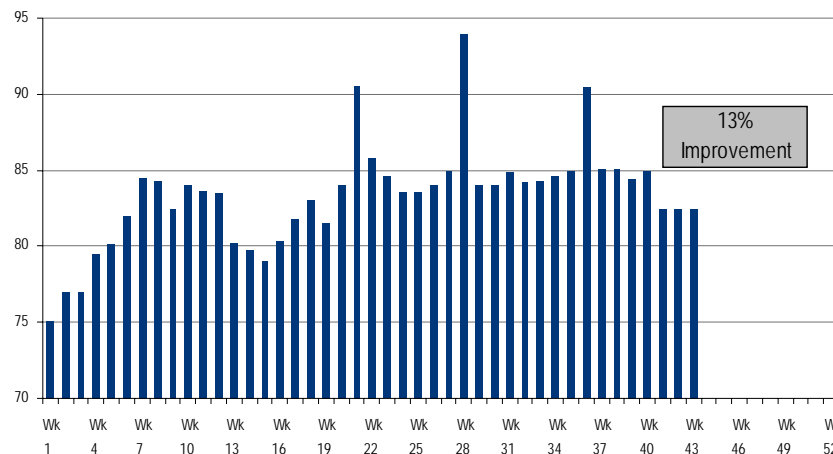
Source: CSX

## Kansas City Southern increases train lengths 13%



Source: Kansas City Southern

## CSX Merchandise Train Length improves 13%

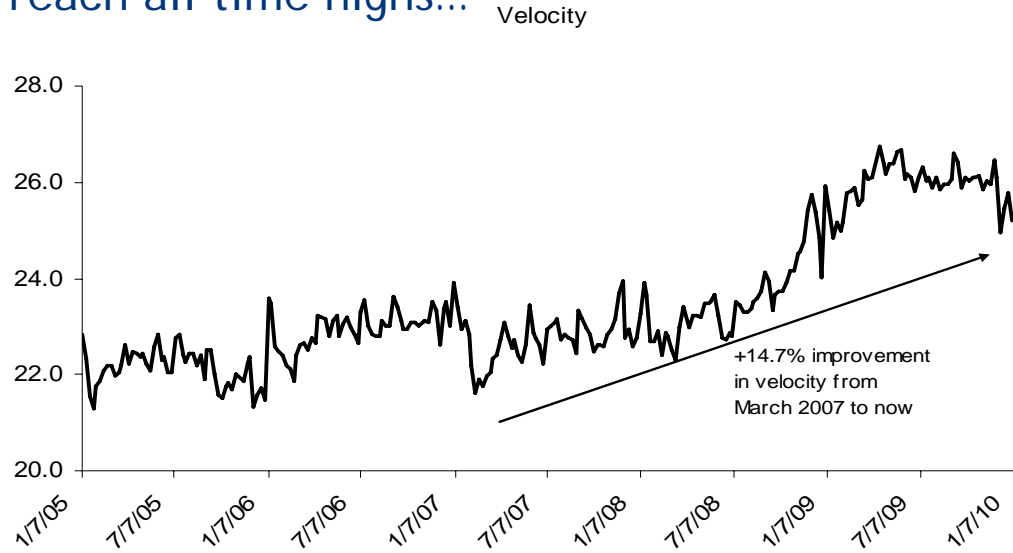


Source: CSX

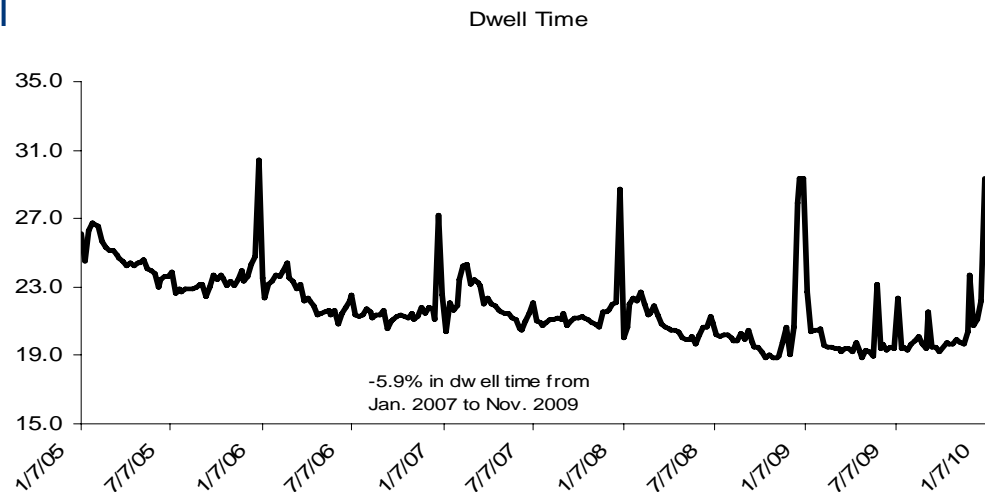
# Despite cost reductions, service levels still improve

- Service metrics reach all time highs...

- Velocity

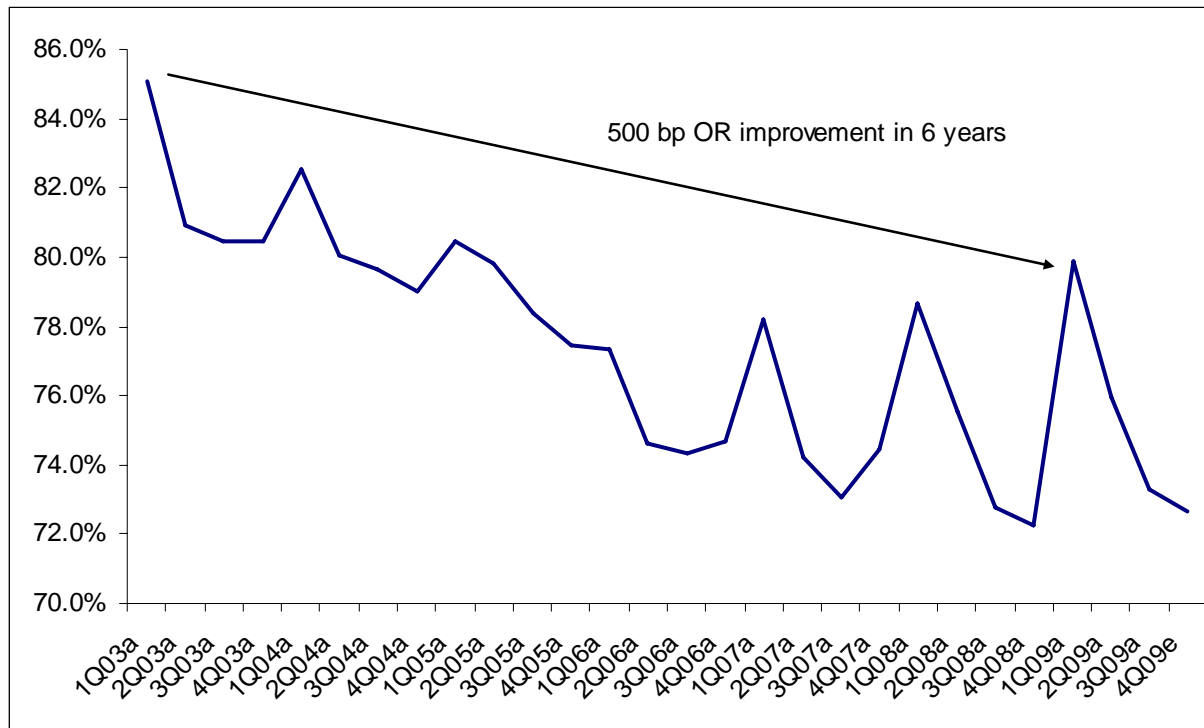


- Terminal dwell



# Rails proved to be more variable than anticipated - what is fixed?

- Past 6 years, rails have shown structural move to reduce costs and benefit from improved pricing environment
- Need to demonstrate that as volumes come back, they have structurally altered cost base - all eyes on this!

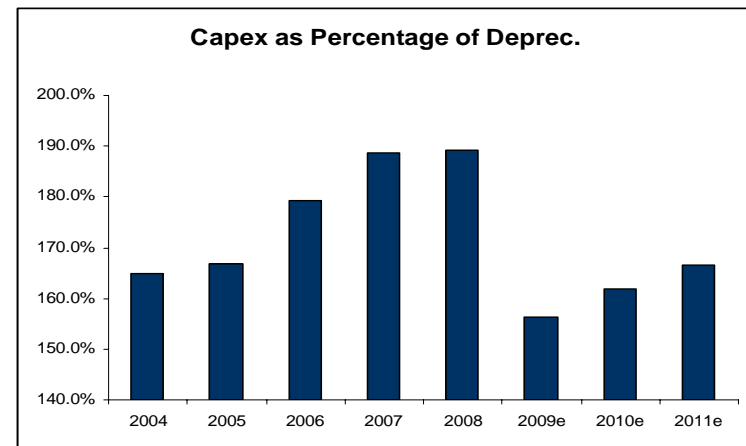
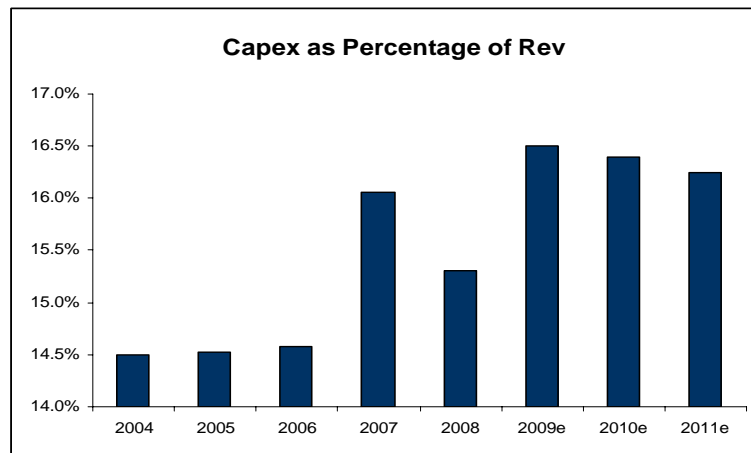
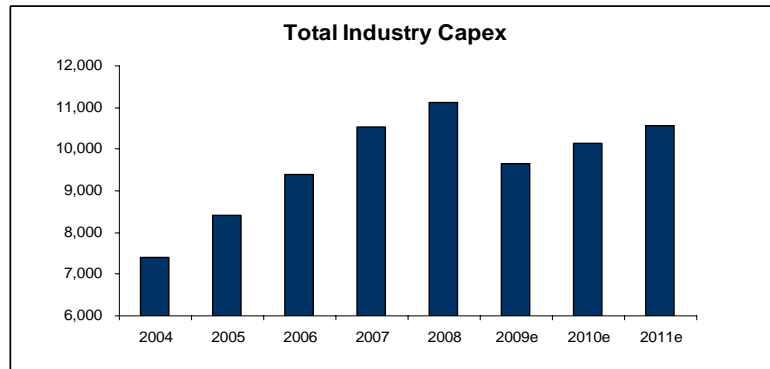


Source: BofA Merrill Lynch Global Research and company reports

# Capex still above maintenance levels

- Capex remains above maint levels and at a high historical level
  - Returns must stay solid, and continue to improve, for rails to keep spending

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009e</u>	<u>2010e</u>	<u>2011e</u>
Total Capex	7,418	8,414	9,377	10,532	11,125	9,666	10,155	10,559
y-y change		13.4%	11.4%	12.3%	5.6%	-13.1%	5.1%	4.0%

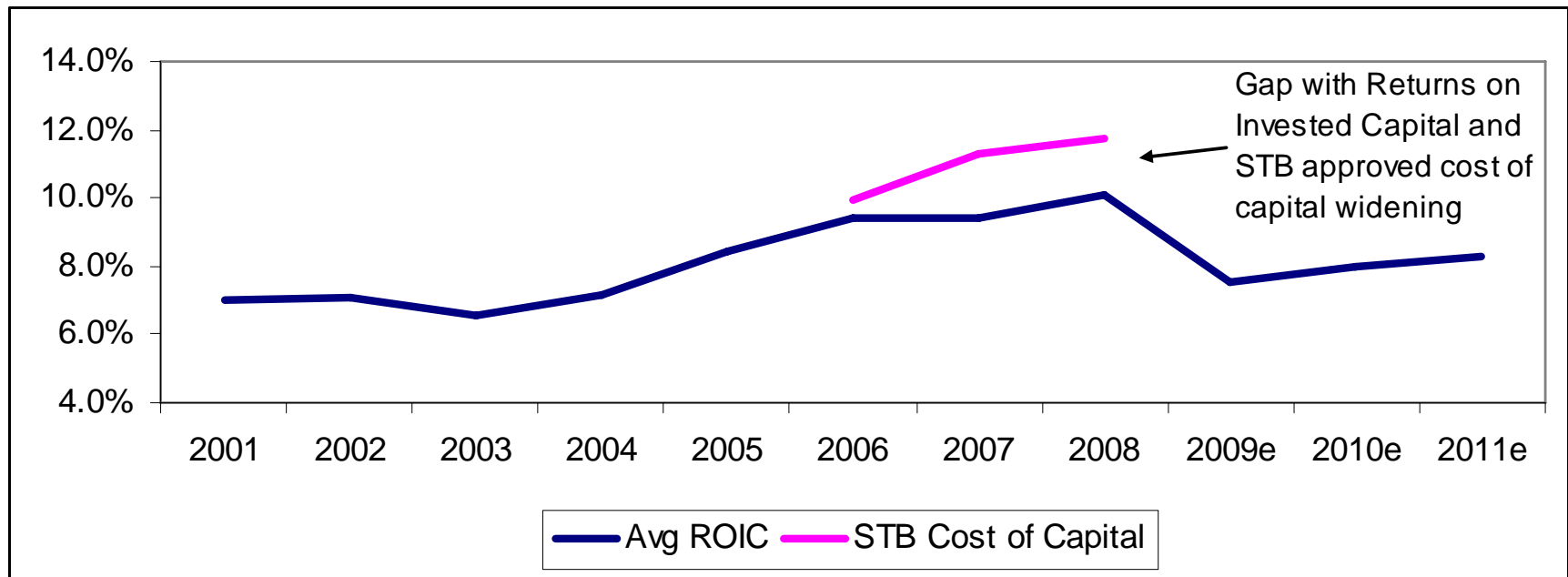


## Legislative overhang remains

- Surface Transportation Board Reauthorization Act of 2009 (S.2889)
  - 4 separate mentions of the need to ensure rails earn proper returns on embedded capital and potentially on replacement capital
  - Places burden on rails to prove rates are reasonable in some cases
  - Establishes bottleneck and terminal switching rates, eliminates paper barriers, and establishes arbitration for smaller shippers - each need details to determine impact
  - Adds
    - 2 new commissioners (shipper view)
    - Provision for STB to investigate without a complaint (more proactive)
    - Additional bureaucracy (ombudsman, customer advocate, 9<sup>th</sup> seat on rail-shipper transportation advisory council)
    - Mandatory studies (URCS, replacement cost, rail practices, rail car interchanges)
  - Will Anti-trust find its way in?
  - Out of Committee...will it see floor time?...and when will House T&I move forward?
    - Oberstar focused on highway reauthorization
  - Will ATA call for trucks to increase weights and break with rail agreement?

# Returns on invested capital below cost of capital levels

- Returns on invested capital - falling below cost of capital levels
  - Average ROIC has increased 300 bps to 10.1% over past 7 years
  - Returns expected to fall 250 bps in 2009
  - STB Cost of Capital was set at 11.75% for 2008, well above current 7% return avgs



Source: BofA Merrill Lynch Global Research, STB, and company reports



## Stock performance - out of downturns

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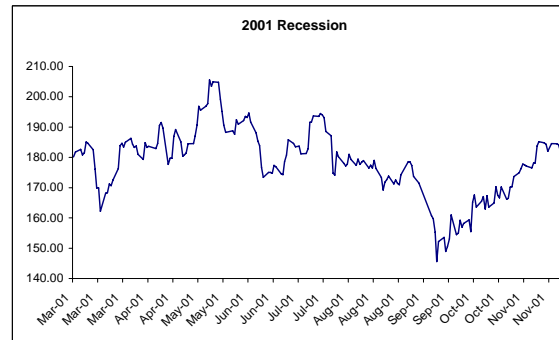
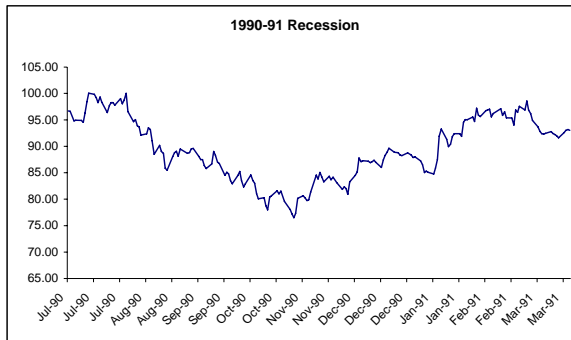
- Stock performance - recent, past outperformance, and ahead of turns
- Outperformed S&P 500 for 10 consecutive years
- Trading range remains within historical boundaries
- Early cycle investment

# Stock performance - out of downturns

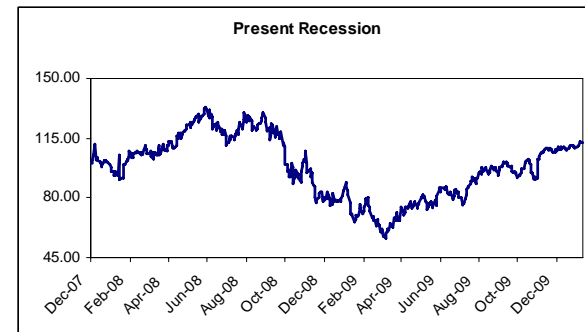
- Stock performance peak to trough leaves upside for rail stocks

1990-1991 Recession	Date	Index	% chg	Days
Peak	7/13/90	100.04		
Trough	11/1/90	77.32	-23%	111.00
Prior Peak	4/17/91	100.37	30%	167.00

2001 Recession	Date	Index	% chg	Days
Peak	5/16/01	205.53		
Trough	9/20/01	145.59	-29%	127.00
Prior Peak	3/4/02	206.70	42%	165.00

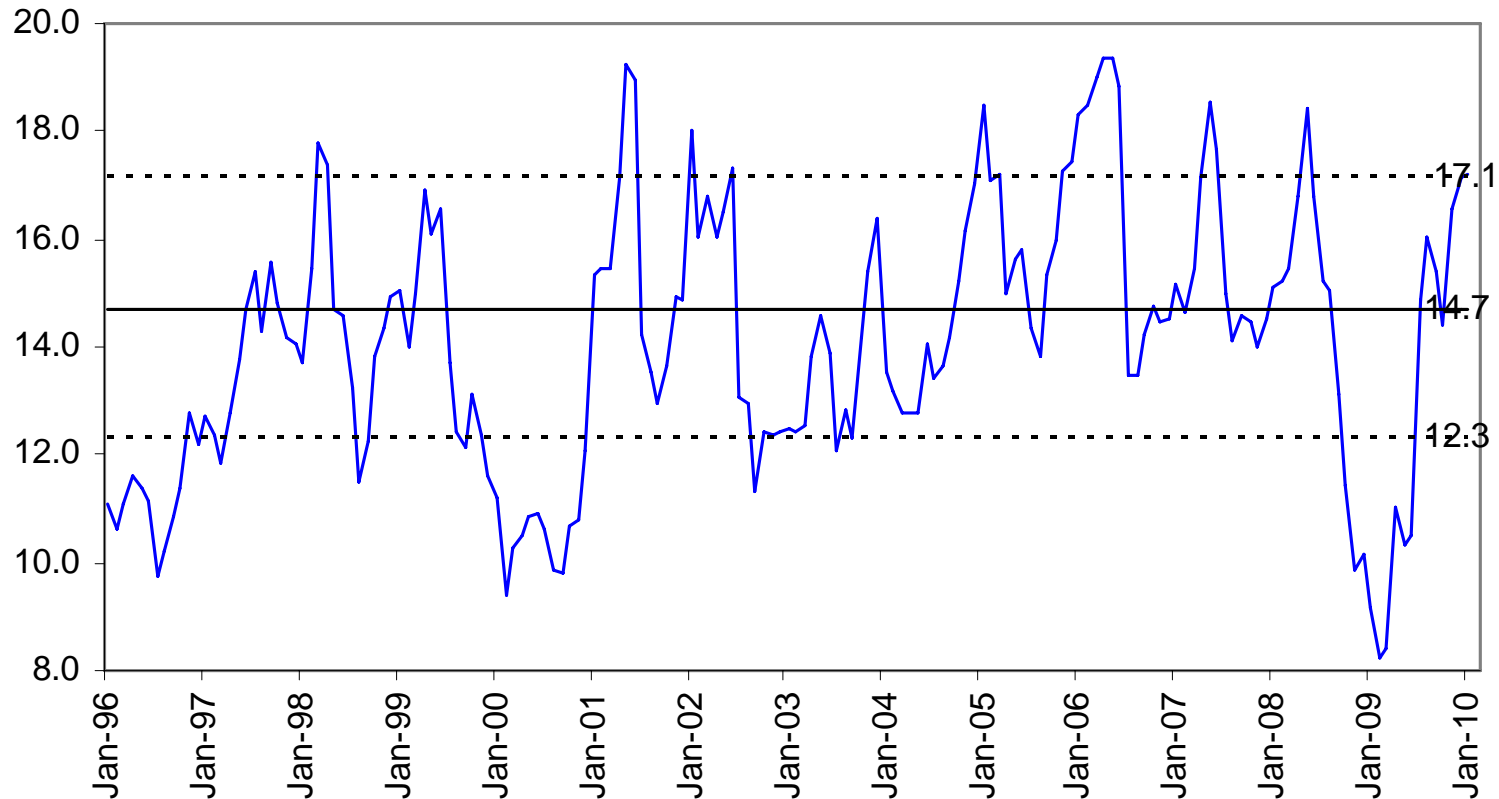


Dec. 2007 to Present	Date	Index	% chg	Days
Peak	5/30/08	133.17		
Trough	3/9/09	55.85	-58%	283.00
Prior Peak	1/11/10	112.68	102%	308.00
*Upside still left to match peak		-16%		



# Stock performance - out of downturns

- Rails remain within one standard deviation of historical forward P/E avg



# Analyst Certification

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I, Ken Hoexter, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

## Important Disclosures

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# Important Disclosures

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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