

Rail Renaissance: Returns, Capital & Capacity

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NEARS/Fall

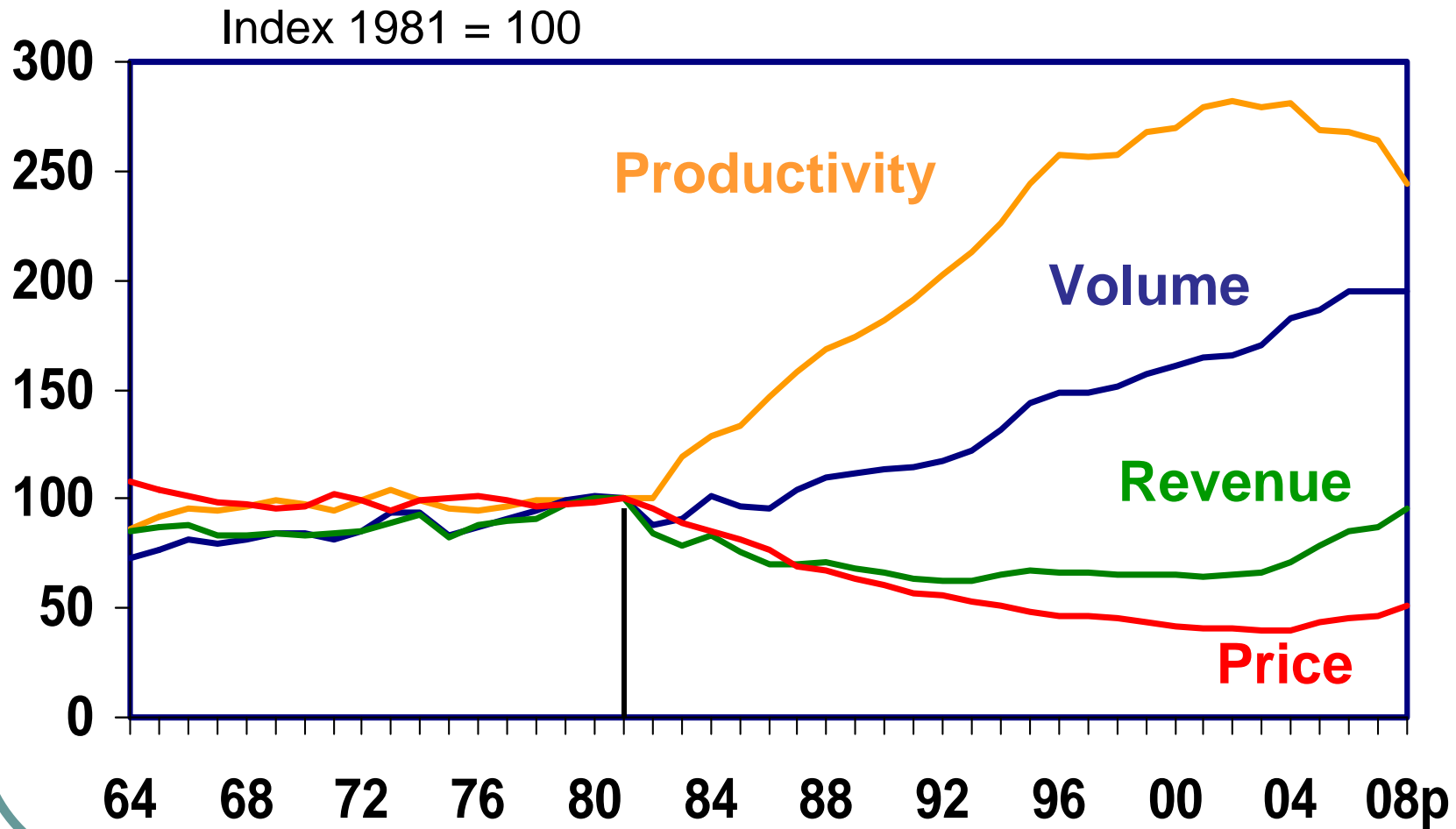
October 21 2009::

Railroads at historic tipping point

- The *Railroad Renaissance* is here – *will it last?*
- Capacity issues across all modes – *or so we thought?*
- Volume increasing – *right?*
- Share, rates, service levels (yes) – and returns increasing
- ***But pushback (shipper/regulator/union) also increasing!***
- A *secular*, not a cyclical story – *right?*
- Capacity and infrastructure – and competitor - issues remain
- ***Fully reflected in the market? Or is this just another cyclical slowdown?***
- ***NET/NET-***
- ***The industry is poised to go up – or down – based on decisions made here & now***

Railroad Performance

Class I Railroads



Source: *Railroad Facts*, AAR (Based on a design by R. Gallamore)

Street influence on RRs – and Why that affects ALL stakeholders

- **Battle for cash**
- **Management's reactions to pressures**
- **Investors, competitors, regulators, politicians, labor – oh, yes, and customers**
- **Short term decisions/long term consequences**
- ***Remember 2004! (?)***
- **Which “bucket” will they place their chips?**

Simple Math

- Rates
- Returns
- Capital Expenditures
- Capacity
- Service

ARE ALL CONNECTED!

Virtuous Circle ('03-07) or Disinvestment?

Key Class1 Issues in Recession '09

- Re-regulation Bigger Threat than Ever
- Rates (versus Volumes)
- The Economy
- Service
- Green Ramifications
- Stimulus, MAP21, ATRK, “High” Speed Rail (ONERail)

New Sources of Capital – Threat or Opportunity?

- **Fortress-RailAmerica/FEC (etc)**
- **Infrastructure Funds (Toll Roads)**
- **Hedge Funds & “Activists” (TCI)**
- **PPPs – Heartland, Nat’l Gateway, CREATE**
- **Share repos**
- **C-1 Buyouts (DM&E)**
- **JVs – Meridian, Patriot corridors**

Threats to the Renaissance

- **Cyclical vs. secular argument**
- **New Congress –impacting labor & shippers**
- **Mandated Reviews – STB, Canada**
- **Rereg – the MAD answer**
- **Execution: service**
- **Execution: merger**
- **Hedge funds?**
- **Liquidity?**

North – or South – of the Border

- Canada as the new model for rail regulation?
- NAFTA review?
- The “J” (& The MidAmerican, etc)
- Auto Restructuring
- Customs/Border issues
- Detroit tunnel?
- Rebirth of passenger rail?
- RR Dayss on the Hills

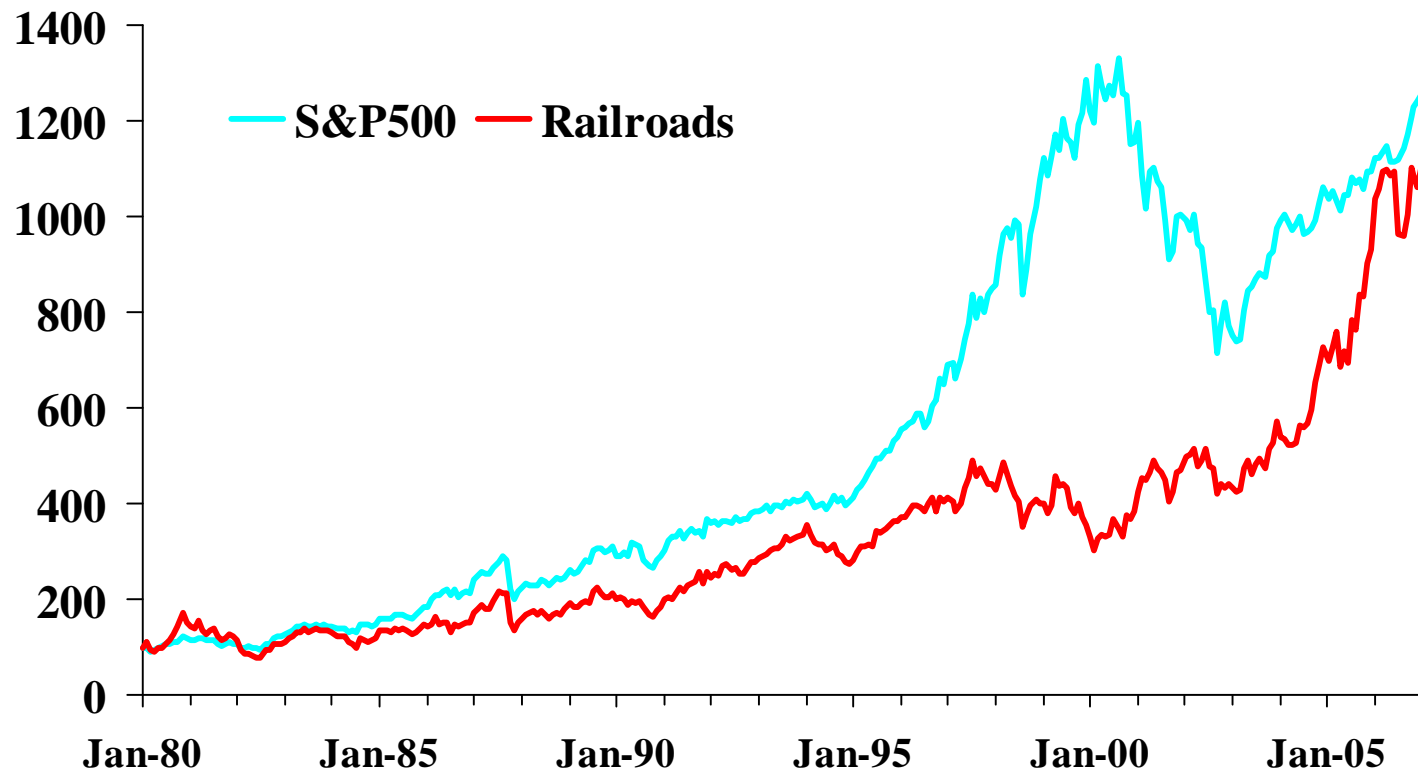
Cyclicalality – Rails & Suppliers

- What happened to the “end of the cycle”?
- Thinking strategically vs. tactically?
- Panic Mode?
- Passenger the new lead dog?

S&P 500 and Railroads

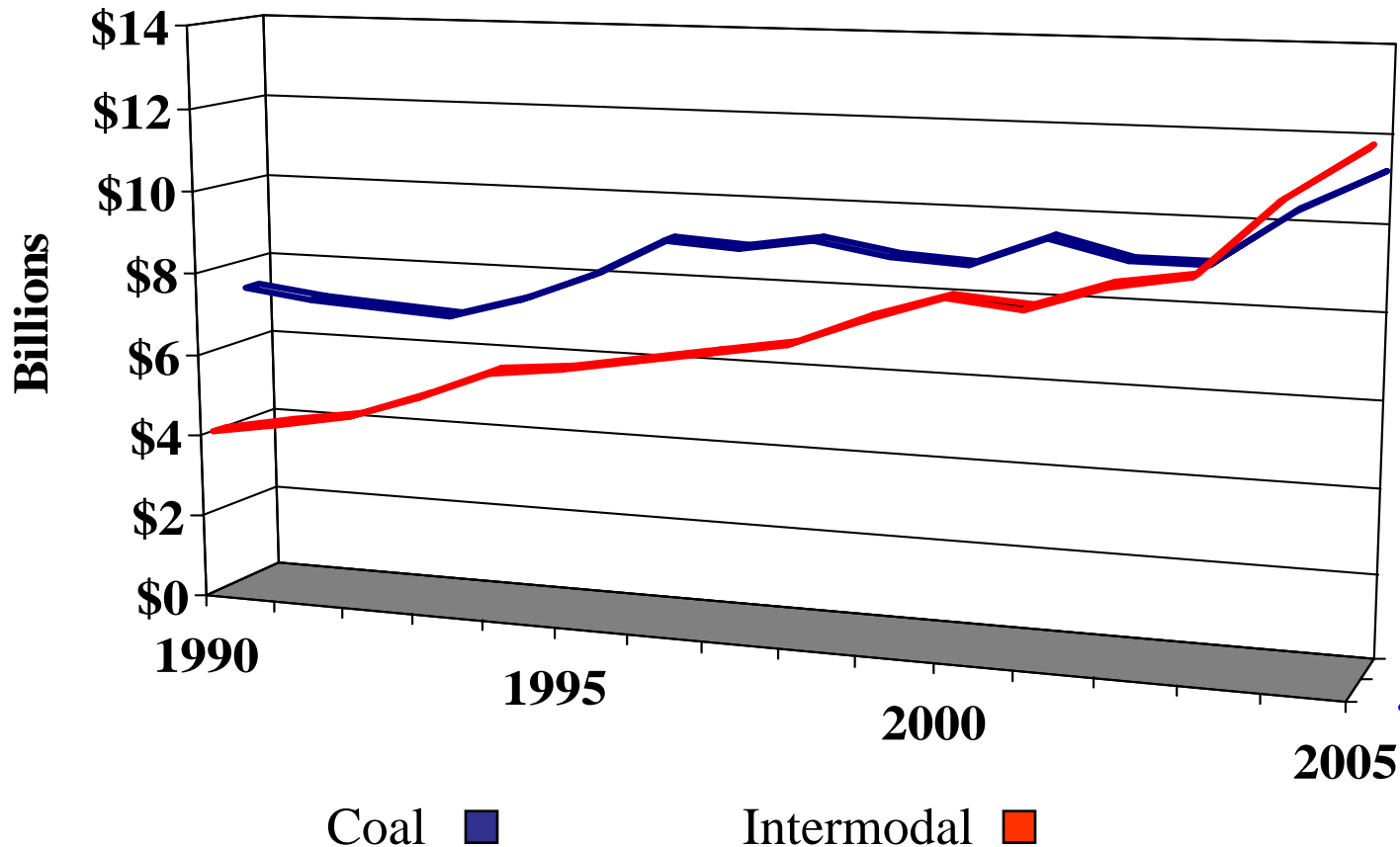
Monthly Data January 1980 – April 2007

Index Jan. 1980 = 100



Sources: MSN and CSI, Inc.

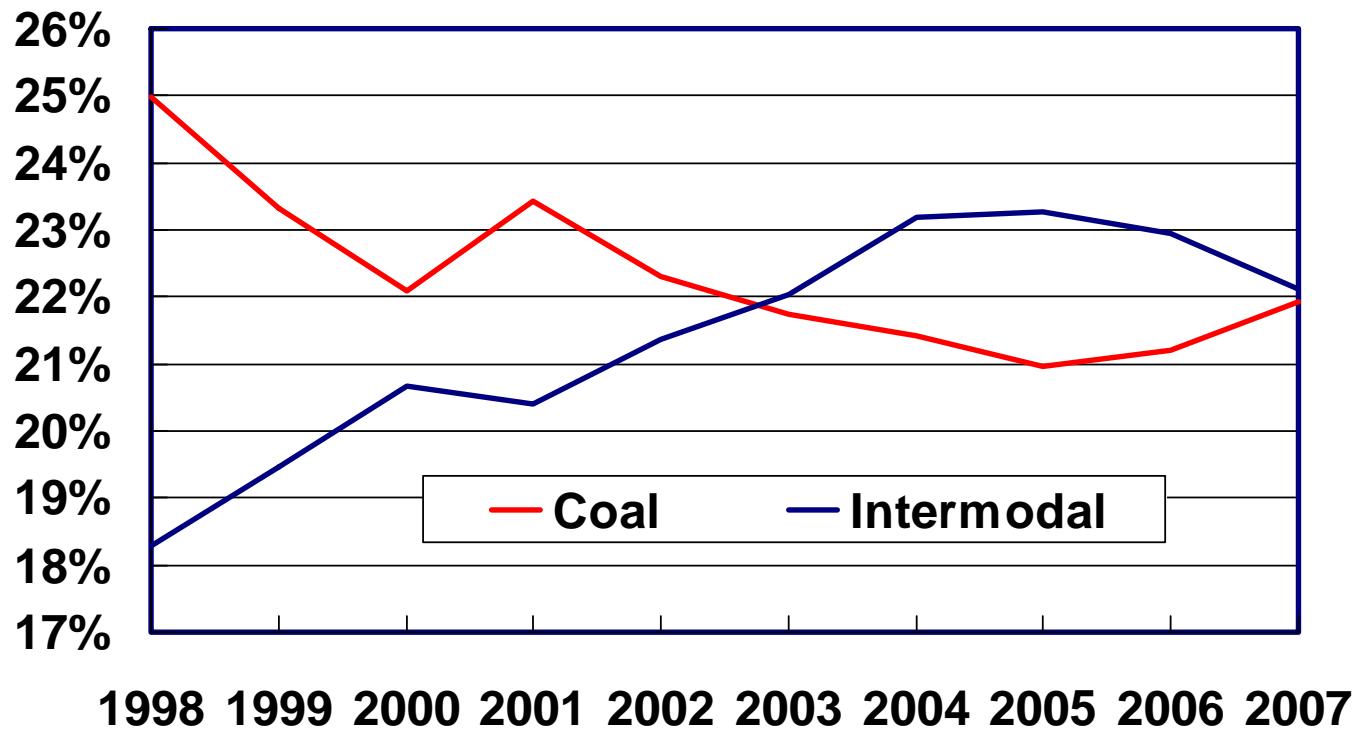
Railroad Intermodal Revenue Growth Over 5% - Long Live the New King!



Source: Carload Waybill Statistics (includes non-Class I railroads)

Intermodal was the Top Source of U.S. Freight Rail Revenue, but Coal will be Number 1 in 2008

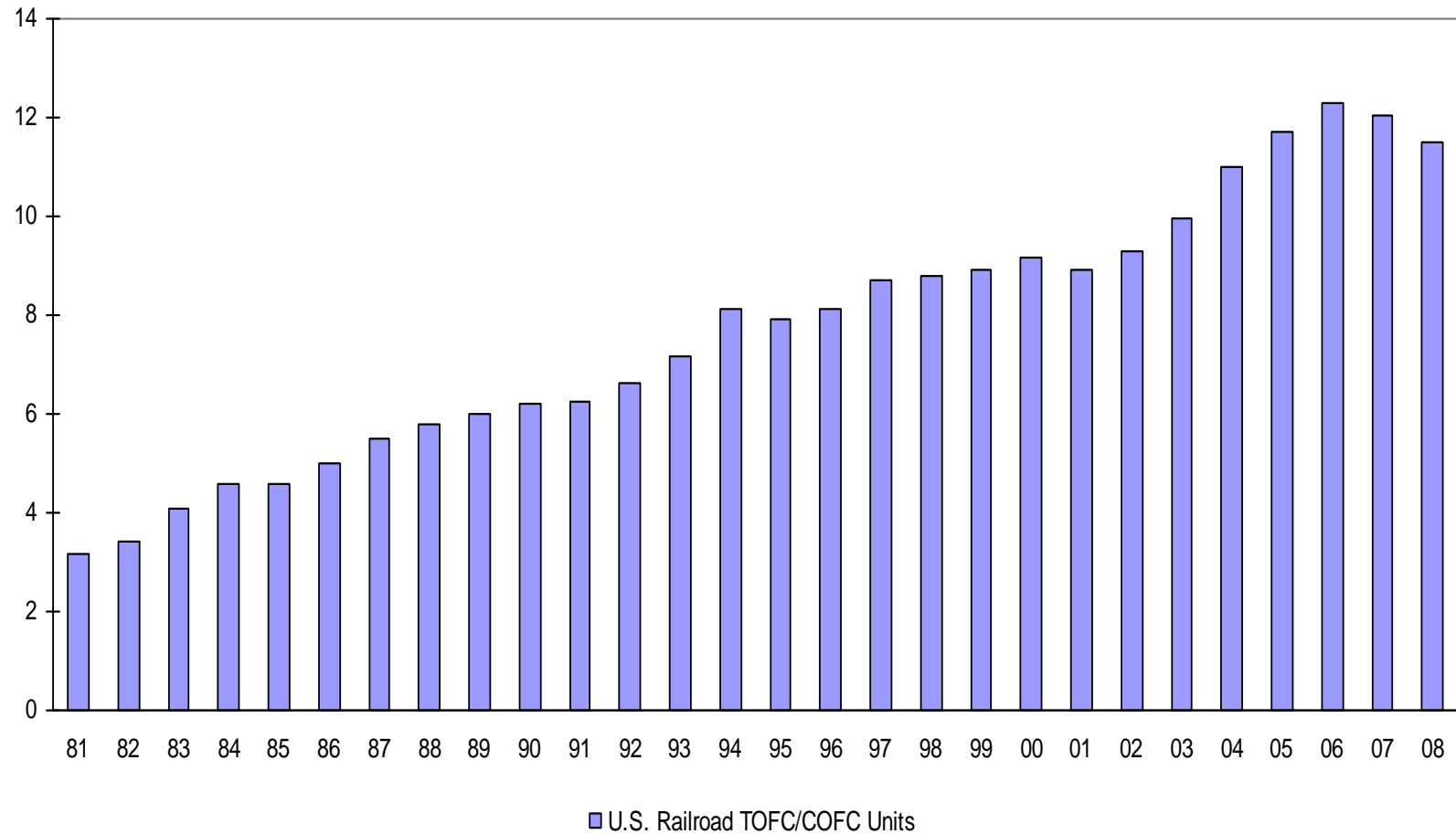
*Intermodal and Coal as a % of Revenue**



*Data for BNSF, CSX, KCS, NS, and UP Source: Railroad financial reports

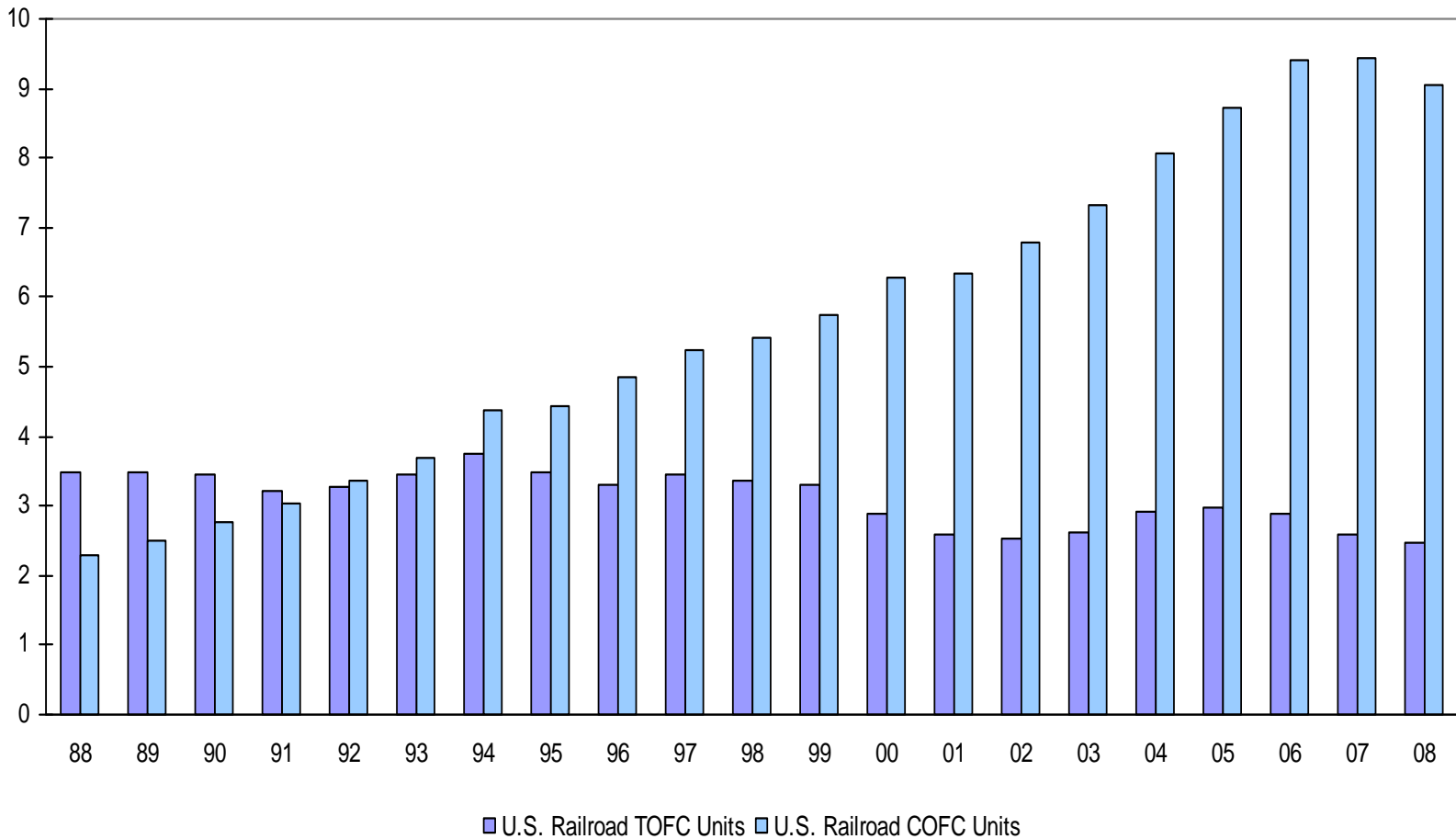
U.S. Railroad Intermodal Traffic

(millions)



Source: Association of American Railroads' *Weekly Railroad Traffic*

U.S. Railroad Intermodal Traffic Trailers vs. Containers (millions)



Source: Association of American Railroads' *Railroad Facts*

Intermodal Growth Drivers

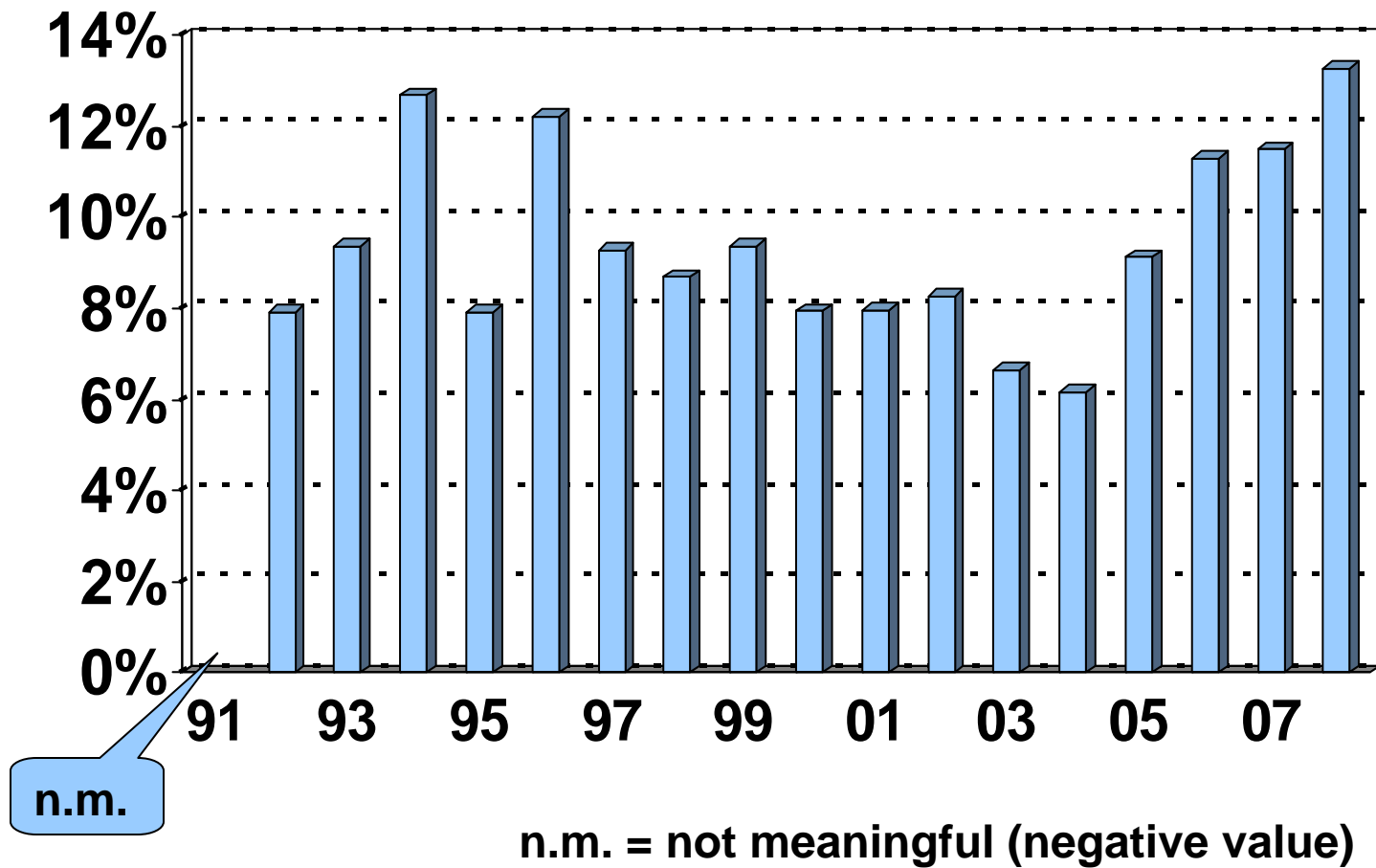
Domestic *and* International

- **Globalization**
- **Trade**
- **Railroad Cost Advantages**
- **Share Recovery From Highway**
- **Truckload Issues**



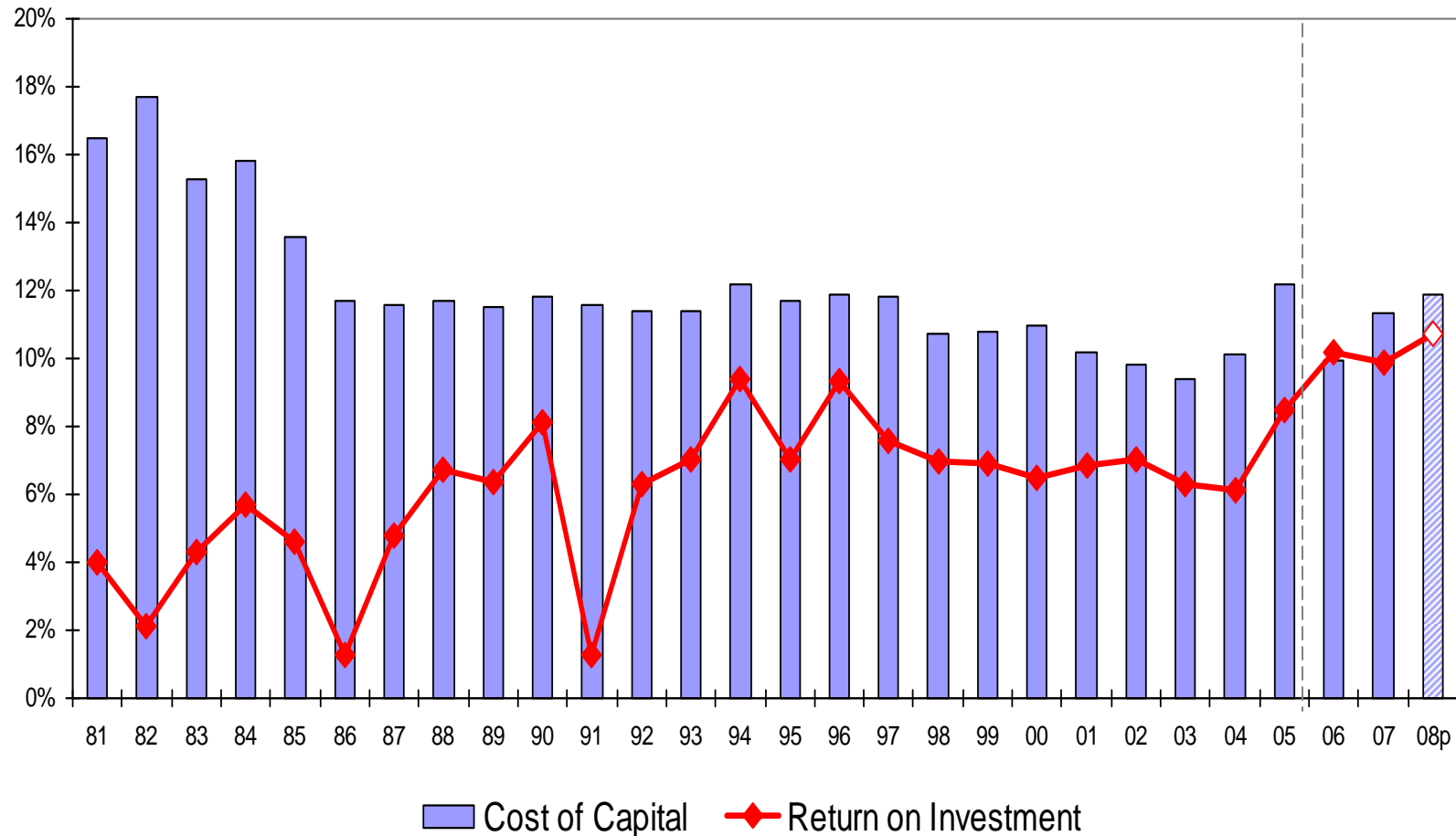
Railroad Return on Equity

Class I Railroads



Source: *Railroad Facts*, AAR

RR CoC vs. ROIC – RR Stocks have done well but... they still trade at a discount to all stocks

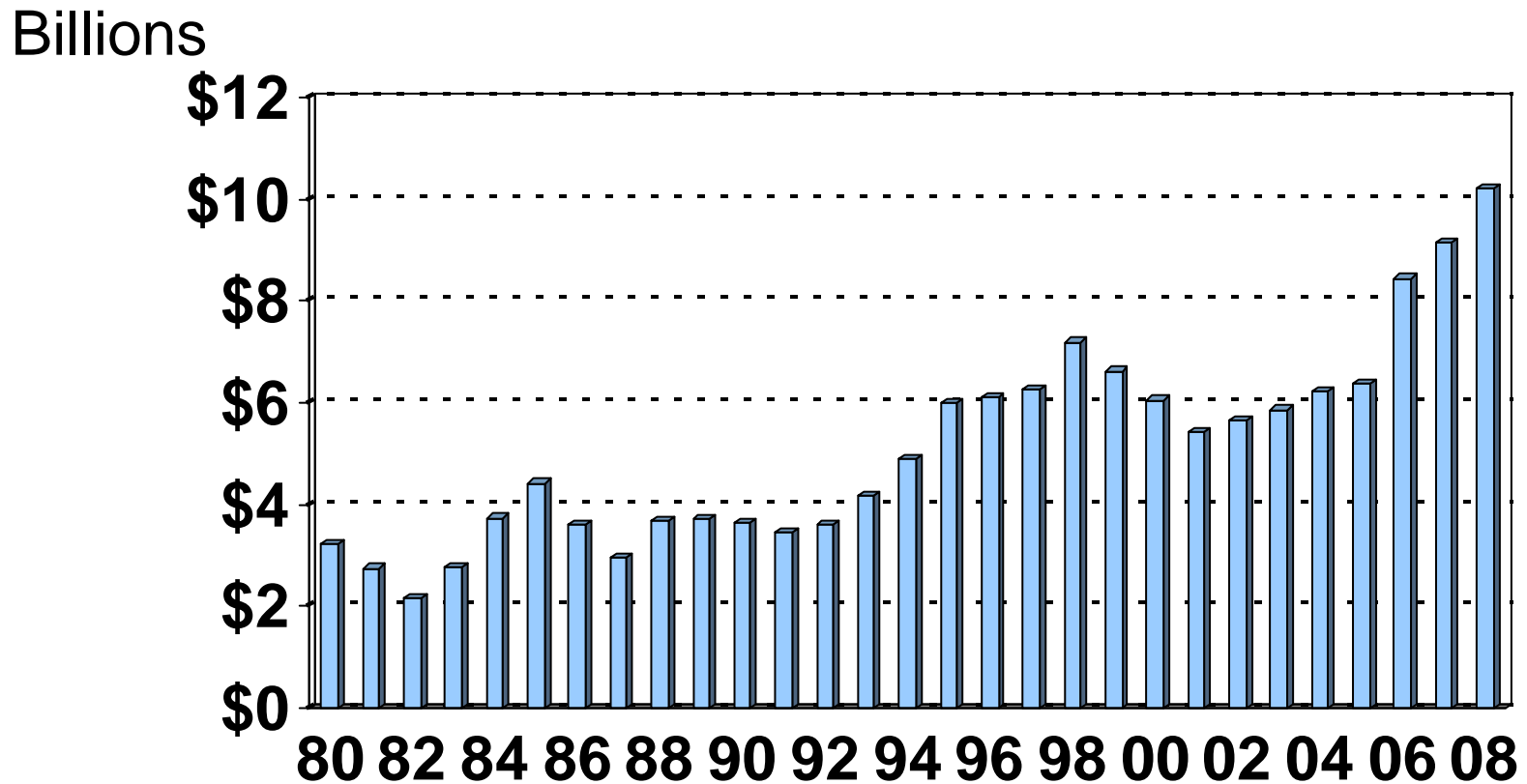


Source: Surface Transportation Board

Note: Cost of equity estimation method changed by Board effective 2006 and 2008.

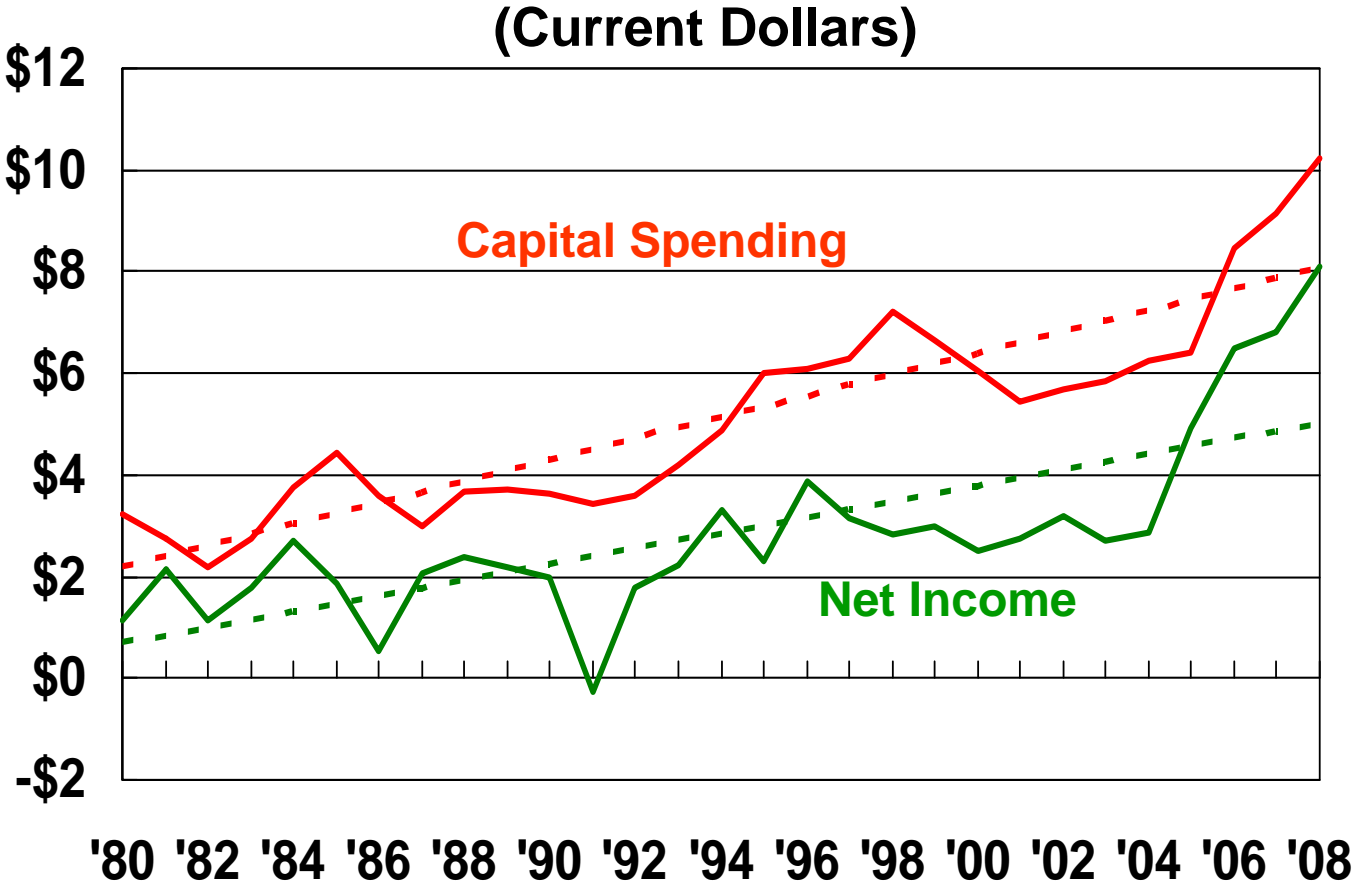
Railroad Capital Expenditures

Class I Railroads



Source: *Railroad Facts*, AAR

Class I Railroad Capital Spending vs. Net Income



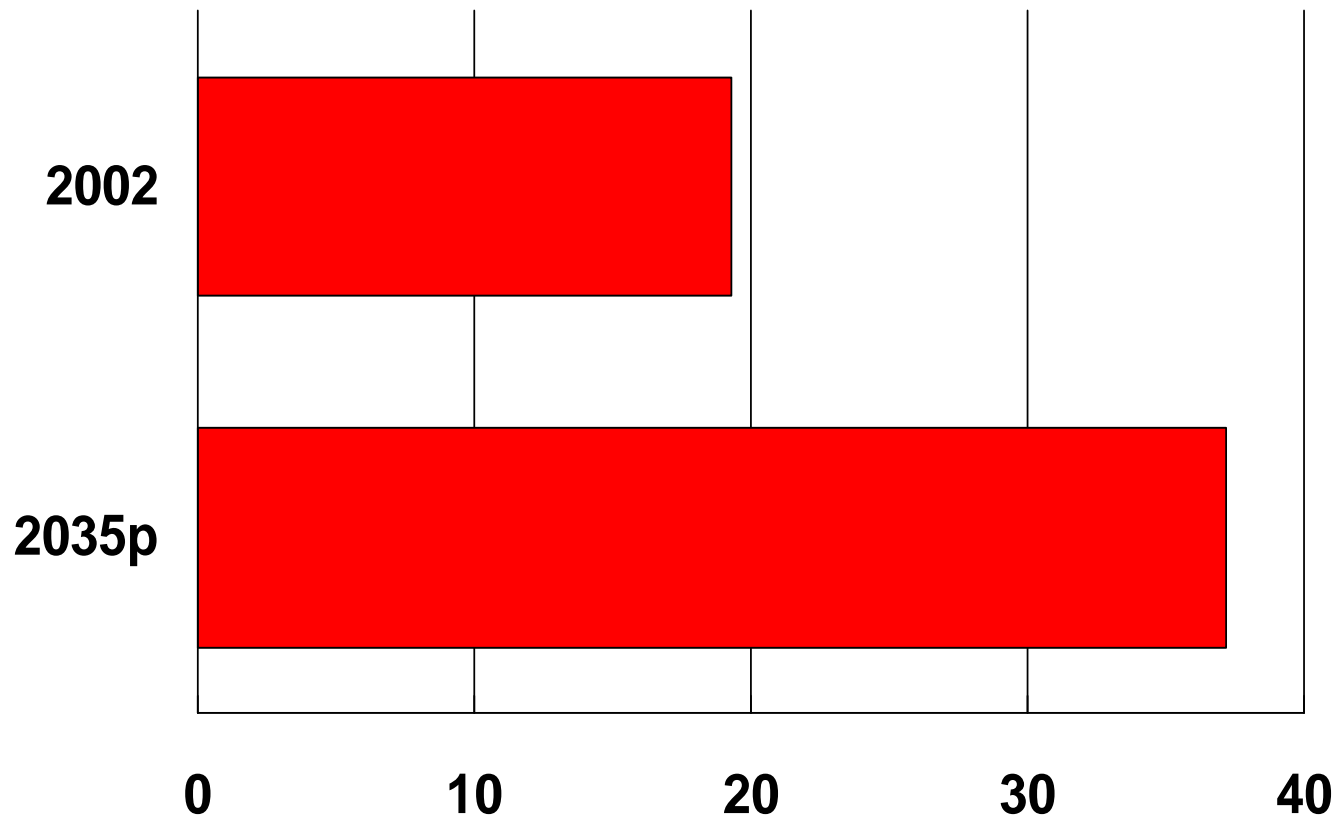
Source: Association of American Railroads

RRs and Investment

- Is growth affordable? Capex up 10% in '07, up 12% in '08, ***so far only down 5-10% for 2009F***
- One rail cuts, most increase capex *during '07*
- **What will 2010 look like? (long term growth v short term weakness)**
- Is additional capacity necessary? Desirable?
- Can the intermodal model extend to carload?
- Wall Street's constrictive role ("fighting the last war") – is it *changing*?
- ***Is this disconnect between the Renaissance and the Street the opportunity of a lifetime?***

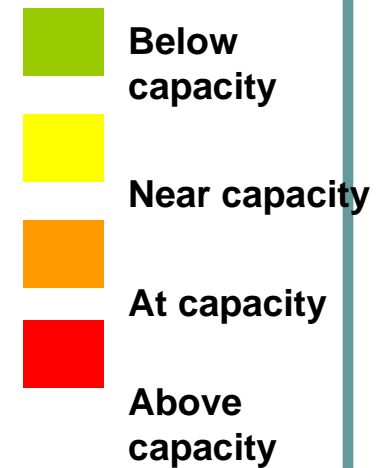
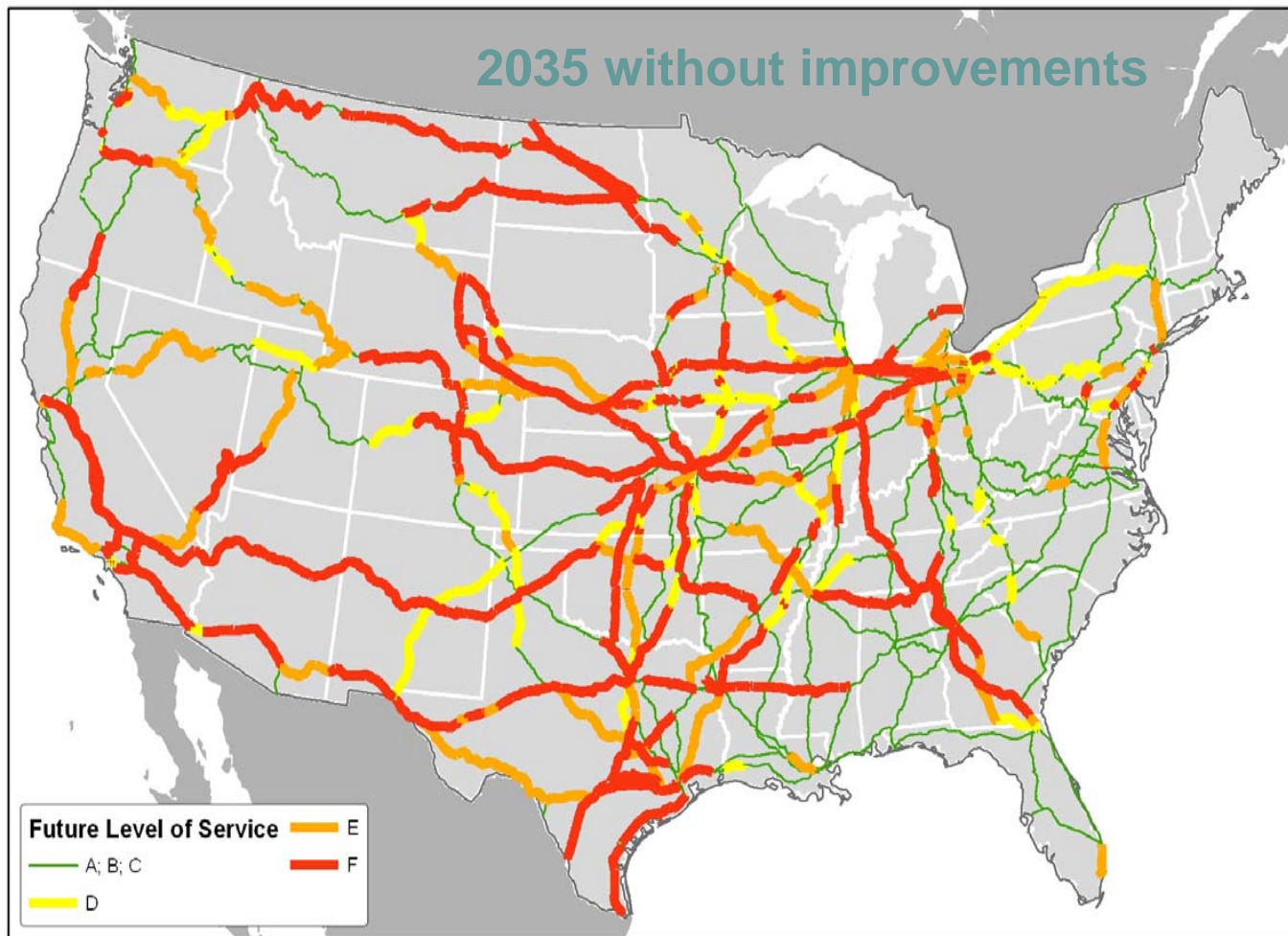
Future Demand for Freight Transportation Will Continue to Grow

Billions of Tons of Freight Transported in the U.S.



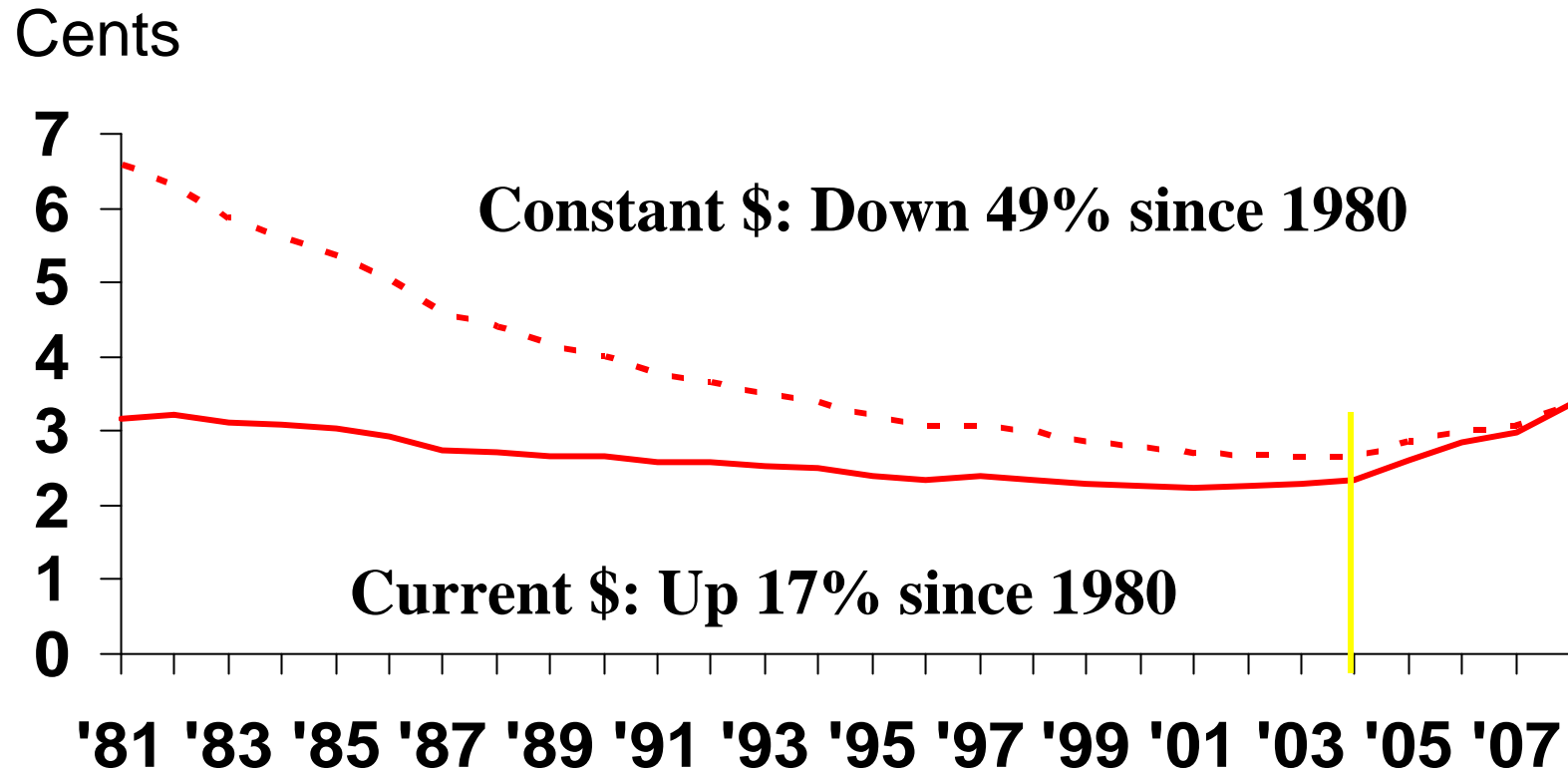
p – U.S. DOT projection

Future Corridor Volumes Compared to Current Corridor Capacity



Railroad Rates- the old story

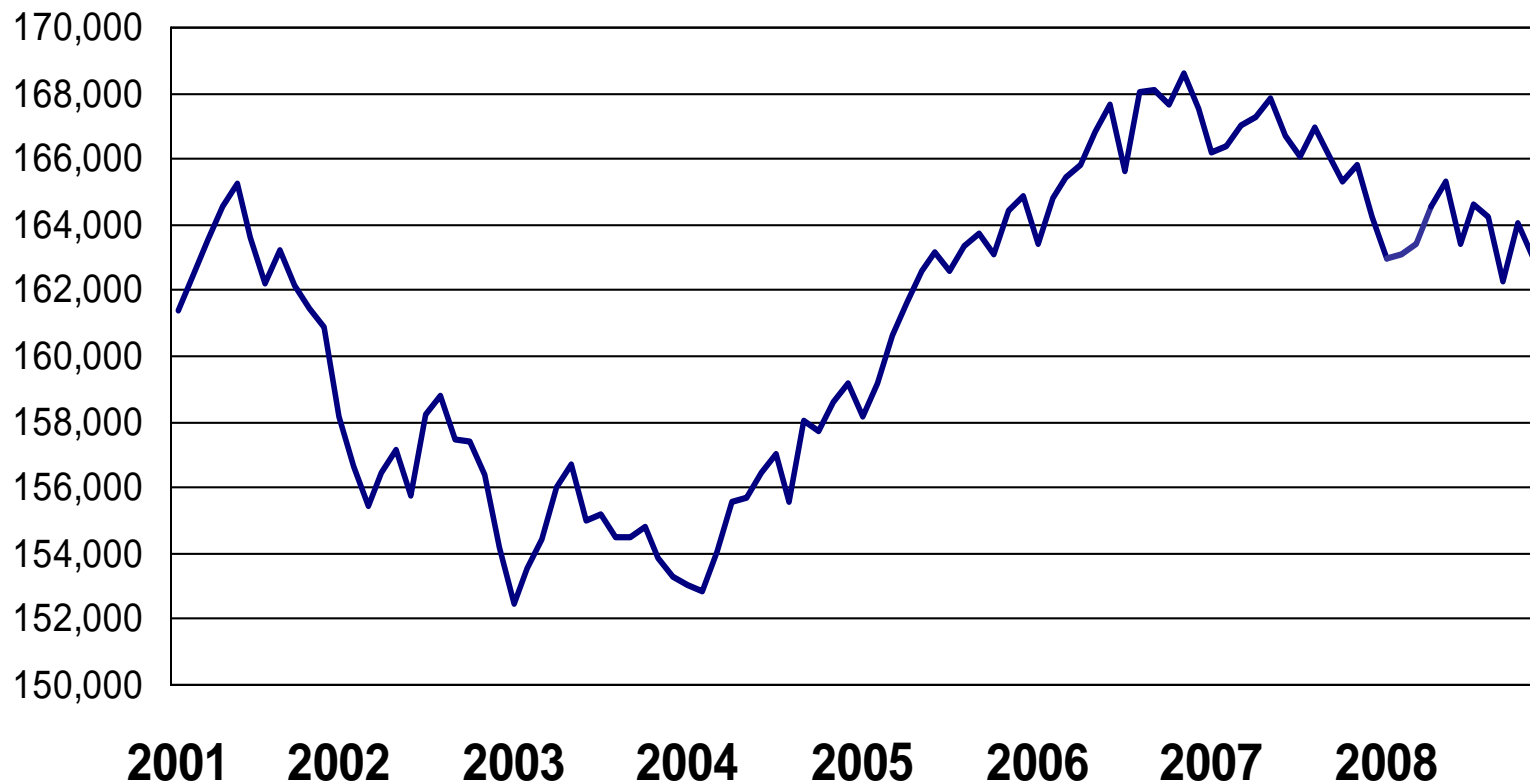
Class I Railroads, Revenue Per Ton-Mile – *another (related) New Paradigm*



Source: *Railroad Facts*, AAR

Rail Employment is Up for the First Time in Decades

Total Class I Employment: Jan. 2001-Nov. 2008

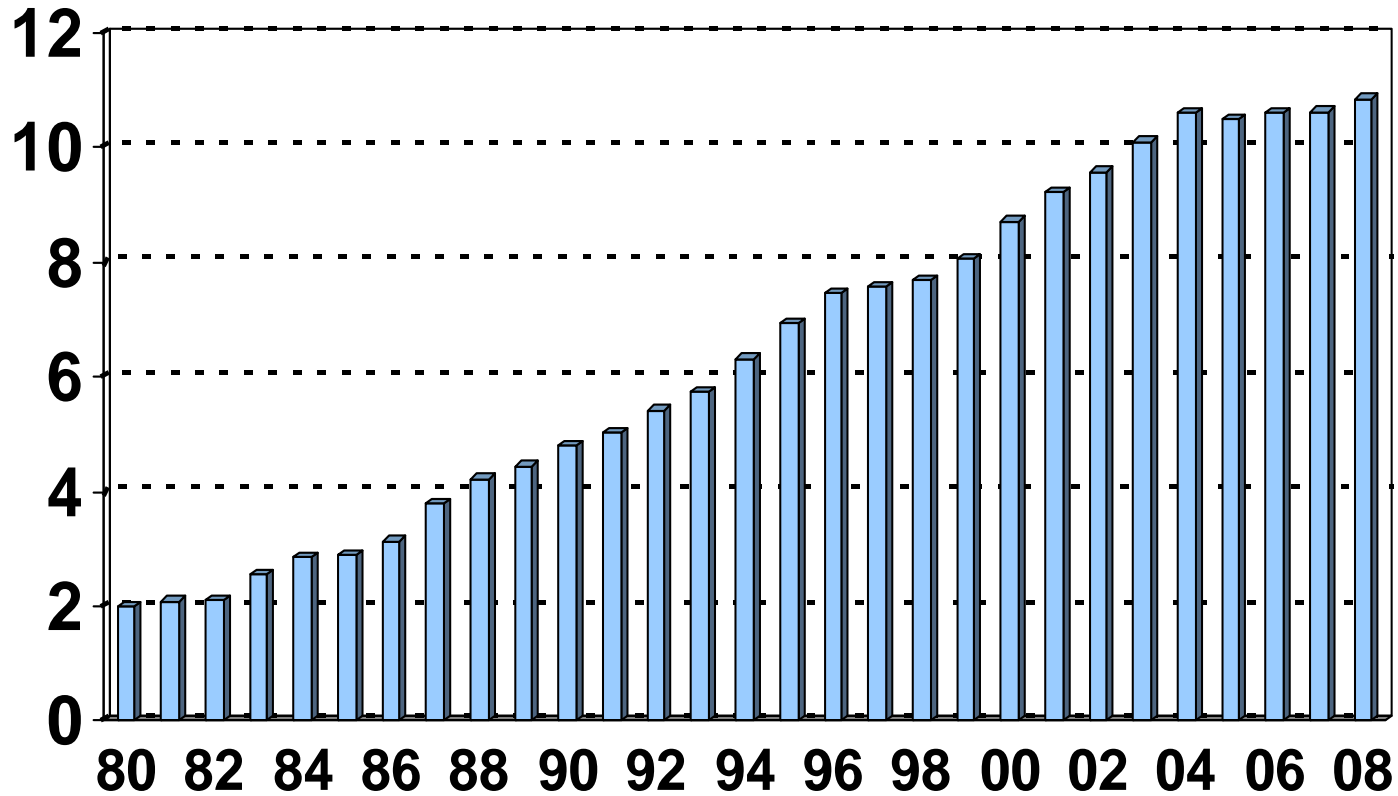


Source: Surface Transportation Board

Railroad Employee Productivity

Class I Railroads, Ton-Miles Per Freight Service Employee

Millions



Source: *Railroad Facts*, AAR

Rail Service Cycles

- Is the recent improvement in the metrics sustainable? Systemic?
- Is it a product of huge capex injection and IT?
- Or, is it merely a product of lower volumes/less stress on the network...

Rail Regulatory Risk

- Biggest Uncertainty Entering '09
- Safety Bill done
- “Competition” Bill (“M-A-D”) vs Anti-Trust
- STB makes it 3-straight shipper “wins”
- *Rocky & The Dark Star – new horror movie?*
- Cost of Capital Revision shock
- Mandated STB, CTA “Reviews”
- AAR/RAC/ASLRRA have great “D” but hard to score on defense

Tax Incentives to Leverage Capacity Expansion



- **25% tax credit for projects that expand rail capacity**
- **Expense other infrastructure capital expenditures**
- **Leverage private investment**

RR/Investor Issues Summary- 3Rs3Cs

- Recovery?
- The Re-Set
- Re-Regulation
- Capital Needs
- Capital Cooperation
- Cash Flow

RailTrends!

- RailTrends 2009 October 6&7
- Affinnia Hotel/NYC
- www.railtrends.com
- The multidisciplinary railway financial event of the year....



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