

Rail Renaissance: Returns, Capital & Capacity

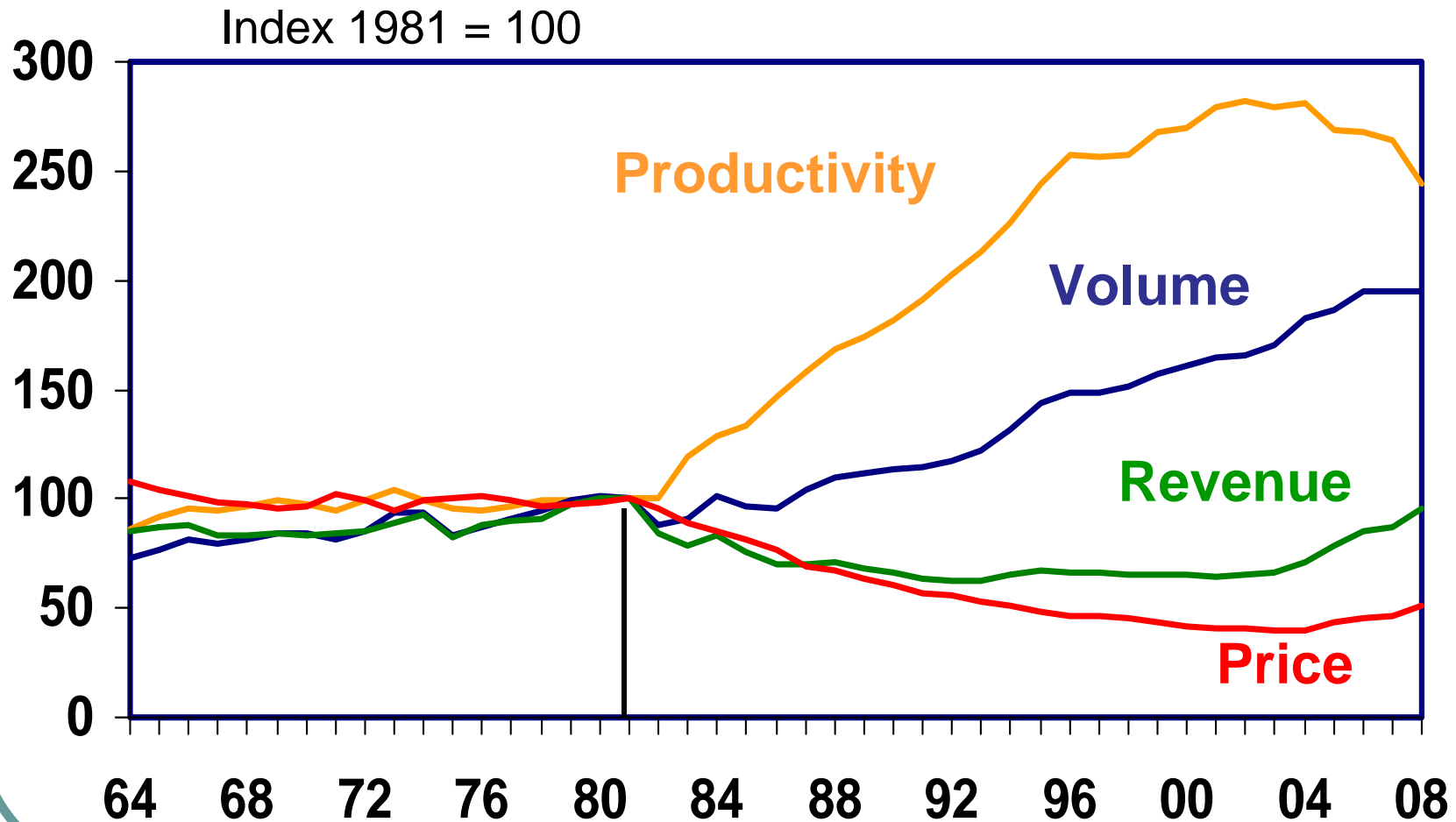
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NEARS/Newport

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Railroad Performance

Class I Railroads



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

Rail Assessment (from Greenbriar Equity Group)

Strengths

- Strong secular growth
- Favorable market structure
- Supply constraints
- Solid barriers to entry
- Limited alternatives

Opportunities

- Pricing
- Volume Growth
- Service levels / productivity
- Modal shift
- Consolidation?

Challenges

- Capital intensity
- Capacity bottlenecks
- Port congestion
- Reliability vs. trucks

Threats

- Economic malaise
- Rising capital requirements
- Regulation
- Maritime trade flows

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 '10

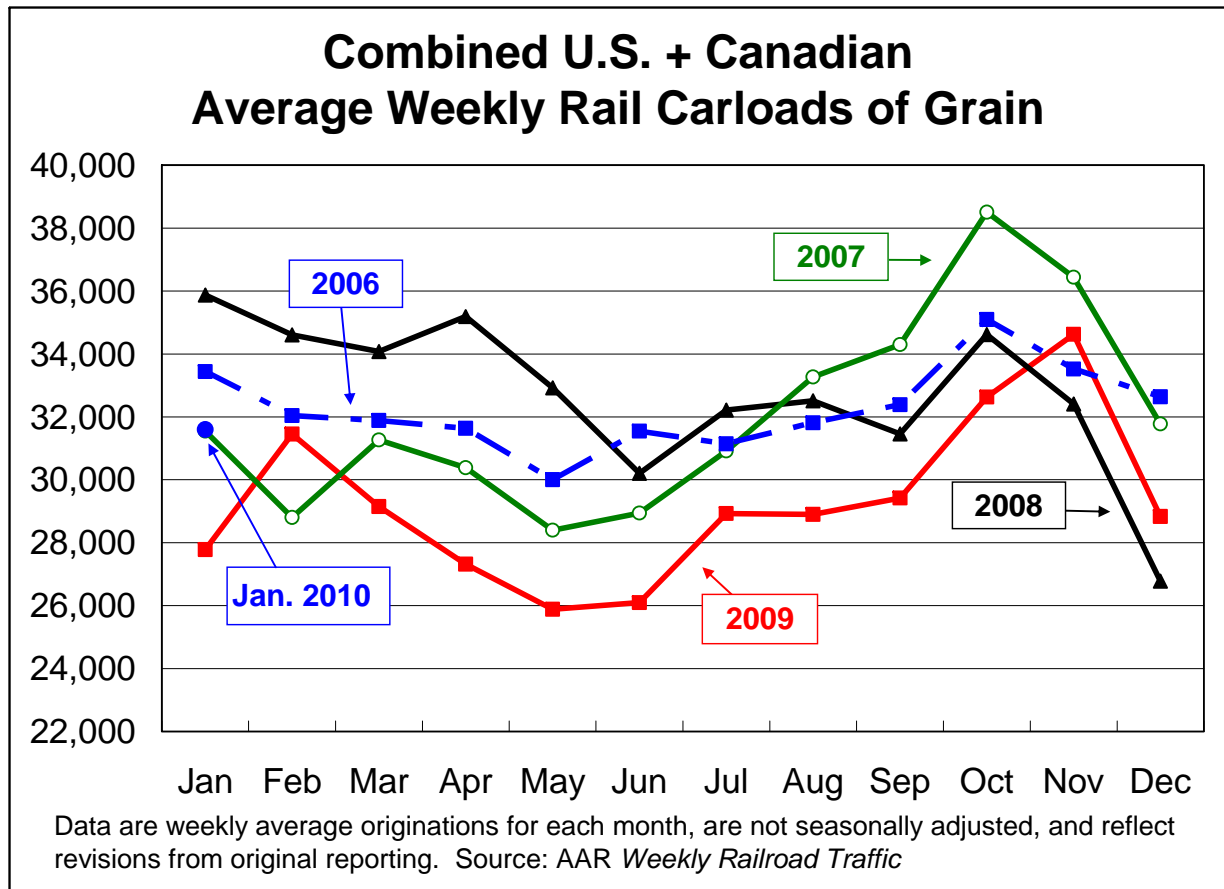
- Re-regulation Bigger Threat than Ever
- Rates (versus Volumes)
- The Economy
- Service
- Green Ramifications
- Stimulus, MAP21, ATRK, “High” Speed Rail (ONERail)
- PTC-”unfunded”- and unknown -mandate

Warren's \$44B "all-in" bet

- Advantages of going private? (capex cycle)
- Influence in DC
- "Robber Baron" vs. "Sage"
- Bets not (just) on economy – rereg, coal, western intermodal
- Bought on the cheap!

Grain Traffic

Major U.S. and Canadian railroads



Source: AAR *Railroad Time Indicators*, February edition, page 12

Intermodal Growth Drivers

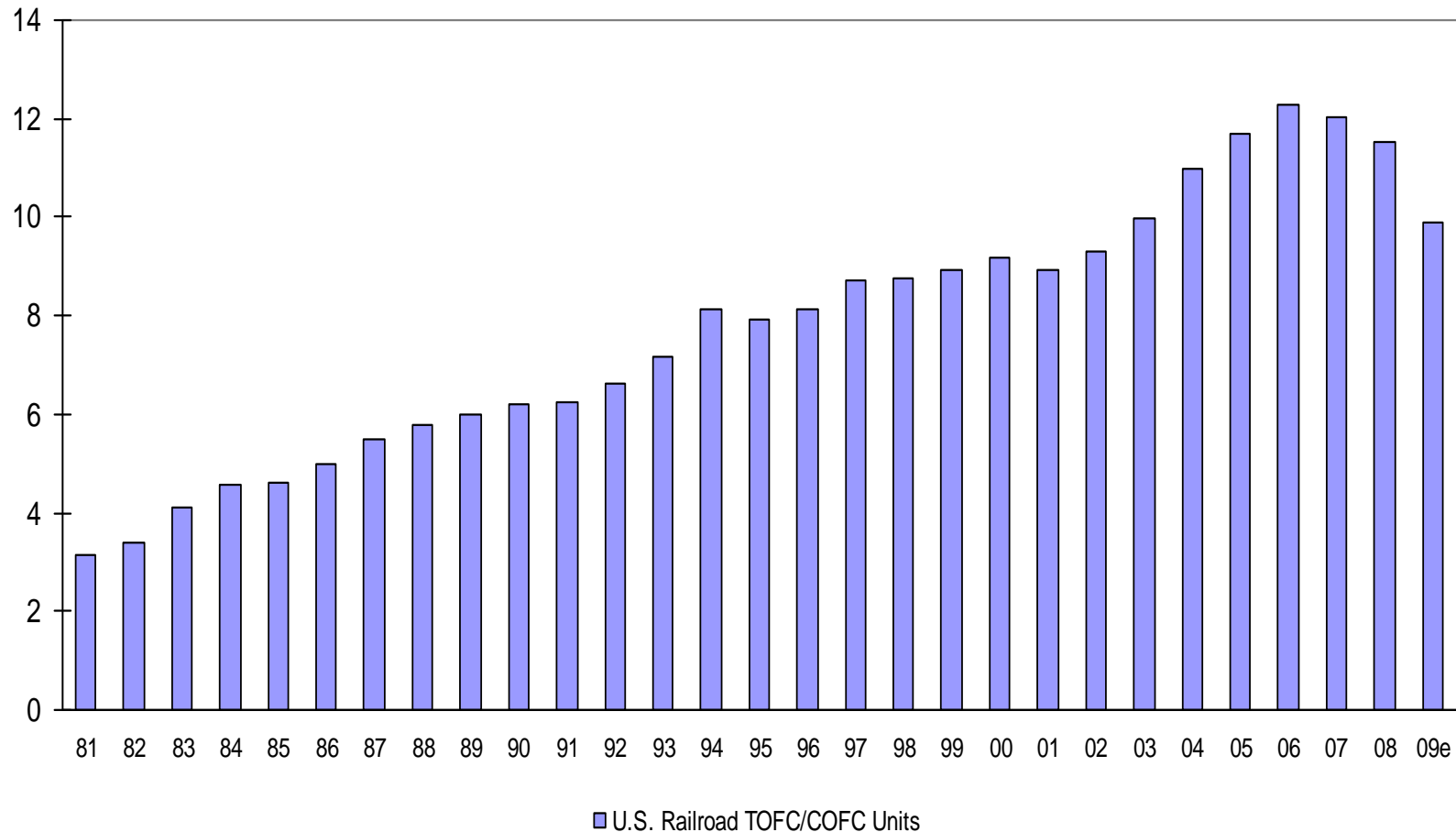
Domestic *and* International

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



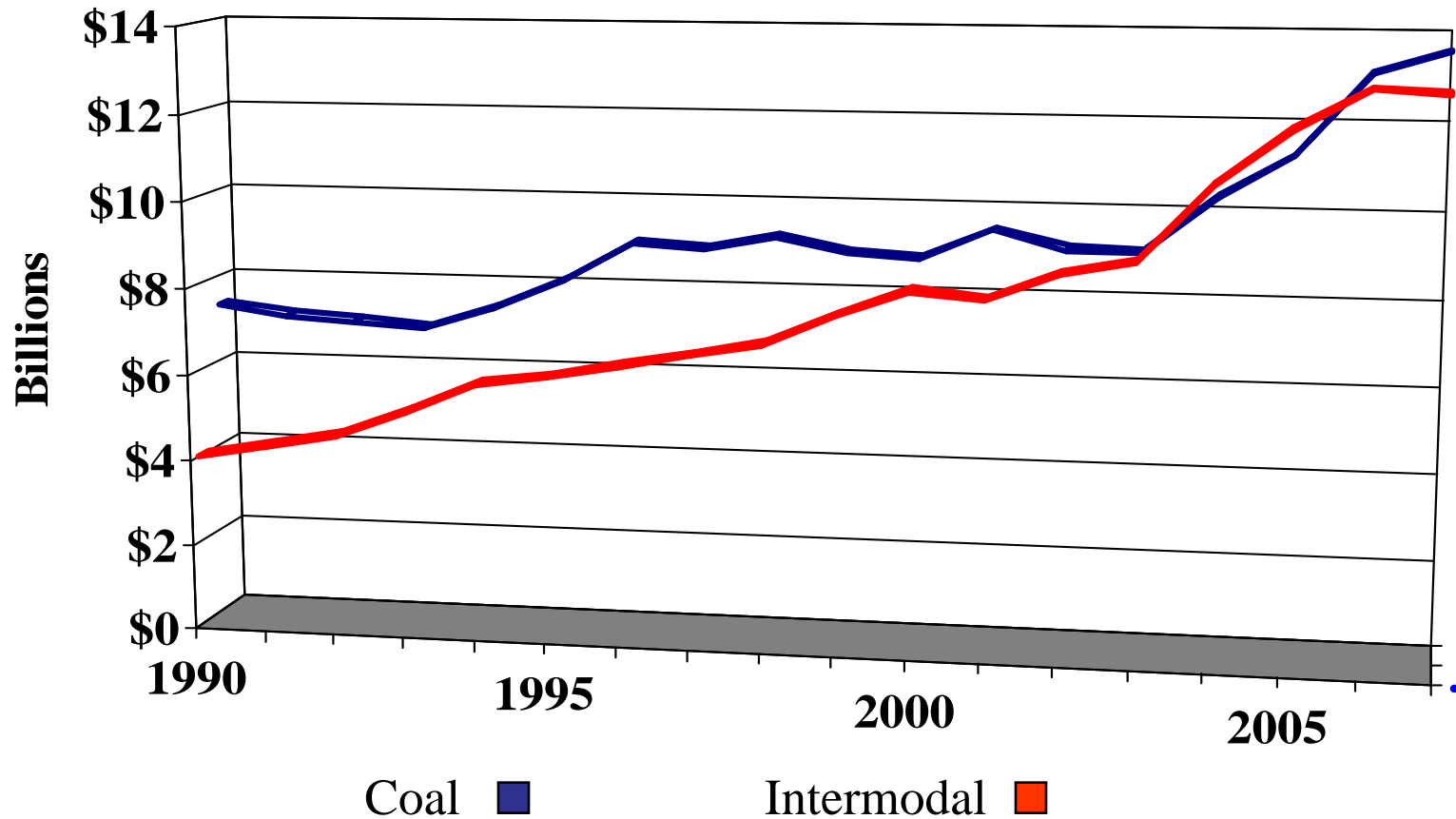
U.S. Railroad Intermodal Traffic

(millions)



Source: Association of American Railroads' *Weekly Railroad Traffic* Year 09e week 52 is estimated

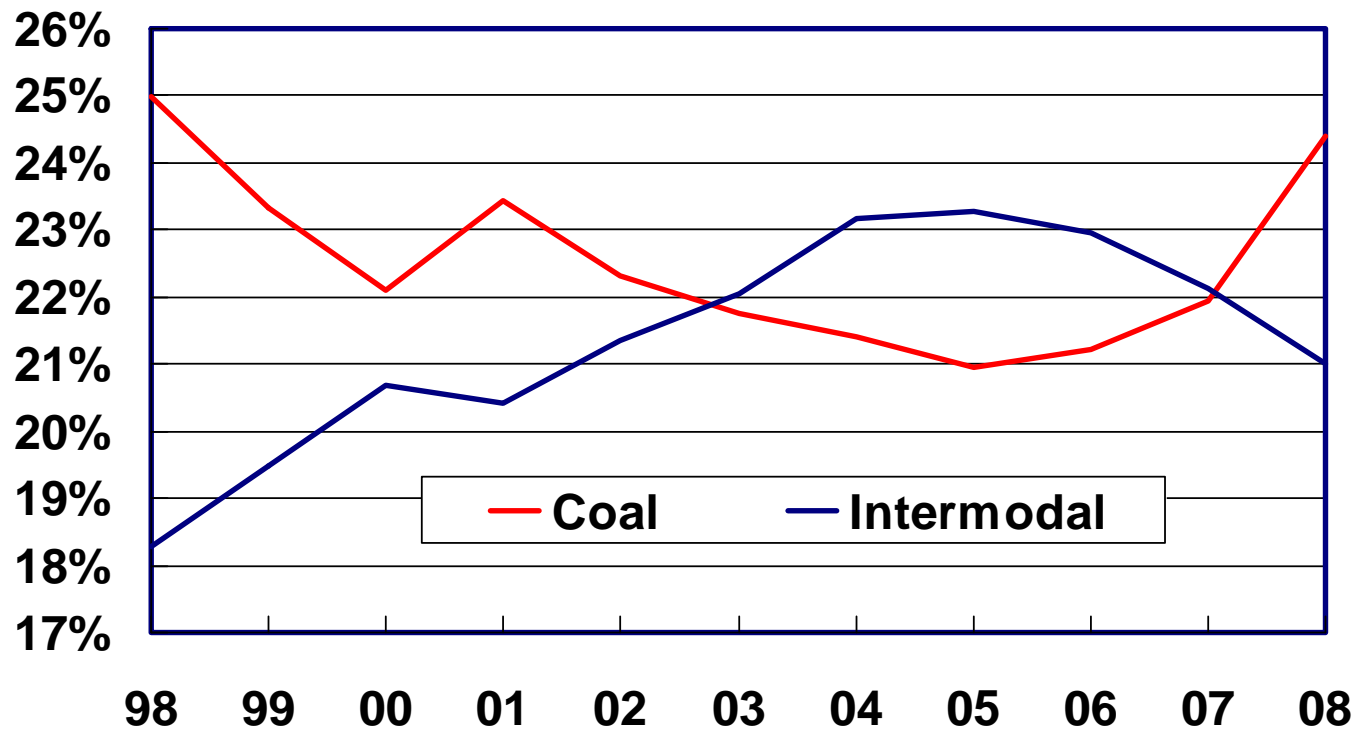
Long-run Railroad Intermodal Revenue Growth Has Outpaced Coal (Short-run has not)



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

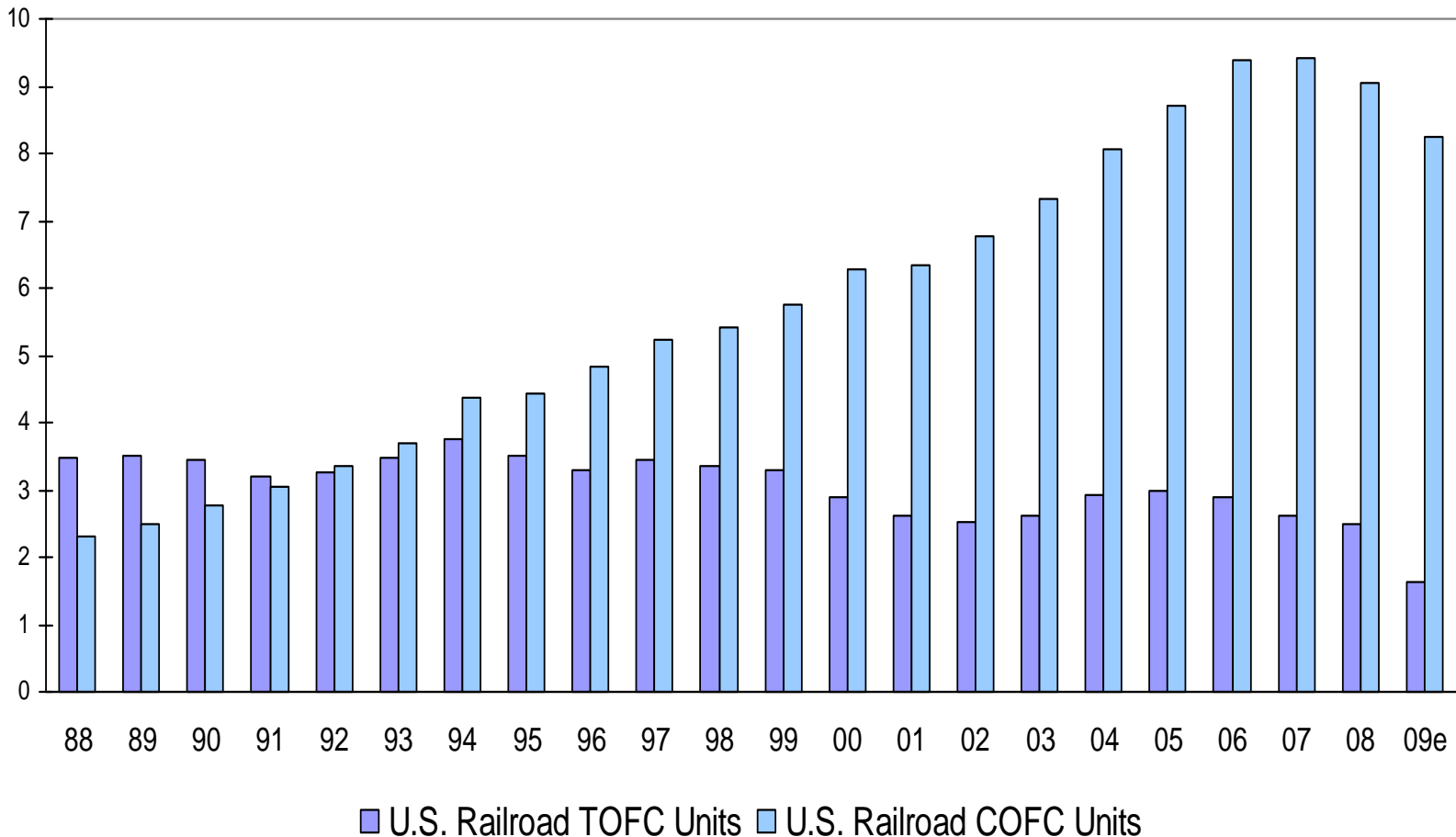
Coal and Intermodal are the Top Sources of U.S. Freight Rail Revenue

*Intermodal and Coal as a % of Revenue**



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

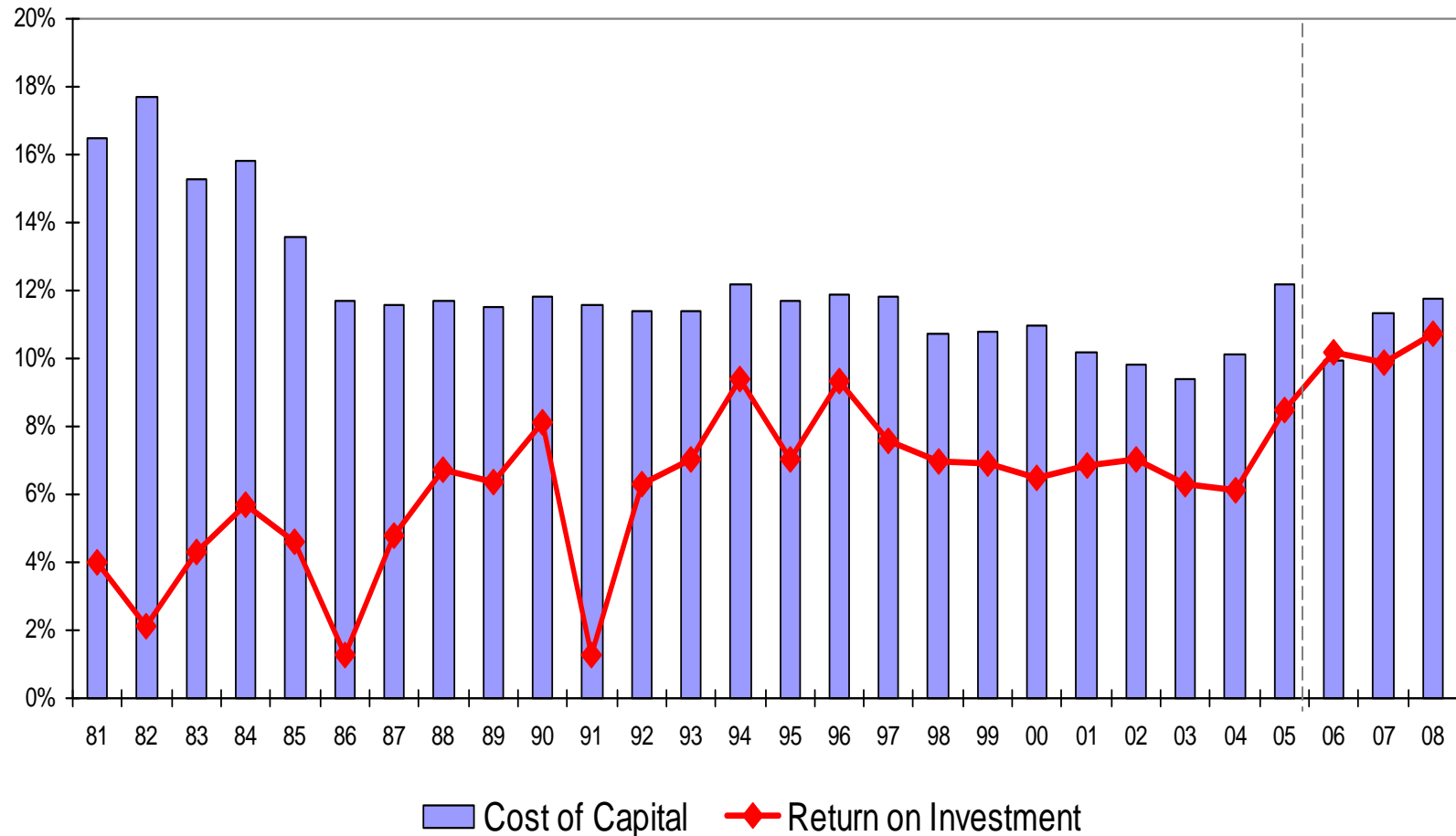
U.S. Railroad Intermodal Traffic Trailers vs. Containers (millions)



Source: Association of American Railroads' *Railroad Facts*

Year 09e week 52 is estimated

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

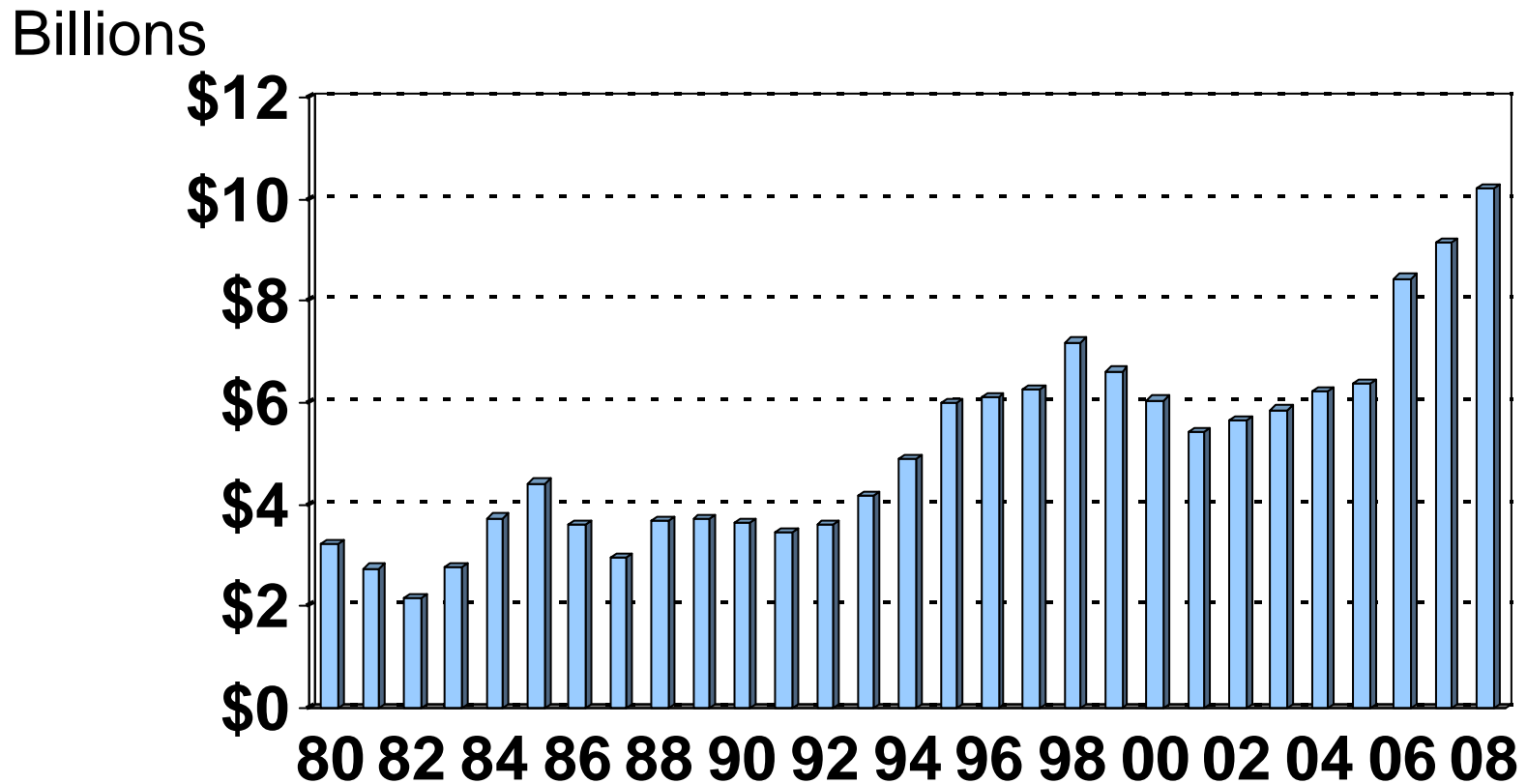


Source: Surface Transportation Board

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

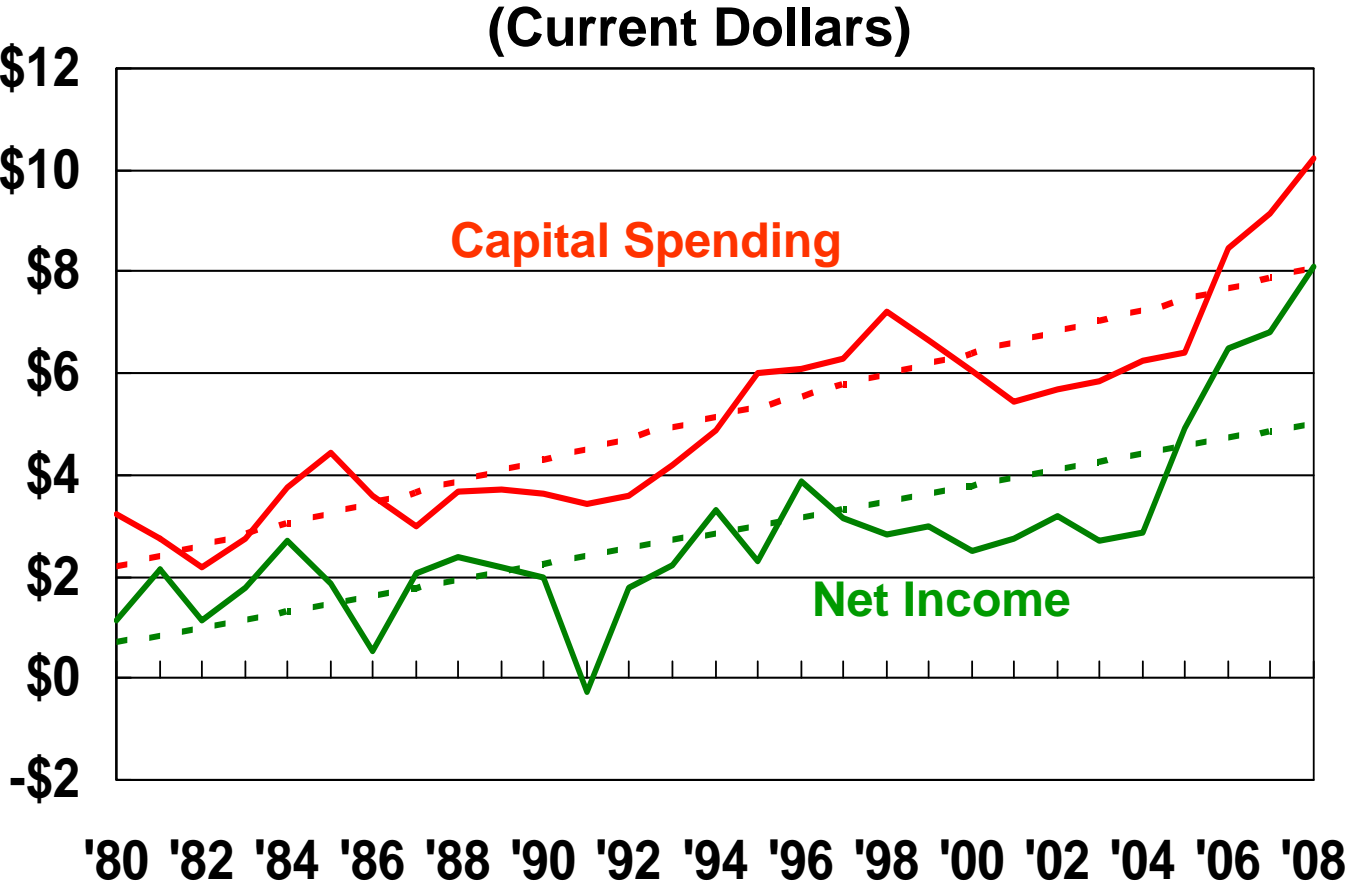
Railroad Capital Expenditures

Class I Railroads



Source: *Railroad Facts*, AAR

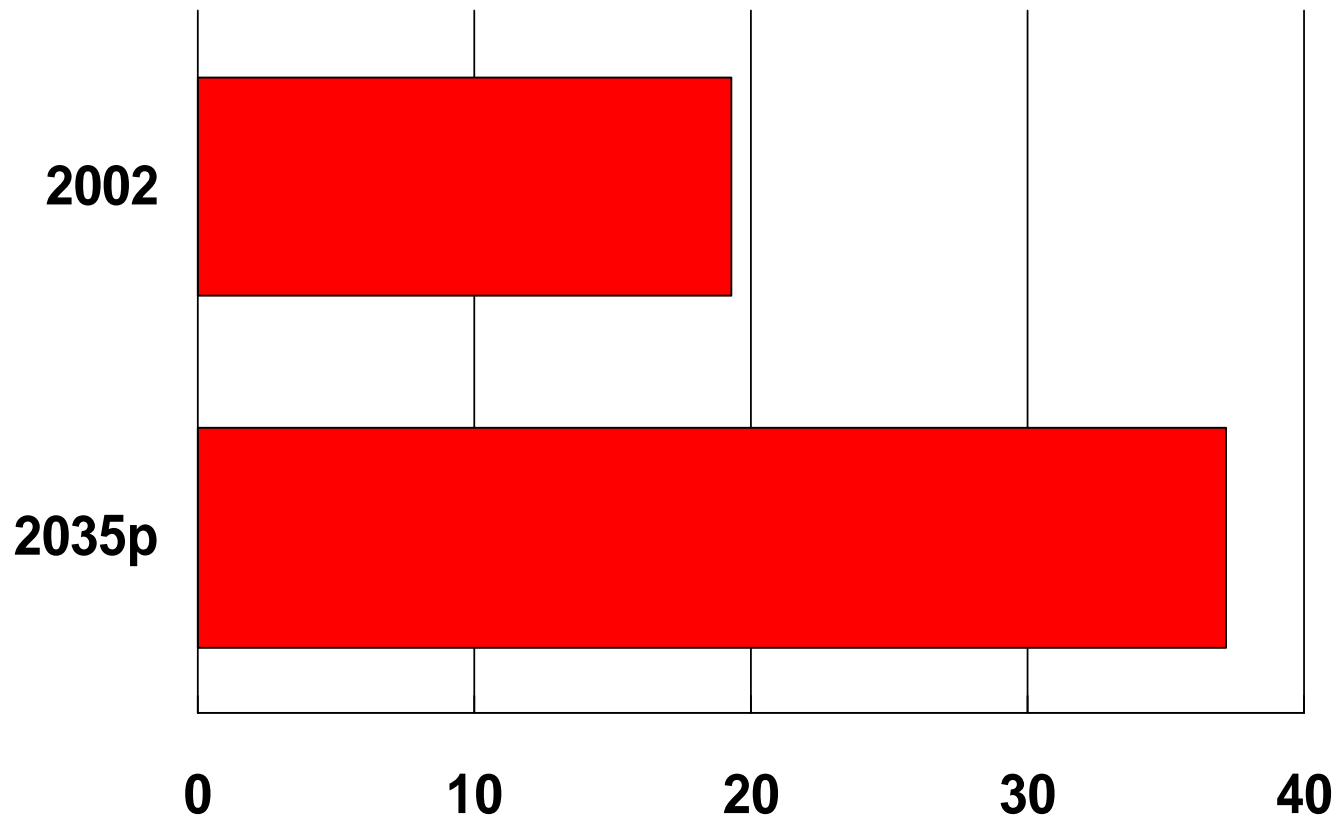
Class I Railroad Capital Spending vs. Net Income



Source: Association of American Railroads

Future Demand for Freight Transportation Will Continue to Grow

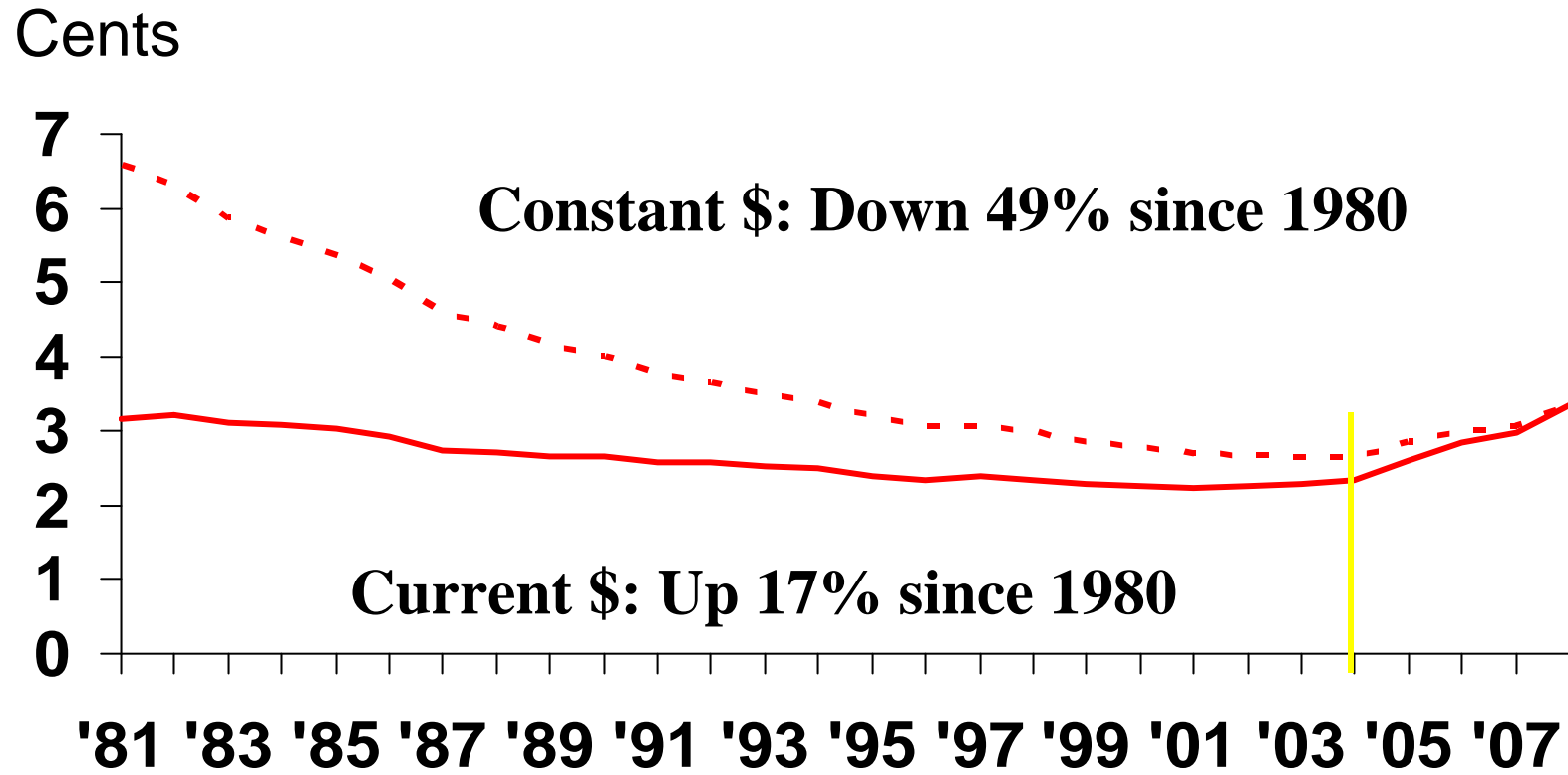
Billions of Tons of Freight Transported in the U.S.



p – U.S. DOT projection

Railroad Rates- the old story

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

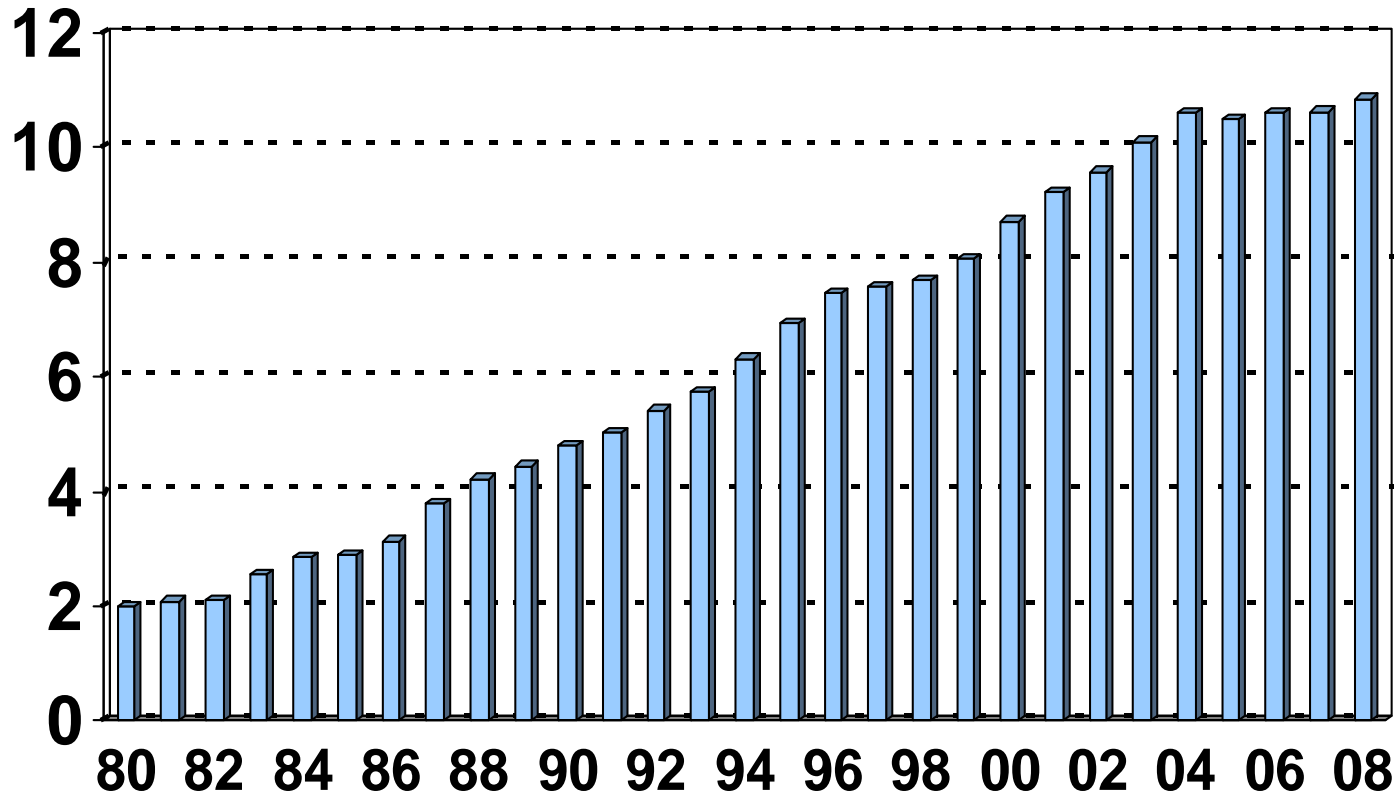


Source: *Railroad Facts*, AAR

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?

Rocky&the Darkstar

- **STILL** Biggest Uncertainty Entering '10
- Safety Bill done/UTU influence
- “Competition” Bill (“M-A-D”) vs Anti-Trust
- And yet, STB makes it 3-straight shipper “wins”
- Cost of Capital Revision shock
- Rocky & The Dark Star - new horror movie? Mandated STB, CTA “Reviews”
- AAR/RAC/ASLRRA have great “D” but hard to score on defense
- Compromise or fight? Quid pro quo in the future?

Tax Incentives to Leverage Capacity Expansion



- **Just ONE example of a “future consideration”**
- **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

Developing website

- www.abhatchconsulting.com
- *TopShipper Survey*
- *RailTrends 2010 September 28-29*



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