

Rail Renaissance: Returns, Capital & Capacity

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SWARS/San Antonio!

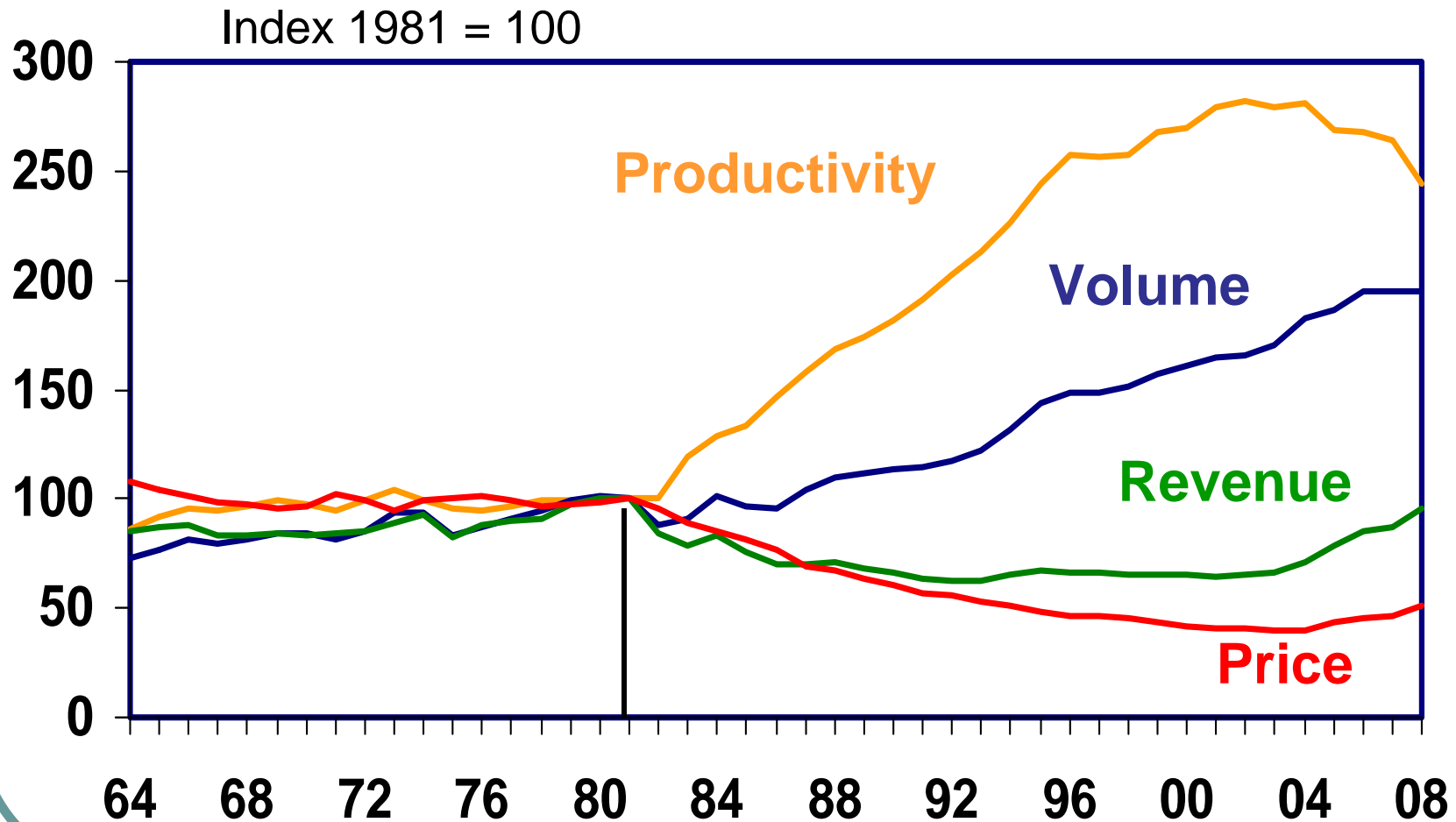
February, 2010

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 '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

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?**

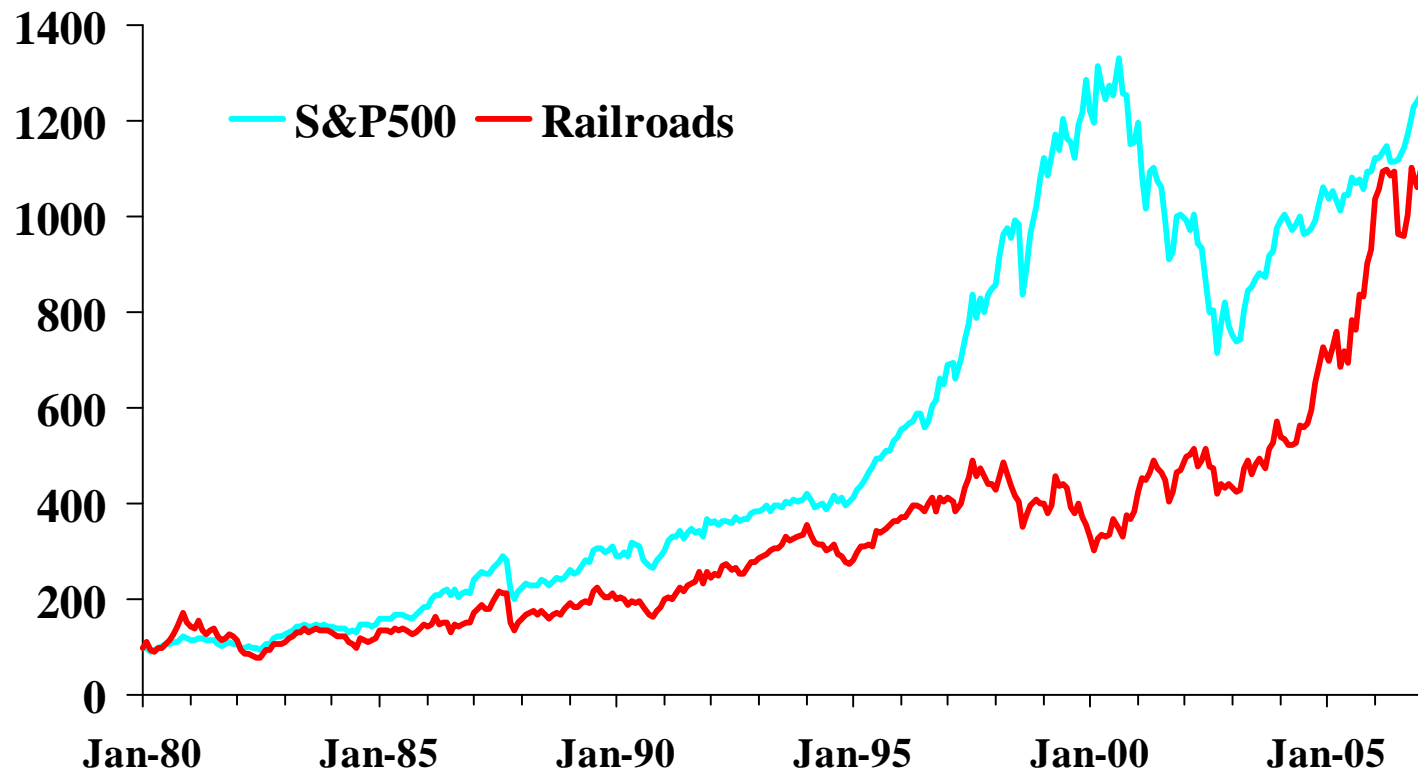
Warren's \$44B "all-in" bet

- 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!

S&P 500 and Railroads

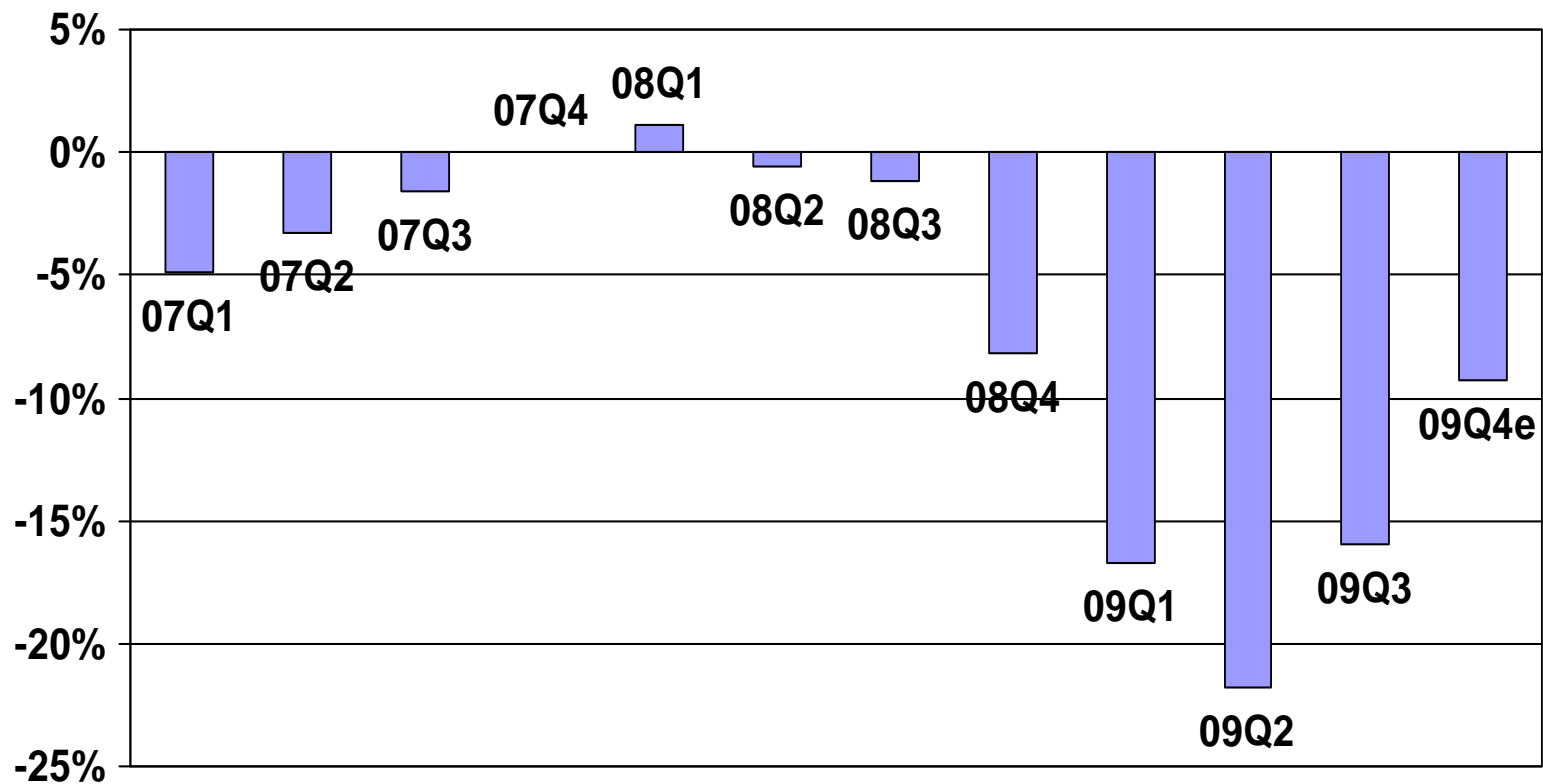
Monthly Data January 1980 – April 2007

Index Jan. 1980 = 100



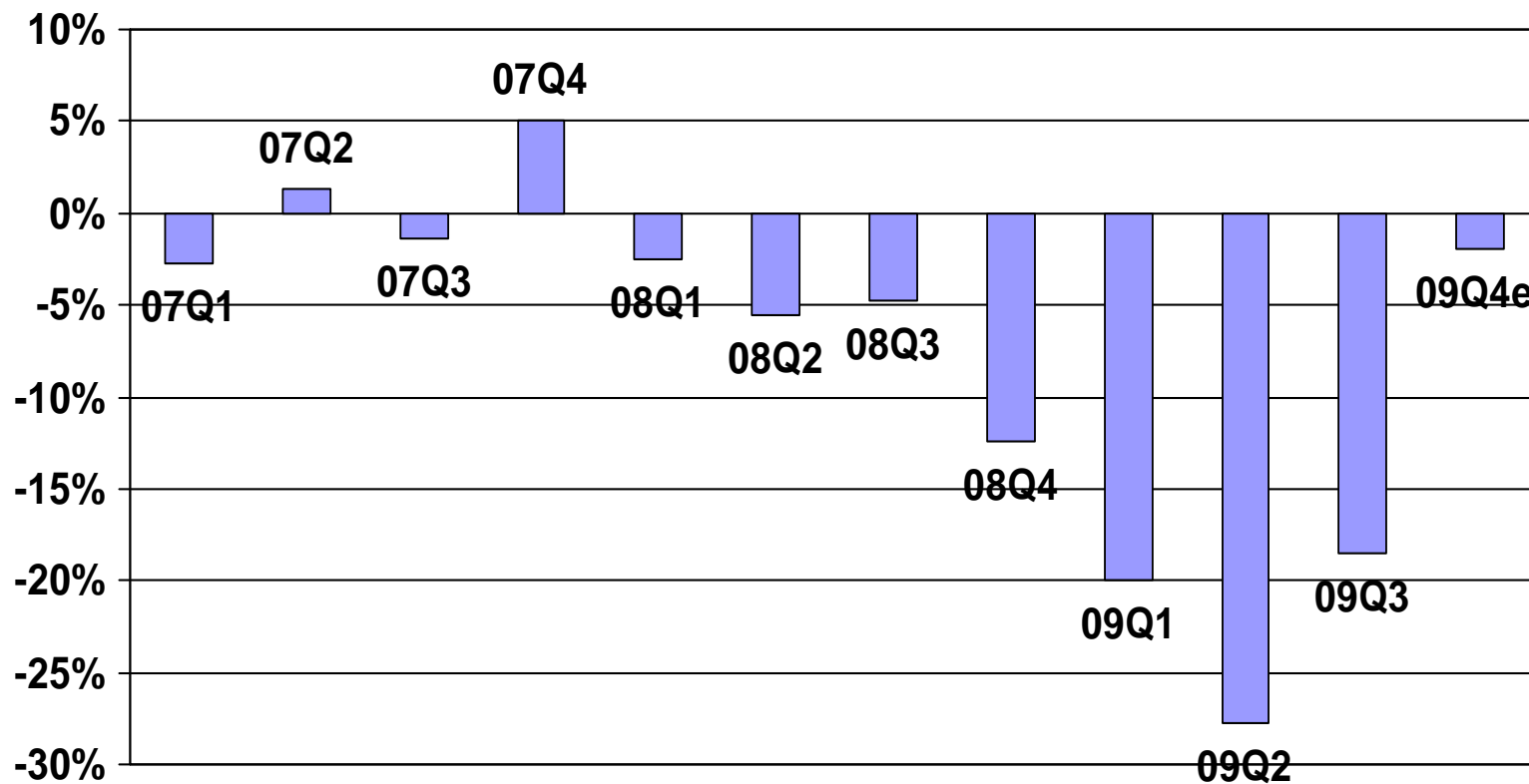
Sources: MSN and CSI, Inc.

Change in U.S. Railroad Non-Intermodal Carloads



Source: AAR Weekly Railroad Traffic

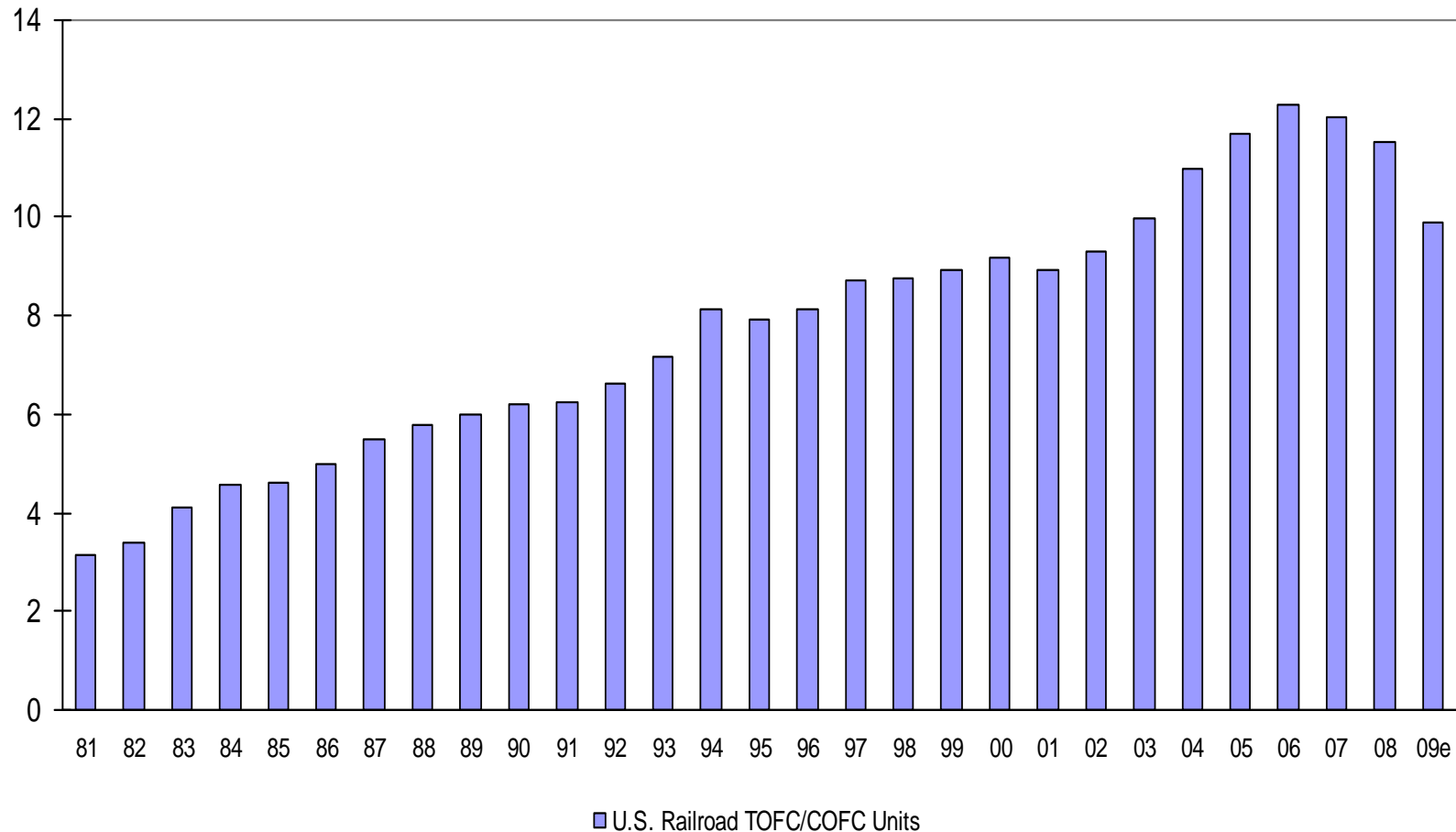
Change in Canadian Railroad Non-Intermodal Carloads



Source: AAR Weekly Railroad Traffic

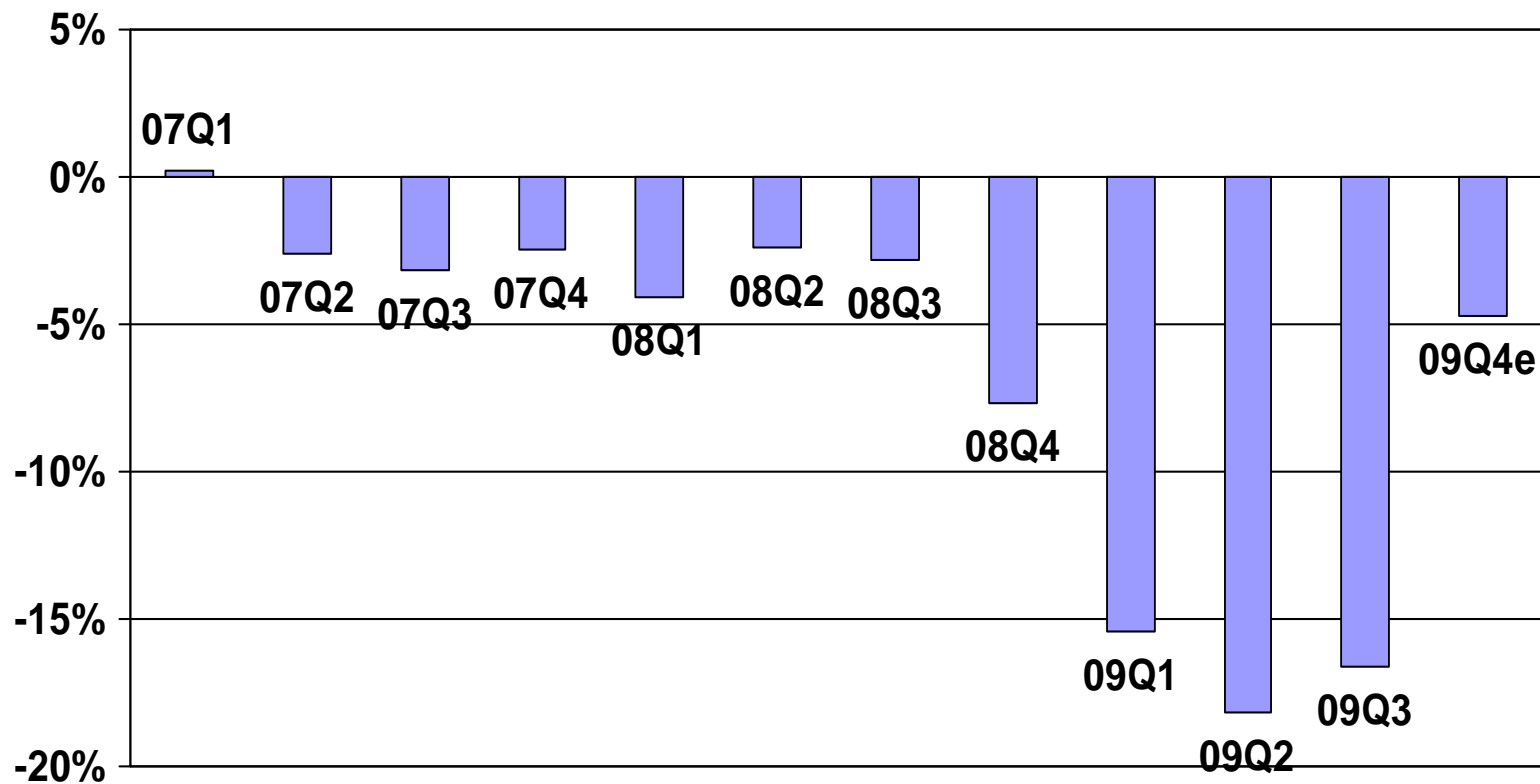
U.S. Railroad Intermodal Traffic

(millions)



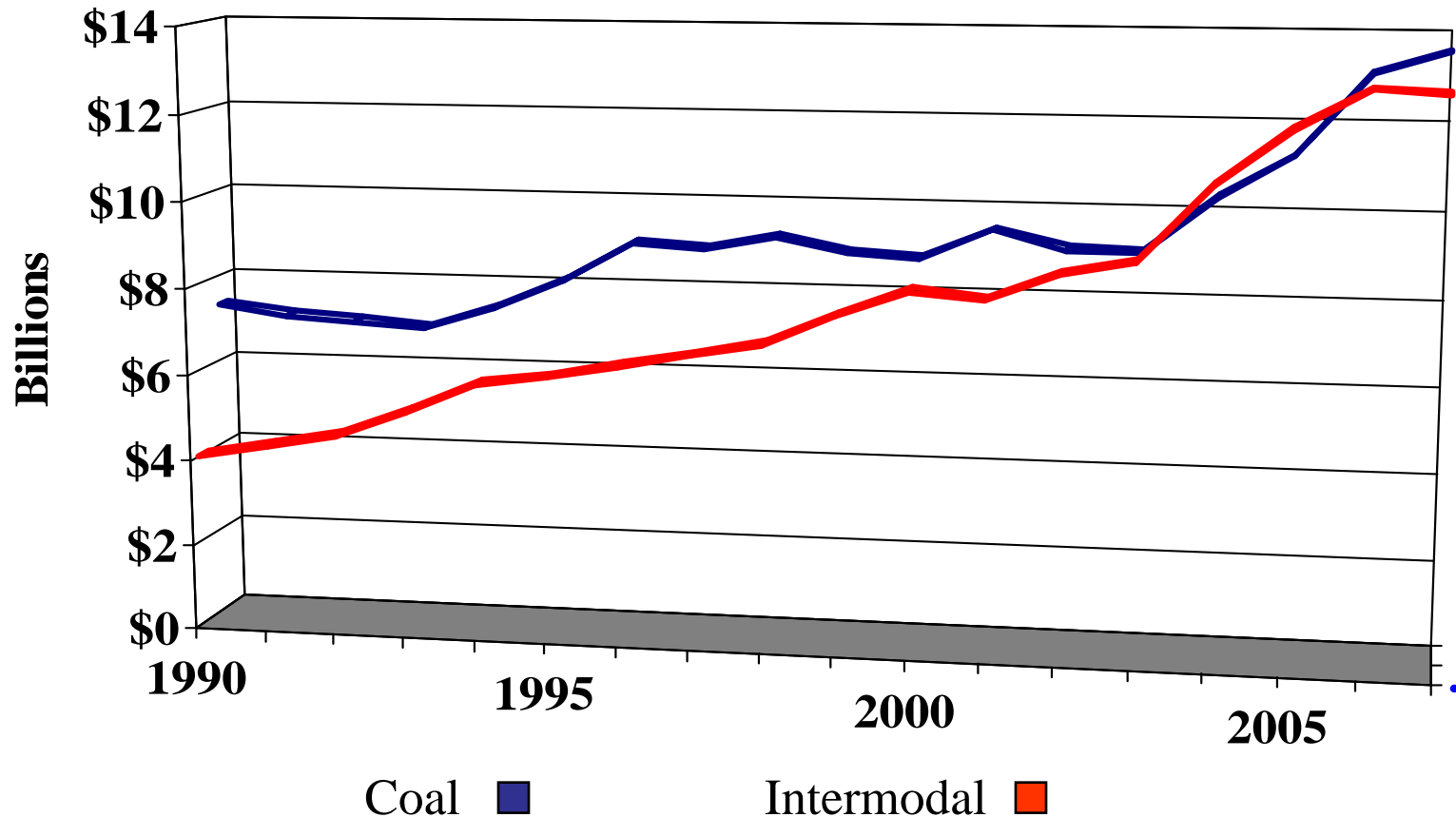
Source: Association of American Railroads' *Weekly Railroad Traffic* Year 09e week 52 is estimated

Change in U.S. Railroad Intermodal Units



Source: AAR Weekly Railroad Traffic

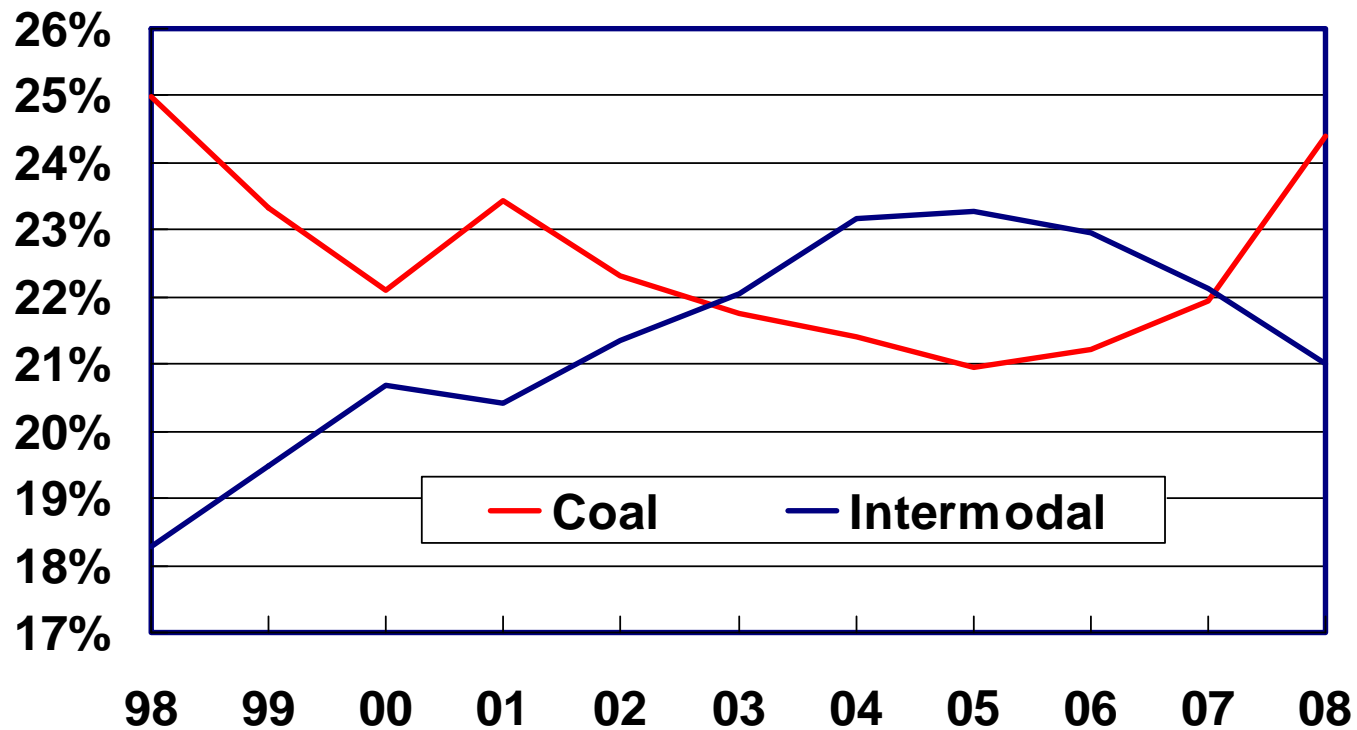
Long-run Railroad Intermodal Revenue Growth Has Outpaced Coal (Short-run has not)



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

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

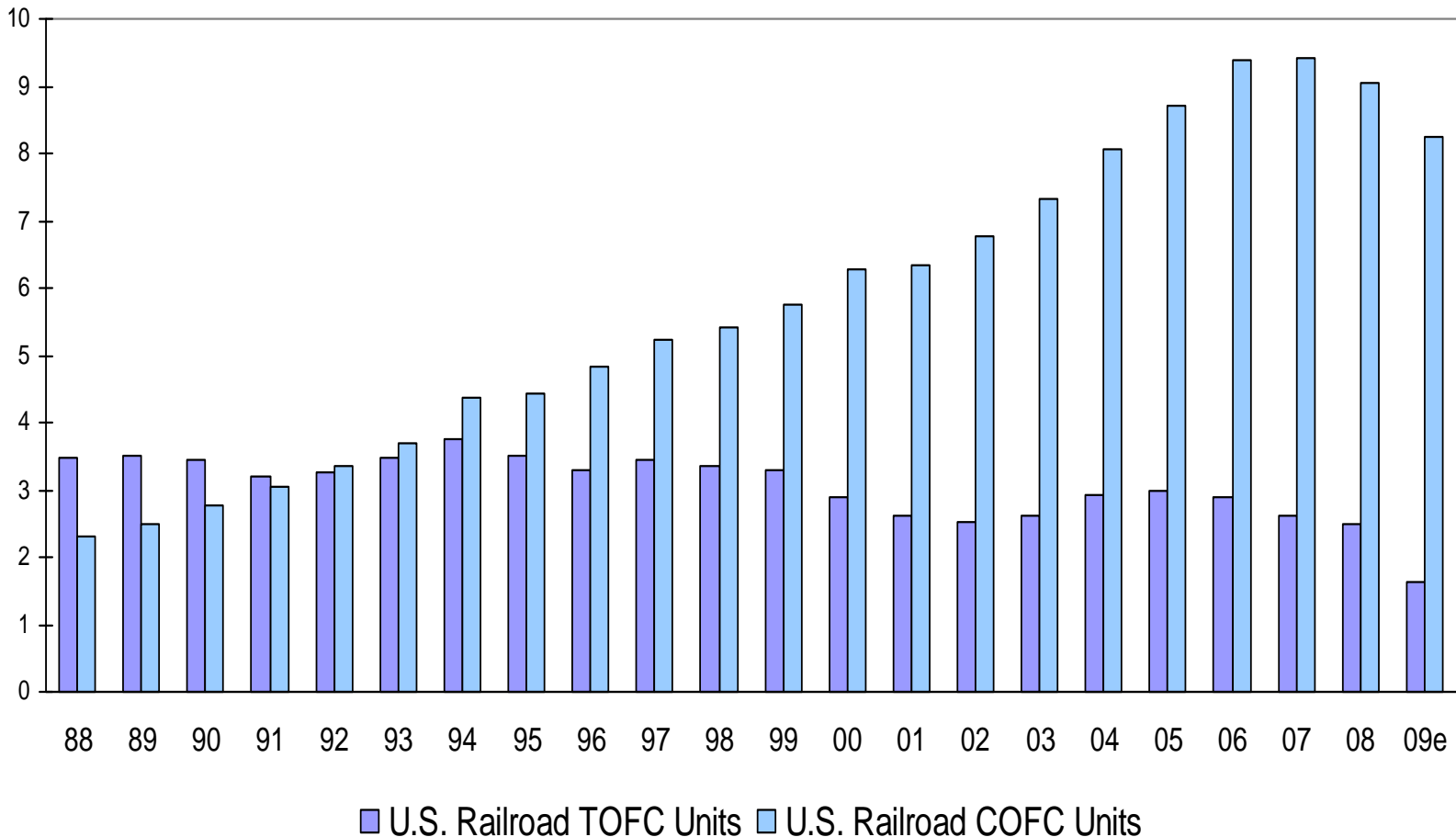
*Intermodal and Coal as a % of Revenue**



*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

Intermodal Growth Drivers

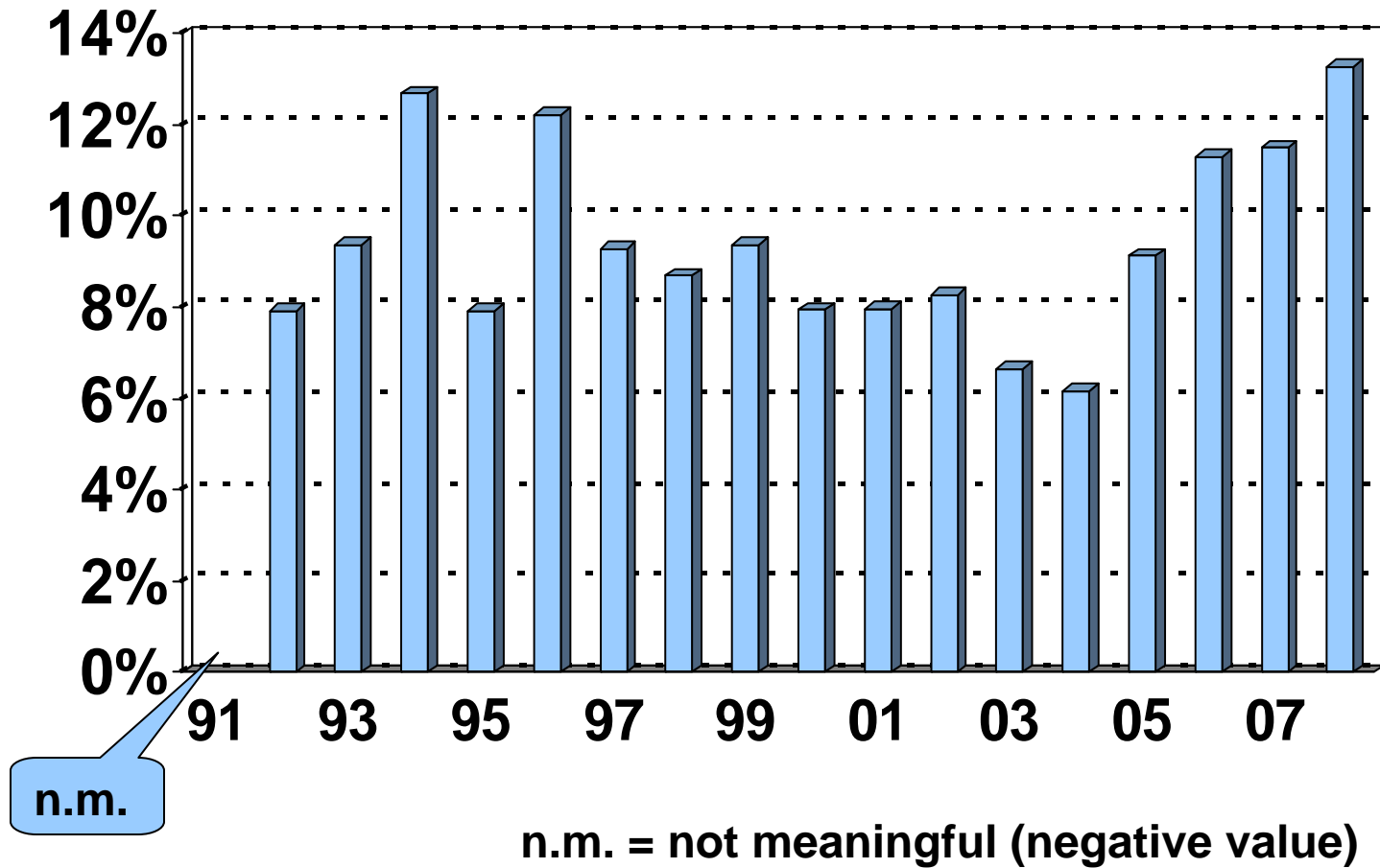
Domestic *and* International

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



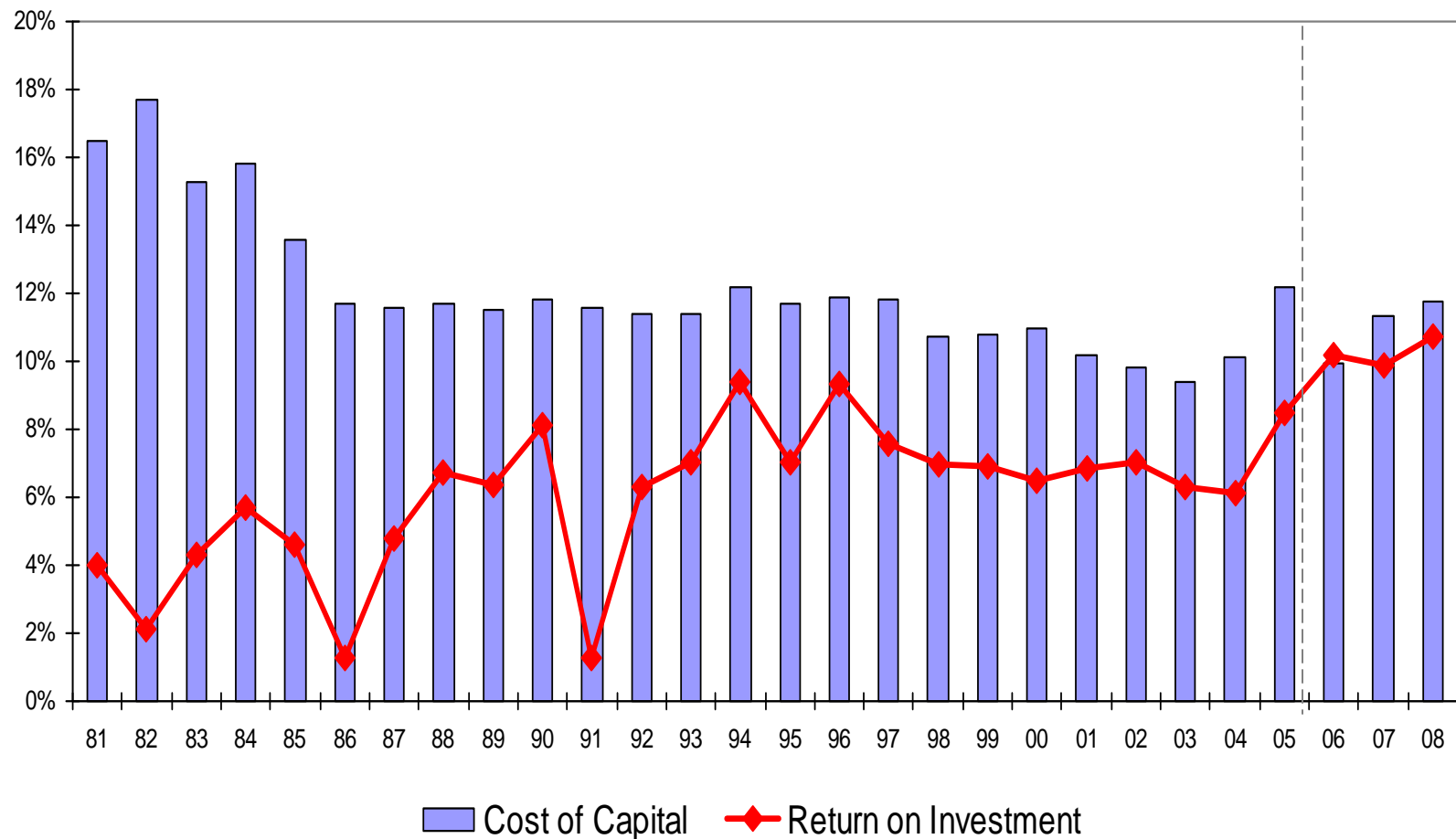
Railroad Return on Equity

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



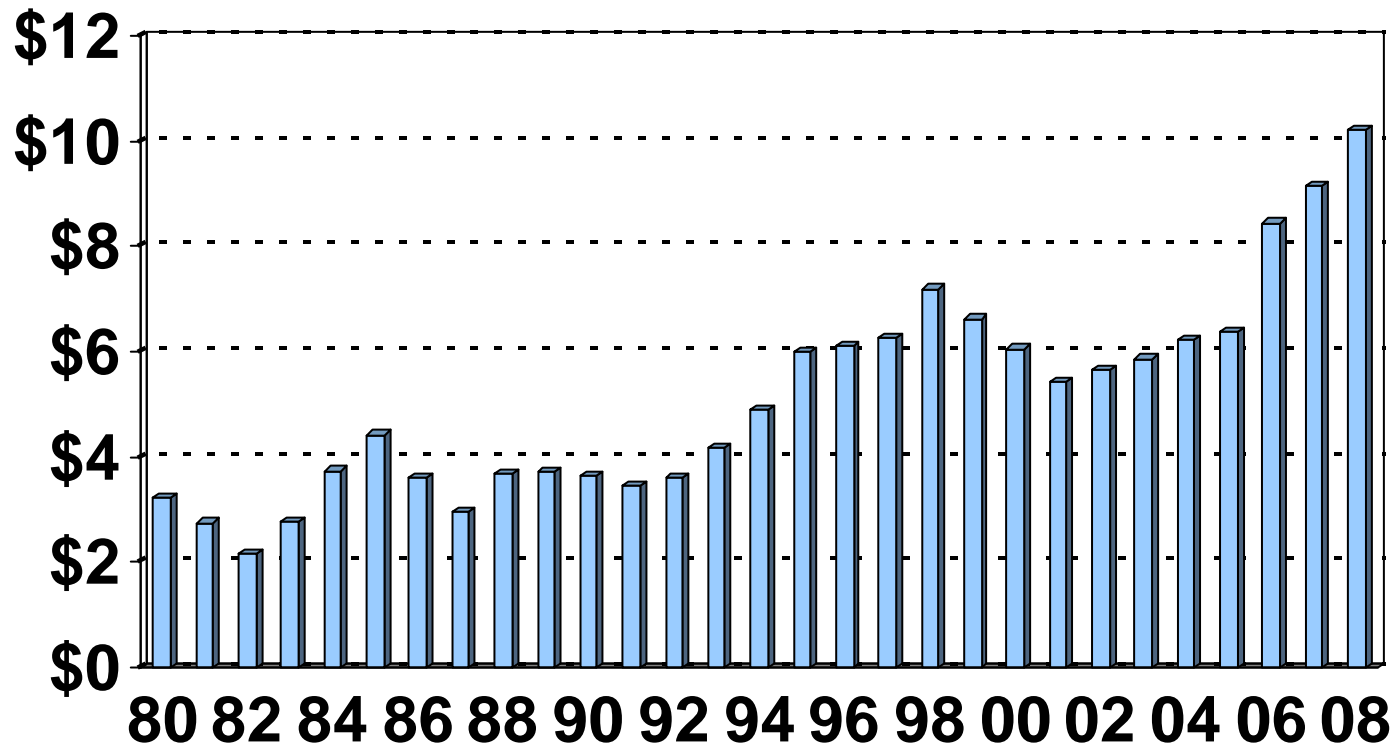
Source: Surface Transportation Board

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

Railroad Capital Expenditures

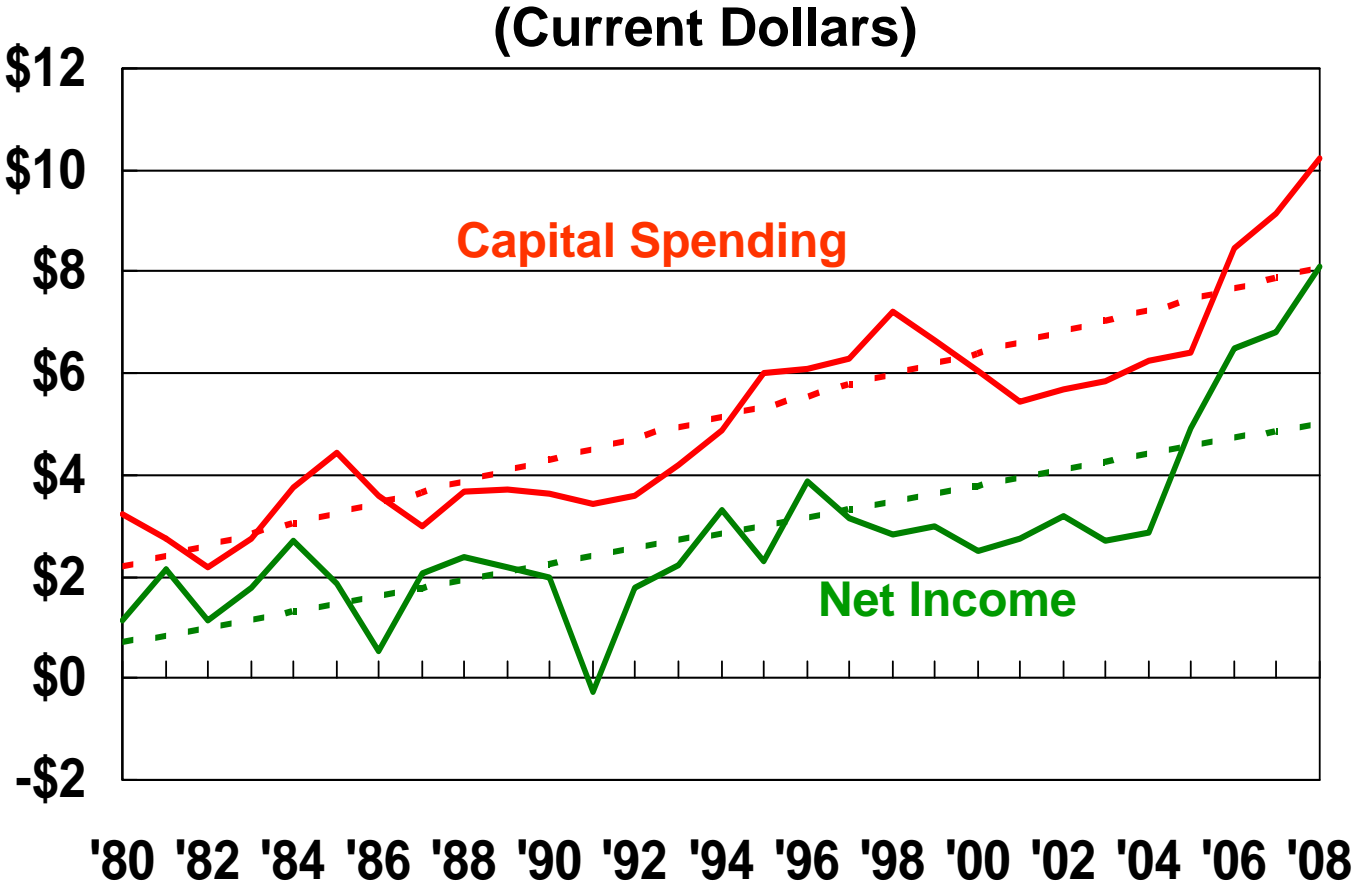
Class I Railroads

Billions



Source: *Railroad Facts*, AAR

Class I Railroad Capital Spending vs. Net Income



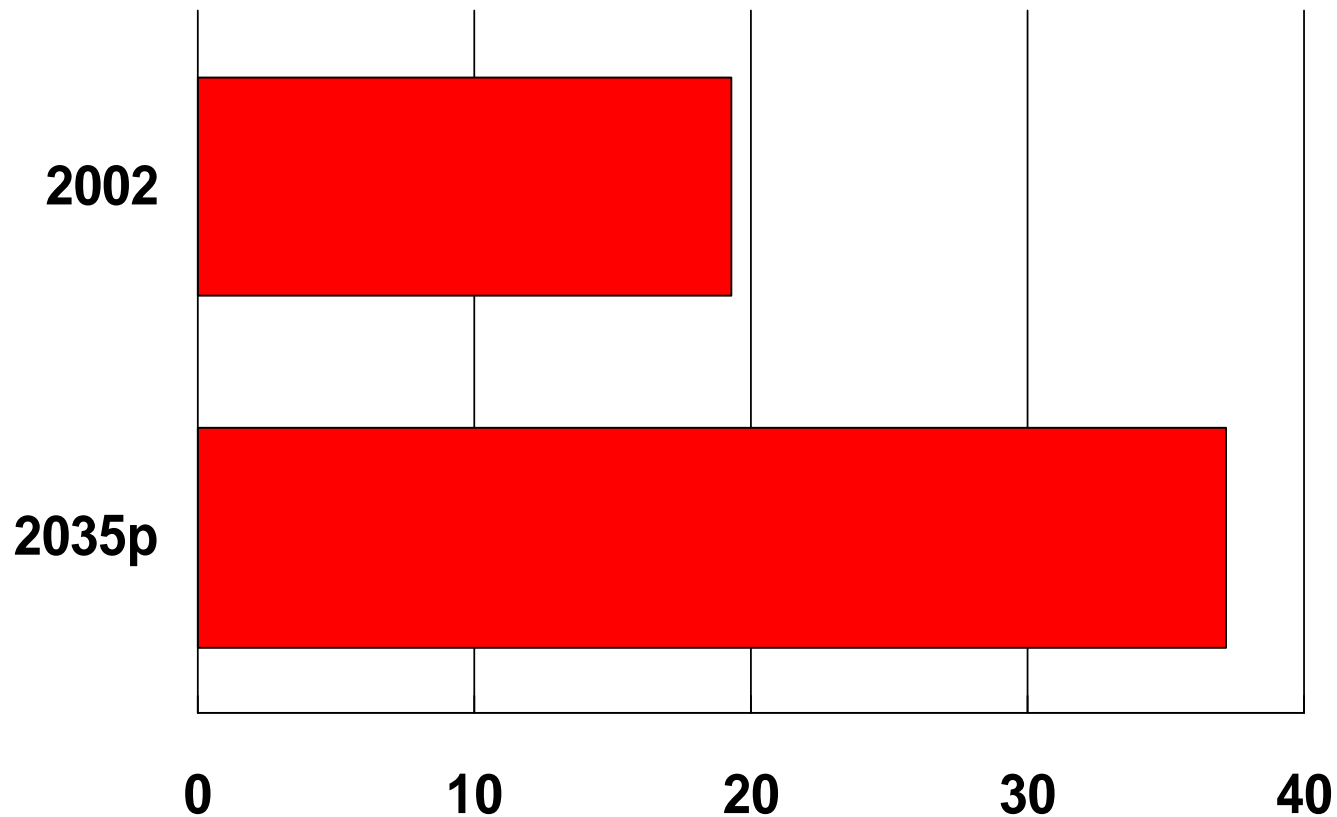
Source: Association of American Railroads

RRs and Investment

- Is growth affordable? Capex up 10% in '07, up 12% in '08, ***only down ~10% for 2009E***
- 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?***

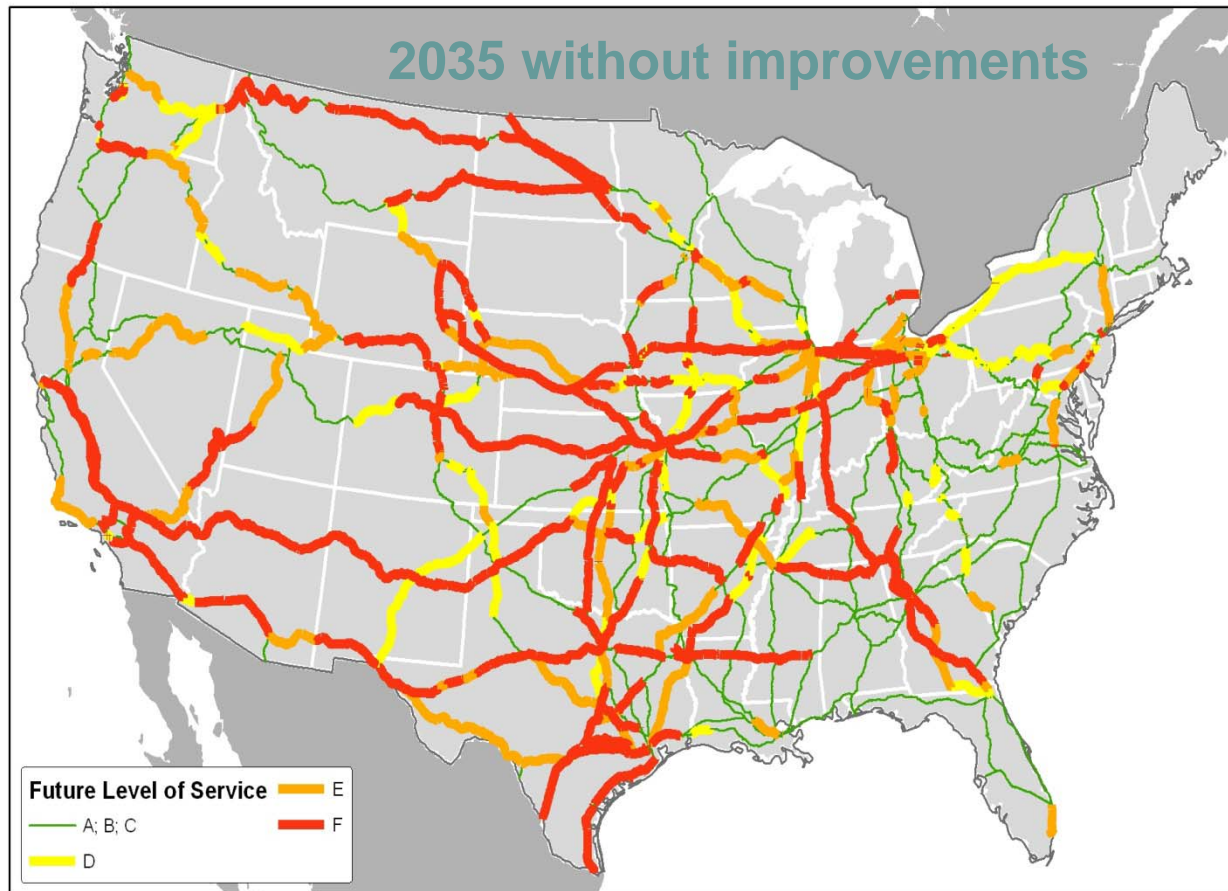
Future Demand for Freight Transportation Will Continue to Grow

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



p – U.S. DOT projection

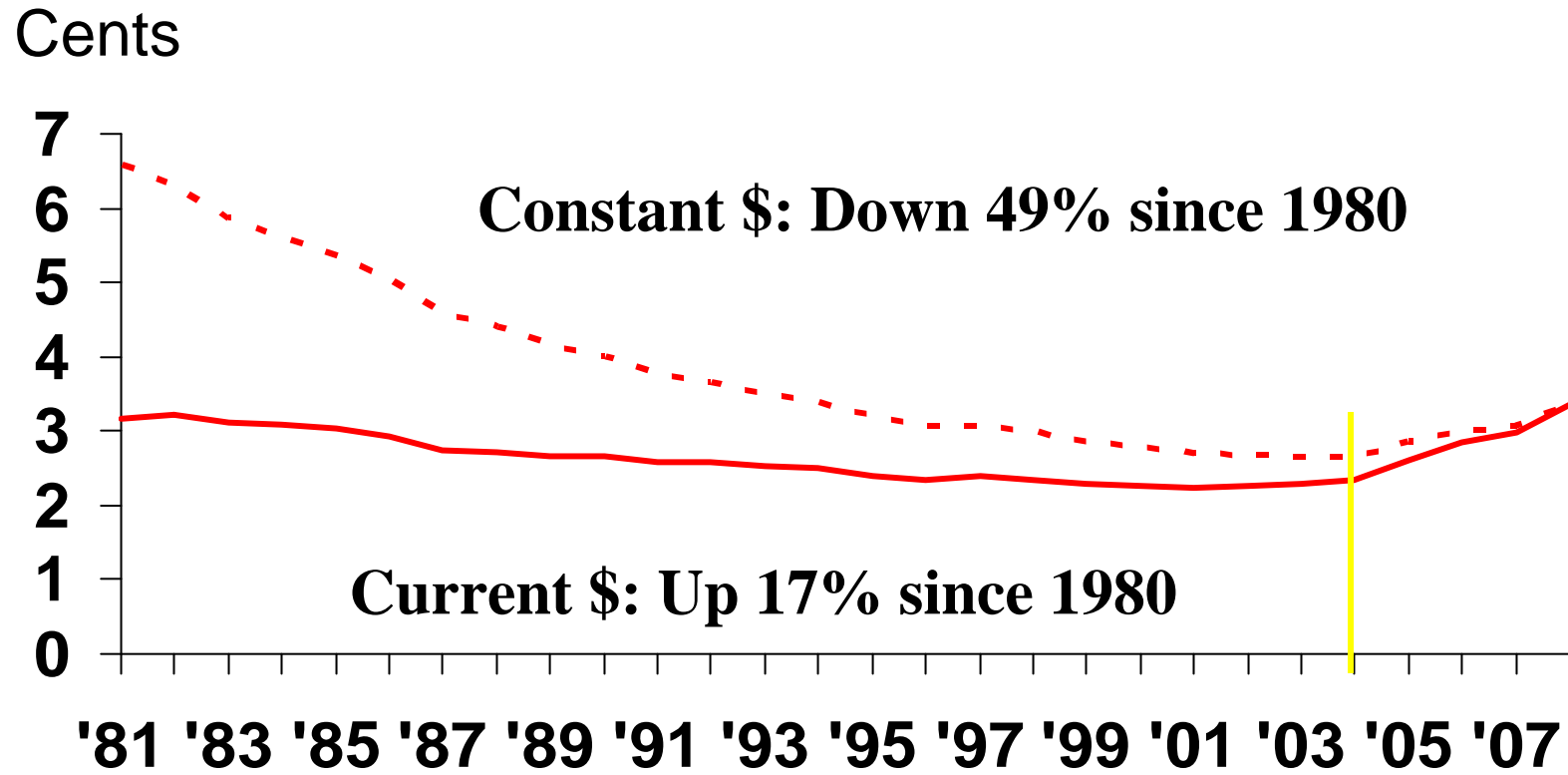
Future Corridor Volumes Compared to Current Corridor Capacity



- Below capacity
- Near capacity
- At capacity
- Above capacity

Railroad Rates- the old story

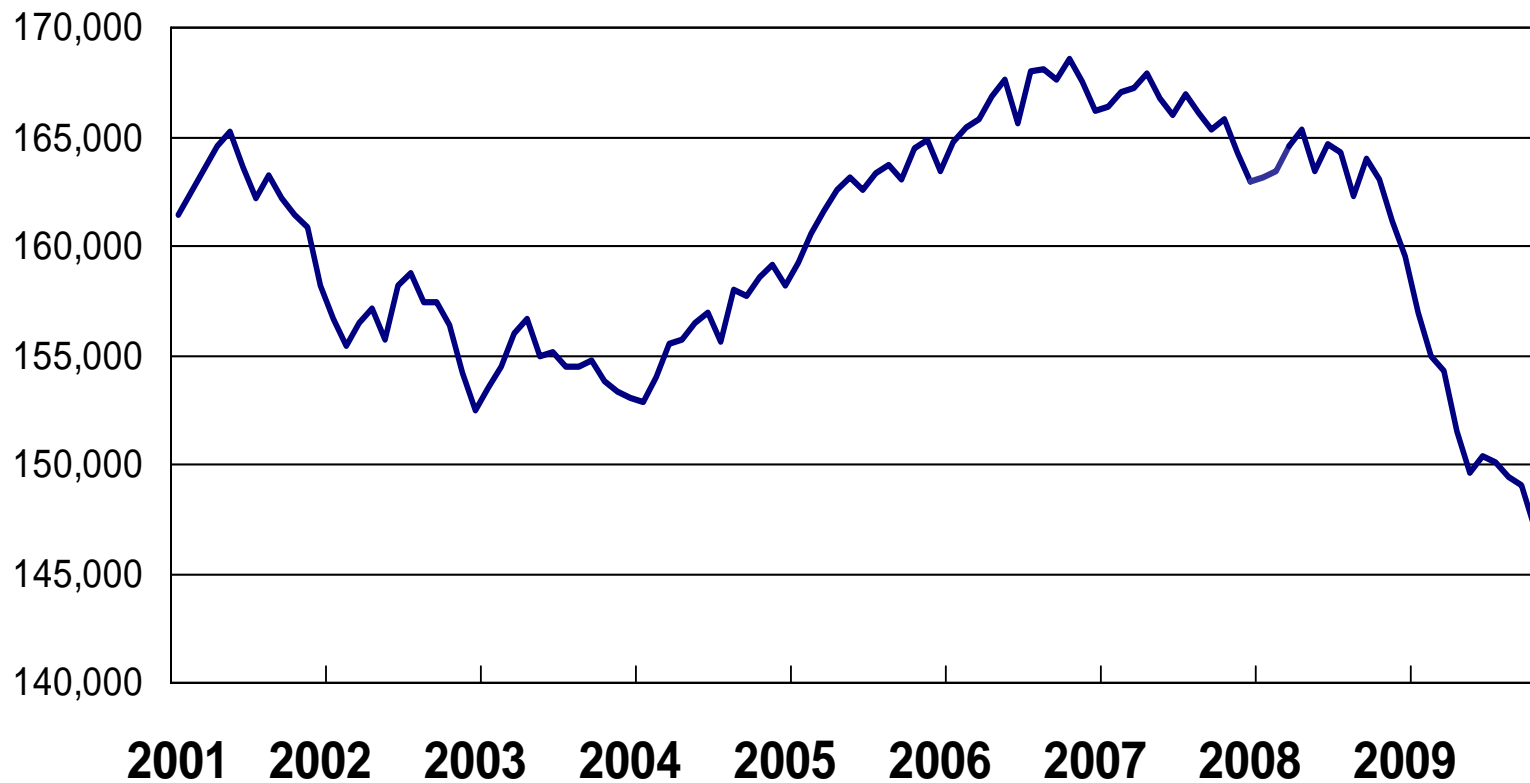
Class I Railroads, Revenue Per Ton-Mile – *another (related) New Paradigm*



Source: *Railroad Facts*, AAR

Rail Employment Was Up for the First Time in Decades...

Total Class I Employment: Jan. 2001-Nov. 2009

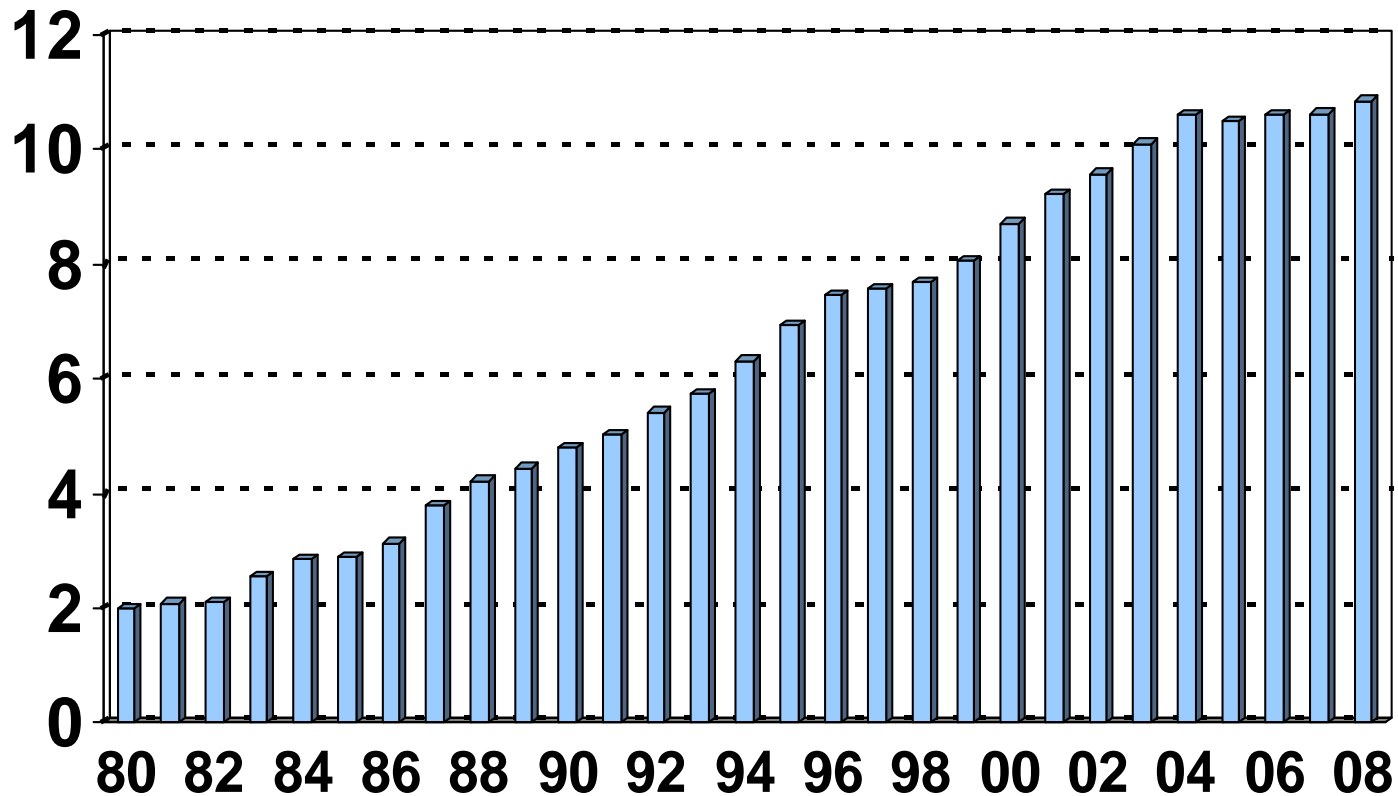


Source: Surface Transportation Board

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?

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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