



**Rails 2021:
CP+KSU, CNI/TCI, the
STB....plus *REAL-RR bidness***

SANDHOUSE 2021

Live in NYC/Virtual in Chicago



Rails Top 10 Pandemic/Recovery 21-?-

1. Covid (duh) – Delta Blues-Not done quite yet
2. The Shark’s Tooth – How RRs handled the down & the ups- and now everyone knows what a “supply chain” is!
3. Uncertainty/Visibility/(Lack of) Guidance – Getting Clearer (or is it?)
4. Accelerated (Not Altered) Trends
5. Intermodal! (see #4)
6. Zooms and (Rail) Trends (now we’re going back Live!
7. Technology – from Portals to Pulses: Tu Simple!
8. ESG
9. Ag
10. Globalization/Slowballization/De-Globalization

Recurring and Accelerating Rail Trends

(Not to be confused with RailTrends November 19-20!)

- The Mix Shift Towards Higher Levels of Service

- The Parallel Faster Decline of Coal

- The Continuation and Success of PSR

- The Continuing “Cult of the OR”

- The Continuing Fight over FCF – Share Buybacks “vs” Capex

- The Consistent “Hype” of EV & AV Highway Competition (response?)

- The Remaining Importance of Trade (and Tariffs Remain)

- Solid Financial Results/Good Cash Flow & Capital Access

- The Continued Lure of M&A in short lines/regionals

- The Continued “Hype” on the Value-Trap of Rail Consolidation

5 Enduring (?) Railroad Competitive Advantages

1 Labor Advantage

(ex: Double-stack LA-Chi – or Rupert-Toronto)¹

2 Fuel Advantage

(4:1 ton/mile; AAR)²

So 2A is Environmental Advantage (see....WMRT, Unilever, etc.)

3 Infrastructure Advantage

(after the IHS buildout; user-pay and capex to support changing logistics patterns – ex: transcon)³

4 Railroads' Excellent Financial Condition, Liquidity, Free Cash flow

5 Railroads' Historic Ability to Reduce Expenses in a Known Slowdown (2009, 2020)⁴

1. AV trucking?; 2. EV Trucking?; 3. Infrastructure Bill? (LOL); 4. Newly Added (in response to C19)

New Administration: A Return to “Normalcy”?

- **STB Impact?** *Even more relevant*
- **Infrastructure?** At long last....
- **Crew Size!!** (FAST Act Re-auth)
- **Emissions, etc?** Plays to RRs/ESG
- **Ethanol?**
- **Amtrak & Passenger?**
- **Trade!!** The only unequivocal good (?)

Dealers' Choice? Deal-Fever in Short Lines (still)

- Many small recent deals (by OmniTRAX, RJ Corman, etc.)
- Watco-Dow deal a new prototype?
- On the market: US Steel lines, many others BTR
- Off Market & Smaller Deals (ex. SLGW)
- Spanner in the works? Problematic STB?
 - Massena Line & lawsuits
 - Amtrak in the Gulf (& elsewhere)
 - *Pan Am still "Incomplete" (NEARS)*
 - *WC-Watco*
 - KSU? A *Slam Dunk*?
- Buyers (all with different CoC, timeframes, ROI expectations):
 - Strategic (above)
 - PE (and PE/partner)
 - Infrastructure Firms
 - Class Ones as sellers (CN?) and/or Buyers (CP-CMQ, CSX-PAR?)

Rails Fall 2021 – Realities & Perceptions

- RR investing themes (managers & investors) move from *“Cult of the OR”* (alone) to
 - Growth
 - Technology
 - ESG
 - COMPARISONS – mostly useless *and* about to get harder in H2/21
 - Rails modestly trail the market H1/21
- Rails get unofficial “B+” for H2/20 Recovery (both operationally & financially)- and by ASCE
- But....Today it’s a “C” as Rail Service is an issue (again) – perception & reality
 - ACC and other Shipper groups
 - House T&I Committee
 - STB commentary
 - Churchill: *“never let a good crisis go unused!”*
 - Rail metrics improving by the end of the quarter into summer – *but NOT (YOY) RR traffic*
- Rail Q3/21 EPS – 4 “wins” 2 “losses” (slight – but from CP & KSU, interestingly)
- As Supply Chain “fragility” tests globalization, sparks inflation, *makes headlines*
 - A truly world-wide issue , and labor based– ocean, ports, rails & trucks, warehouses, shippers
 - JIT to JIC actually benefits rails
 - Near-shoring?
 - Front page news!
- Add Consolidation to the mix....giving the STB an opportunity?....
- Add the White House to the mix....

Executive Order (& Leak) Sows Confusion

- Biden's EO against power consolidation/BIG business includes rail
- Clearly a late addition
- Leaked as "part 2" to the WSJ, the scoop send sends RRs stocks down
- So....2 paragraphs/page 9 (*"Is That All There Is?"*) – *only an Encouragement (STB is "very, very independent")*
 - *Advises freight rail to work with Amtrak (remember the POTUS nickname)*
 - *Suggests "fairness"*
 - *NO mention of current M&A (KSU); almost definitely coincidental*
 - *DOES provide "cover" for the STB opposition to the merger (if....)*
 - *DOES support the consistently public statements by the STB/Chairman that RRs have too much power and are:*
 - *Monopolistic (EO suggested Duopoly)*
 - *Overly focused on cost - & headcount – reduction*
 - *"In bed with Wall Street", in thrall with PSR*
 - *So consistent with existing STB viewpoints*
- *Most likely outcome: HEARINGS!*

STB says “NYET” to CN’s VT; TCI gets Active

- The STB *unanimously* turns down the VT application, with nods to “Downstream Effects”
- That was game-over for CN proposal (*never had a chance under 2 sets of rules*)
- I expect that’s game-over for *any* future C1 consolidation (on *this* I agree with Marty!)
- KSU pivoted back to CP – filed the application – reveals revenue benefits from rail share opportunity higher than publicly discussed; STB timing?
- This move relieves some industry pressure – but *succession issues* remain
- TCI (remember them?) owns 5% of CN (and shades of Jay Gould, 8% of CP!) and issues a challenge:
 - Jim Vena to replace JJ? JJ to retire
 - OR “gap” must be closed, pivot *away from* growth!
 - Letter seems rushed (typos) & inaccurate (in OR accounting)
 - But activists, including TCI-CSX, are 3-0 in the modern era
 - New vote is March 2022

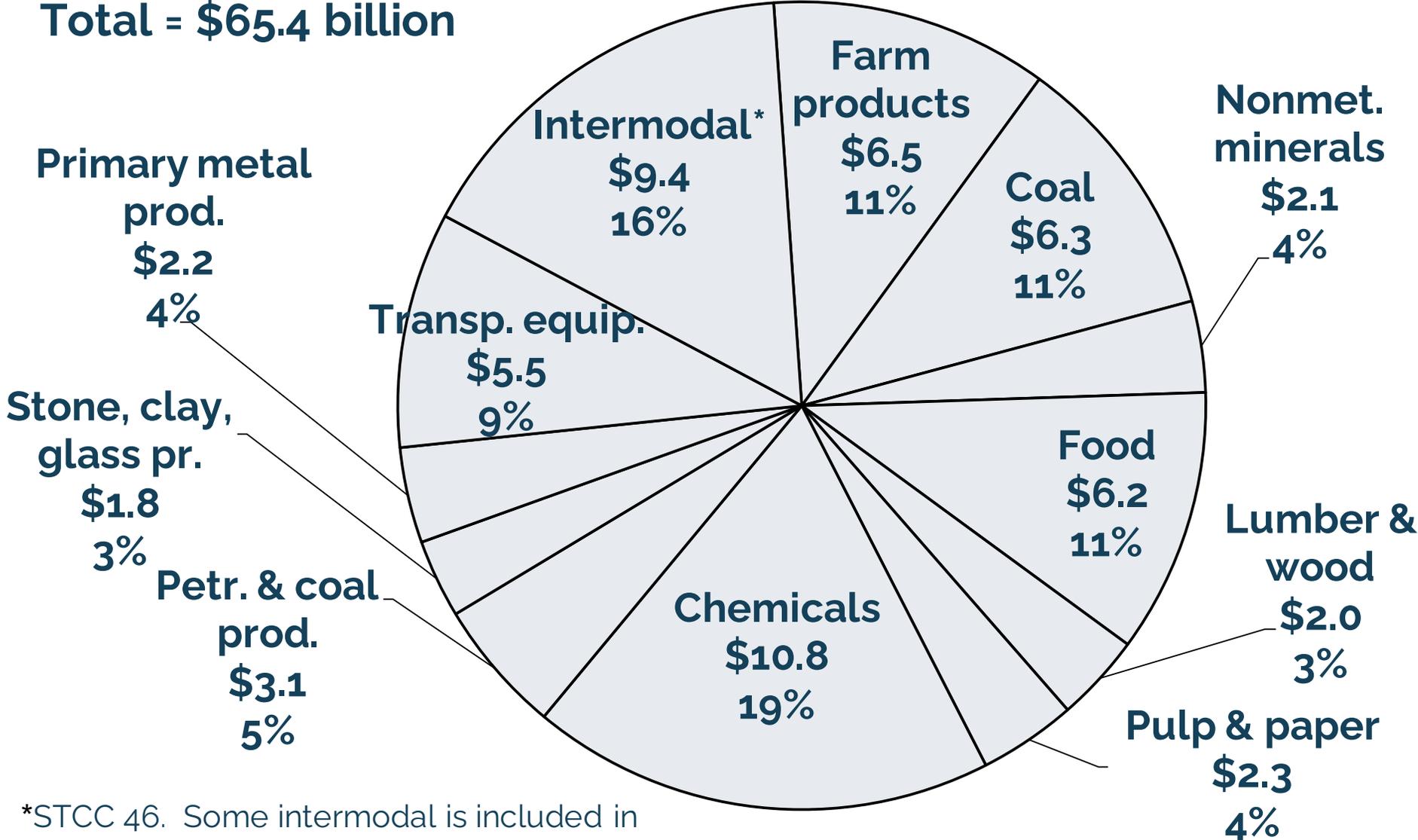
To meet coming “existential threats”, Rail
Tech/Innovation is Accelerating (T10) – 2022
Budgets will be critical

1. Inspection Portals (from CN to the world)
2. Track Inspection Cars (at speed) and other preventive MoW)
3. New loco power (BN-WAB, PHL, **CP!**)
4. Rail Pulse – a game-changer (and other EODB efforts)
5. Moving Blocks/Quasi-moving Blocks (BNSF) – unlocking PTC
6. Outside Investments – CN/UP+Tu Simple; KSU (etc?)
7. Big New Hires at CN (WAB) and UNP (WMRT); Innovation; LOS to the CEO?
8. Simulation (UP’s “Train Builder”)
9. Remote meetings, virtual crew offices, zoom (sigh)
10. AVR – the “Holy Grail”, change the RR strategy? Terminals.....

U.S. Class I RR Gross Revenue in 2020

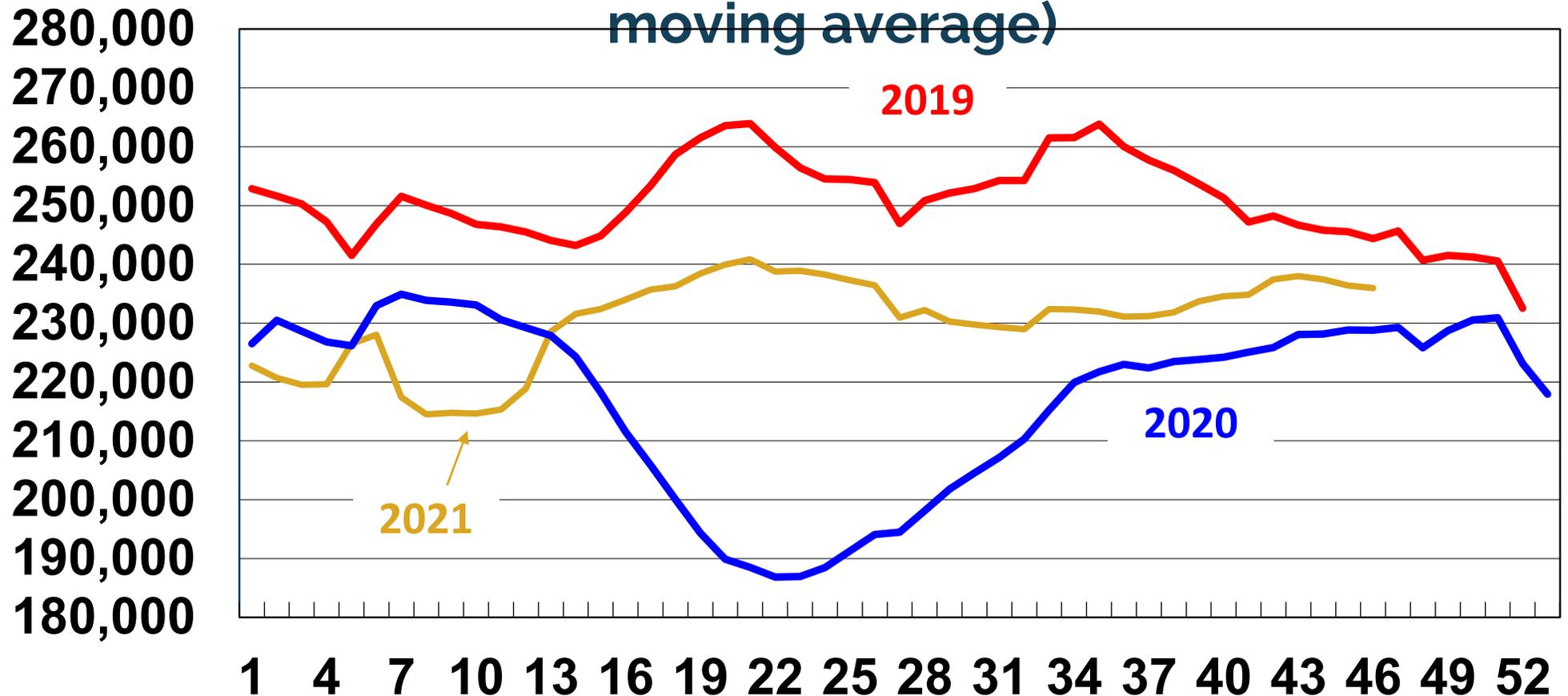
(\$ billions)

Total = \$65.4 billion



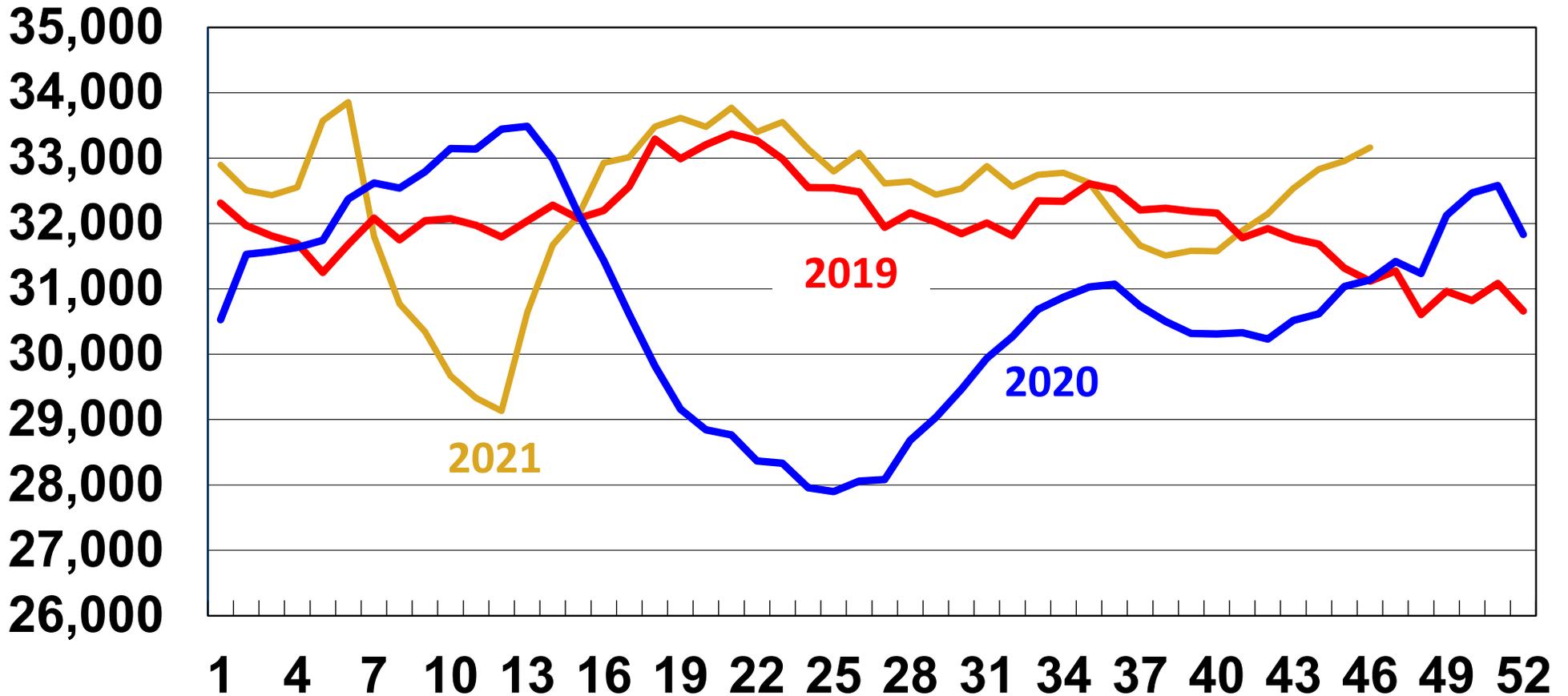
*STCC 46. Some intermodal is included in other commodities. Source: AAR (FCS)

(TOTAL US CARLOADS 6-week moving average)



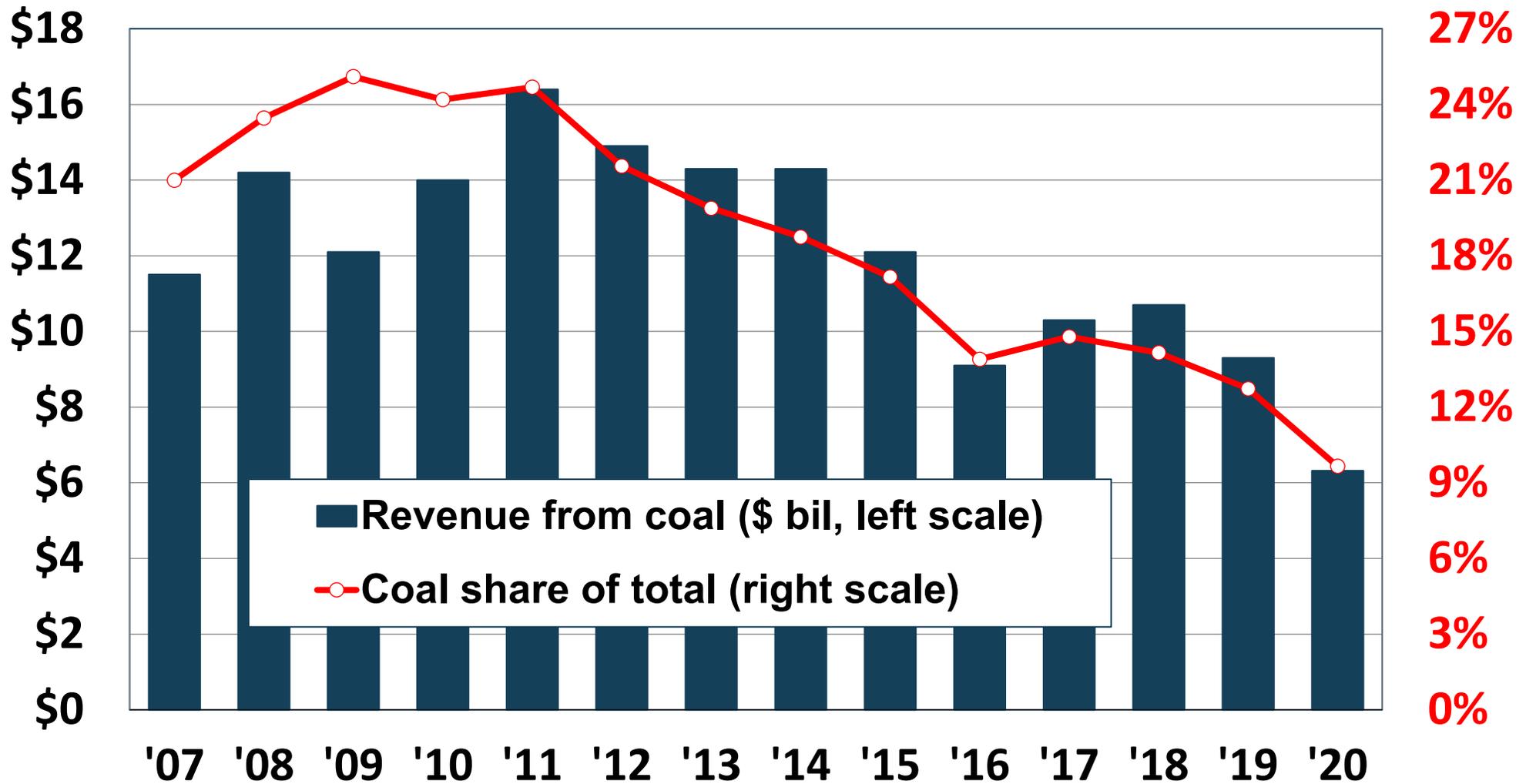
Data are originations, do not include intermodal, and do not include the U.S. operations of CN, CP, and GMXT. Source: AAR *Rail Time Indicators*

US CHEMICAL SHIPMENTS ON RAIL (6-week moving average)



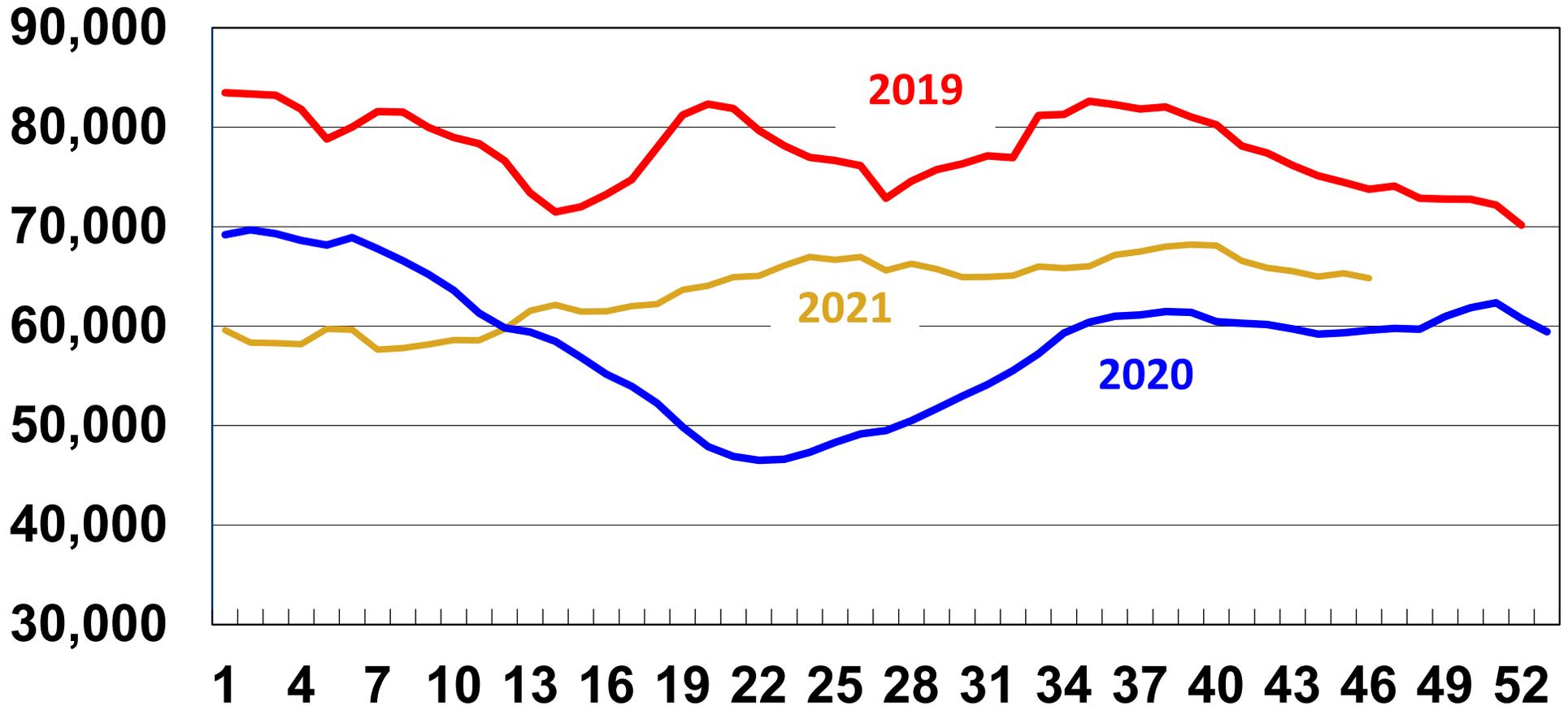
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U.S. Rail Revenue From Coal



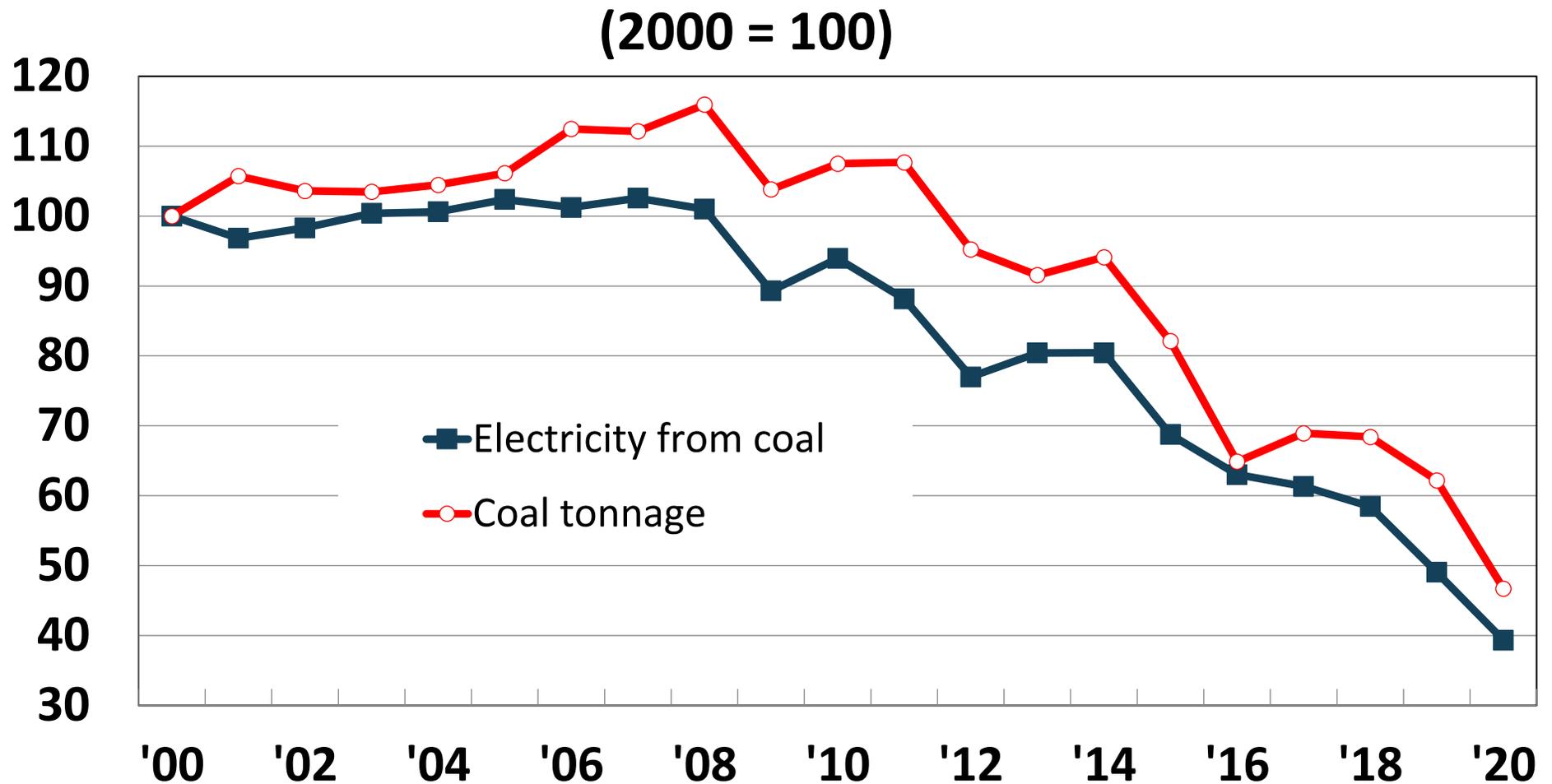
Source: AAR Freight Commodity Statistics

TOTAL US COAL CARLOADS 6-week moving average)



Data are originations, do not include intermodal, and do not include the U.S. operations of CN, CP, and GMXT. Source: AAR Rail Time Indicators

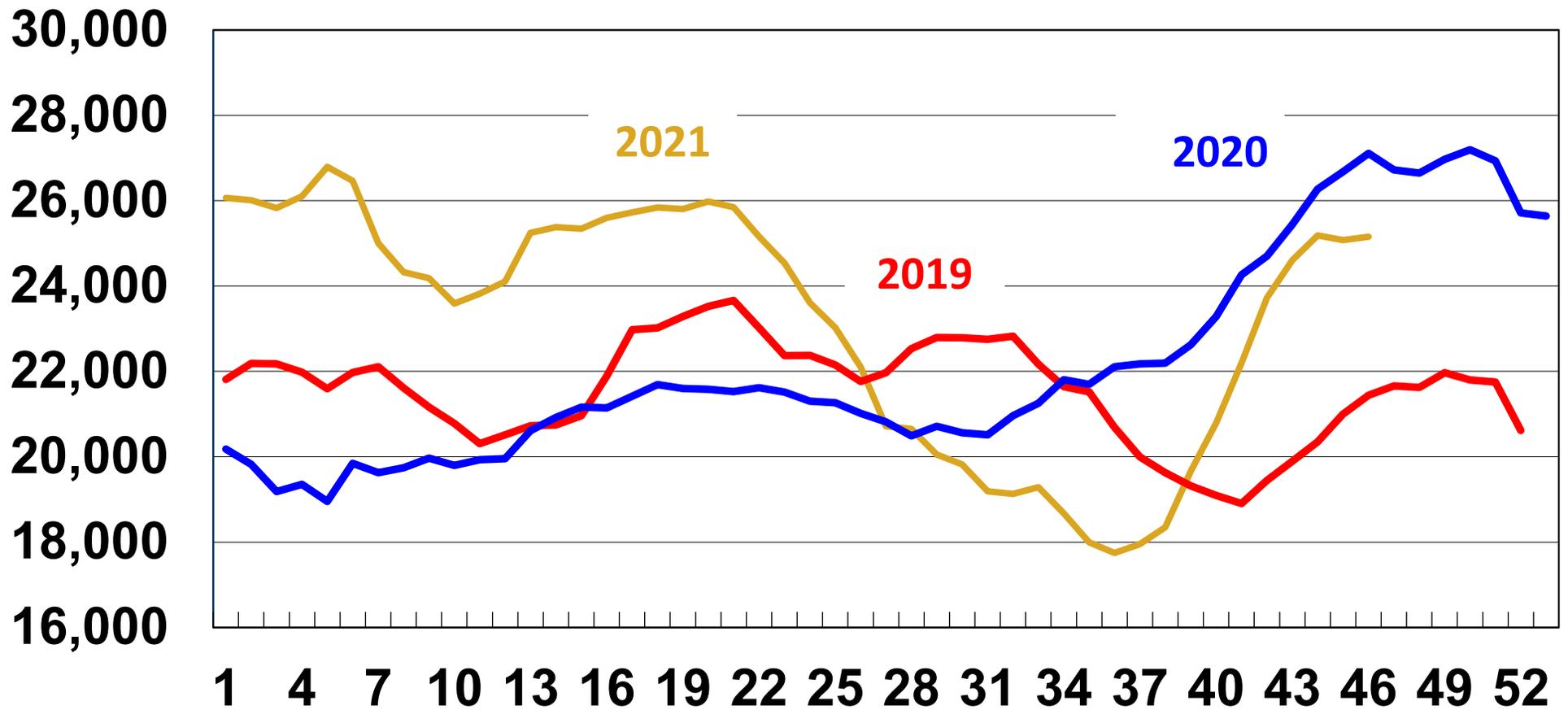
Rail Coal Volumes Are Closely Tied to Electricity Generation From Coal



Coal tonnage based on originated tons by U.S. Class I railroads.

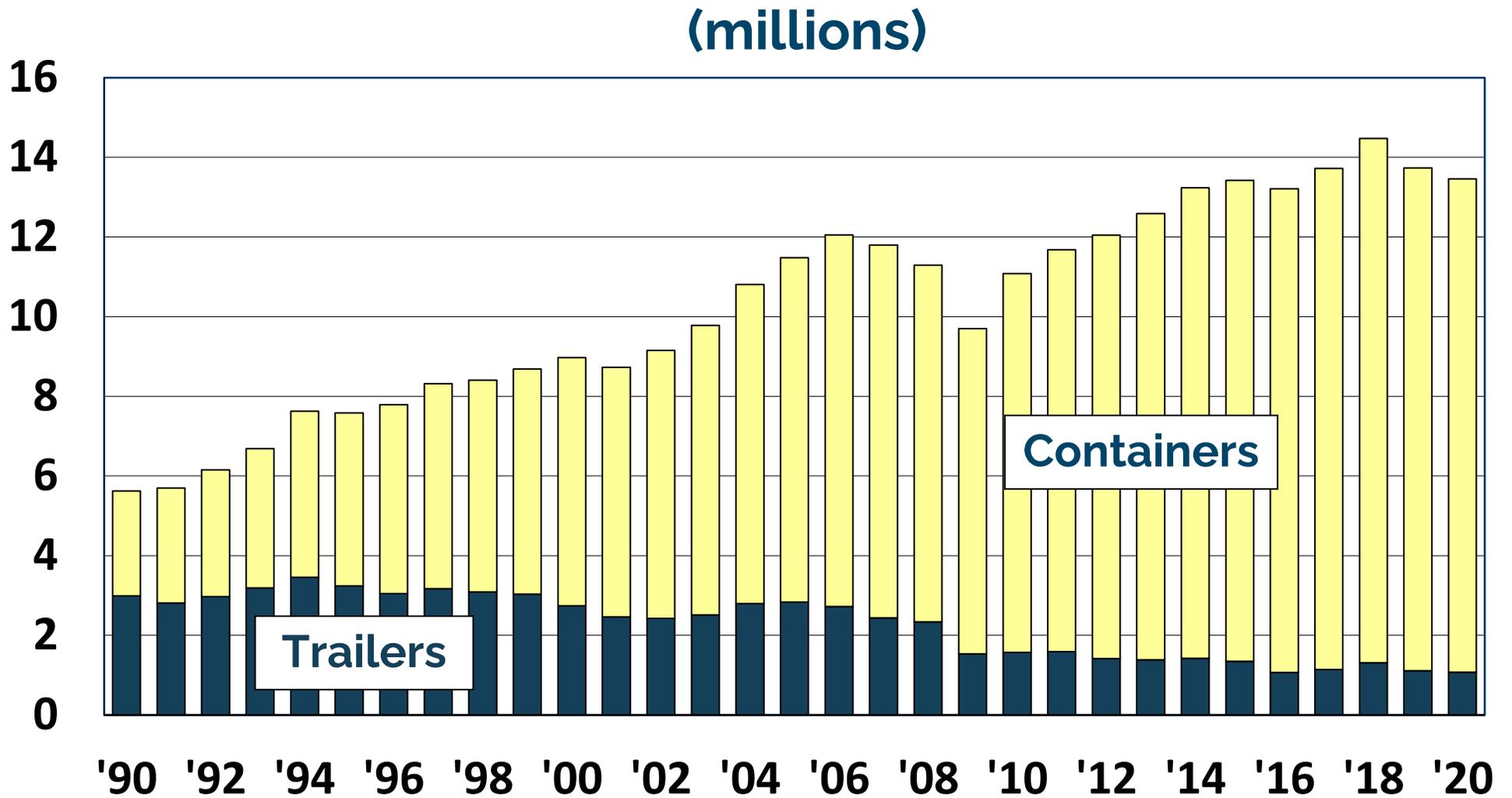
Sources: Energy Information Administration, Association of American Railroads

US (ONLY) GRAIN CARLOADS (6-week moving average)



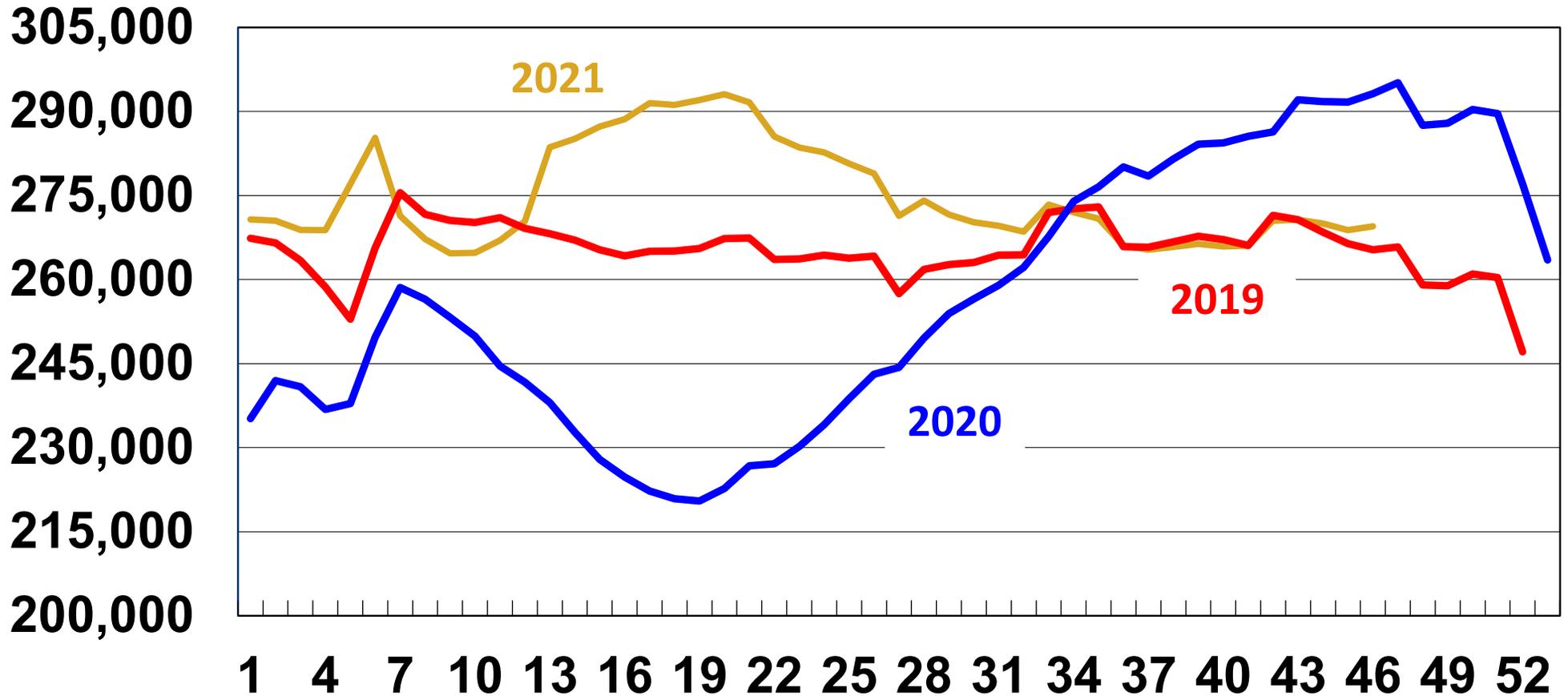
Data are originations, do not include intermodal, and do not include the U.S. operations of CN, CP, and GMXT. Source: AAR Rail Time Indicators

Rapid Intermodal Growth



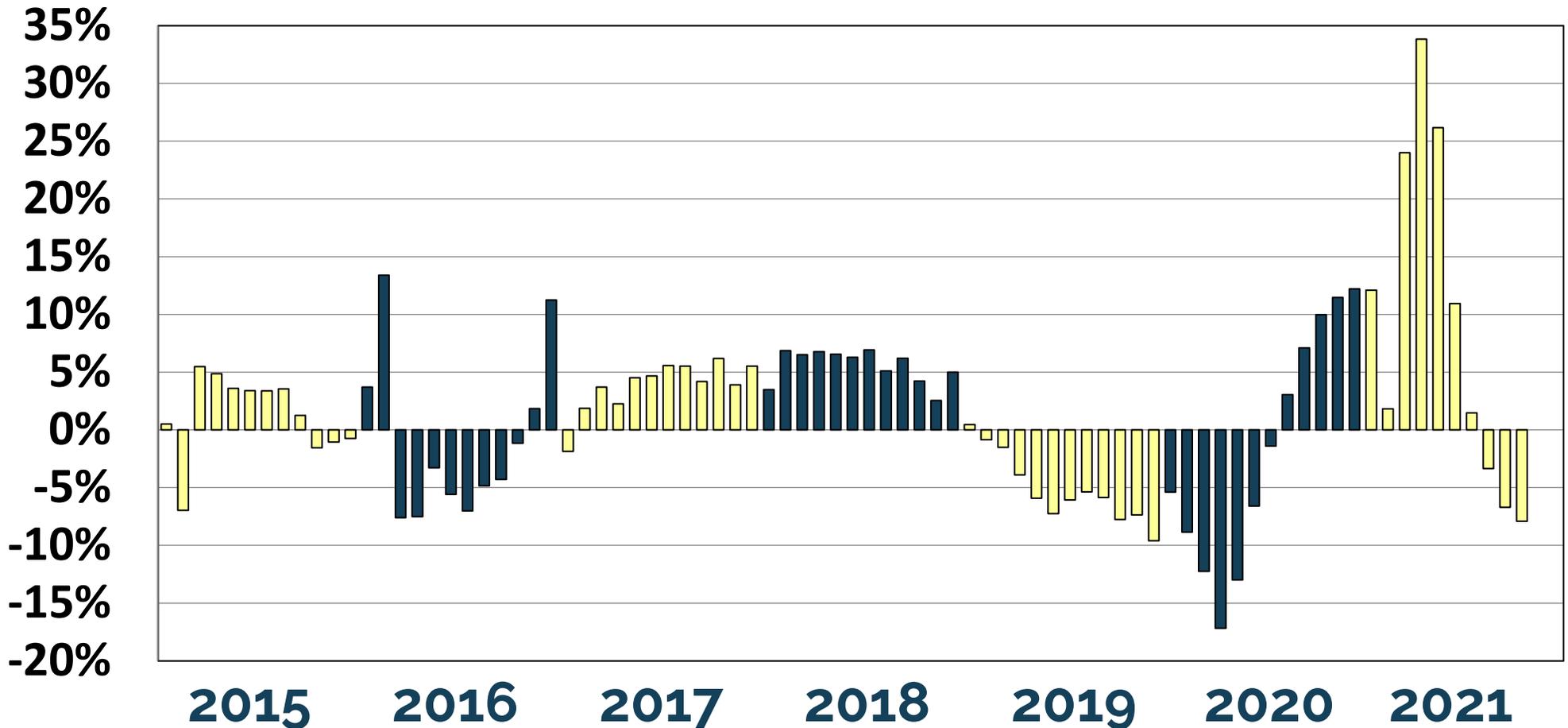
Source: AAR Weekly Railroad Traffic

(TOTAL US-ONLY INTERMODAL LOADS 6-week moving average)



Data are originations, do not include intermodal, and do not include the U.S. operations of CN, CP, and GMXT. Source: AAR Rail Time Indicators

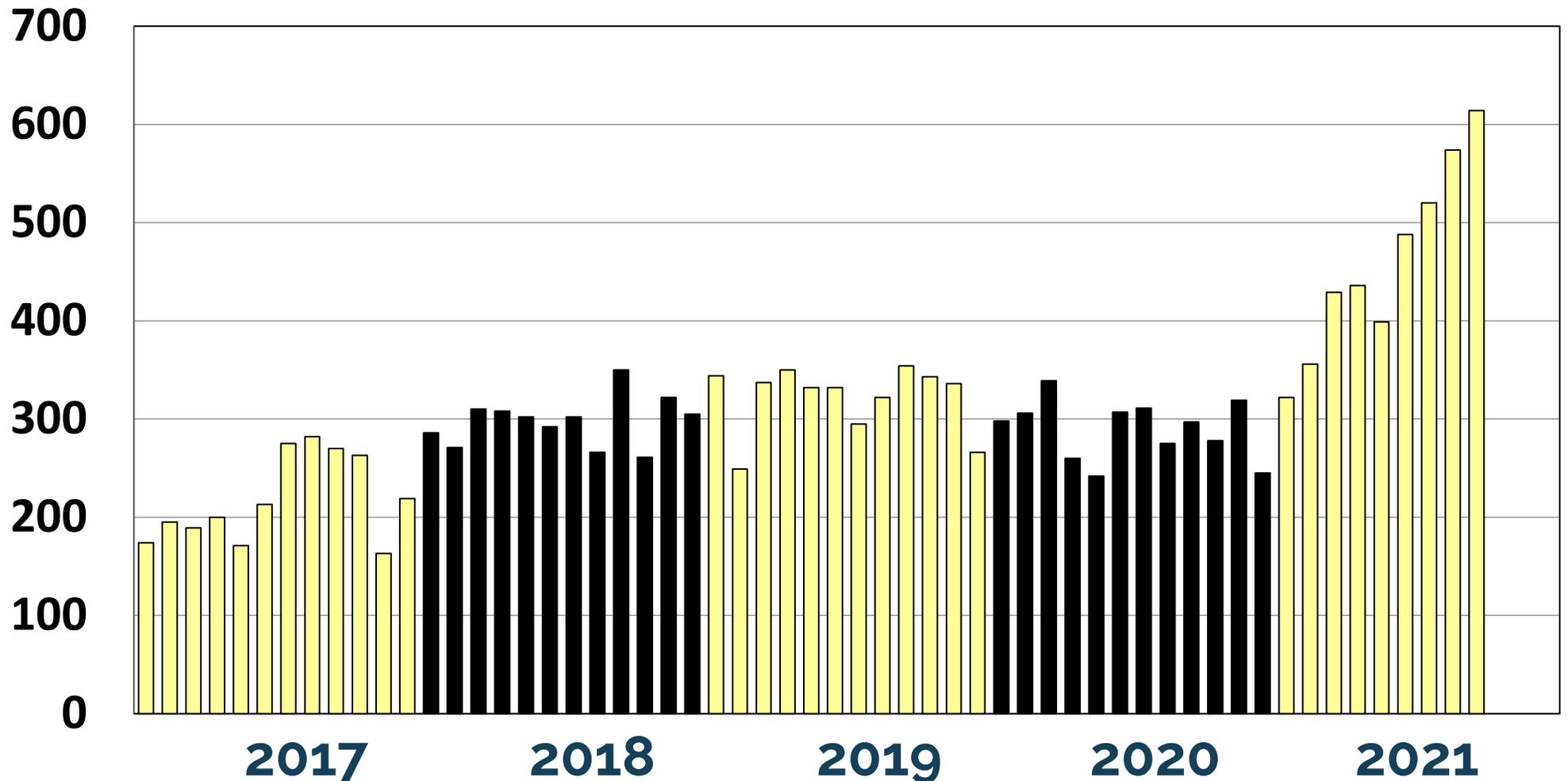
(INTERMODAL % change from same month previous year)



Data are based on originations, are not seasonally adjusted, and do not include the U.S. operations of CN, CP, and GMXT. Source: AAR *Rail Time Indicators*

Job Openings: Transportation, Warehousing, & Utilities

(000s)



Source: Bureau of Labor Statistics

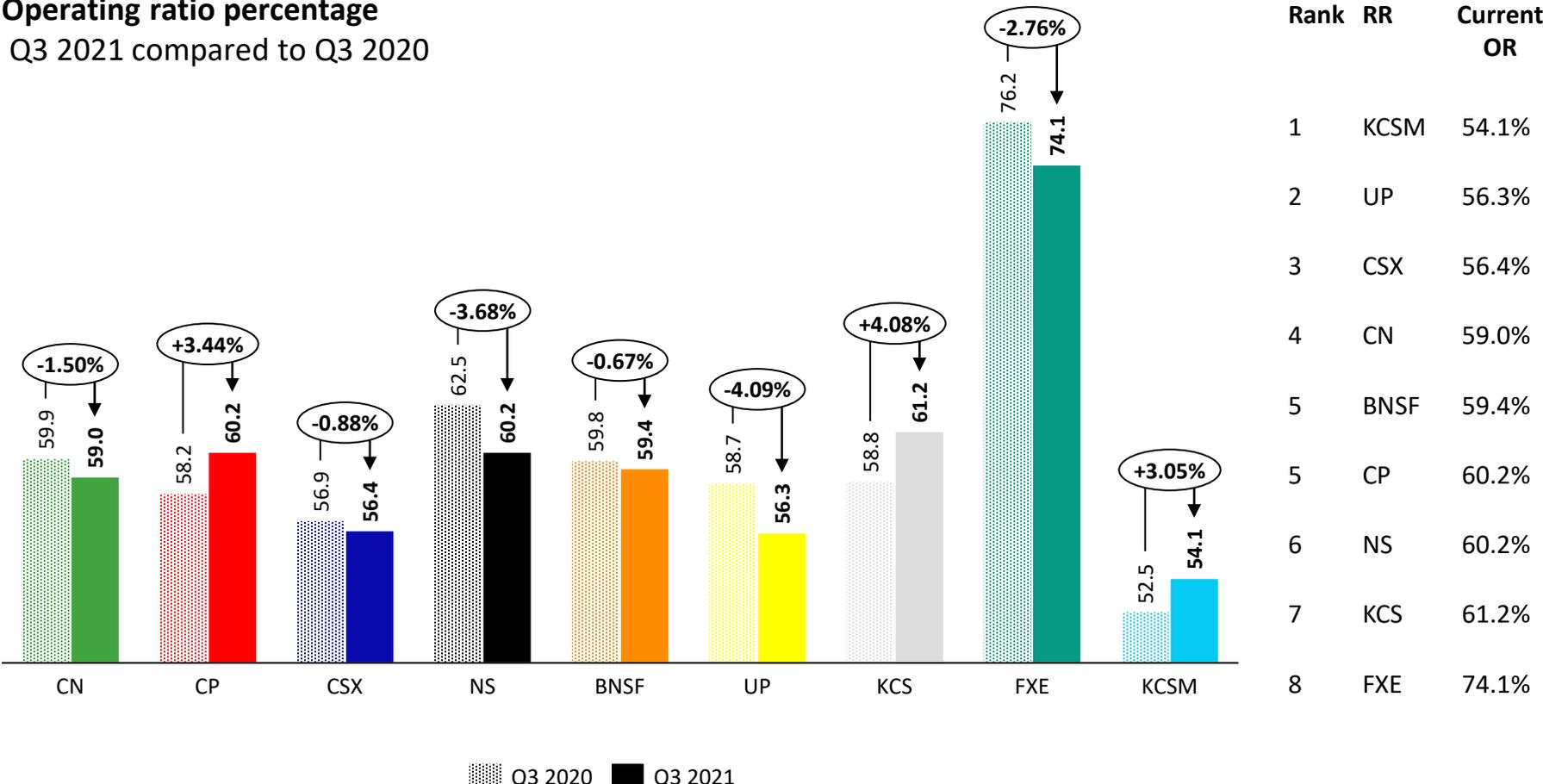
Summary/Winter Themes

- CP+KSU *will be approved* (under the old rules); the Last Merger
- CNI & TCI will dominate near term headlines (11/21) – except for supply chain coverage/misunderstanding
- RailTrends in November; Christmas (will happen) in December
- RRs must improve metrics – in the face of losing business, share and (any) govt. support
- Expect Hearings next year! Discussions of Reciprocal Switching, Demurrage, headcount....etc
 - Street Influence/Buybacks/OR/Duopoly?
 - 5/7 US RRs “earn CoC” – in 2020
- Other STB Issues: Massena/PAR/WC/Amtrak/PSR/*train length?*
- Succession Issues must be resolved
- Key Themes to re-emerge: Growth/Tech/ESG
- Q3 Results solid – but supportive? Q4?
- Coal – the last stand?

Operating ratio

Except for CP, KCS, and KCSM, all carriers saw year-over-year operating ratio decreases. Still, KCSM had the lowest overall OR at a calculated 54.1 percent, with UP following at a reported 56.3 percent.

Operating ratio percentage
Q3 2021 compared to Q3 2020

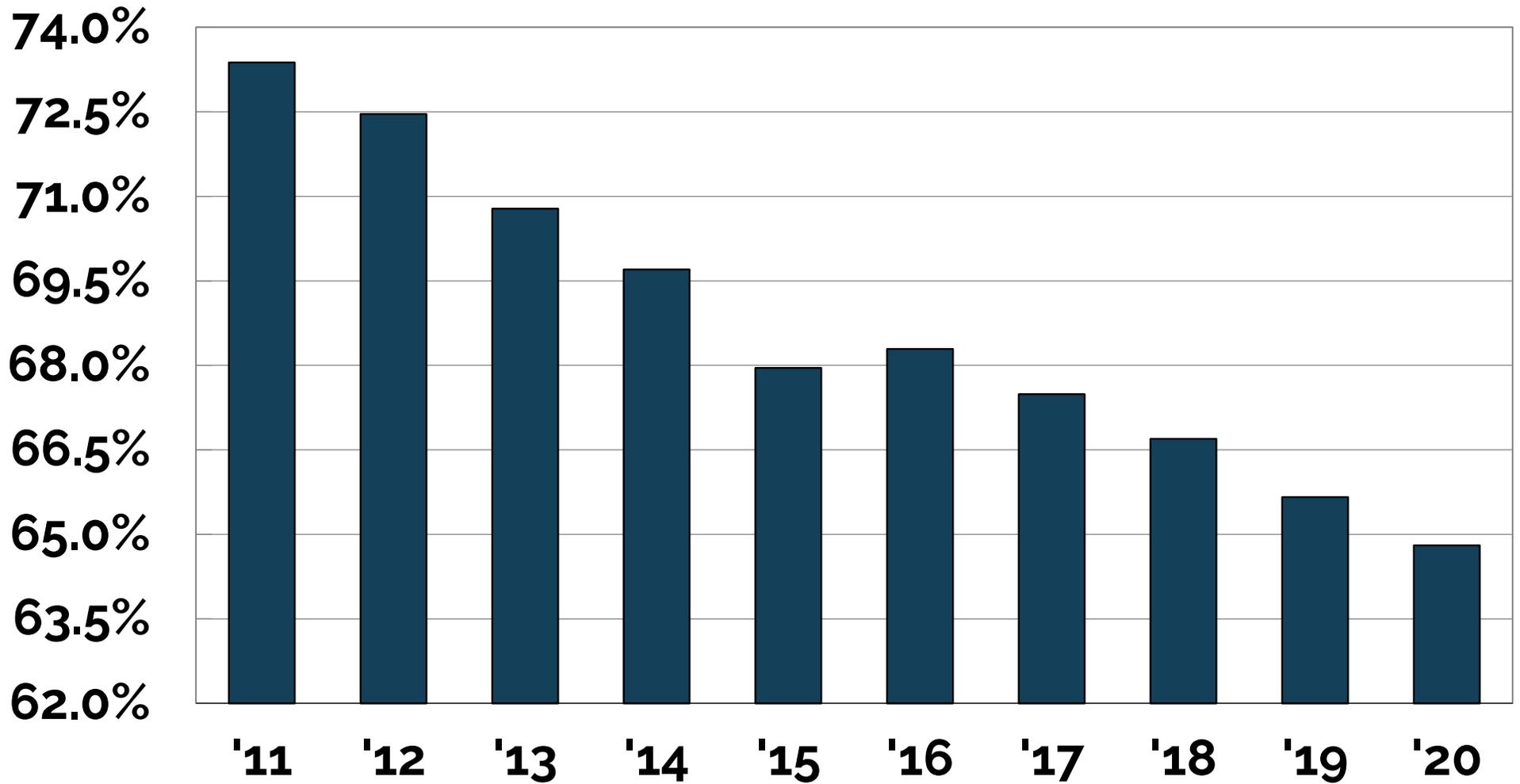


Note: Adjusted operating ratios in Q3 2020 for NS (unadjusted OR: 66.5%) and in Q3 2021 for CN (62.7%) and KCS (66.1%). Operating ratios for BNSF, FXE, and KCSM are calculated. All other operating ratios are as reported by the carriers.

Note: BNSF is BNSF Railway, not BNSF, LLC

Note: KCS's operating ratio reflects the company's operations in the US and Mexico.

Sources: Industry financial reports; railroad company press releases; Surface Transportation Board, Quarterly Revenue, Expenses, and Income; and Oliver Wyman analysis



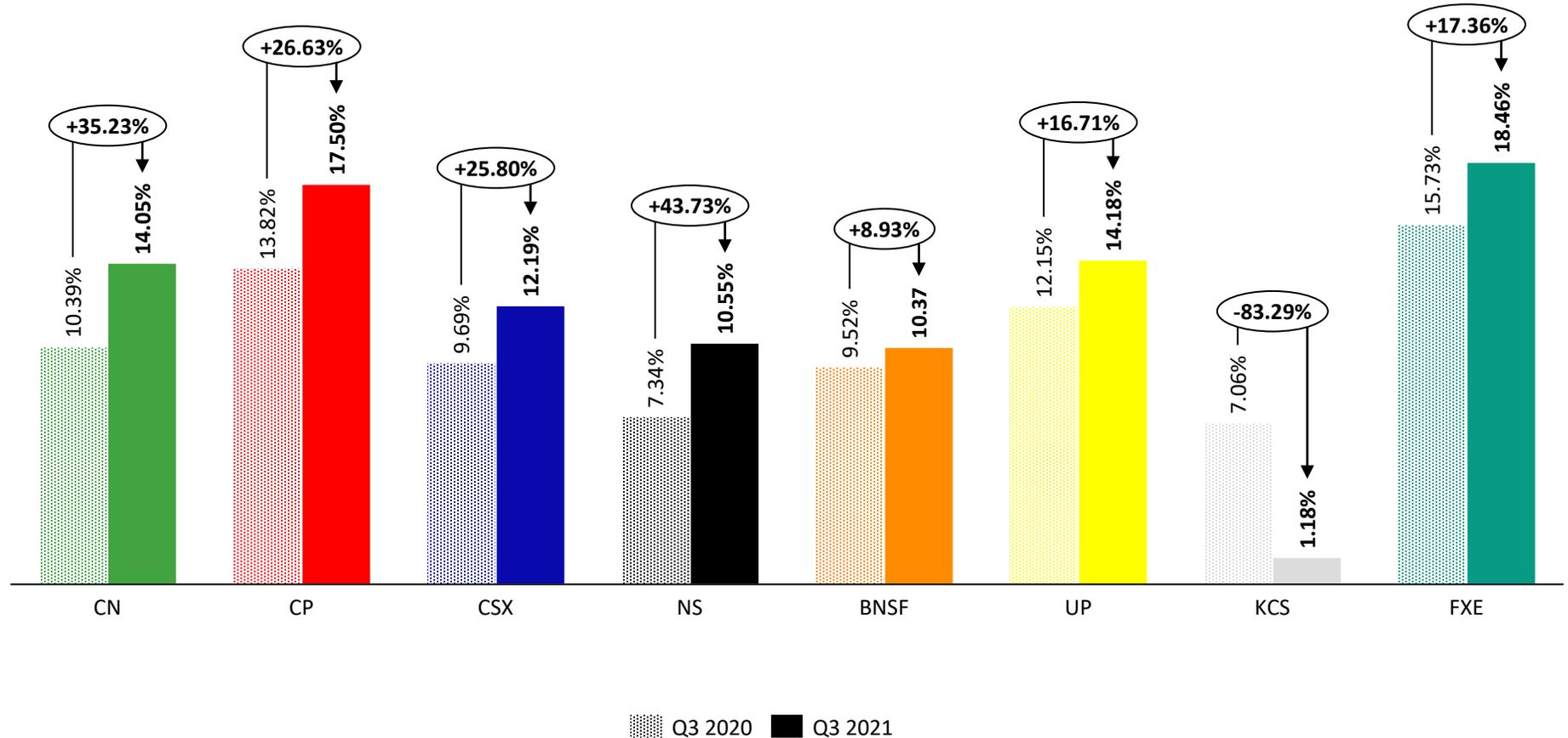
*OR – US-ONLY - Operating expenses as a percentage of operating revenue.
Source: AAR

Return on invested capital (ROIC)

All carriers, save KCS, saw a year-over-year increase in ROIC. KCS's decline was due to merger-related charges \$720.8 million and \$36.5 million taken in the second and third quarters of 2021, respectively.

Return on invested capital

Q3 2021 compared to Q3 2020

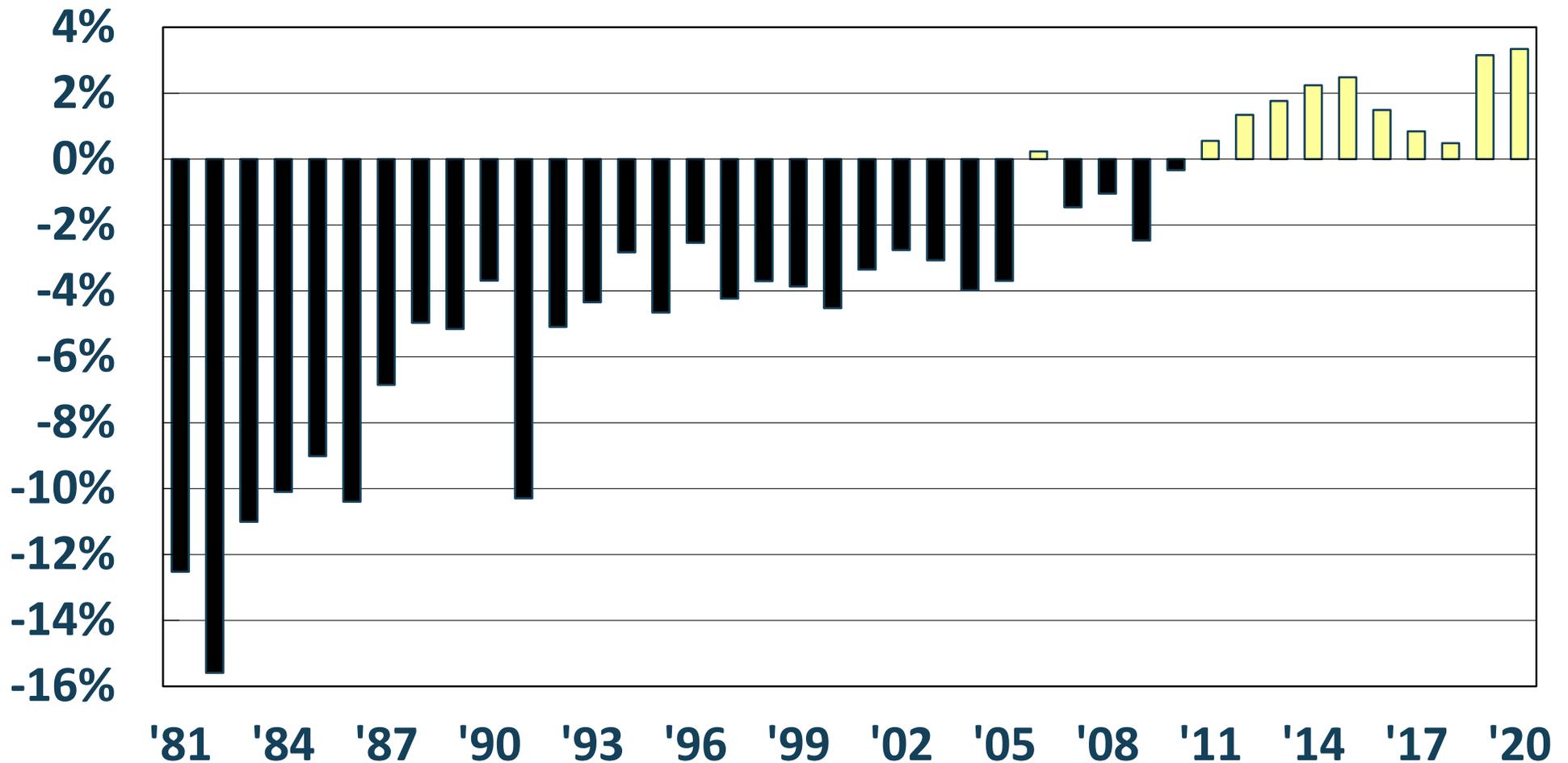


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Note: KCS's return on invested capital figure reflects the company's operations in both the US and Mexico

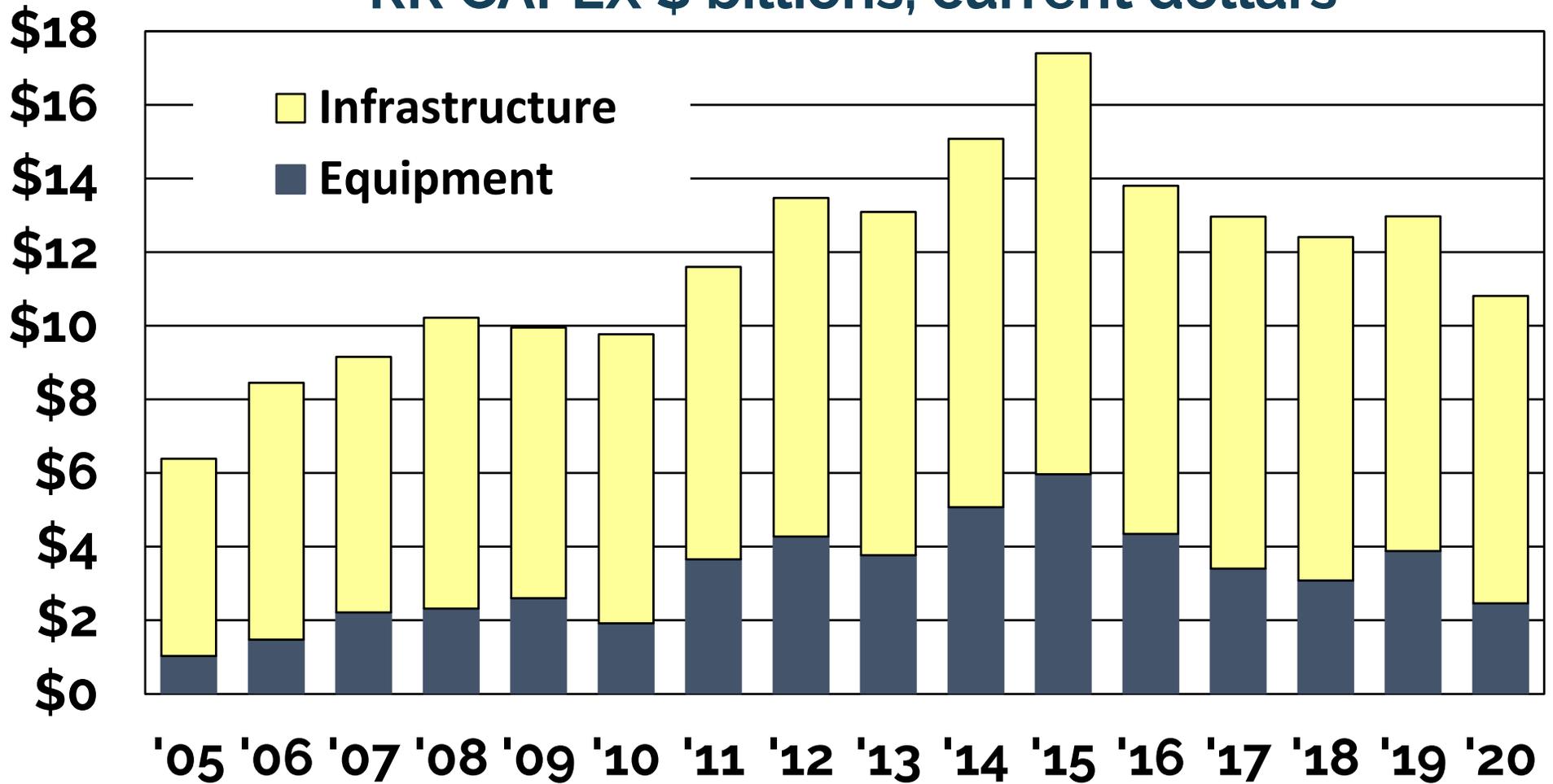
Sources: Industry financial reports, Ycharts.com, press releases, and Oliver Wyman analysis

Spread Between Rail Industry's Return on Investment and Cost of Capital



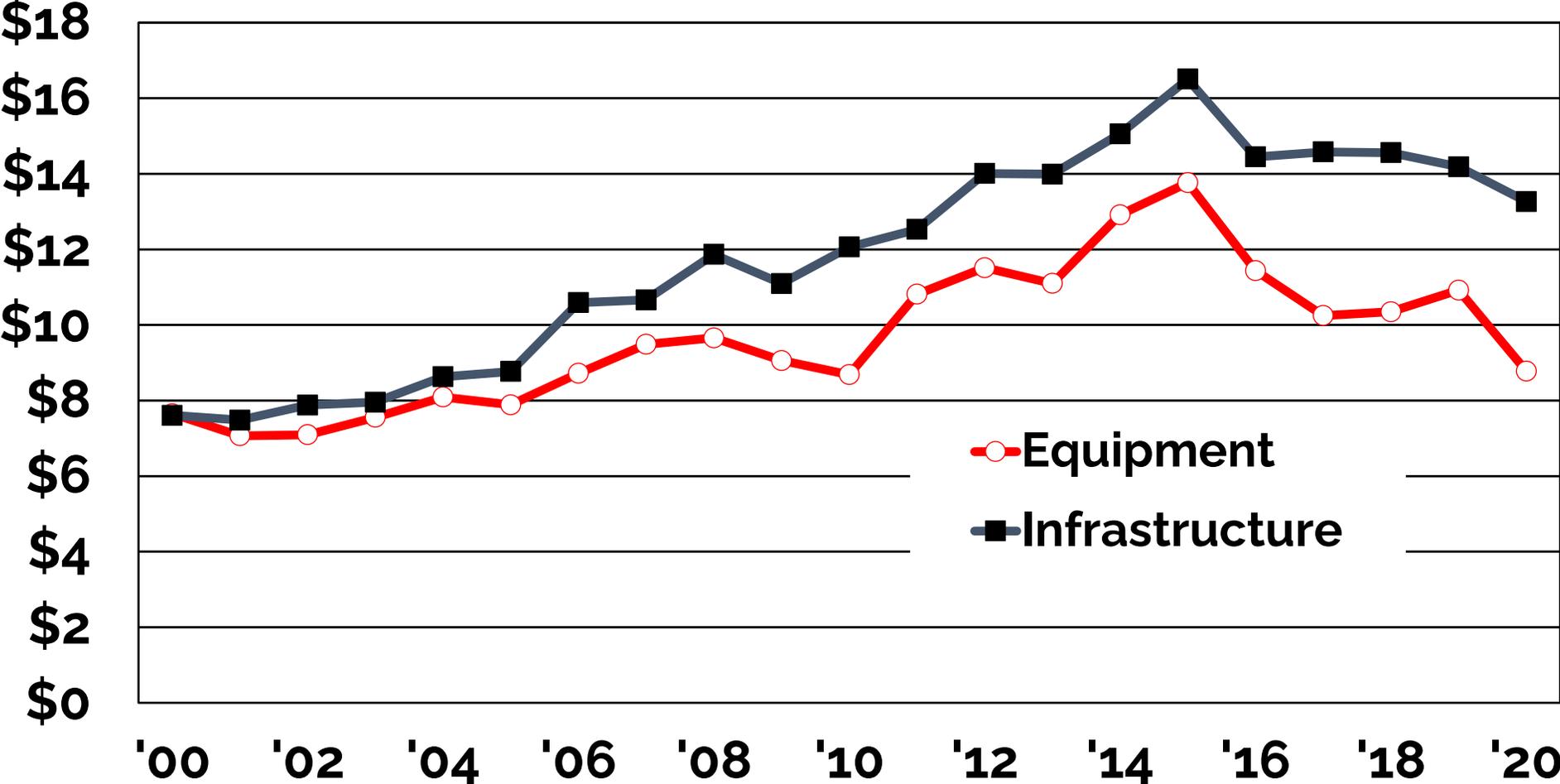
*In 2006, the Surface Transportation Board significantly changed the method by which it calculates the rail industry cost of capital. Source: STB

RR CAPEX \$ billions, current dollars

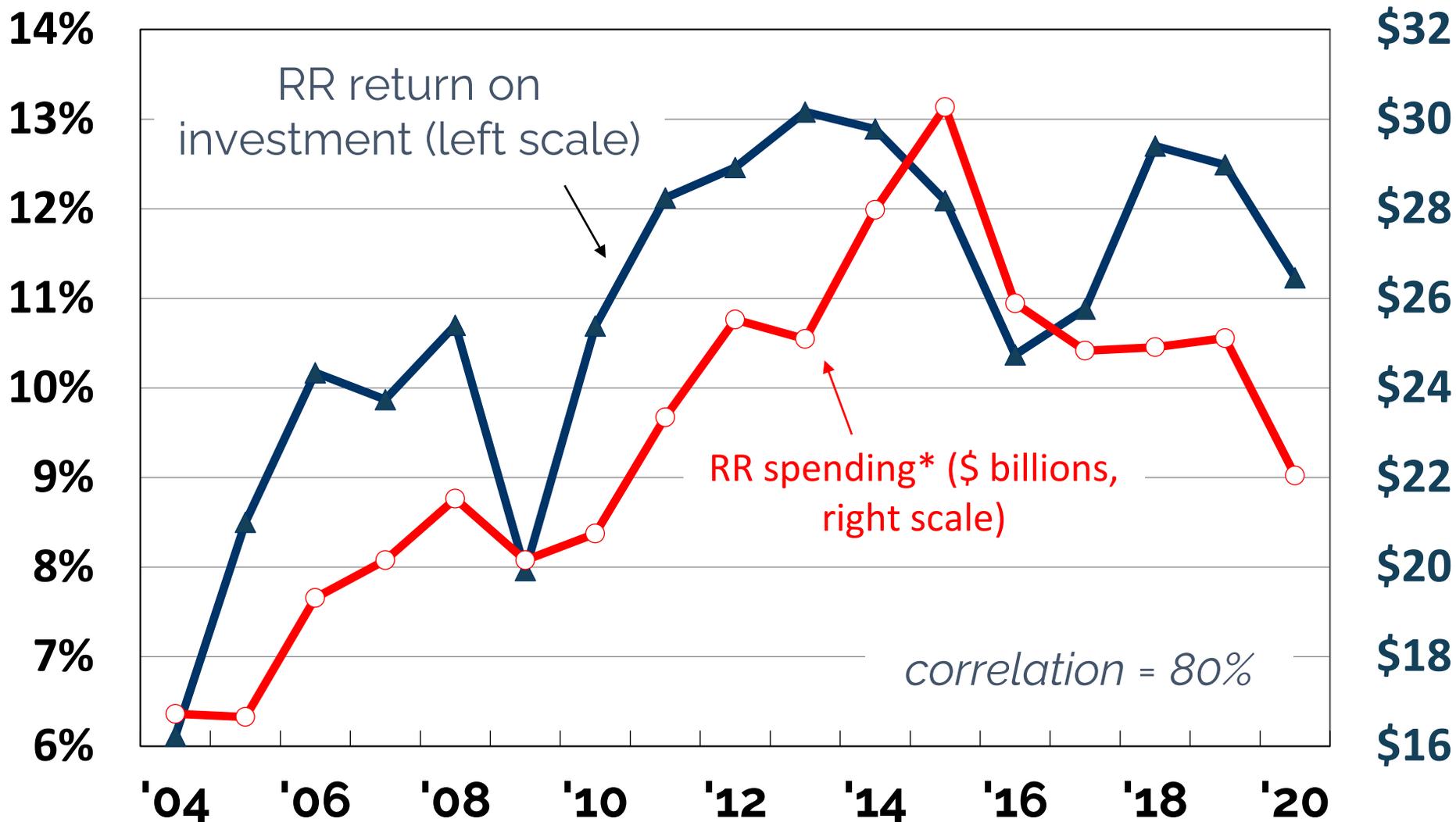


Data are for Class I railroads. Source: AAR

RR CAPEX \$ billions, current dollars

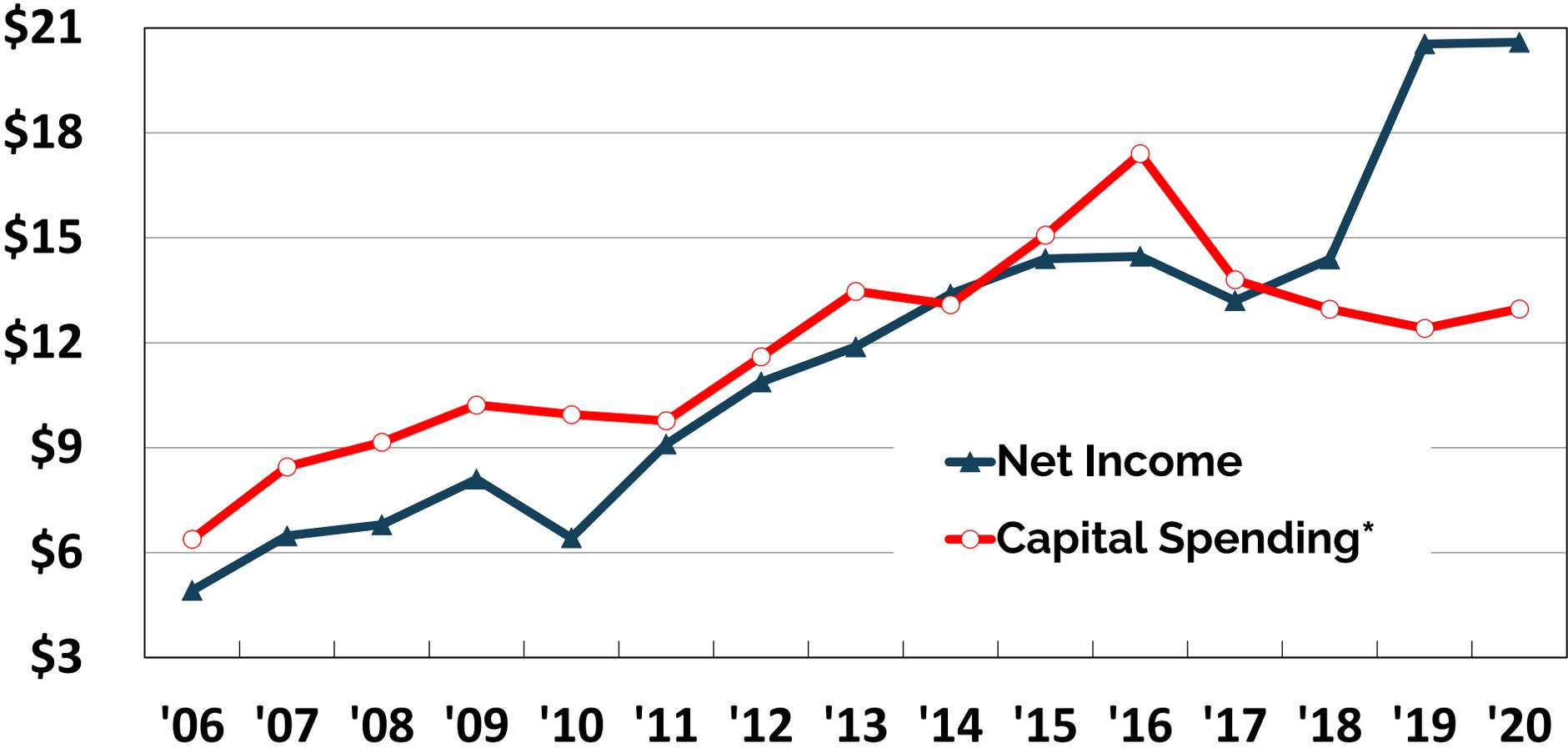


Data are for Class I railroads. Source: AAR



*Capital spending + maintenance expenses. Source: AAR

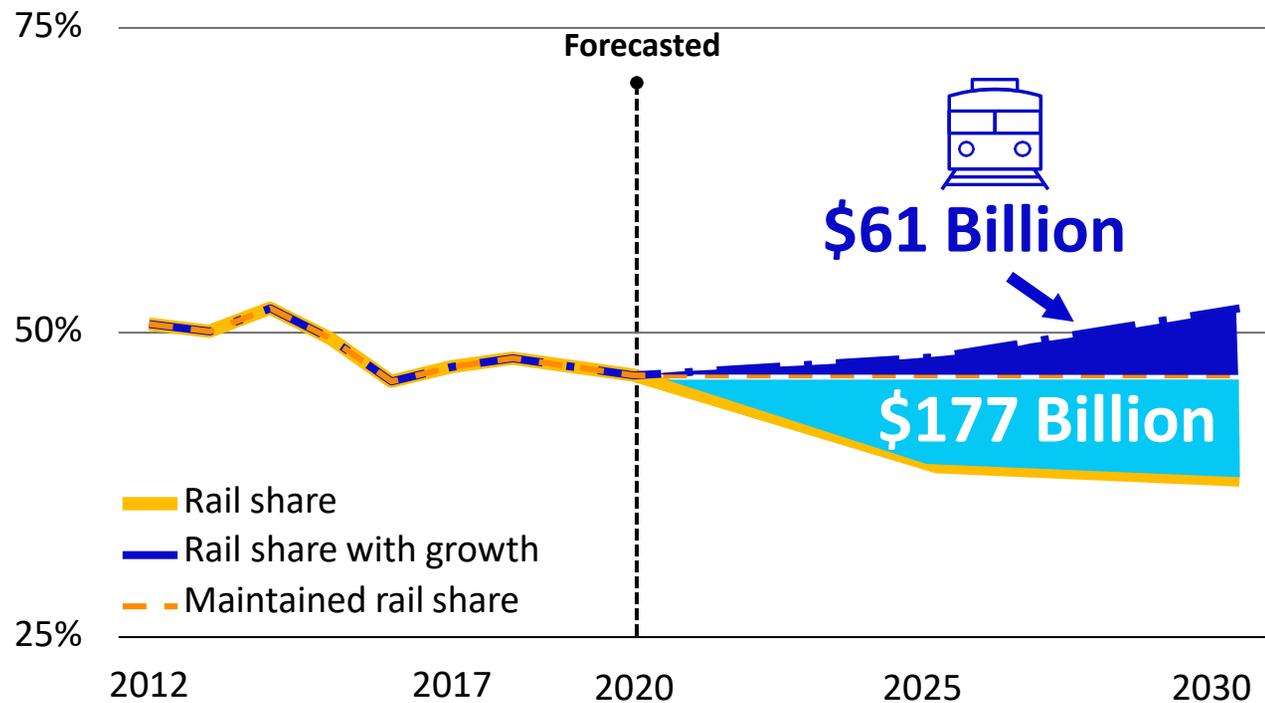
CORRELATION BETWEEN NET INCOME AND RR CAPEX \$ billions



*Net income for 2017 has been adjusted to account for tax effects from the Tax Cuts and Jobs Act of 2017. Data are current dollars and are for U.S. Class I railroads. Source: AAR

BY USING AVAILABLE CAPACITY, RAILROADS COULD ADD \$61B MORE IN GROWTH REVENUE – WITH LIMITED CAPEX

Freight market share analysis and forecast by ton-mile



Gaining a half point of share per year delivers growth that by year ten fills current available capacity



Assumes no material technology advancements

Person of the Year

NARS recognizes
Tony Hatch
with the
NARS 2019 Person of the Year Award
for his steadfast support of NARS and its regional associations.

*Thank you Tony for your guidance, dedication and service
to NARS and its regional association!*





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