

2016 CRS Presentation

Wounded sentiment pressures balanced cash flow
policy – *Long Term Thinking is Critical*

May 2016

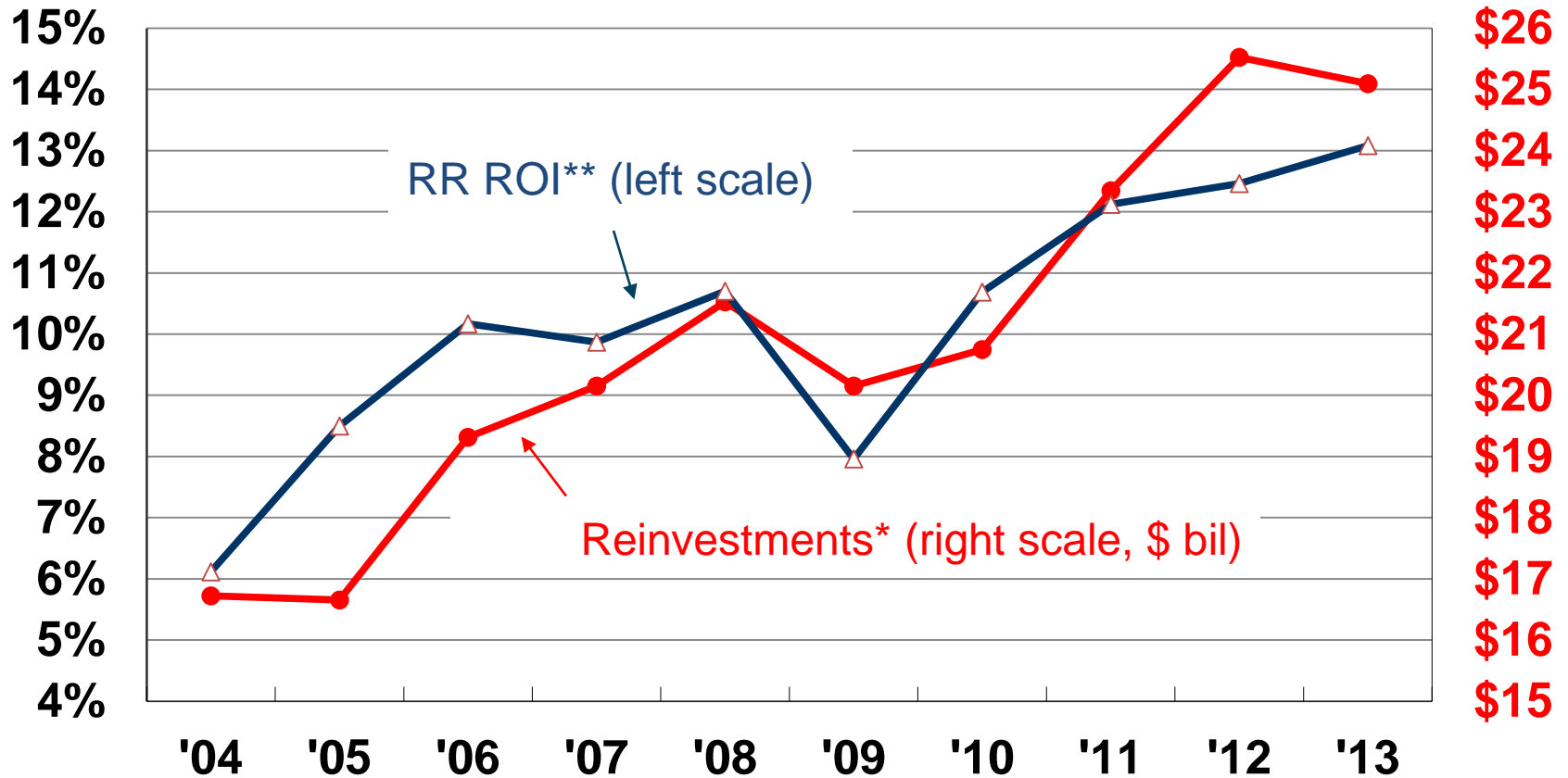
abh consulting

NYC

Overview of North American Rail Environment & Key Issues

- Rail Renaissance the key theme (1980-) 2001-2013
- Challenges Emerge – Energy Decline (Coal/Oil)
- End of the “Commodity Super Cycle” (?); Trade Slowdown
- Service & Safety Issues; Rereg threats re-emerge
- Rails are *still* re-gaining market share from the highway
- (therefore) Intermodal is Even More Important
- (and....) *Service & Productivity & Safety (all related to Capex) are Even More Important*
- Managements, New & Challenged: *Visibility, Guidance; Capex & Cash*
- Is M&A the Solution? (What’s the problem?)

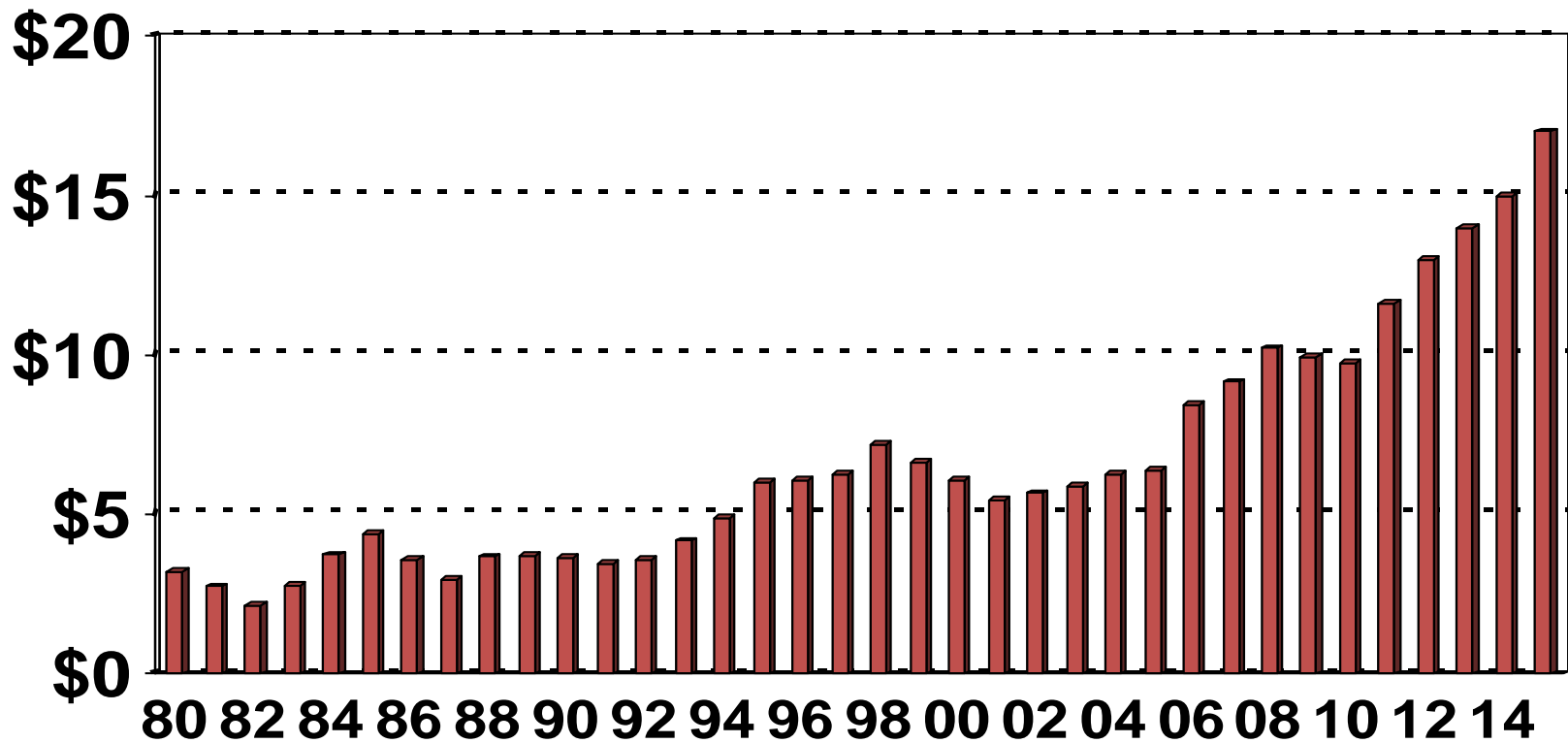
Close Correlation Between RR ROI and Reinvestments



*Capital spending + maintenance expense. **Net railway operating income / average net investment in transportation property. Data are for Class I railroads. Source: AAR

Railroad *Renaissance* Capital Expenditures Class I Railroads

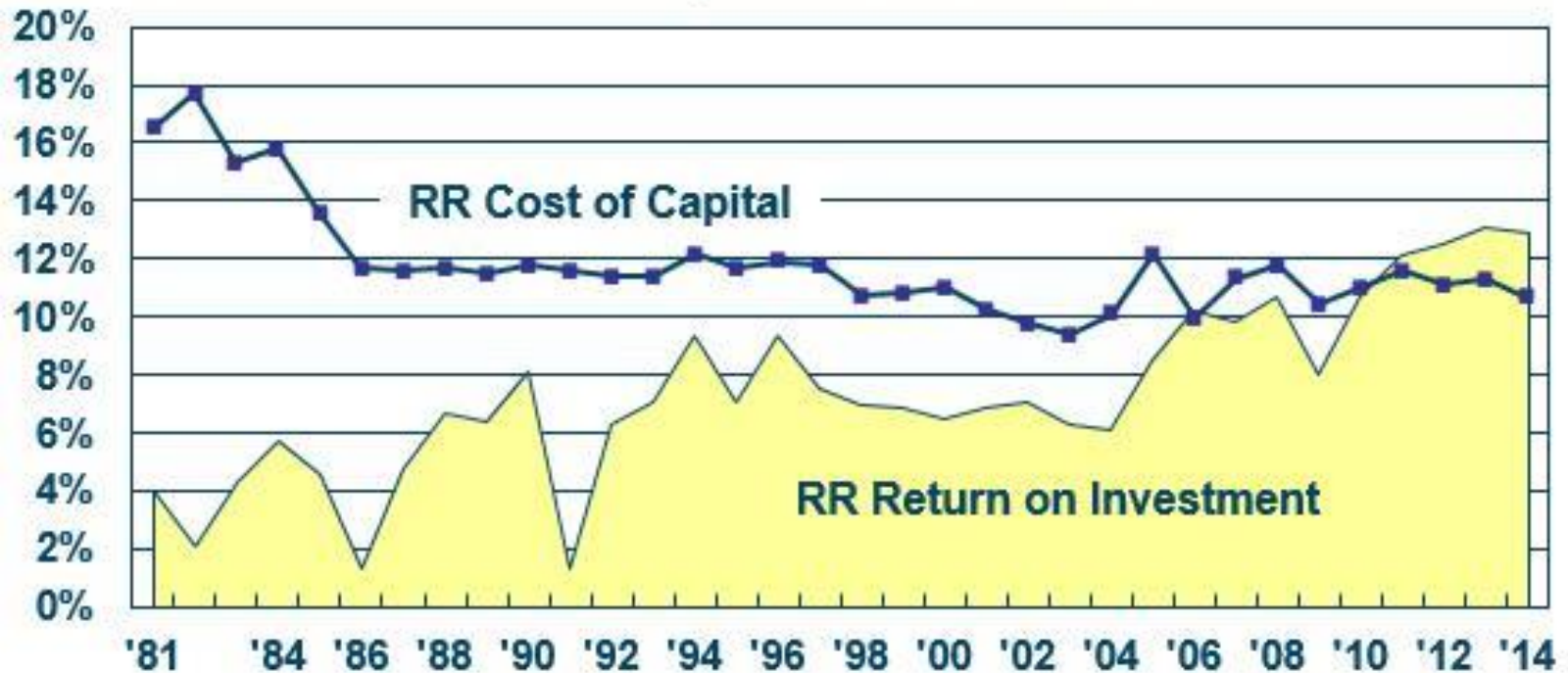
Billions



Source: *RRFacts & Analysis of Class I RRs*, AAR; abh estimates

Returns Finally Justify the Massive Expenditures

Class I RR Cost of Capital vs. Return on Investment



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

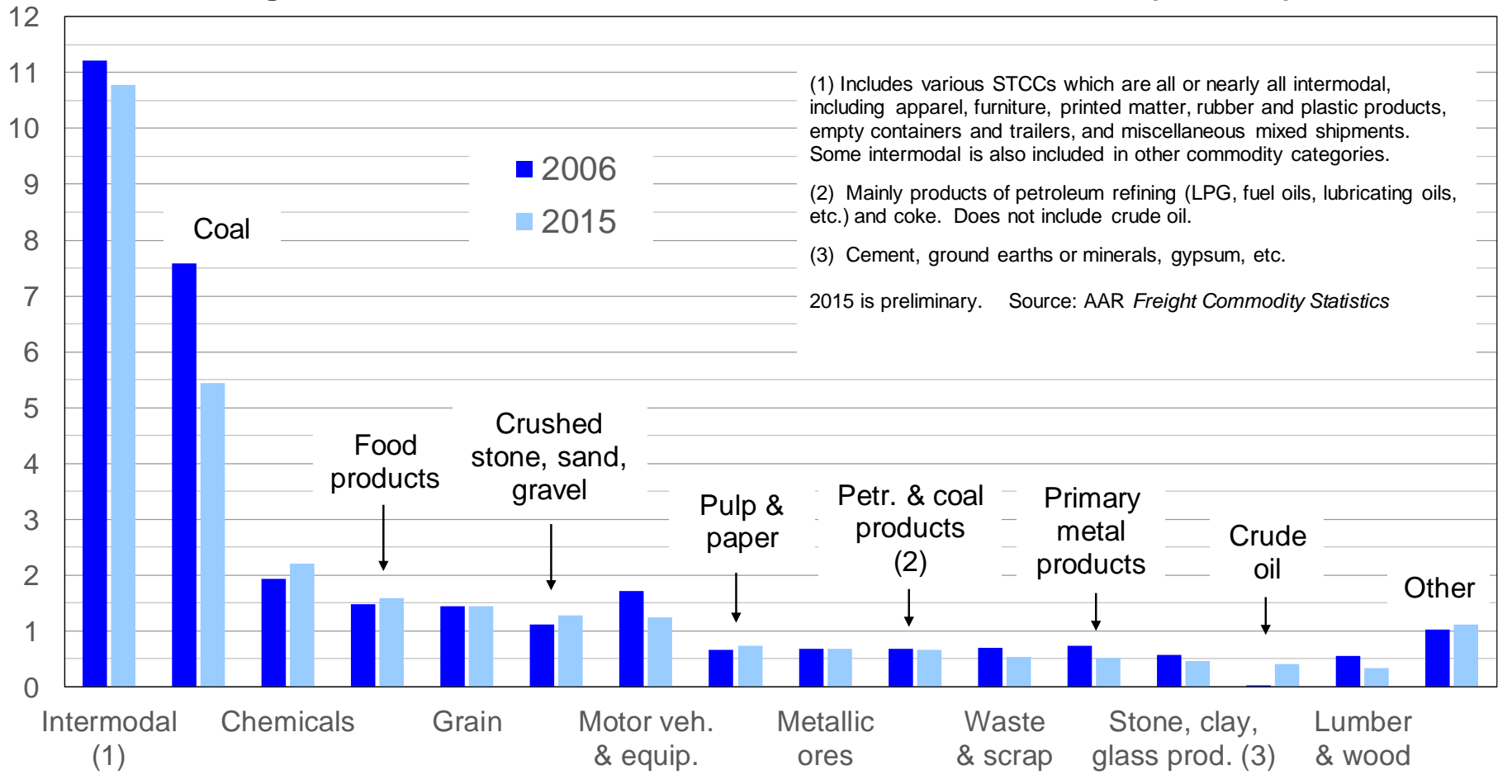
21st Century: the *Railroad Renaissance*

- *Rails as a group beat the market 2001-2014*
- *LTM (16) – “Not So Much” (CP doing relatively well)*
- (Yet) Earnings Power misunderstood: “Troubled” 2015 yielded record Income – and Capex – and direct payouts (buybacks+DPS)
- Even in Q1/16, ERails beat Street estimates – as in the Boom, in the great Recession, and the tepid recovery
- Record margins & results despite the US coal hit (and FX and oil and Ag and the lukewarm economy, etc....)
- Rails are *still* re-gaining market share from the highway

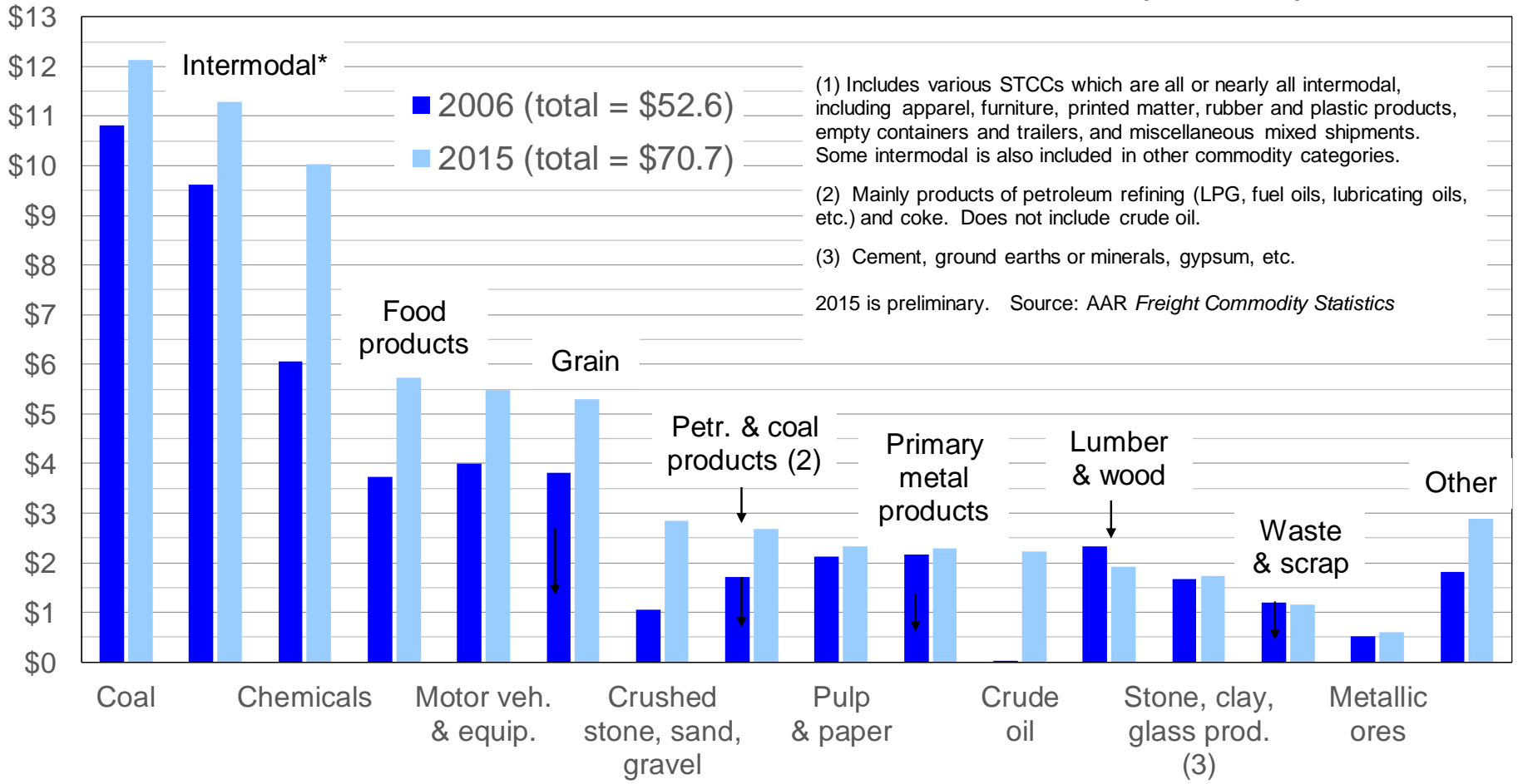
Emerging Challenges to the Railroad Renaissance

- *Earnings & Ratings Reductions/Sentiment*
- Coal's Decline (#1US Utility #2 NA Export)
- CBR Volatility (XL; CRR, etc....)
- Rail Service, Safety & Capacity Issues
- Rereg Threats
- Cyclical Traffic Weakness (metals, etc)
- Management Changes & turnover
- Management Reactions: Guidance, Capex....M&A?

Originated Units for U.S. Class I Railroads: 2006 vs. 2015 (millions)



Gross Revenue for U.S. Class I Railroads: 2006 vs. 2015 (\$ billions)



Change in U.S. + Canadian Rail Carloads: 2015 vs. 2014

Note: intermodal is not included in this chart. Intermodal was up 364,192 units (2.2%) in 2015 over 2014.

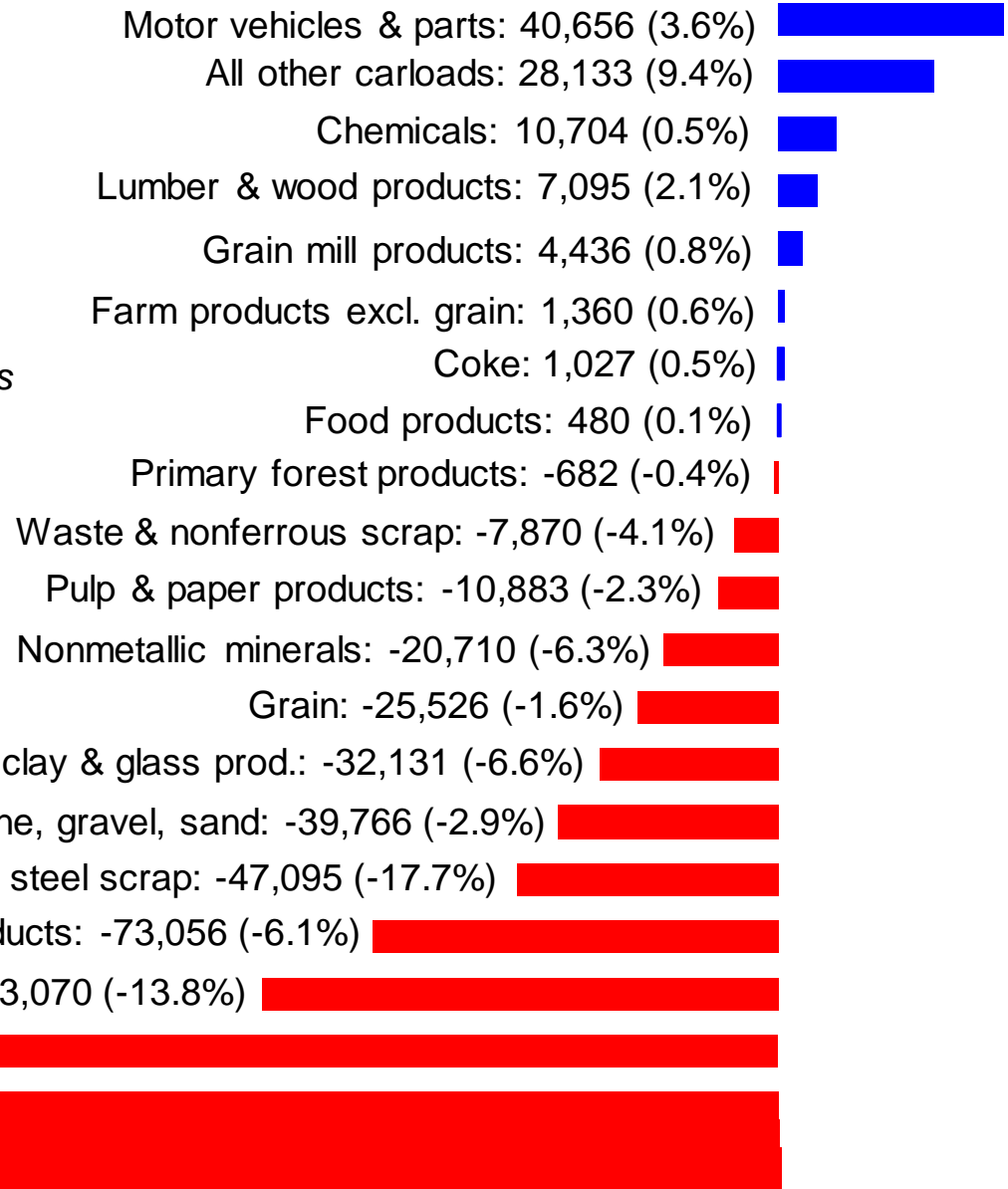
Source: AAR
Weekly Railroad

Coal: -755,916
(-12.0%)

Metallic ores:
-182,607 (-18.5%)

Petrol. & petr. products: -73,056 (-6.1%)

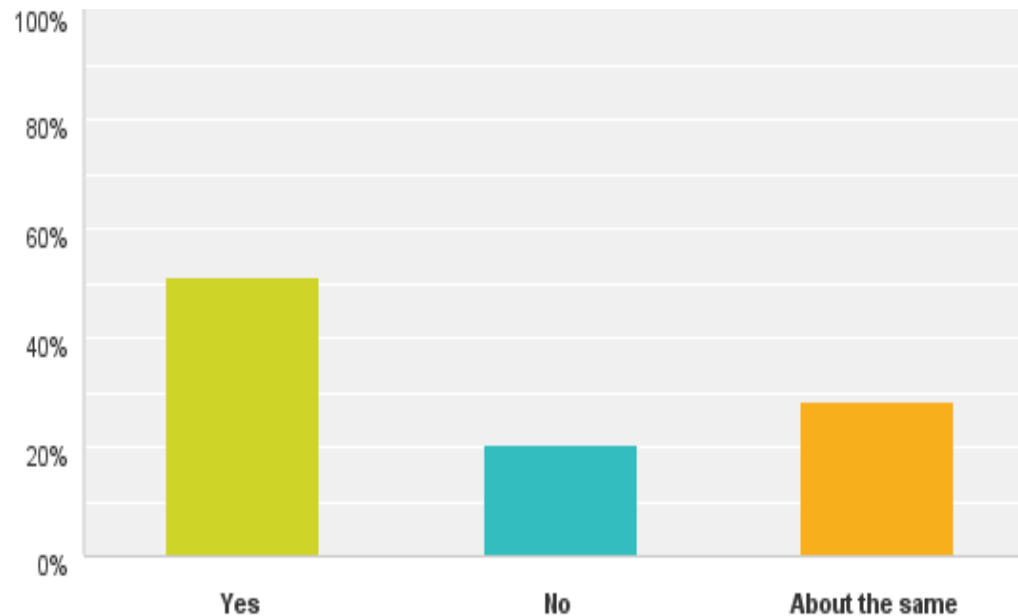
Primary metal products: -93,070 (-13.8%)



Silver Linings?

- *Service (& Safety) Recovery Trend (Capex Pays Off)*
- Restoration of the “Grand Bargain”
- Reduced (N/T) Political Pressure
- Productivity (& volume?) Inflection
- Coal “stabilization” (Part Two)??
- Q1/16 generally positive surprises; Pricing Power Remains
- IM (etc.) latent demand....Bi-Modal results
- Industrial Buildout (SHIELD); Southbound migration of industry
- *Revised MoW Capex (GTM/Mix) frees CF/2016*

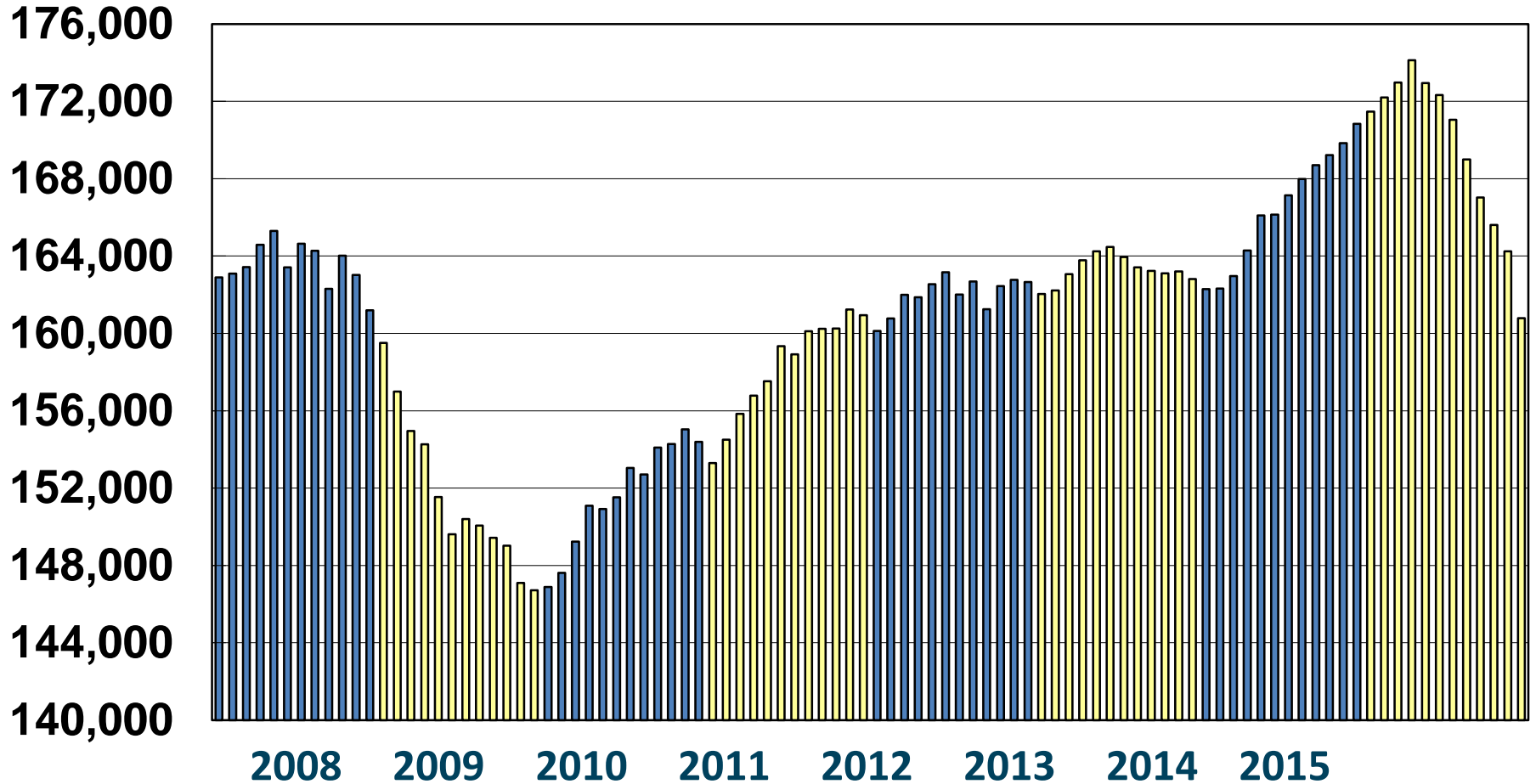
Shipper Poll January 2016: Has RR service noticeably improved over the past year?



Issues for RR & Intermodal 2016+

- Return to Growth?
- Fight over Capital – a few carriers reduced 2016P Capex again in the last few weeks....
- M&A Fight fallout effect on Capex?
- Pricing Power Still?
- Factors: Oil Prices, Consumer Spend, Truck Capacity
- Infrastructure Advantage (vs subsidized highway)
- Panama Canal impacts?
- Rail Service Improvements (and the ties to productivity!)
- Driver Shortages Re-emerge?

Class I Railroad Employment



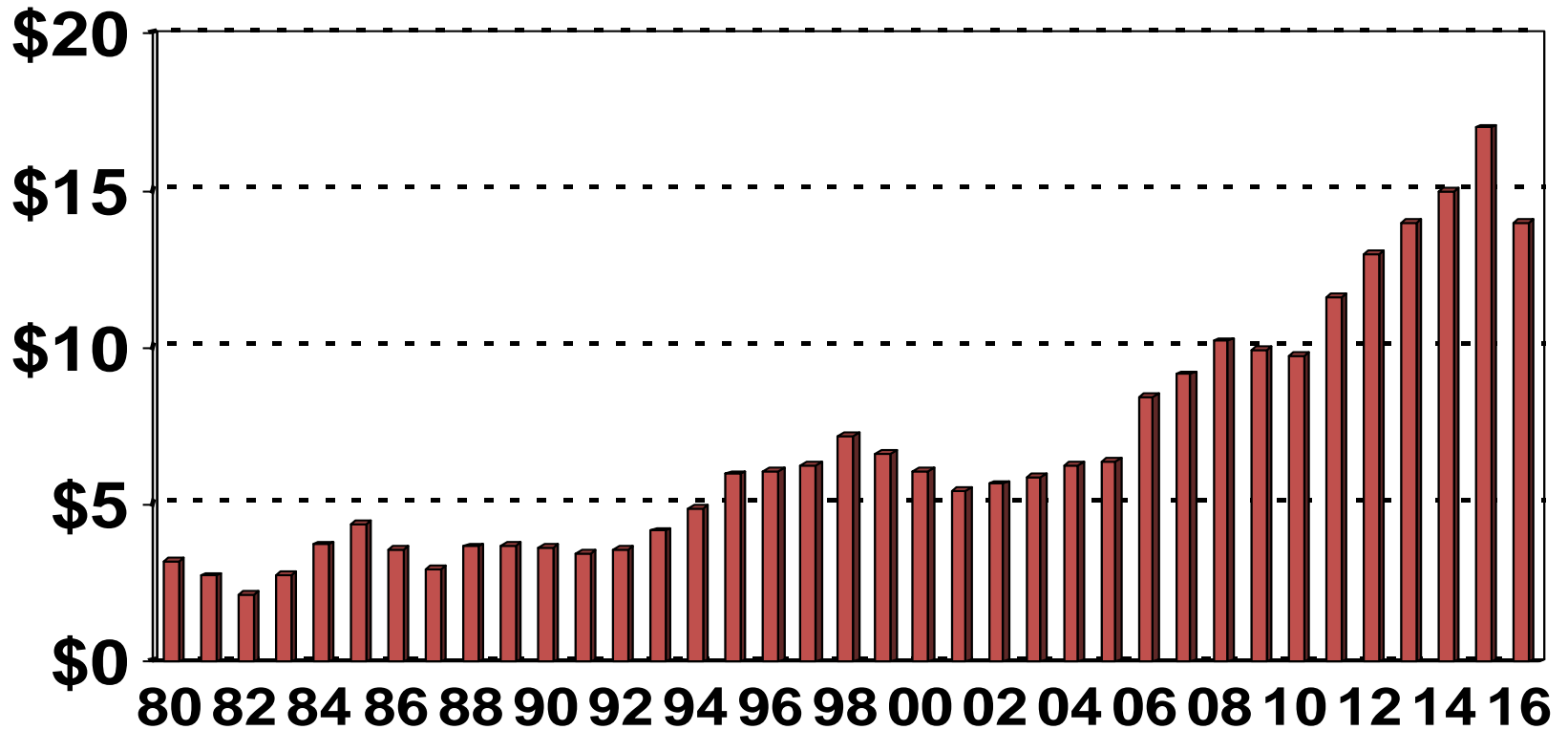
Source: STB

2016+ Capex

- *Most Important Decision Period in Years*
- *Capex down across the board (average -16%!) – except CN!*
- Coal: “Stranded Assets”?
- Coal/Mix: Reduced Gross Ton Miles, Reduced Maintenance of Way?
- *Yet Service & Safety are even more critical to future RR success*
- Changing mix of capex?
- Changing %revenues (16%)?
- PTC Extension resolution?

Railroad Capital Expenditures Class I Railroads

Billions



Source: *RRFacts & Analysis of Class I RRs*, AAR; abh estimates

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