Update on the North American Rail Equipment Market

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Wells Fargo Surface Transportation Group, Wells Fargo Rail
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Opinions expressed and topics discussed are my personal opinions and not those of Wells Fargo Rail or Wells Fargo.

Today’s discussion will focus on:

- Wells Fargo Rail Overview
- Economic Overview & Railcar Impact
  - Impacts to Rail from 2017 Tax Reform
- Railcar Market Overview
  - Market Opportunities & Challenges
  - Carloads
  - Orders, Deliveries, and Backlog
  - N.A. Fleet Utilization
- Key Car Types Impacting the N.A. Railcar Market
  - Coal
  - Grain
  - Sand
  - Plastics
- Market Conclusions & 2018 Forecast
Rebranded from First Union Rail in 2016 with purchase of GE Rail

- 225 employees, based in Rosemont, IL

Products:

- Customized Operating Leases
  - Full Service & Net Lease

- Finance Leases: long term net leases (10+ years), lessee may have a purchase option at the end of the lease

- Equipment Management: WFR manages equipment owned by other companies

- All staff in-house including customer service, accounting and inspectors

- Largest private railcar fleet in North America

Wells Fargo Rail owns 175,000 railcars and 1,700 locomotives
Growth in U.S. economy continues, but effects of strong performance are having lackluster impact on North American rail carloads

### U.S. Growth Outlook
- 2.8% GDP growth projected in 2018, up from 2.2% growth in 2017
- Inflation and interest rates remain low, healthy corporate balance sheets, commodity price rebound

**Rail Impact:** Slow increase in North American Carloads

### Global & Industrial Stability & Weaker U.S. $
- Industrial Production up 4% q/q in 4Q17 after stagnating in 2016
- Growth in global trade strengthening

**Rail Impact:** Boost in U.S. exports support box and intermodal traffic

### Domestic Tailwinds
- Housing: low existing home inventory spurring construction
- Consumer spending supported by balance sheets & jobs

**Rail Impact:** Increases in demand for aggregate and box cars

### Low Domestic Natural Gas Prices
- Higher energy prices and global oil demand
- Low cost producer of natural gas, plastic pellet expansion

**Rail Impact:** Increase in demand for small cube covered hoppers for frac sand and plastic pellet cars

Source: Wells Fargo Securities, Wells Fargo Rail
Impacts to Rail from the 2017 Tax Reform

2017 Tax Reform Impacting Railcar Finance Market

- Top corporate tax rate reduced from 35% to 21% effective January 1, 2018
- The corporate Alternative Minimum Tax is repealed
- For tax years 2018 through 2023, 100% tax expensing of qualifying rail assets replaces MACRS
- NOLs may no longer be carried back and deductions are limited to 80% of taxable income

What Could These Mean for the 2018 Rail Leasing Market?

- Lessors/Shippers evaluating the impact of lower tax rates and 100% tax recovery to returns on railcar investments
- Some Lessors/Shippers evaluating capacity to absorb 100% tax recovery in conjunction with NOL changes
- Changes may accelerate the sale of older fully tax depreciated assets that would be taxed at lower rates and reinvestment in newer assets that can be 100% expensed for tax in 2018 and forward
Railcar Market Overview
### Market Challenges and Opportunities

<table>
<thead>
<tr>
<th>Rail freight demand continues to recover</th>
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</thead>
<tbody>
<tr>
<td>▪ N.A. carloads remain well below historical average but continue to improve from 2016 trough; up 2.9% in 2017</td>
</tr>
<tr>
<td>▪ Fleet utilization improvement; averaging 77% in 2017 from 69% in 2016</td>
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<table>
<thead>
<tr>
<th>Oversupplied new equipment market</th>
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<tbody>
<tr>
<td>▪ Builders working through backlog, backlog at 64k cars at 9/17</td>
</tr>
<tr>
<td>▪ New car deliveries trending towards equilibrium</td>
</tr>
<tr>
<td>▪ Estimated that 40k cars were delivered in 2017</td>
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<table>
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<th>Robust secondary market</th>
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<tr>
<td>▪ Strong sale prices for assets with leases attached</td>
</tr>
<tr>
<td>▪ Multiple players bidding for assets as investors seek yield in low-rate environment</td>
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<tr>
<th>Accelerated scrapping of older assets</th>
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<tr>
<td>▪ New car surplus creates challenging market for older assets</td>
</tr>
<tr>
<td>▪ Relatively healthy scrap prices projected for 2018</td>
</tr>
<tr>
<td>▪ Opportunities to scrap less desirable assets; 4,750s, coal cars</td>
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<th>Improving conditions in 2\textsuperscript{nd} half of 2018</th>
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<tr>
<td>▪ Petchem expansion driving demand for plastics</td>
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<tr>
<td>▪ Construction markets driving demand for aggregate cars</td>
</tr>
<tr>
<td>▪ Growth in frac sand usage driving demand for small cubes</td>
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Carload data: AAR January 2018, utilization data: FTR January 2018
# State of the Industry Today

## North American Carloads 2017 vs. 2016

### Winners
- **Stone, Sand & Gravel:** +21.5%
  - One of the few bright spots in 2017 with record carloads
- **Iron & Steel Scrap:** +8.3%
- **Coal:** +7.7%
- **Stone Clay & Glass:** +2.1%

### Losers
- **Automotive:** -6.2%
- **Forest Products:** -1.7%
- **Grain:** -1.0%
  - Decrease in grain carloads largely due to increased global supply creating low crop pricing

## Changes in North American Carloads (2016 vs. 2017)

<table>
<thead>
<tr>
<th>Category</th>
<th>Change</th>
<th>2016 vs. 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stone, Sand &amp; Gravel</td>
<td>+21.5%</td>
<td></td>
</tr>
<tr>
<td>Iron &amp; Steel Scrap</td>
<td>+8.3%</td>
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<td>Coal</td>
<td>+7.7%</td>
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<tr>
<td>Stone Clay &amp; Glass</td>
<td>+2.1%</td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>+0.8%</td>
<td></td>
</tr>
<tr>
<td>Petroleum</td>
<td>+0.8%</td>
<td></td>
</tr>
<tr>
<td>Waste &amp; Scrap</td>
<td>+0.7%</td>
<td></td>
</tr>
<tr>
<td>Pulp &amp; Paper</td>
<td>-0.4%</td>
<td></td>
</tr>
<tr>
<td>Grain</td>
<td>-1.0%</td>
<td></td>
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<tr>
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<td>Automotive</td>
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Source: AAR January 2018 - carloads data as of 12/30/17
Railcar builds expected to have reached cycle bottom in 2017

North American Railcar Deliveries

- Covered Hopper
- Tank
- Other Freight

2017 YTD: Deliveries: 32k cars, Orders: 32k cars

Source: FTR, RSI
Car builders working through overhang of large backlogs of small cube covered hoppers and tank cars built up in the CBR and fracking boom; market moving towards equilibrium

Source: RSI
North American Railcars in Storage

~81% railcar utilization estimated at January 1, 2018 an increase from 77% at January 1, 2017

North American Fleet % of Stored and Empty Railcars

<table>
<thead>
<tr>
<th>Category</th>
<th>% Stored</th>
<th>% In Service</th>
</tr>
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<tbody>
<tr>
<td>Covered Hoppers</td>
<td>16%</td>
<td>84%</td>
</tr>
<tr>
<td>Tanks</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>Gondolas</td>
<td>20%</td>
<td>80%</td>
</tr>
<tr>
<td>Open Top Hoppers</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>Flats</td>
<td>9%</td>
<td>91%</td>
</tr>
<tr>
<td>Box</td>
<td>15%</td>
<td>85%</td>
</tr>
<tr>
<td>All Other</td>
<td>22%</td>
<td>78%</td>
</tr>
</tbody>
</table>

% Change y/y: +2% +2% +4% 0% +4% +2% +4%

Present estimate is 312k idle assets, year over year decrease of ~35k cars

Source: Railinc, AAR January 2018
Key Car Types Impacting the N.A. Railcar Market
2017 uptick in coal demand, but long-term outlook calls for further decline

Total Coal Carloads 2006 vs. 2018F
(Originated carloads)

-51%

Coal Share of Rail Carloads by Car Type
2006 vs. 2018F
(Excludes Intermodal)

- All Other Carloads
- Coal Gondolas
- Coal Hoppers

Total Rail carloads have fallen 26% (2006 vs. 2018); Coal has declined from 35% to 25% of total volume

Source: FTR
Challenging Grain Market and Oversupply of New Cars

Increased global grain production threatens U.S. market share of exports; depressed crop prices & record crops causing farmers to delay shipments

**Global Exports of Grain by Market Share**

- N.A.: 40% in 2015, 35% in 2017 E, 33% in 2026 F
- South America: 33% in 2015, 27% in 2017 E, 25% in 2026 F
- Other: 27% in 2015, 25% in 2017 E, 25% in 2026 F

**Grain Carloads by Car Type 1995 vs. 2014**

- 1995:
  - 4,750s: 86%
  - 5,150s: 14%
- 2014:
  - 4,750s: 93%
  - 5,150s: 7%

Excess of grain cars in the market; retirements required in the 4,750 c/f fleet

Source: USDA, AAR
Frac Sand Demand Accelerating Since Trough in 2Q16

2017 set a new record for proppant demand
Increases in lease rates for small cubes leading to new car investment

North American Proppant Demand
7% CAGR projected 2017 to 2020

By 2021, demand is forecast to grow to more than double the previous peak in 2014

Source: U.S. State Filings (actual) Wells Fargo Securities (forecast)
Deliveries for plastic pellet cars have significantly increased; estimated current backlog at 12k cars

Source: UMLER, WFR
Equipment Market Conclusions
### 2018 Outlook

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
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</table>
| **Sand**         | ▪ Demand for cars to continue  
▪ Surplus from 2016 has disappeared and lease rates rebounding accordingly, triggering new car investment |
| **Grain**        | ▪ Challenging year for domestic market due to increased global competition and increased supply of new cars  
▪ Robust scrapping in 4,750 c/f fleet |
| **Coal**         | ▪ Some utilization improvement projected as cars are scrapped  
▪ N.A. Fleet is years away from equilibrium  
▪ Hopper demand far exceeds demand for gondolas |
| **Plastics**     | ▪ Production originally slated for 2016/17 is expected to come online in the second half of 2018  
▪ Increase in plastic pellet car demand, with average of 5k new car deliveries projected each year through 2021 |
| **Carloads & Utilization** | ▪ 2018 forecast for modest improvement in carloads with 2.4% growth and average fleet utilization of ~82%  
▪ N.A. fleet retirements projected at >60k cars, new car deliveries at 41k = slightly shrinking fleet  
▪ Surplus of cars will continue across many commodity sectors |
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