

Can the North American Railway network really “Pivot to Growth”?

After Renaissance, Retreat – Now What?

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(OOPS – 2024!)

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5+ Enduring (?) Railroad Competitive Advantages

1	Labor Advantage (ex: Double-stack LA-Chi – or Rupert-Toronto) ¹
2 & 3	Fuel Advantage (2A) (4:1 ton/mile; AAR) ² – So 2B is EMISSIONS /Environmental Advantage (see...WMRT, Unilever, etc.)
4	Infrastructure Advantage (after the IHS buildout; user-pay and capex to support changing logistics patterns – ex: transcon) ³
5	Railroads' Excellent Financial Condition, Liquidity, Free Cash flow
?	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)

Can Rails Change the Narrative After the 3 *Big Blows*?

- Rails suffer # (3, at least) Big Body-blows over the last 18-24 months (some wounds self-inflicted but not all)
 - Supply Chain Crisis/STB Hearings
 - Regular labor round goes the distance
 - East Palestine and ramifications
 - *So - Are Rails Inept, Greedy & Dangerous?*
- *NSC Investor Conference (joined by CSX new CEO) – “The Great Experiment”,* change in incentives, furlough policy, investment
- *CNI Investor Conference – Growth through Investment*
- *CPKC Debutant’s Ball – Growth through Competition*
- *Slow but steady* progress on service consistency & *resiliency*

NSC, East Palestine & the (over?) reaction – Existential Threat?

- NS accident couldn't have been worse timed - or to a more unfortunate carrier
 - NS safety history, efforts at Common Carriage, originator of TGE
 - Rails are not *allowed* to carry haz-mat, they are *compelled* to do so
 - ASCE Grade of B; Big & Consistent Capex
 - Everyone on the attack:
 - Train length??
 - Crew size???
 - **ECB Brakes (car-based!) – your thoughts??**
 - *Corp Greed/share buybacks??*
 - *Don't trust the EPA*
 - *Fix everything but the problem!*
 - *Doubling hot-box detectors price tag \$1-2B*
 - *Etc*
 - *~\$900mm* spent, excluding reputational and political hits*
- *Not sure of the current number! Much bigger!*

Union Pacific's Sunday Surprise

- Soroban forces a change of leadership (in February)
- Suggests Vena (again)
- Another “existential fight for the soul of the rails”? (from growth to margin focus?)
- Many gaffes - Capex at 15% or less; G55; STB issues
- Chronic under-performance (of *potential*)
- Still the best job in the business
- KC remained “otherwise occupied”

Tale of the Two Jims

- Vena in at UP
 - Lots of vetting
 - Why not right away?
 - How long (Beth)?
 - H2, K2 or J2?
- Jamie out at CSX
 - “Culture change”
 - Similar pattern as at CN
 - Orr? Cory? Reilly? Sanborn? Other? It's Mike!
 - Where will JB show up? UP?

Brand New Baby Railroad

- CPKC “Last Spike” April 14
- Never (NEVER) in doubt – just listen to the STB (and to me)
- Congrats to the STB for filtering out the noise (DOJ, Warren)
- New Growth Opportunities can help to turn around perception of rail
- Rail/Rail Competition
- Rail/Truck/Competition
- 80% Synergies – i.e; revenues
- Can the Unicorn bring it home – yes. In 3 years? (A: No – they pushed out the really big numbers to '28)

3 Railroad Investor Conferences Push Growth

- NSC December 2022 – the initiation of the Great Experiment
- CNI in May – growth (but it will cost!)
- CPKC “Debutant’s Ball” in June – bigger growth than the application, more time needed to achieve it (and three sets of numbers!)
- Flurry of deals and alliances – Falcon, CSX-Meridian, etc
- Next up: CSX?
- Waiting for direction: UNP
- Beginnings to talk: BNSF (with their renewed marriage partner)

But Q3/23 Offered No Proof of Life

- Rails earnings lackluster and mostly below sharply reduced estimates
- Rail share/EPS performance trailed the market (rather unusual)
- Near-term outlooks reduced
- Little visibility/guidance – Freight Recession enduring, pricing pressure
- Prepared for the upturn!
- Growth Pivot/Great Experiment is a long term play
- Rails must prepare a road map/visible check list; Investor Days (UP, CSX?)

RailTrends 2023 – Competition & Cooperation

- Increased *rail-to-rail competition* (CPKC)....
-has unleashed new levels of *cooperation and alliances* (Falcon)
-and new levels of (planned) entrepreneurialism (ex Quantum)
-and, hopefully, more partnerships with *short lines* (despite CN/IN?)
- All examples of the *Great Experiment* – loY Alan Shaw (and others)
- But not without healthy *skepticism* (CSX, analyst panel) – requiring a level of *faith*
- And of course, there was drama: STB/UP, Mexico

Recurring and Accelerating Rail Trends

(Not to be confused with RailTrends November 2023!)



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

Mexico's Moment?

- For rails, since NAFTA it has *always* been momentous
- Near-Shoring is the headline grabber
- However:
 - Pemex support
 - KKR
 - Passenger traffic forced on the freights?
 - Election (you get my point....)
 - 25% of Latam GDP; 17% FDI
- But – CPKC; Falcon, Tesla – especially now BNSF/JBHunt
- Modelo Especial!

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

- *Short Lines & Regionals still hot properties*
 - Multiples have doubled in the last 5 years
 - No public companies left (GWR)
- Many small recent deals (by OmniTRAX, RJ Corman, etc.)
- Watco-Dow and CN deals a new prototype?
- On the market: At least four? Lake State Railway just completed
- Off Market & Smaller Deals (ex. SLGW)
- Financial Partnerships (RDC, Watco, etc)
- Spanner in the works? Problematic STB?
 - Massena Line & lawsuits - **Withdrawn**
 - WC-Watco, Pan Am finally finished!
 - KSU? A Slam Dunk? Views from my trip to DC
- Buyers (all with different WACC, timeframes, ROI expectations):
 - Strategic (above)
 - PE (and PE/partner)
 - Infrastructure Firms
 - Class Ones as sellers (CN?) and/or Buyers (CP-CMQ, CSX-PAR, BNSF-MRL)?

Short Lines To the Rescue of Class Ones?

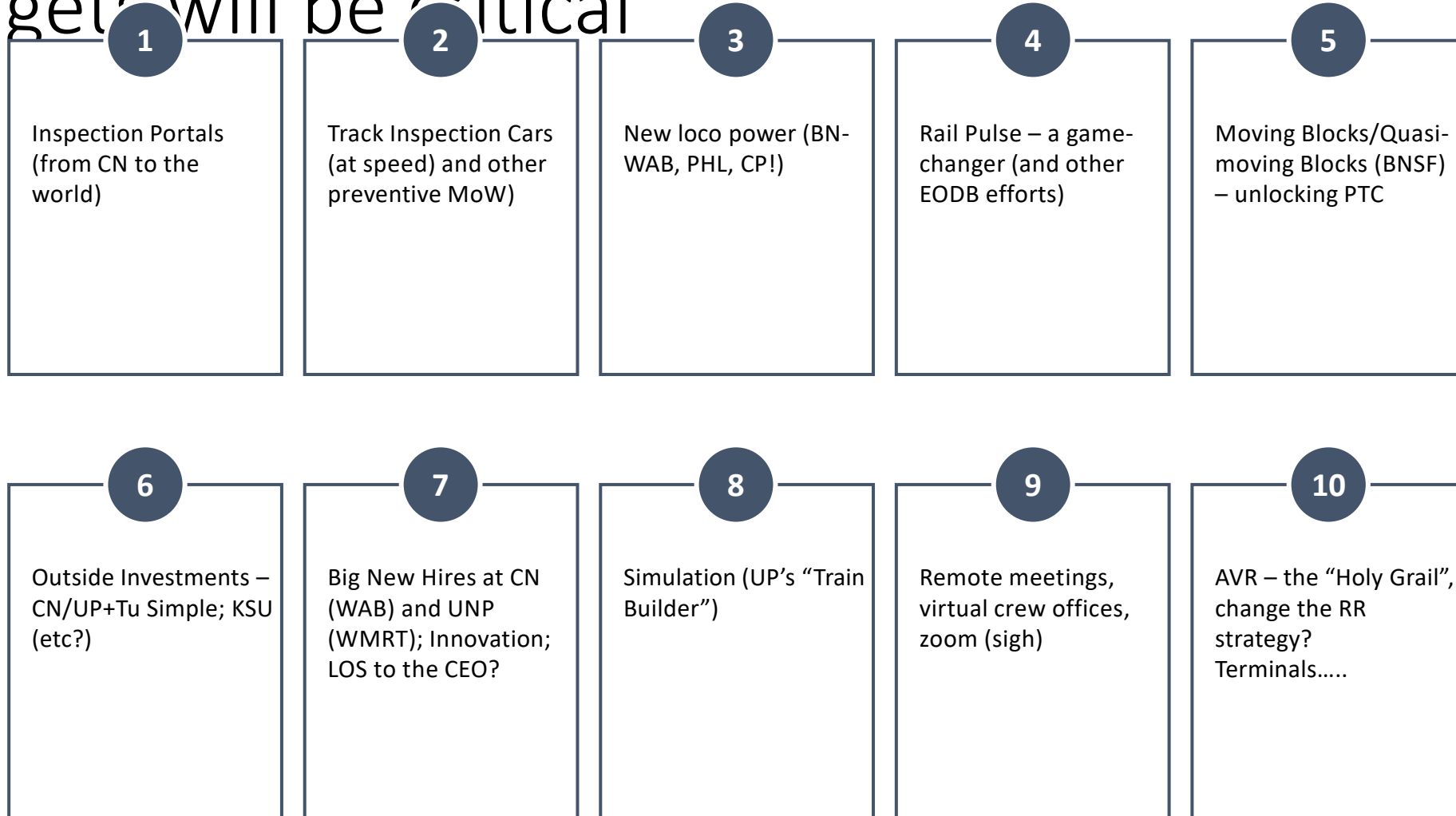
- *Class One service crisis and the impact on/of regulators (STB/FRA) and Legislators*
 - New focus, data on First Mile/Last Mile (and it ain't pretty!)
 - Service failures are manna to STB concerned about rail market power (price)
 - Reciprocal Switching (which is about pricing power!) is coming, in modified form
 - STB use of *common carrier obligations* as a lever (UP/Foster Farms), focused on weekly switches
 - Declining Class One carload growth since the 2008-9 Financial Crisis
- **SOLUTION? Increased use/creation of Short Lines!!**
 - Short lines have consistently out-grown C1 in carloads
 - Short lines offer tailored, customizable switching services
 - Short Lines have better work rules, less severe labor shortages
 - Short Lines are looked upon quite favorably by regulators and legislators!
 - Watco's Dow and especially Dutchtown Southern (Louisiana/CN) increased weekly switching from 3-5 to 7+ and grew carloads by over *one third* in the first year of operations – win (customer switches)/*win* (Watco new business)/win for C1 partner CN (more cars for its long-haul business)
 - All SLHCs have logistics/switching arms etc
- *So why is the momentum of C1 strategy seemingly to buy or retake SLs* (see DMQ/Pan Am/MRL)??
 - I support a “feed the beast” strategy (looking to extend a C1 market reach – ex CN 2018-21)
 - However that should not preclude thoughtful C1-SL partnerships (that solve customer problems!) – ex RailPulse
 - *Nonetheless, I see no evidence of C1 leadership taking these steps (yet?)*

Regulators, Luddites & Data – DC in tha House

- Peak STB post merger?
- Reciprocal switching – a “nasty curveball”, but good for analysts – and?
 - Canada sticks to a larger milage-based plan
 - Standardized (and more) data will be useful in the US
 - A tailwind for service recovery?
 - But will a fastball follow the deuce?
- Will the Hatfield (UP) & McCoy (STB) feud finally end?
- The FRA takes the Trident – anti-technology in favor of jobs

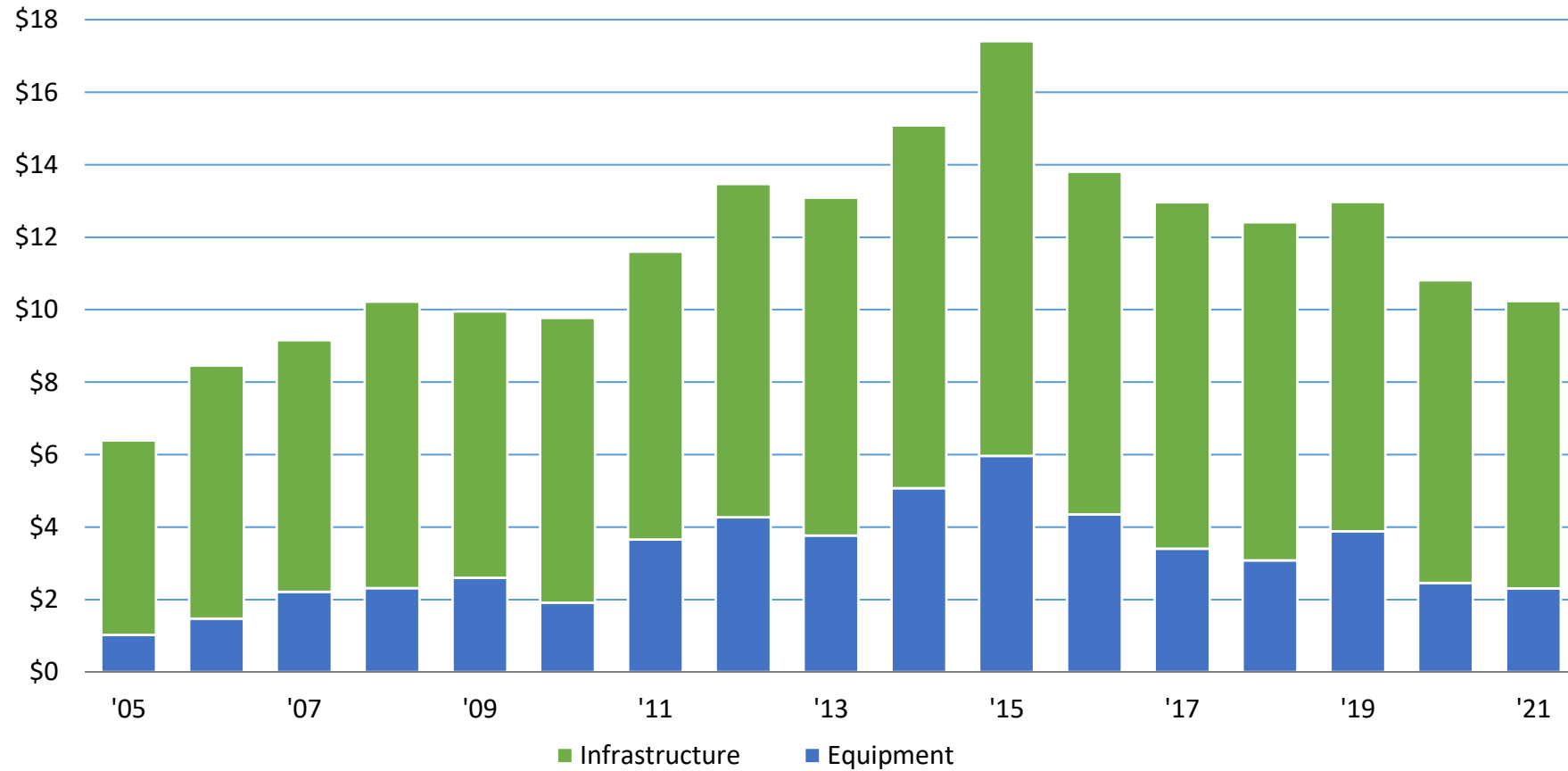
To meet coming “existential threats”, Rail *Tech*/Innovation is Accelerating (T10) – 2024

Budgets will be critical



Railroad Capital Spending

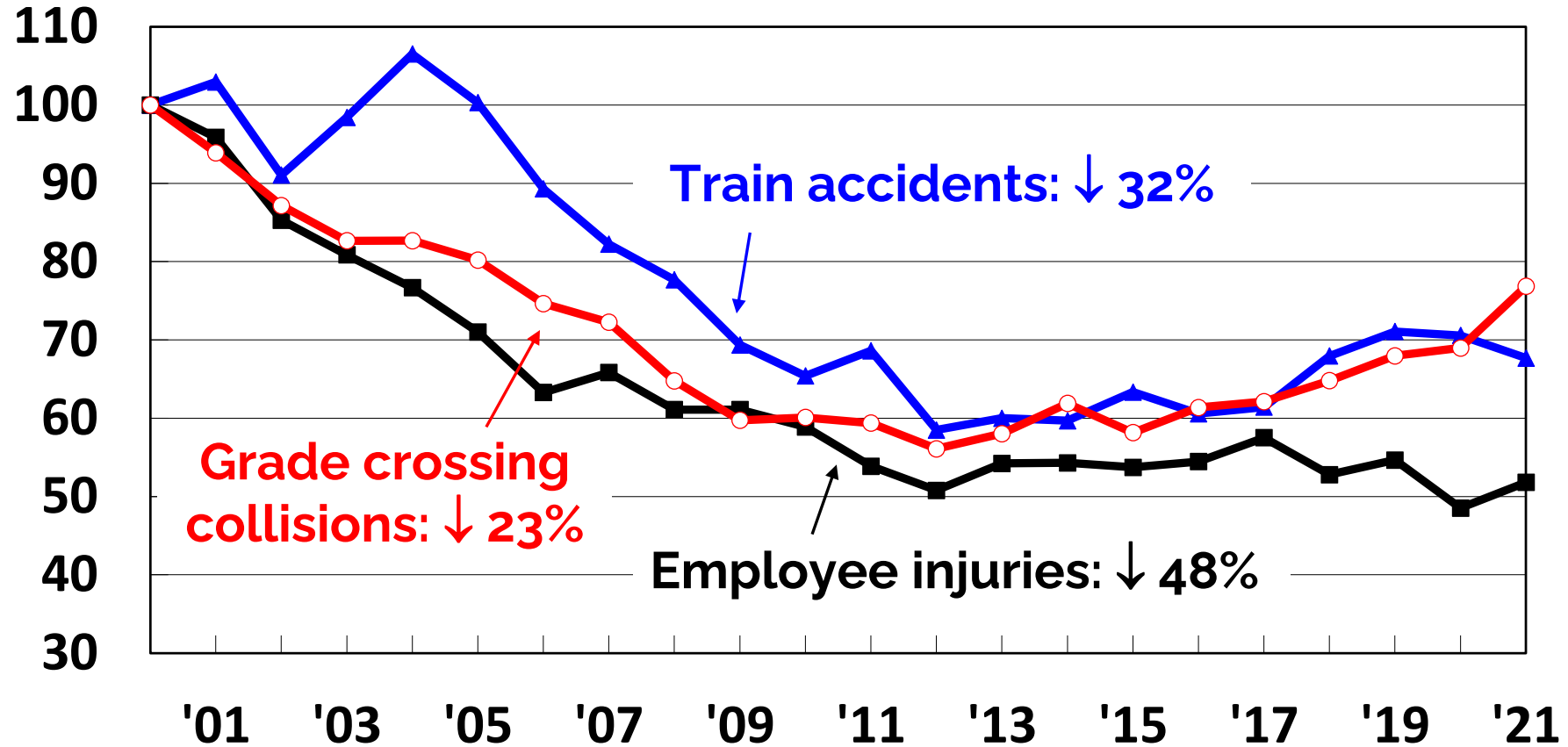
(\$ billions, current dollars)



Data are for Class I railroads. Source: AAR

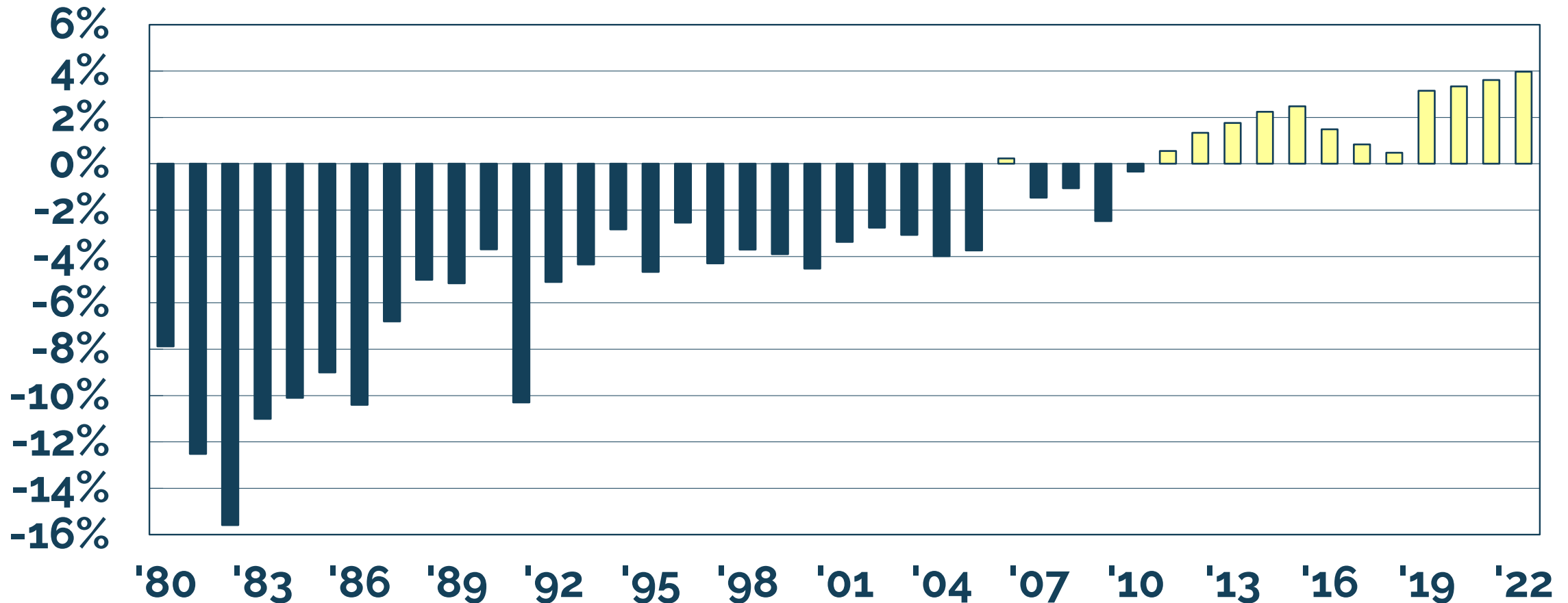
Recent Decade Was Safest Ever

(Index 2000 = 100)



% = change in rate from 2000-2021. 2021 is preliminary. Source: FRA

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

Return on Investment is Crucial

If ROI > cost of capital:

- **Capital spending expands**
- **Stronger physical plant; more and better equipment.**
- **Faster, more reliable service**
- **Sustainability**



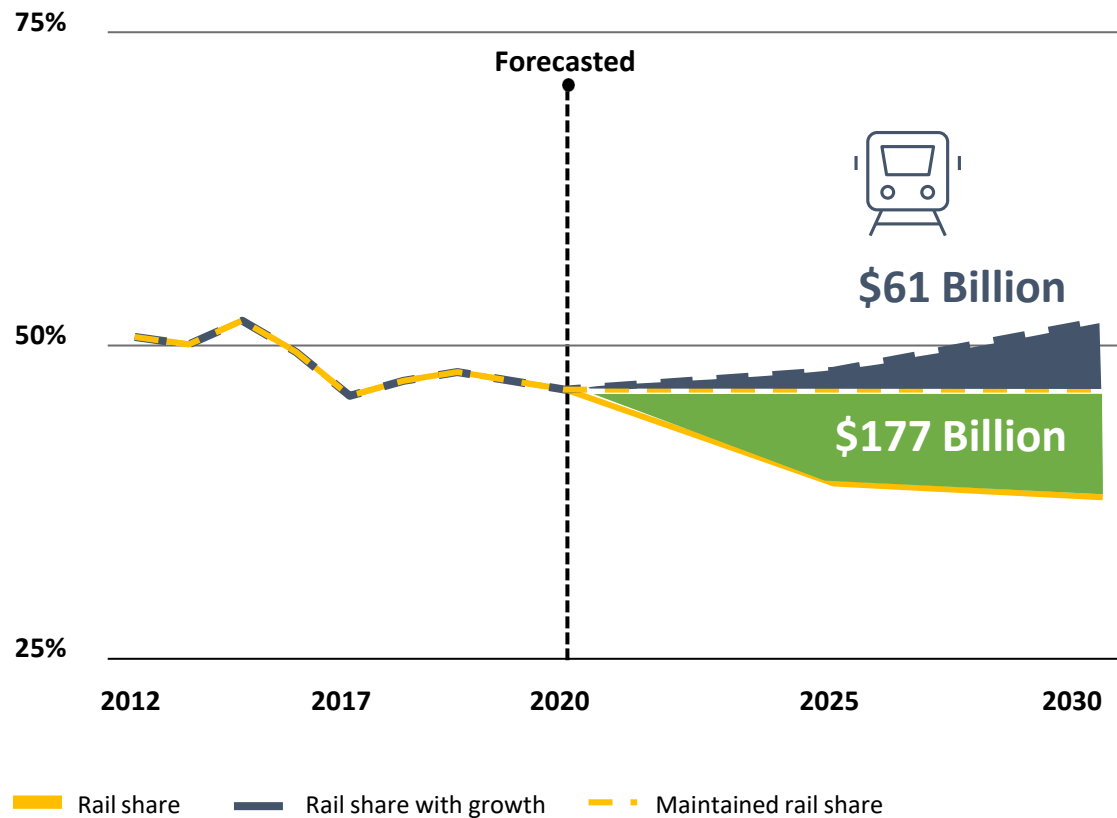
If ROI < cost of capital:

- **Lower capital spending**
- **Weaker physical plant, equipment**
- **Slower, less reliable service**
- **Disinvestment**



By using available capacity, railroads could add \$61BN more in growth revenue – with limited capex

Freight market share analysis and forecast by ton-mile capex



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



Assumes no material technology advancements



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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