

# Rail Renaissance: Returns, Capital & Capacity

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Railroad Financial Roundtable

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# Railroads at historic tipping point

- The *Railroad Renaissance* is here – will it last?
- Capacity issues across all modes
- Volume increasing – *right?*
- Share increasing
- Rates increasing
- Services levels (yes) increasing
- 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?***
- ***The industry is poised to go up – or down – based on decisions made here***

# Street influence on RRs – and Why that affects ALL stakeholders

- Battle for cash
- Management's reactions to pressures
- Investors, competitors, regulators, politicians, labor – and customers
- Short term decisions/long term consequences
- Which “bucket” will they place their investment?

# Show Me the Money

- Share Price is *the* Indicator – over time!
- Cash (Flow) is King/Battle for Cash
- High ROIC = High Stock Price
- And Vice Versa
- Key is the phrase “through a cycle”
- Old Model: Disinvestment
- New Model: TBD (But CP gives us a clue)

# Spending \$: Mgmt.'s #1 Decision

- Capex for Maintenance – “base”
- Capex for Capacity, Service & Growth
- Dividends
- Share Buybacks
- M&A – Strategic
- M&A – Non-strategic (conglomeracy)
- *How management allocates indicates confidence & direction and impacts all stakeholders*

# Virtuous Circle 2004-06 –and beyond?

- Better returns (half *finally* earn returns equal to the cost of capital)
- Better stock prices
- Better revenue prospects – up double digit '04-06
- Equals more investment – capex up sharply
- Equals more capacity, better service
- ...equals better returns and growth....

# Sources of capital

- FCF – booming at most carriers (capex vs. ROIC)
- Governments – states, PAs, Feds
- Governments – Canada as contrast
- Traditional Street sources & Banks
- Institutional investors
- Hedge funds
- Private Equity/Infrastructure Funds (still?)

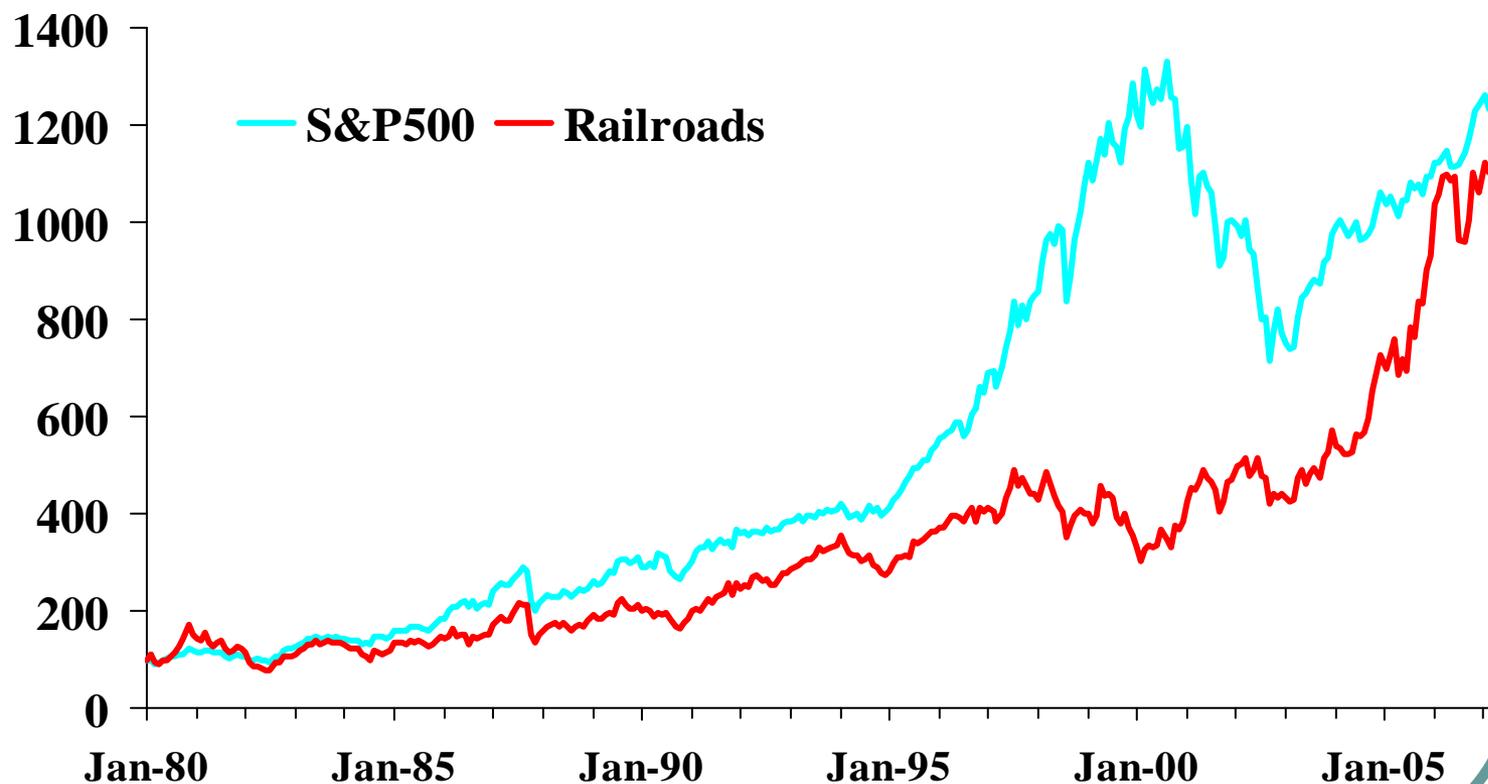
# Threats to the Renaissance

- Cyclical vs. secular argument
- New Congress – impacting labor & shippers
- Rereg – the MAD answer
- Execution: service
- Execution: merger
- Hedge funds?
- Liquidity?

# S&P 500 and Railroads

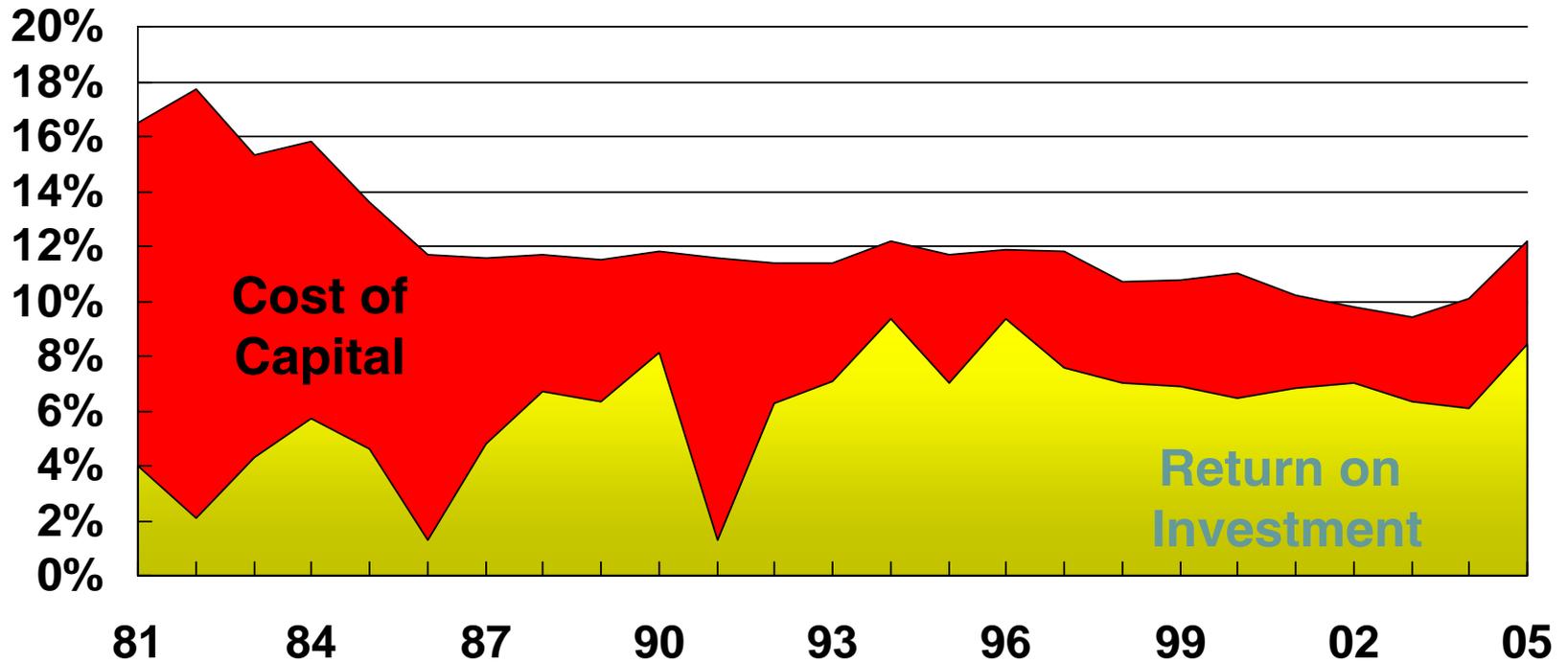
Monthly Data January 1980 – April 2007

Index Jan. 1980 = 100



Sources: MSN and CSI, Inc.

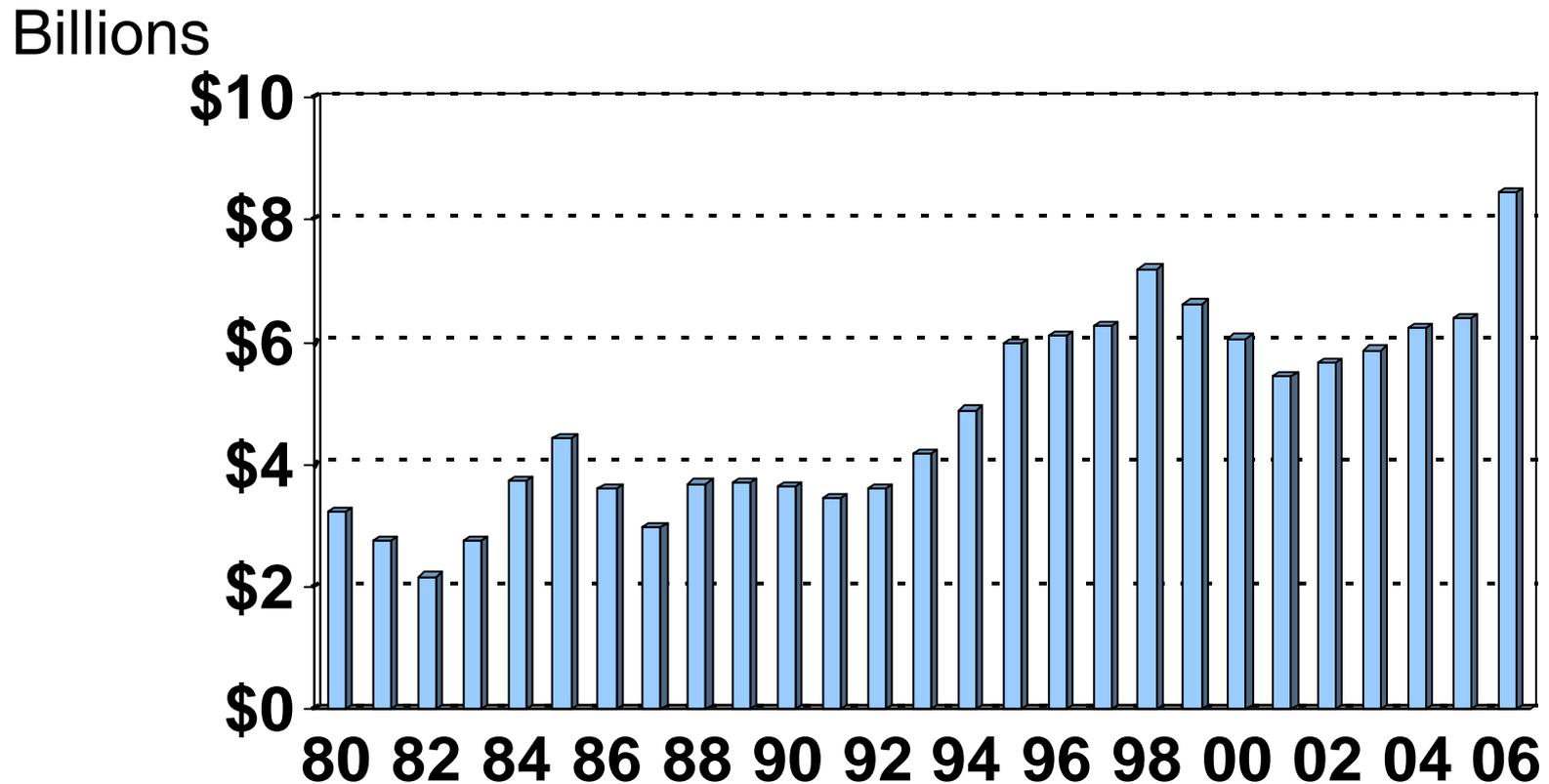
# RR CoC vs. ROIC



Source: Surface Transportation Board

# Railroad Capital Expenditures

Class I Railroads



Source: *Railroad Facts*, AAR

# RRs and Investment

- Is growth affordable? Capex up 10% in '07?
- One rail cuts, 2 increase capex *during* '07
- **What will 2008 look like?** (long term growth v short term weakness)
- Is additional capacity necessary? Desirable?
- Wall Street's role as capital provider
- Returns versus risk – assumption of a stable regulatory environment