



# State of the Industry Outlook and Trends

**2007 Rail Equipment Finance Conference**

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# Today's Discussion

- The big picture: State of the rail industry today
- Review of The Economy: Where are we going?
- Forecasts: Traffic, locomotives, freight cars



# Double WOW!

- Rail industry earnings way up
- Rail industry revenue up – double digits
- 2006 traffic volume up
- Even rising prices couldn't chase traffic away!
- Rail share of revenue and ton-miles increased
- Service levels improved over the year
- Substantial investment in capacity

# A Great Year

- Dramatic improvements in operating ratio's
  - Partly revenue driven
  - Partly continuing cost reduction – improved ops
- Increasing effort to schedule operations paying off
- Service improvements impact asset utilization
  - Locomotive utilization reaching new highs
  - Freight car utilization improving
- Increased infrastructure investments for capacity

# Improved Financial Performance

- Large and growing free cash flow
- Rail stocks up 50% over last two years, almost 100% in five
- Class I earning power increasing
- Stock buyback's increased
- Industry has shown it can grow margins
- Ability to finance not in question



# The Economy

## Guessing the Future of the Industry

# Recent Traffic Trends, Uh-Oh!

- Economic growth/trade driving transport demand
  - Intermodal, chemicals, grain, coal continue strong
  - Housing and Auto industry problems have impact
  - Economic growth now slowing
- Volume bumping against rail capacity constraints
  - Really significant margin gains in '06
  - Will continue this year ('07), maybe not next year
  - Economy, down sectors, rising prices affect volume
- Service improvements ride the reduction in volume



# Significant Drivers of Industry Future

- Course of the economy
  - Soft patch in 08 but recession not likely (housing weak, inflation eases, interest rates decline, oil stays high(er))
  - After that, depends on election and tax policy after 2010
- Price of fuel
  - Affects costs, but also GDP, trucking, traffic volumes
  - May drive increasing eco-focus of economy (think TXU)
- Ecology, global warming (whether true or not)
  - Ethanol, a positive
  - Locomotives, a negative; trucking, a positive

# Significant Drivers of Industry Future

- Mix changes
  - Housing: remains weaker than in past – it was a bubble
  - Autos: Detroit will take several years, sales off 10-15%
  - Coal: good volume but equipment needs somewhat soft
- Ethanol
  - Growth continues - as just an additive; more as fuel, but,
    - Greenhouse impact is unclear
    - Global trade pacts could result in imports
    - Impact on food and sugar prices
    - What if it loses it's tax advantage?
- Global trade

# Strategies for Growth

- Smarter may be better than bigger – move up-market
  - Manage capacity for yield
  - Planned operations lower cost and higher yield, and permit managing yield
- Environmental Issues ?
  - Cap and Trade could create enormous value for rails
    - Diversion from road to rail
    - Help pay for new locomotives
    - Is it time to think about electrification?



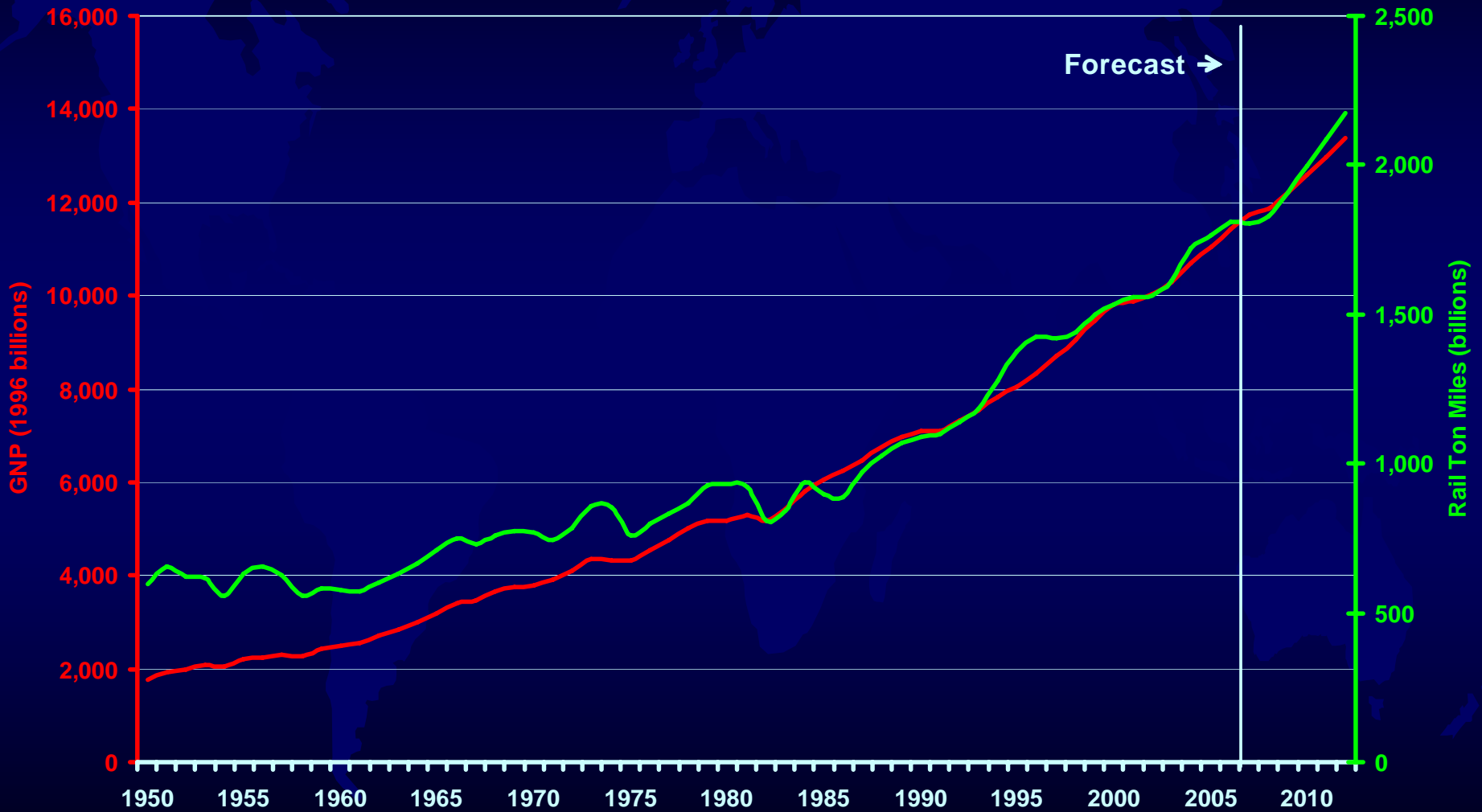
# Rail Freight Tracks GDP

Real GDP and Rail Ton Miles



# Rail Traffic Slows, then Grows

## Economic & Ton Mile Forecast



# 2008 A Turning Point?

- Production strong again this year('07), but not another '06
- Leasing markets soften in some car types
- Rough patch in US economy impacts rail volume in 2008
  - Housing and autos reduce volume, slowdown in 2007 and 2008
  - Ethanol, coal and intermodal remain pretty good markets
  - Revenue remains good next year, but not so much growth
  - Reduction in volume eases operating costs/capacity constrains
- Global markets still offer potential and opportunity
  - New market building in Russia-private investors will buy 60,000 freight cars this year, need 20,000 locomotives over next decade
  - Chinese will build 50,000+ this year, more in the future; will also need locomotives
  - India an expanding market, AAR standards

# Equipment Sales Peaked But Level-Off

## Rail Equipment Forecasts

