



**STRATEGIC RAIL FINANCE**

**FOR SUSTAINABLE INDUSTRIAL DEVELOPMENT**

# Railroads

Opportunities for 3Ps

January 31, 2019



# STRATEGIC RAIL FINANCE

FOR SUSTAINABLE INDUSTRIAL DEVELOPMENT

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## **Strategic Rail Finance**

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[strategicrail.com](http://strategicrail.com)  
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Established in 1995 in Philadelphia to advise short line railroads and companies in the rail industry, SRF has advised on projects in 42 US states and Canadian provinces

## **Currently advising on \$1.7B in port-rail projects**

- Public and private finance
- Business sales and acquisitions
- Transportation planning and policy
- Business development and site selection

Created OnTrackNorthAmerica in 2007, a 501c3 non-profit advancing sound transportation policy and collaborative, holistic growth of the rail industry

# Presentation Outline

**3P and Trade** – Two current SRF examples of Port/Railroad 3P finance

Railroad industry as context

Fundamentals of railroad economics

Opportunities for 3P structures with railroads

## Quotes and Notes from Yesterday...



Port of New Orleans

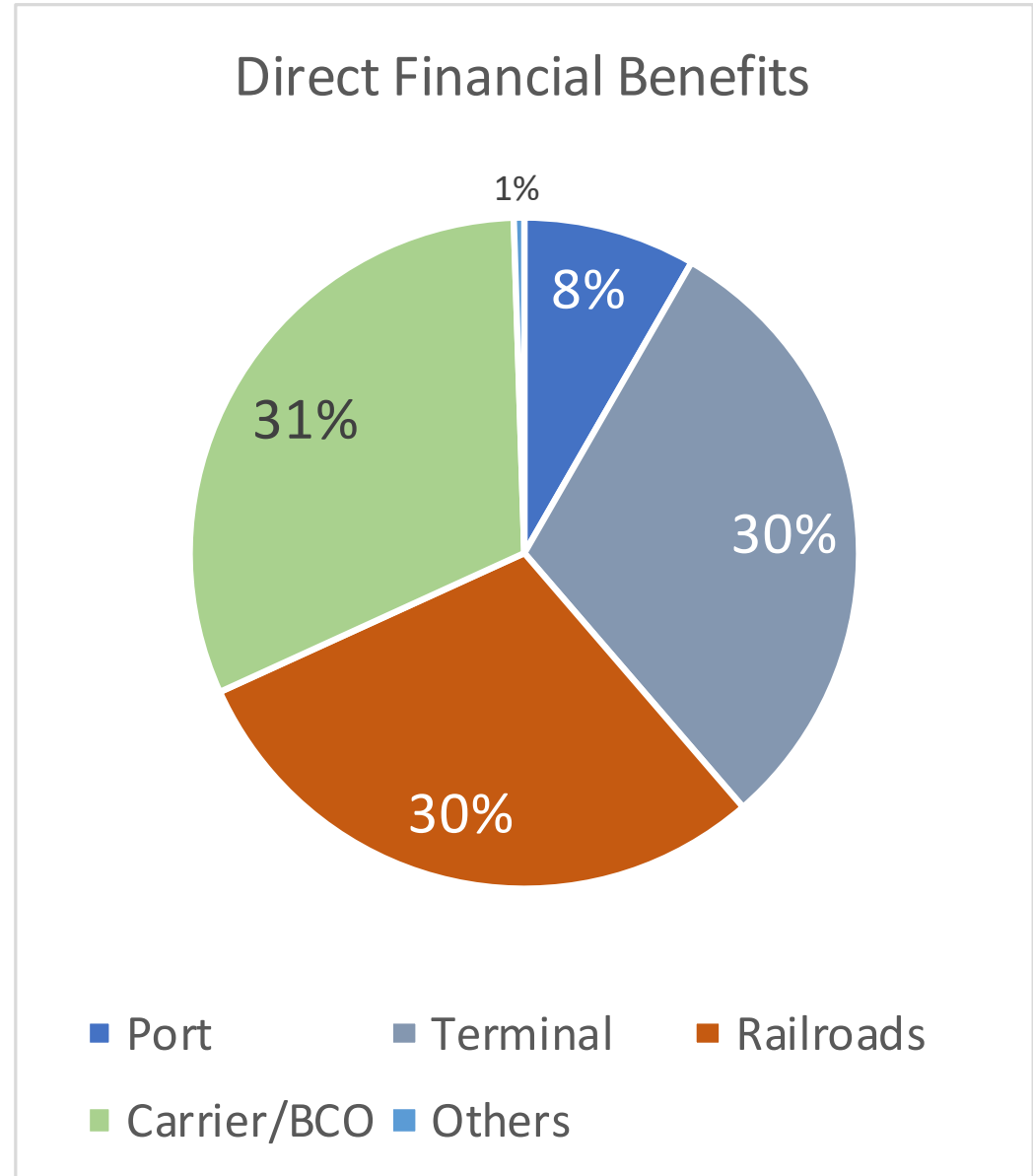
- As a Port, “the world does not end at the gate”
- “Ocean carriers can contract for rail capacity, but cannot contract for long-term trucking”
- After “necessary disruptions” precision railroading creates value
- “Inland Ports present strategic opportunity”
- “Ports must press forward the infrastructure agenda”

# Direct Financial Benefits for On-Dock Rail Development

SRF calculated 16 different value streams in a high, mid, low revenue scenarios for a Port client seeking to finance on-dock rail improvements to facilitate new business

- > Port is funding 100% of the project and will receive 8% of direct financial benefit
- > Port is hesitant to levy fees on its tenants (earning 30% of the benefits)
- > Port is hesitant to charge the carrier / beneficial cargo owner they seek to attract (earning 31% of the benefits)

**Question: how to get railroad investment into public rail infrastructure?**



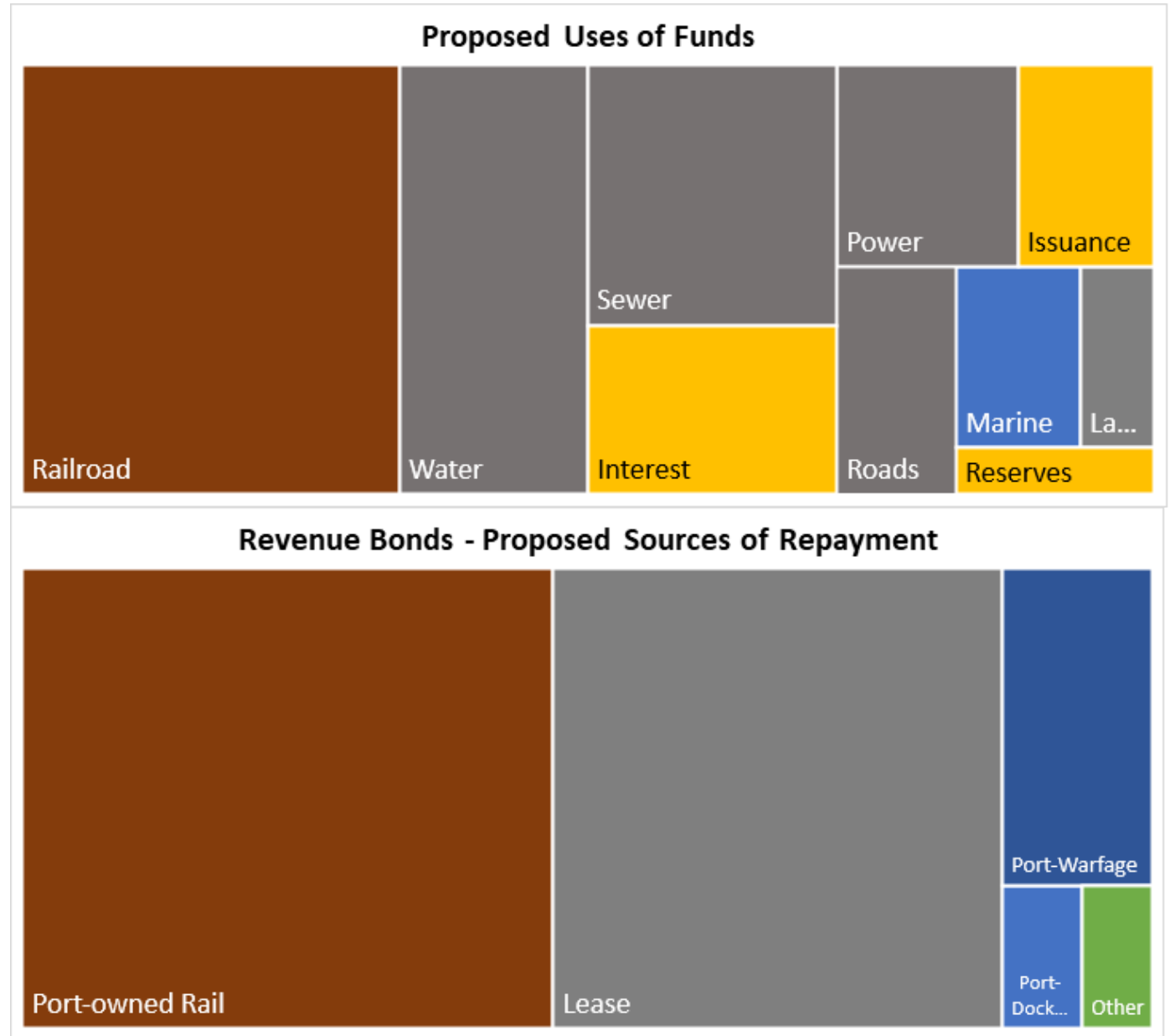
# Example #2

## Port, Lease, and Rail Revenues to Fund Infrastructure

SRF structured a large debt issuance backed by corporate guarantees of a lease, port fees, and rail fees to fund an infrastructure for a near-dock industrial development supporting exports of 14,000+ TEU and 0.8M T/yr bulk

**Port-controlled rail assets provided opportunity to capture incremental revenue share from guaranteed rail activity to fund more than the rail improvements**

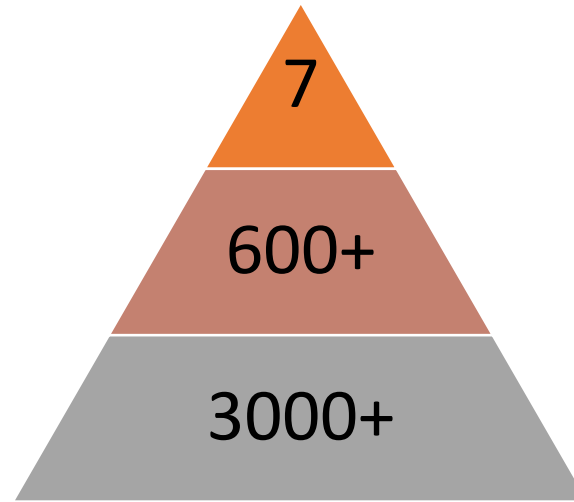
Port revenues from lease and dockage and wharfage fees (all company backed) supports a complete infrastructure package on the project



# Railroad Industry Context

Opportunities created in differences between Railroad and Port economics.

# Structure of the North American Rail Industry



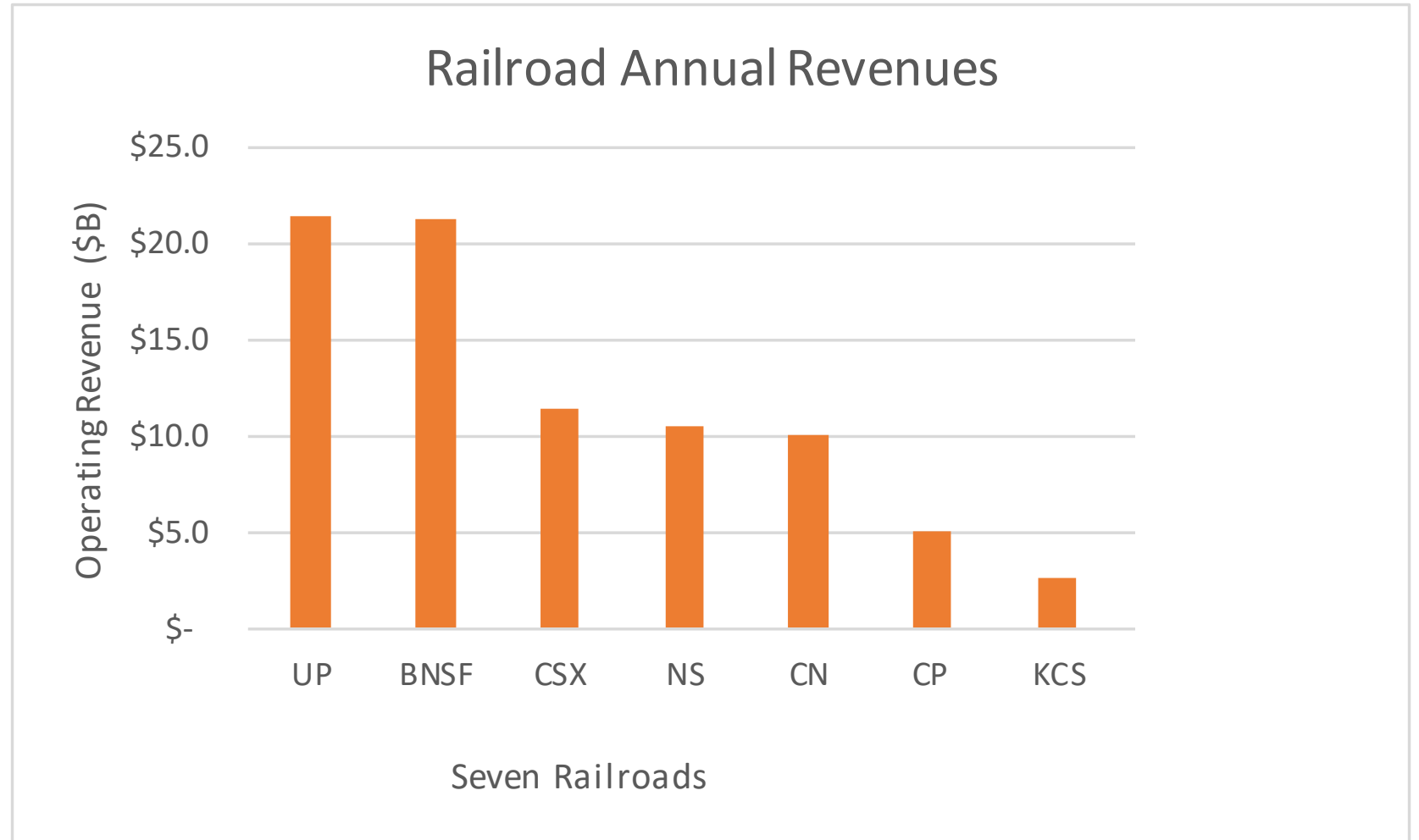
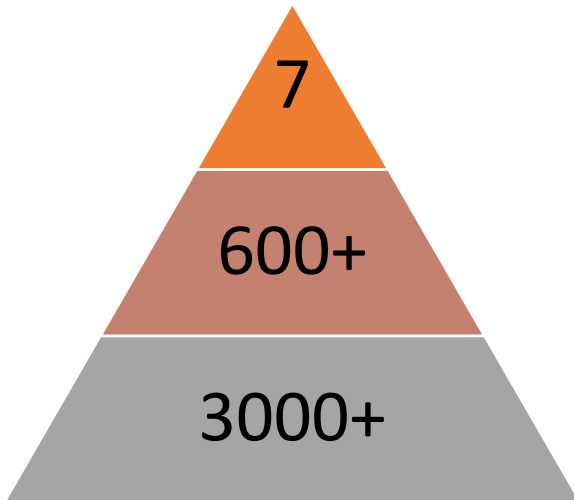
Class I Railroads

Class II and III Railroads

Industrial Rail Shippers







# Comparison of Railroad Types

## Class I and Regional Railroads

- Long-haul carriers
- The railroads are “public” like a utility but without price controls
- Railroads privately fund the infrastructure and locomotives
- Railroads maintain exclusive operational control over tens of thousands of route miles

## Terminal (Class III) Railroads

- Last-mile carriers
- Typically operate a few miles of track and switching yards
- **Many public, private and hybrid ownership / operation models**
- Perform the blocking and interchange for Class Is and switching for customers

# Fundamental Railroad Economics

To design a Private-Public-Partnership you must address the fundamental economic interests and requirements of each party

# Revenue Sources

## Revenue Diversity

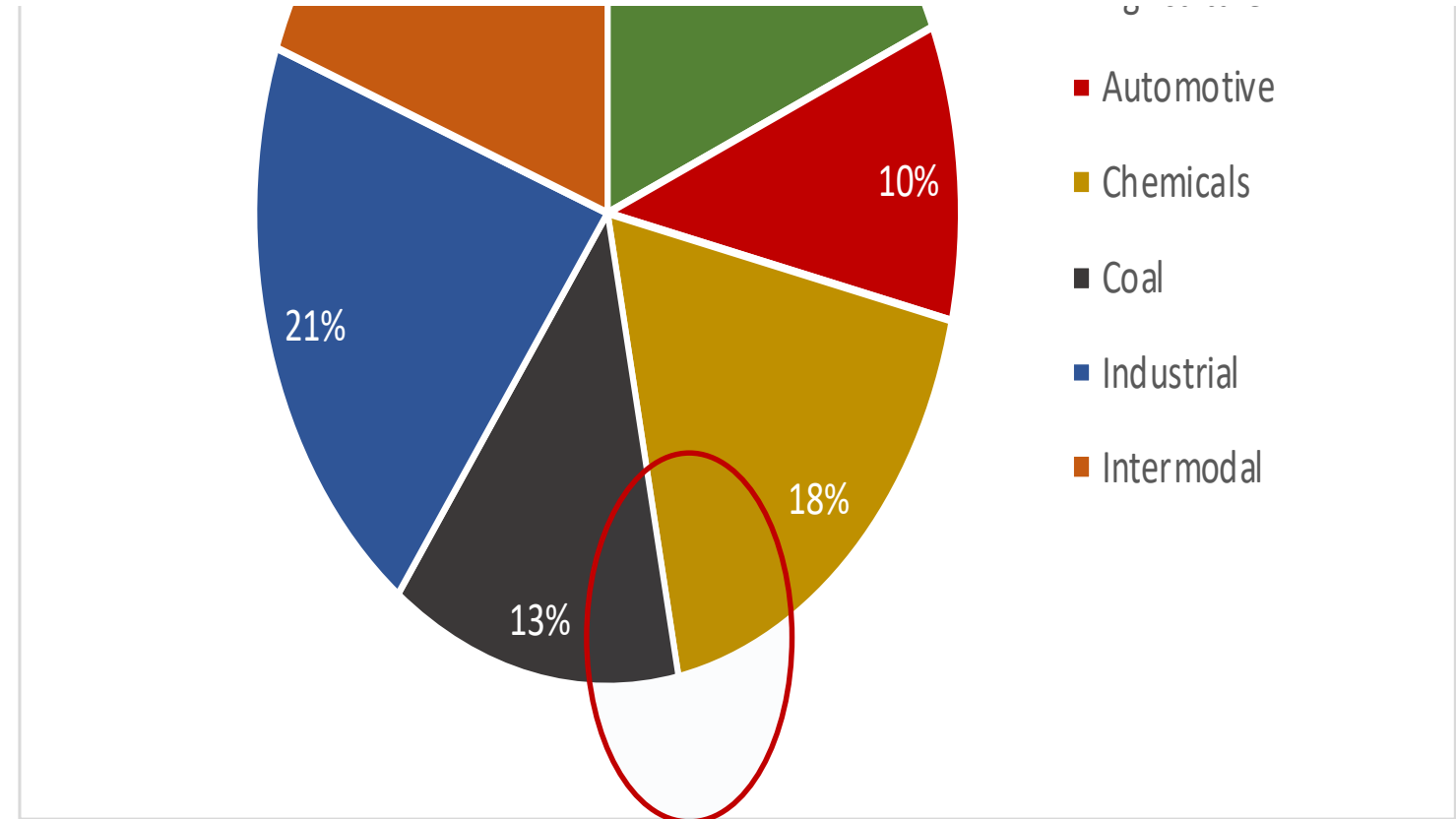
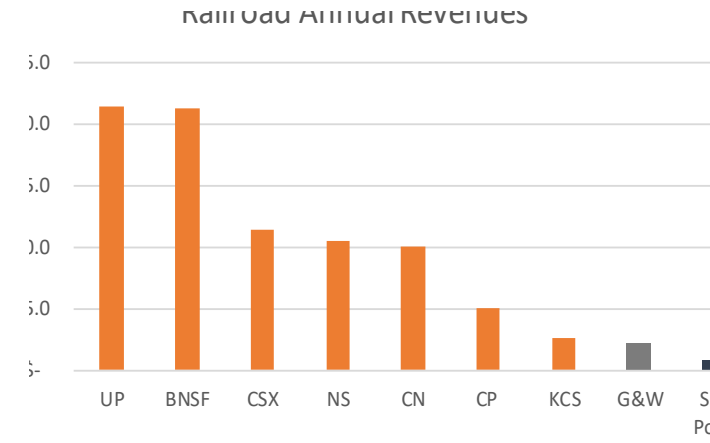
- Balance by sector
- Intermodal v. Carload v. Unit Trains

## Revenue per Car

- Agriculture, Chemical, Industrial
- Coal / Auto have smallest per-car revenue
- Intermodal (per container ... context)

## Long trains, Long hauls

- ... And the *long* story of *short* lining



# Highlighting the Highlights

## Operating Ratio

- What does it mean?
- Why does it matter so much?

## Capital RE-Investment!

- Over half of net cash
- *These are not really "additions"*

## Leverage

- Debt is typically 40% +/-
- NS: the undisputed long-bond champion!

## How are they using extra cash?

- Paying for capital!
- Paying down debt
- And giving equity back!

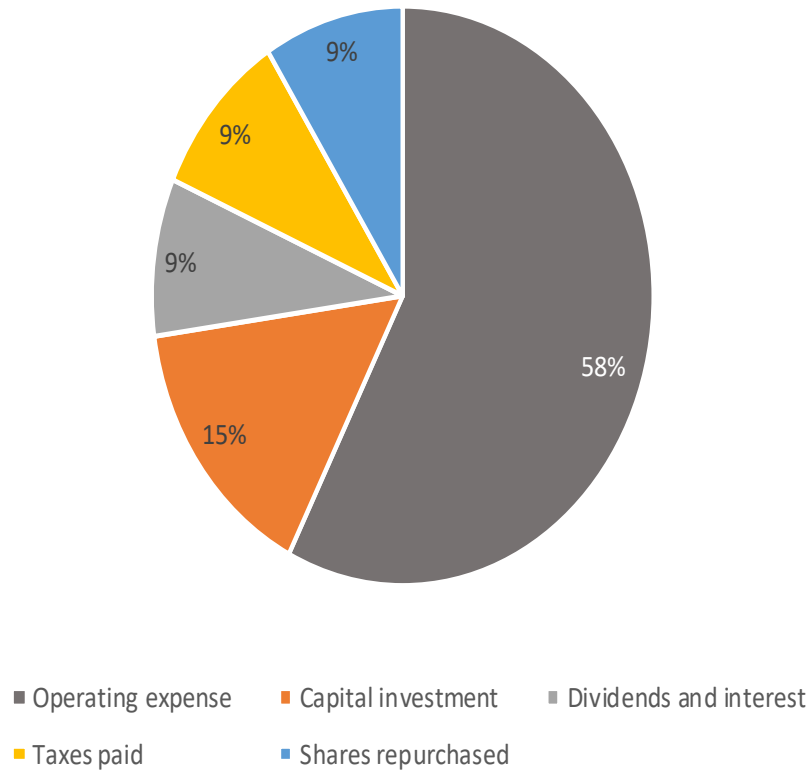
<b>Freight Revenues</b>				<b>% Change</b>	<b>% Change</b>
<i>Millions</i>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2017 v 2016</b>	<b>2016 v 2015</b>
Agricultural Products	\$ 3,685	\$ 3,625	\$ 3,581	2 %	1 %
Automotive	1,998	2,000	2,154	-	(7)
Chemicals	3,596	3,474	3,543	4	(2)
Coal	2,645	2,440	3,237	8	(25)
Industrial Products	4,078	3,348	3,808	22	(12)
Intermodal	3,835	3,714	4,074	3	(9)
<b>Total</b>	<b>\$ 19,837</b>	<b>\$ 18,601</b>	<b>\$ 20,397</b>	<b>7 %</b>	<b>(9)%</b>

<b>Revenue Carloads</b>				<b>% Change</b>	<b>% Change</b>
<i>Thousands</i>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2017 v 2016</b>	<b>2016 v 2015</b>
Agricultural Products	958	980	941	(2)%	4 %
Automotive	838	863	863	(3)	-
Chemicals	1,055	1,074	1,098	(2)	(2)
Coal	1,232	1,166	1,459	6	(20)
Industrial Products	1,227	1,097	1,213	12	(10)
Intermodal [a]	3,278	3,262	3,488	-	(6)
<b>Total</b>	<b>8,588</b>	<b>8,442</b>	<b>9,062</b>	<b>2 %</b>	<b>(7)%</b>

<b>Average Revenue per Car</b>				<b>% Change</b>	<b>% Change</b>
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2017 v 2016</b>	<b>2016 v 2015</b>
Agricultural Products	\$ 3,847	\$ 3,702	\$ 3,805	4 %	(3)%
Automotive	2,384	2,317	2,498	3	(7)
Chemicals	3,410	3,234	3,227	5	-
Coal	2,146	2,092	2,218	3	(6)
Industrial Products	3,324	3,051	3,139	9	(3)
Intermodal [a]	1,170	1,138	1,168	3	(3)
<b>Average</b>	<b>\$ 2,310</b>	<b>\$ 2,202</b>	<b>\$ 2,251</b>	<b>5 %</b>	<b>(2)%</b>

# The “Average” Class I - \$13B Annual Revenue

## Sources of Cash

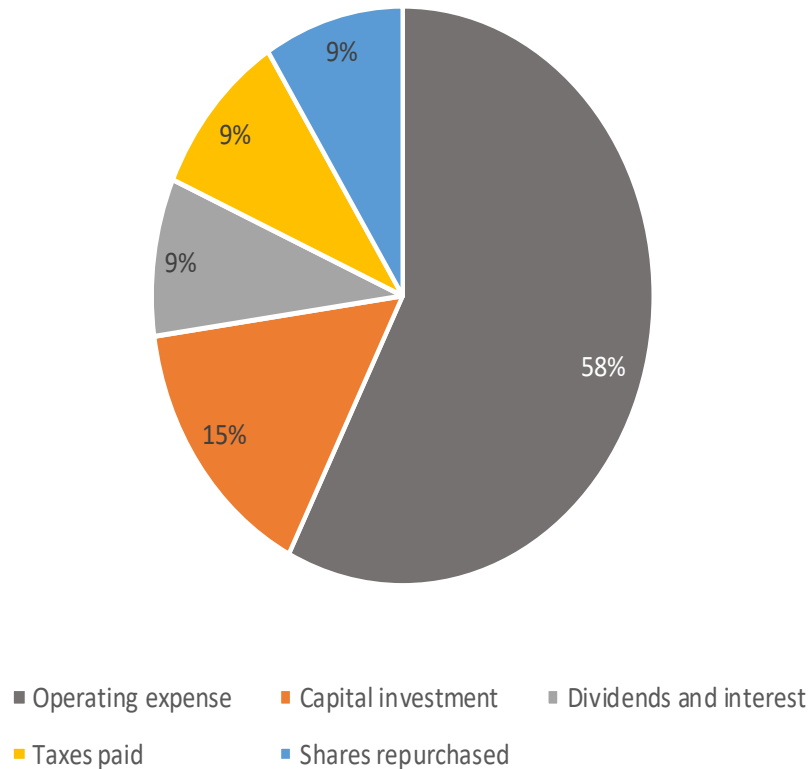


## Uses of Cash

FOR THE YEAR	2017	2016	2015
(Numbers in millions, except per-share amounts)			
Way operating revenues	\$ 10,551	\$ 9,888	\$ 10,000
Income from railway operations <sup>1</sup>	\$ 3,435	\$ 3,074	\$ 2,800
Income <sup>1</sup>	\$ 1,922	\$ 1,668	\$ 1,500
Per share – diluted <sup>1</sup>	\$ 6.61	\$ 5.62	\$ 5.00
Dividends per share	\$ 2.44	\$ 2.36	\$ 2.00
Dividend pay-out ratio <sup>1</sup>	37%	42%	40%
Cash provided by operating activities	\$ 3,253	\$ 3,034	\$ 2,900
Property additions	\$ 1,723	\$ 1,887	\$ 2,300
Free cash flow <sup>2</sup>	\$ 1,530	\$ 1,147	\$ 500
<b>YEAR END</b>			
Total assets	\$ 35,711	\$ 34,892	\$ 34,100
Total debt	\$ 9,836	\$ 10,212	\$ 10,000
Stockholders' equity	\$ 16,359	\$ 12,409	\$ 12,100
Shares outstanding	284.2	290.4	290.0
Stockholders' equity per share	\$ 57.57	\$ 42.73	\$ 40.00
<b>FINANCIAL RATIOS</b>			
Operating ratio <sup>1</sup>	67.4%	68.9%	72.0%
Debt to total capitalization ratio	27.5%	29.3%	29.0%

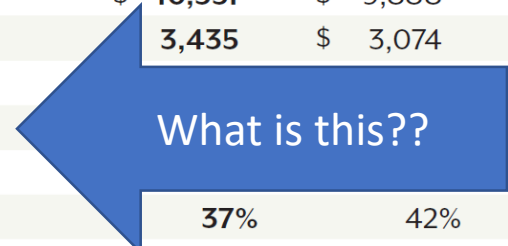
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## Reinvestment vs. Returning Capital

**Q** At what point is it worth building something new?!

**A** When you can get a 10 or 12 month payback!!

**Buy back  
shares**

**AT ZERO RISK!!**

**Revenue from asset**  
- Operation cost  
- Maintenance  
- Cost of capital  
- Taxes on Income

**DIVIDED BY THE  
BUSINESS RISK**



# 3P Structure Opportunities


- > Revenue Sharing
- > Cost of Capital and Programmatic Returns on Investment
- > Asset Ownership, Operations, and Lease Structures

# Revenue Sharing via “Carload Credits”

## Keeping it simple

Recoup a small (six-figure) investment with a “carload credit” acknowledging \$2.5M/yr of new rail revenue

- > Warehouse owner invests in dock and doors
- > Transload tenant pays “improvement rent”
- > Railroad credits the tenant \$100 per car on new rail traffic for three years
- > Railroad benefit: spot four more box cars on every switch (960 cars per year) with no increase in op ex and no cap ex
- > Port benefit: transloader ships an extra 2900 export containers of paper, generating \$0.7M/yr in new wharfage revenue



Extend dock and  
add 4 more doors


Paper transload to export container:  
Simple project to double rail capacity on a  
warehouse siding > \$100 per car credit

# Menus for Hybrid Ownership / Operations



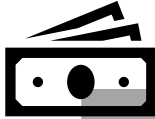
**Ownership**

- Land
- Repair facilities
- Locomotives
- Mainline and yard tracks
- Structures
- Industrial tracks
- Rolling stock
- Leasing options



**Operations**

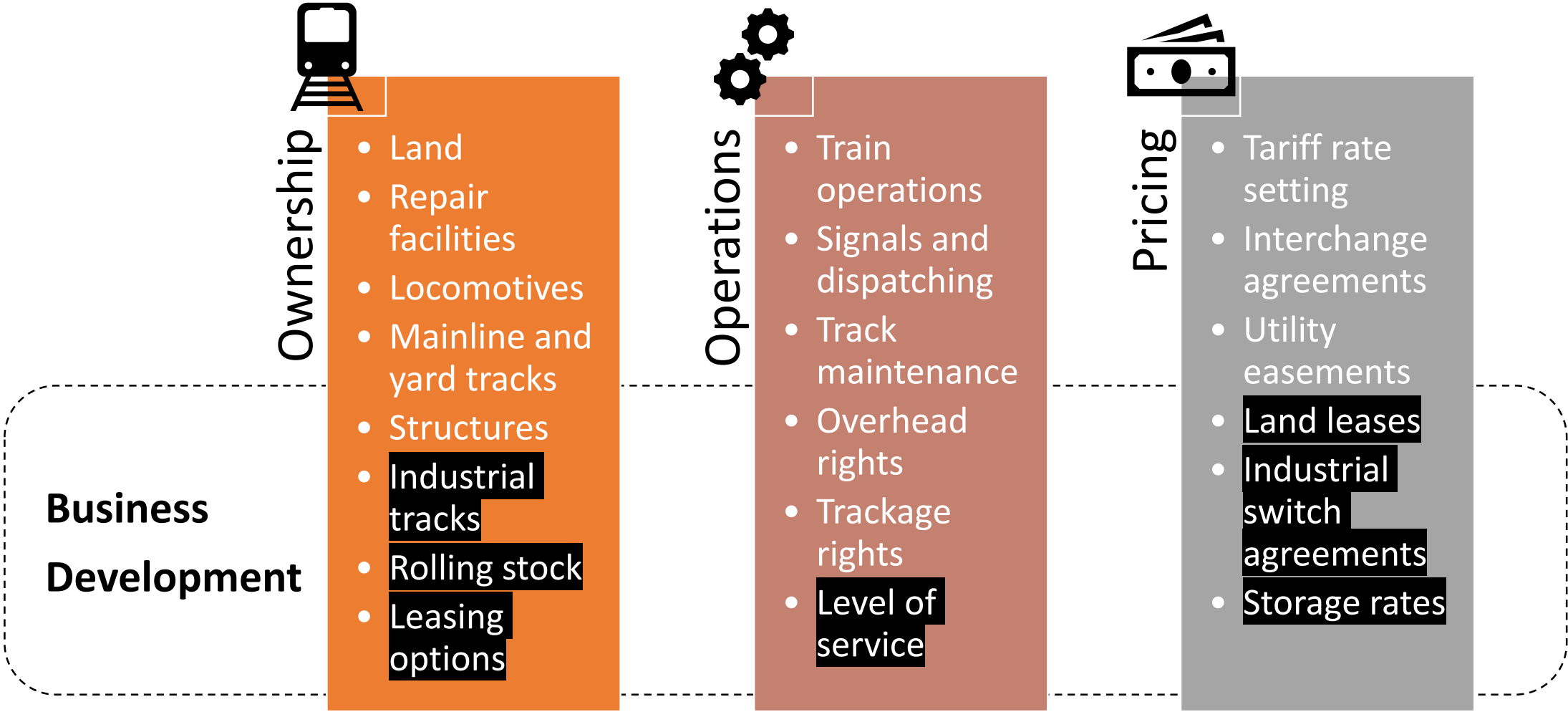
- Train operations
- Signals and dispatching
- Track maintenance
- Overhead rights
- Trackage rights
- Level of service



**Pricing**

- Tariff rate setting
- Interchange agreements
- Utility easements
- Land leases
- Industrial switch agreements
- Storage rates

# Menus for Hybrid Ownership / Operations



# Cost of Capital, Hurdle Rate, and Programmatic ROI

Two forms of Return on Investment

1. Financial returns
2. Programmatic returns

Private entities focus on #1 - Public on #2

**Port Hurdle Rate: 6% to 8%**

**Railroad Hurdle Rate: 25% +**

**A Port's access to capital AND ability to balance financial returns with programmatic returns provides a low financial hurdle rate**



## Examples of Programmatic Returns on Investment

- ✓ Job creation
- ✓ Tax base
- ✓ Increasing exports
- ✓ Infrastructure development
- ✓ Foreign direct investment
- ✓ Congestion reduction
- ✓ Air and water quality

# Summary Points

- **Simplify**
- **Know the economics**
- **Manage risk allocation**
- **Develop business for the railroad**
- **Leverage your low hurdle rates and access to capital**
- **Consider all the operation / lease alternatives**
- **Own the rail assets**



Valuation and Acquisition Advisor

# Thank You!



**John Elliott, Senior Vice President**

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