RAILROAD WEEK IN REVIEW

August 27, 2021

"So that the Board can fully evaluate whether the impact of the Merger and Related Transactions would have any potential for environmental impacts warranting environmental review when the PAR System integration has occurred, the Board directs CSXT to update its projections by ***providing traffic forecasts through 2027****—five years after the date of the anticipated year of the issuance of a final decision from the Board." —STB in Decision No.4, FD-36472, Notice of Acceptance of Application and Related Filings, July 30, 2021*

CSX Executive VP Mark Wallace submitted his Supplemental Verified Statement on August 19, as directed in Decision No. 4, excerpted above (emphasis added). He states,

> The conversion of interline movements to single-line movements will result in improved operations. From a marketing perspective, the single-line service will allow CSXT to support rail customers' organic traffic growth as the economy in New England grows, and to better compete with trucks.
>
> However, these benefits, including truck diversions resulting from service improvements, will not occur immediately. As I explain below, I expect that these benefits will increasingly be experienced in growth of traffic in years three to five following consummation of the Merger Transaction.

From here Wallace goes into exhaustive detail about his reasons for writing, "None of the traffic growth scenarios over a five-year period would exceed the STB's thresholds for identifying significant environmental effects on any segment of rail line that is at issue in this proceeding." But for our purposes it is the marketing message that must be stressed, especially given the STB's stated concerns about the competitive effects of railroad mergers. [1]

CSX has estimated an annual growth rates of 1.5 percent per year for the line segments under consideration — a number mirroring the CSX internal estimates for system-wide growth. Wallace then drills down into volume projections for the present PAR/PAS system with and without the effects of the present transaction.

His rationale for this assumption is that without the merger transaction, PAR may not be able to keep up with any traffic growth beyond the base-line of economic growth that is assumed for

[1] See also STB concerns re the competitive effects of the CSX Massena Line sale to CN and the Board's comments on the KCS sale.

CSXT on a system-wide basis, adding that "PAR is an under-resourced rail network that will be improved with the investments that CSXT intends to make." And finally,

> To avoid complicating the forecast estimates for 2020-2022 with pandemic effects, I use for the GDP Update scenario the average annual growth in the median forecast value in each year from 2023 through 2027. The median GDP growth figures range from 1.7% (2025 to 2026) to 2.3% (2022 to 2023), and result in an annual growth rate of 1.9%.

Wallace then provides a series of organic growth assumptions for each PAR commodity. The accompanying exhibits identify more than 13 million tons of goods to and from New England by road, rail and mixed modes.To this the Exhibit adds forward estimates for 2024-2027 tonnage and carloads diverted to rail and volume growth assuming 1.5 percent growth rate cited above.

This is only a sampling of the transaction detail one can garner by drilling down into the finer points of any STB filing. And, for me at least, this transaction amplifies the STB focus on the competitive effects of railroad mergers and, even more important, provides valuable insights for those affected by the merger — other railroads big and small, customers, and suppliers.

One reason to watch financial TV programming is to say ahead of the sectors that could have an effect on railroad carloads. My favorites are the XLY (autos, white goods), XLP (canned goods, beer, wine), XLI (railroads, large manufacturers, farm equipment), XLE (frack sand, crude oil), XLB (construction materials, chemicals), and XLU (nat gas, coal).

No surprises here. Most are up double-digits YTD, though utilities and staples lag in comparison. Housing starts year-to-date continue to increase both in numbers and percentage growth, the House is getting serious about an infrastructure bill, and commodity prices remain on their solid path up and to the right.

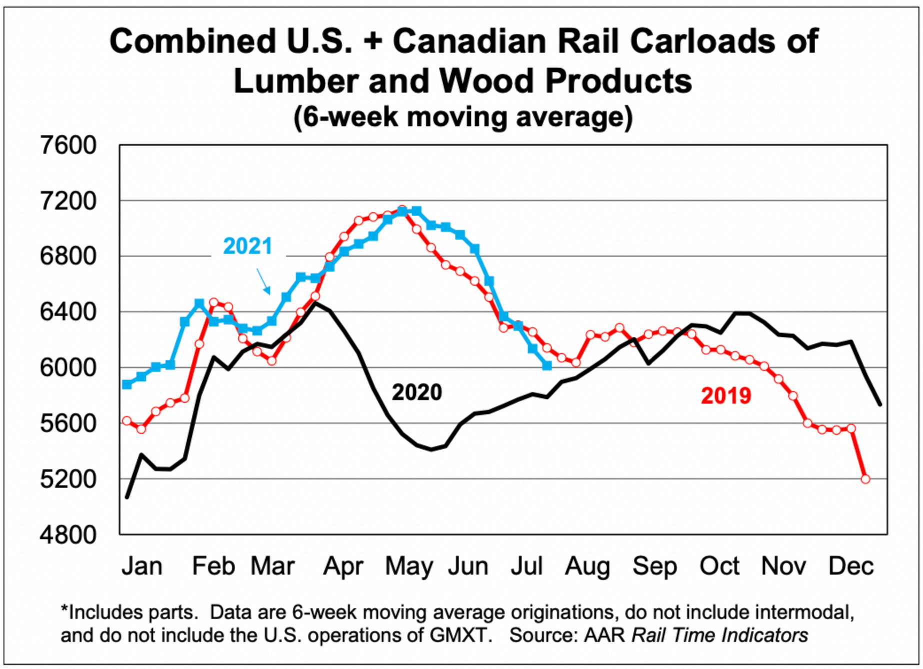
SECTOR	Ticker	Price	1-Day % Chg	MTD % Chg	QTD % Chg	YTD % Chg
Consumer Discretionary	XLY	$181.18	0.71%	0.42%	1.47%	12.69%
Financial Select Sector	XLF	$38.23	0.61%	4.68%	4.20%	29.68%
Health Care Select Sector	XLV	$135.68	-0.35%	2.67%	7.73%	19.61%
Technology Select Sector	XLK	$157.57	-0.11%	2.72%	6.71%	21.19%
Consumer Staples Select Sector	XLP	$71.98	-0.76%	0.66%	2.87%	6.72%
Industrial Select Sector	XLI	$103.99	0.50%	0.61%	1.55%	17.44%
Materials Select Sector	XLB	$85.03	0.63%	1.20%	3.30%	17.46%
The Energy Select Sector	XLE	$48.40	1.66%	-2.00%	-10.15%	27.70%
Utilities Select Sector	XLU	$68.58	-0.65%	3.96%	8.46%	9.38%
Real Estate Select Sector	XLRE	$46.47	-0.75%	0.19%	4.83%	27.11%
Communications Services Sector	XLC	$84.00	0.32%	1.94%	3.74%	24.48%
S&P 500	SPX	4,486.23	0.15%	2.07%	4.39%	19.44%

CAPTION

The AAR *Rail Time Indicators* for August confirms much of the above. Take lumber:

> The category "lumber and wood products" consists of products in STCC 24 except STCC 241 — that is, lumber and dimensional stock, millwork, veneer and plywood are included, but excluding primary forest products like wood chips and pulpwood logs. Most of lumber and wood products is used for building construction, which is why there's a clear positive correlation between rail carloads of lumber and wood products and U.S. housing starts. We combine U.S. and Canadian carloads for this category because much of the lumber consumed in the U.S. originates in Canada or in areas served by the U.S. subsidiaries of Canadian railroads.

Graphically,



The same AAR carload pattern repeats pretty much across the board. So take these AAR charts to your customers and compare their experience and expectations with these trends. Money in your pocket if you do.