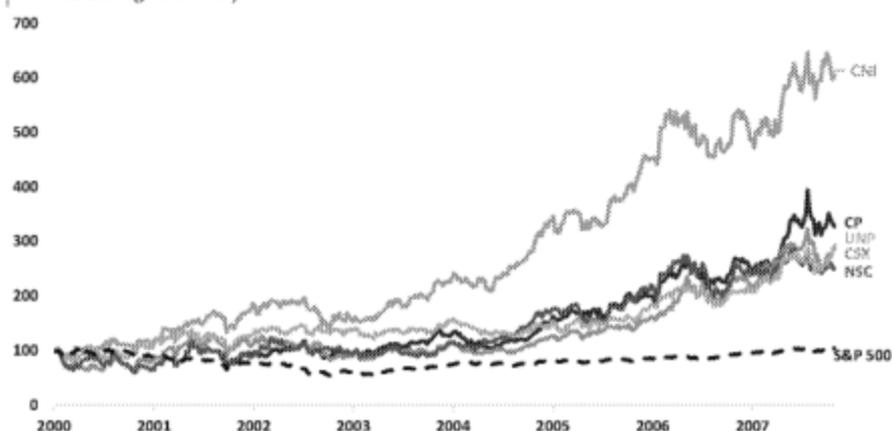




Shares of rail companies have consistently outperformed the market since 2000, generating an average annualized return of 16.5% (including dividend reinvestment) compared to 5.1% for the S&P 500. CNI has been the strongest performer with a 19.8% CAGR while CSX has been the group's laggard (15.4% CAGR) due largely to a lower dividend yield. During this time, shares of railroad companies have experienced three major up-cycles with two periods of extended weakness. Outperformance and/or underperformance within the group have been driven by a number of different factors throughout different cycles, though recently investors have been more eager to reward companies for potential margin expansion. The first major major up-cycle for the industry lasted from 2000 until 2008. As seen below, CNI was the clear winner during this time as the company expanded its network through a number of acquisitions, generated best-in-class volume growth, and removed costs through the implementation of Hunter Harrison's Precision Railroading model.

Figure 73: The rails solidly outperformed the S&P 500 from 2000-2008 with CNI leading the way



Source: Deutsche Bank, FactSet

After peaking in May 2008, railroad shares fell 60% on average, underperforming the broader market (the S&P 500 fell 50% peak to trough). This makes sense to us given the aforementioned run-up and higher fixed cost nature of the rail industry. To this point, earnings for the group were down 26% on average in 2009 on a 19% reduction in revenue. We note that CSX declined the most peak to trough in 2008/09 (due to its run-up ahead of the recession) followed by CP as Consensus EPS forecasts for 2009 fell 56% vs. 37% on avg. for the rest of the group.