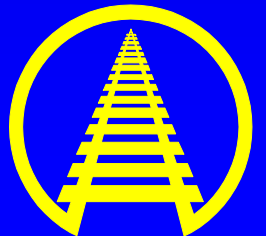
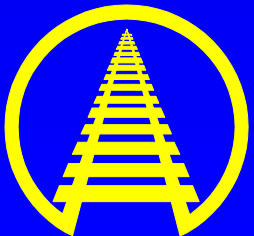


U.S. Freight Railroads

**Presentation to the
American Association
Of Port Authorities**

March 21, 2006



25 Years After Staggers: Solid Gains and a Promising Outlook

- Unprecedented productivity gains passed to customers as lower rates
- Dramatic safety gains
- Infusion of advanced technology
- Growth of non-Class I carriers
- Closer to financial sustainability



2005 Was a Good Year

Class I Railroad Performance

(billions, except percentages)

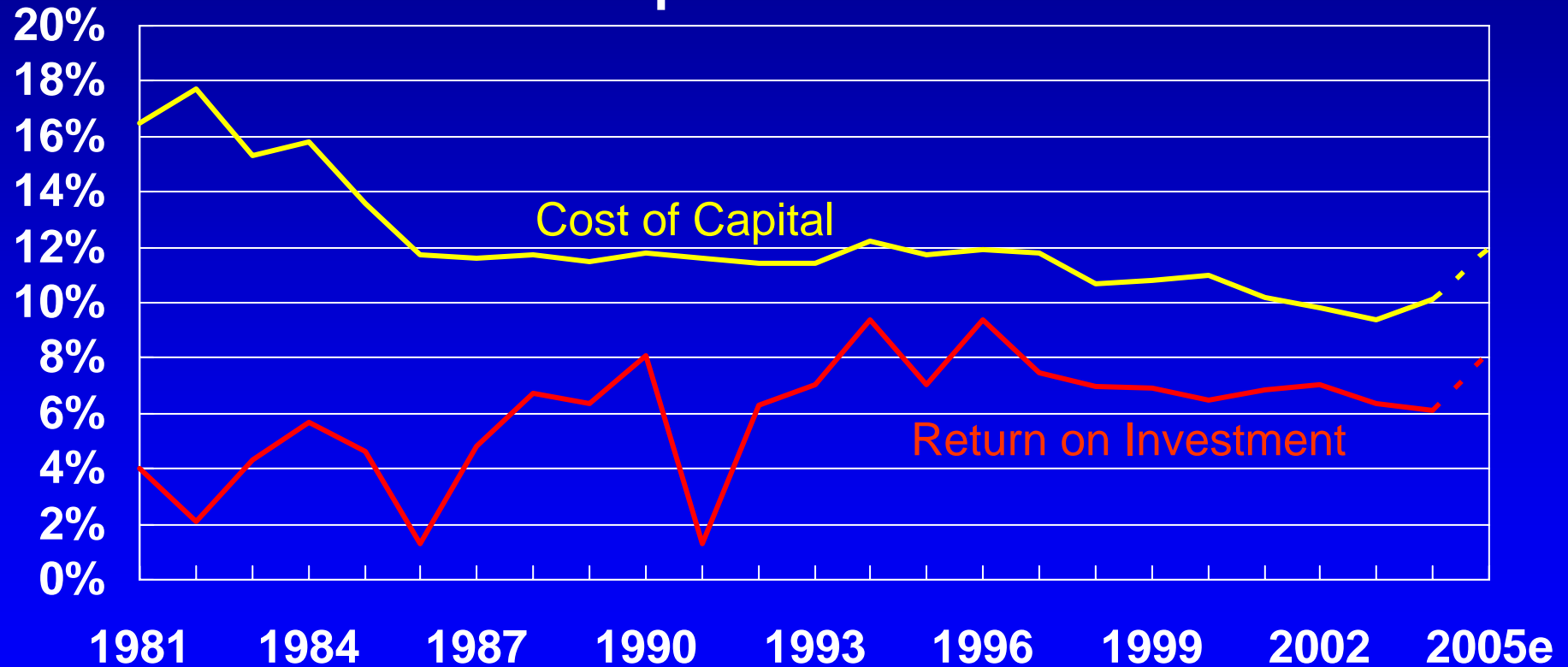
	<u>2004*</u>	<u>2005**</u>	<u>% change</u>
Operating Revenue	\$40.5	\$46.1	13.8%
Operating Expenses	\$35.1	\$37.8	7.8%
Net Revenue From Oper.	\$5.4	\$8.3	53.0%
Net Income	\$2.9	\$4.9	71.2%
Ton-Miles	1,663	1,698	2.1%
Operating Ratio	86.6%	82.1%	
Net Margin	7.1%	10.6%	
Return on Equity	6.2%	9.1%	
Return on Investment	6.1%	8.2%	

*From R-1 annual reports

**Preliminary, from Q4 2005 cumulative AAR RE&I report

Closing the Earnings Gap?

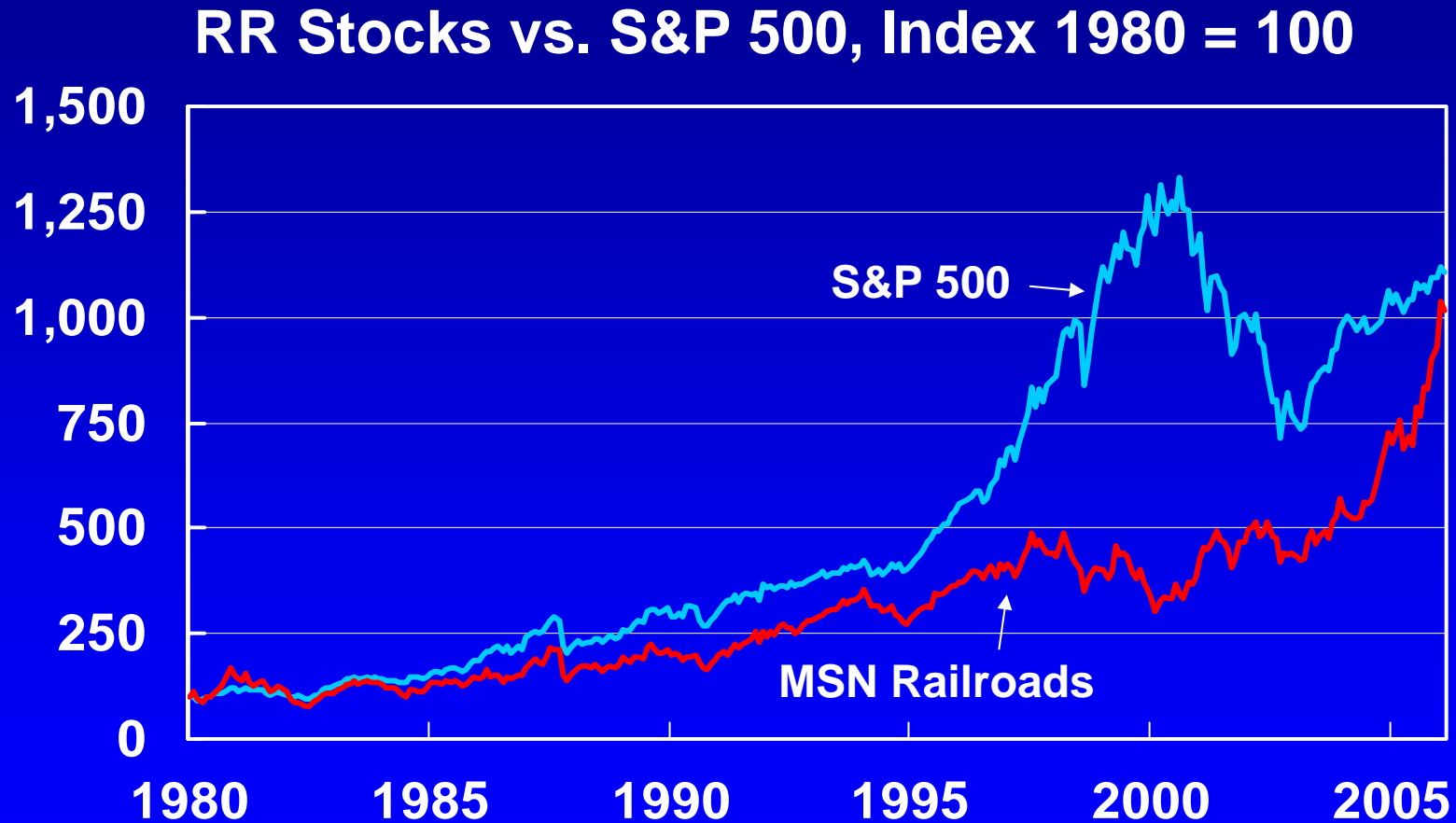
Class I Cost of Capital vs. Return on Investment



e – preliminary AAR estimate

Sources: AAR, STB

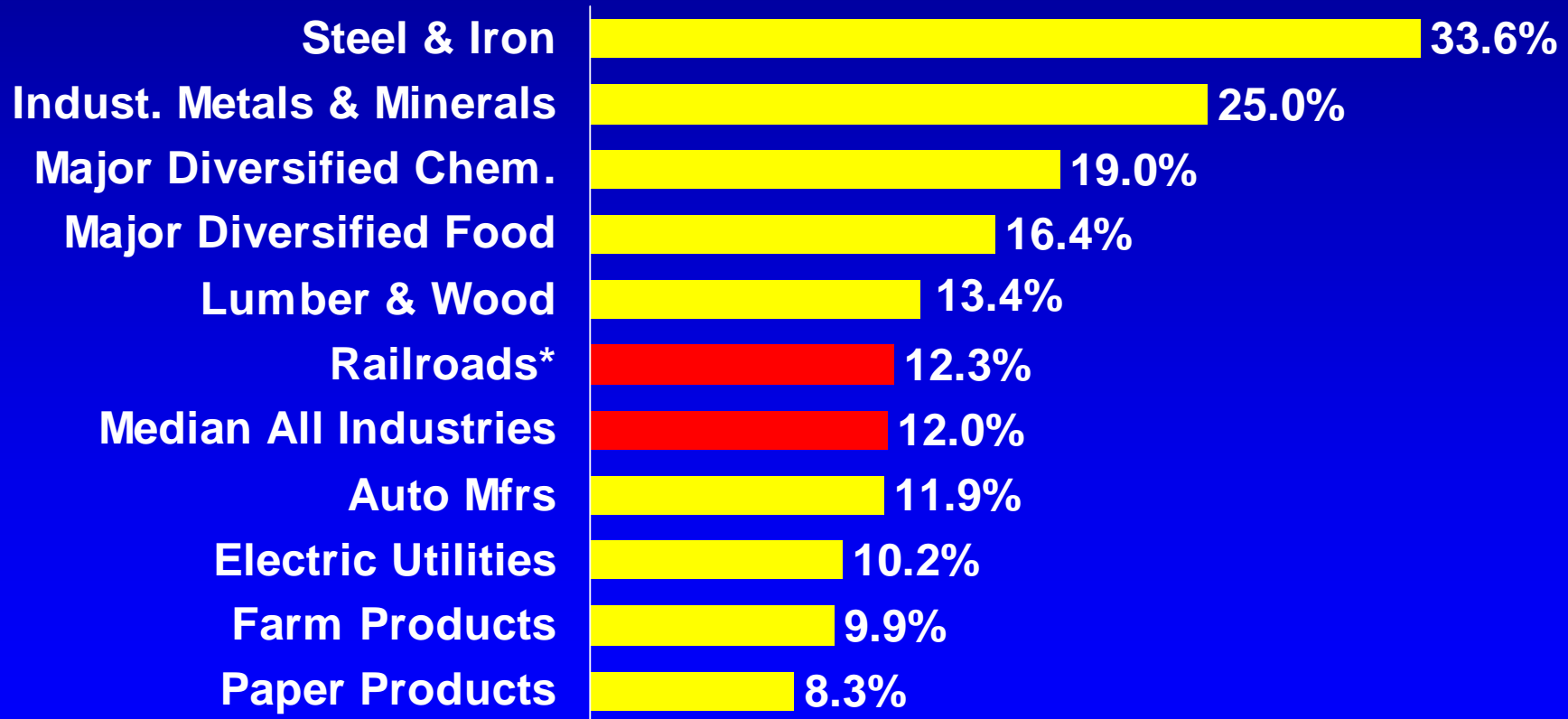
Railroad Stocks Have Been Gaining



Source: MSN Money

RR Earnings Are Still Modest Compared to Most Other Industries

Return on Equity in 2005



*Median of BNSF, CSX, NS, and UP Some data may be preliminary. Source: Yahoo! Finance

Capacity Has Become a Critical Issue

“In 23 years, I have never seen a situation where the supply chain is at capacity. It’s busting at the seams.”

Air Products & Chemicals

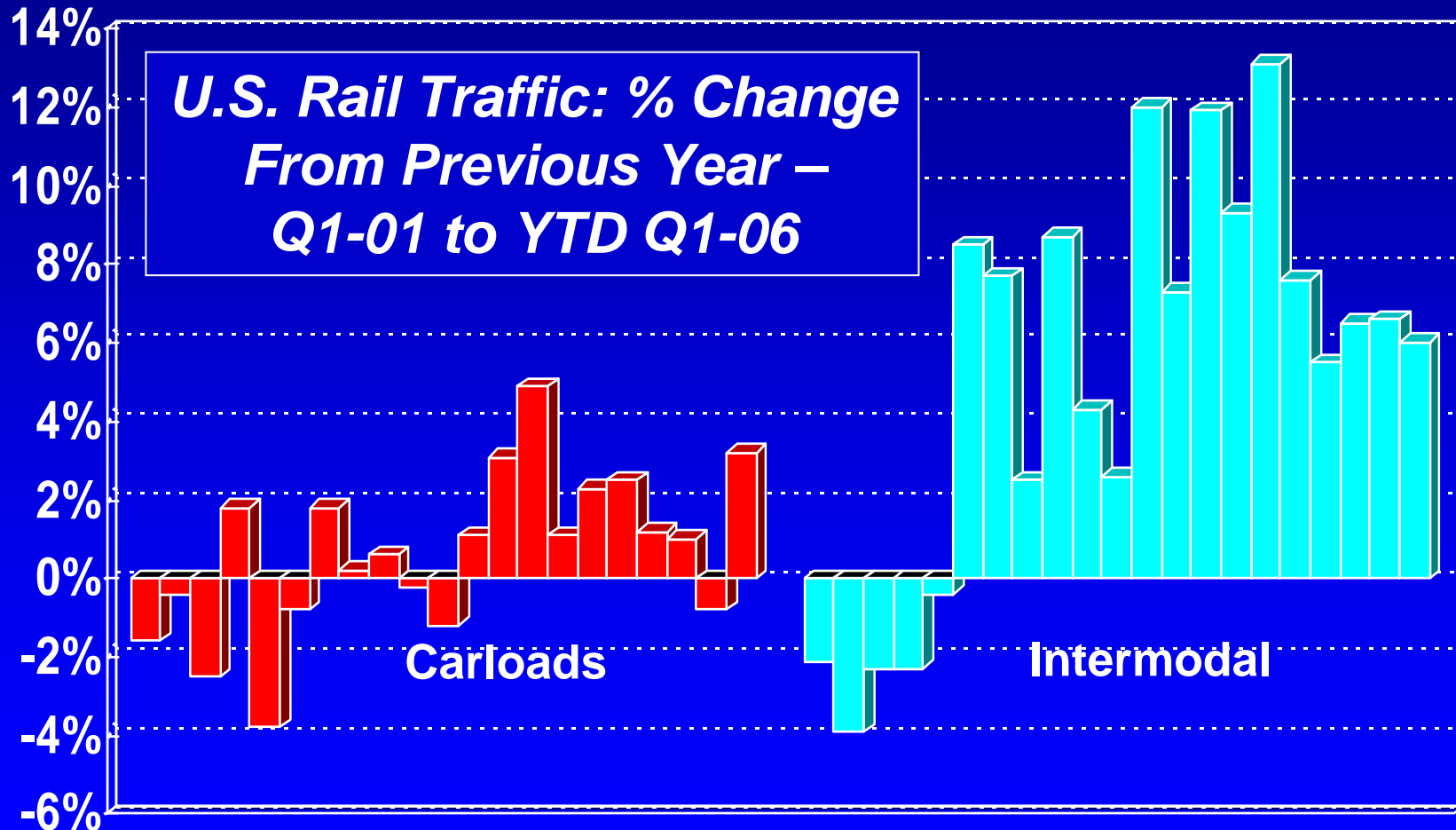
“We are out of capacity as a country on virtually every segment in the transportation industry at the same time.”

Norbridge Associates

“None of us can do business the way we did last year. The volumes are simply too high.”

*International Transportation Service Terminal
(Port of Long Beach)*

Record Traffic Means RRs Face Capacity & Service Challenges Too



Source: AAR Weekly Railroad Traffic through Week 6, 2006.

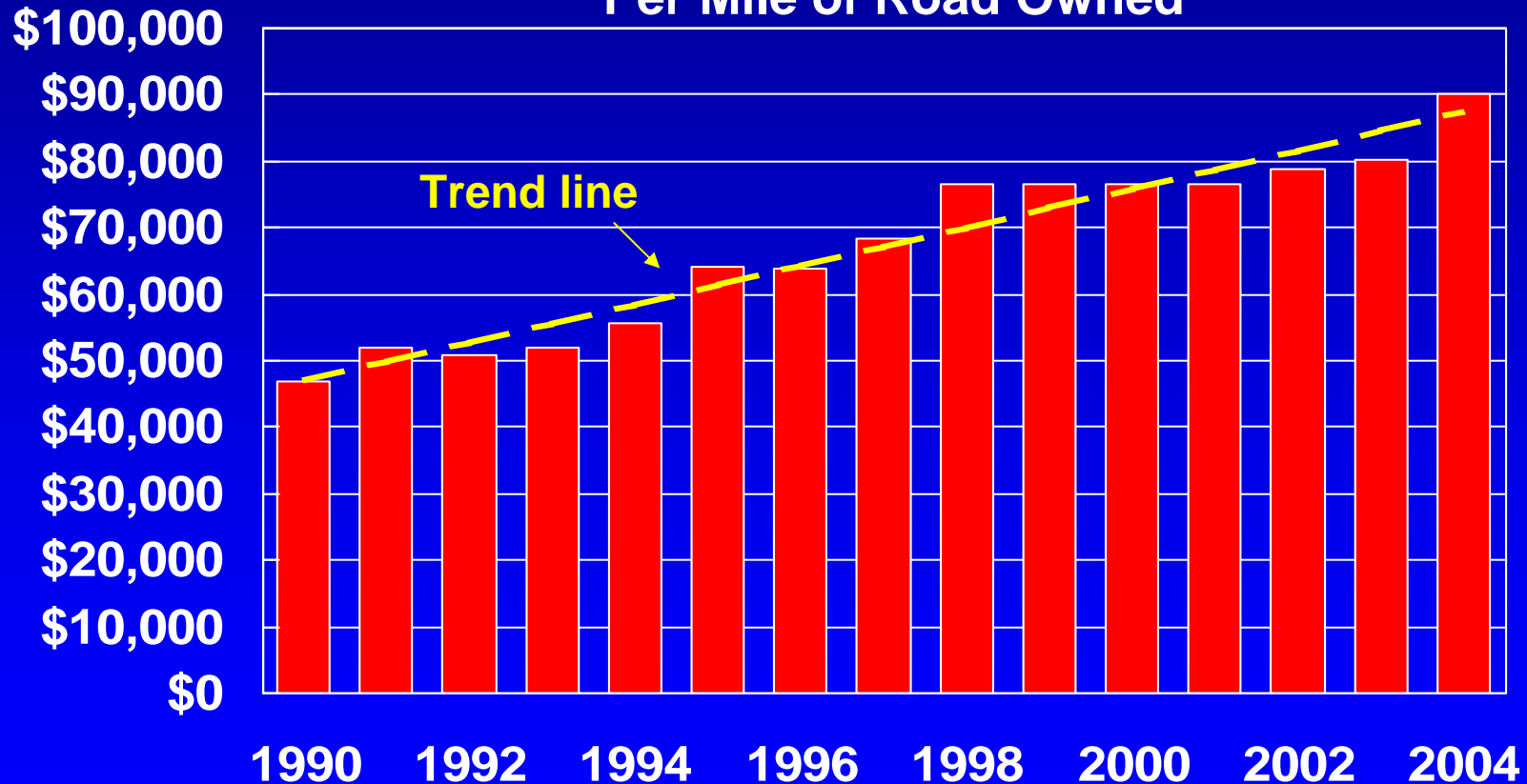
In Response, RRs Are Increasing Capacity and Capability

- Stepped-up spending on equipment and infrastructure
- Infusion of technology
- New operating plans
- Cooperative alliances
- Aggressive hiring
- Working with customers



RRs Have Been Increasing Spending for a Long Time...

Class I Spending* on Infrastructure & Equipment
Per Mile of Road Owned

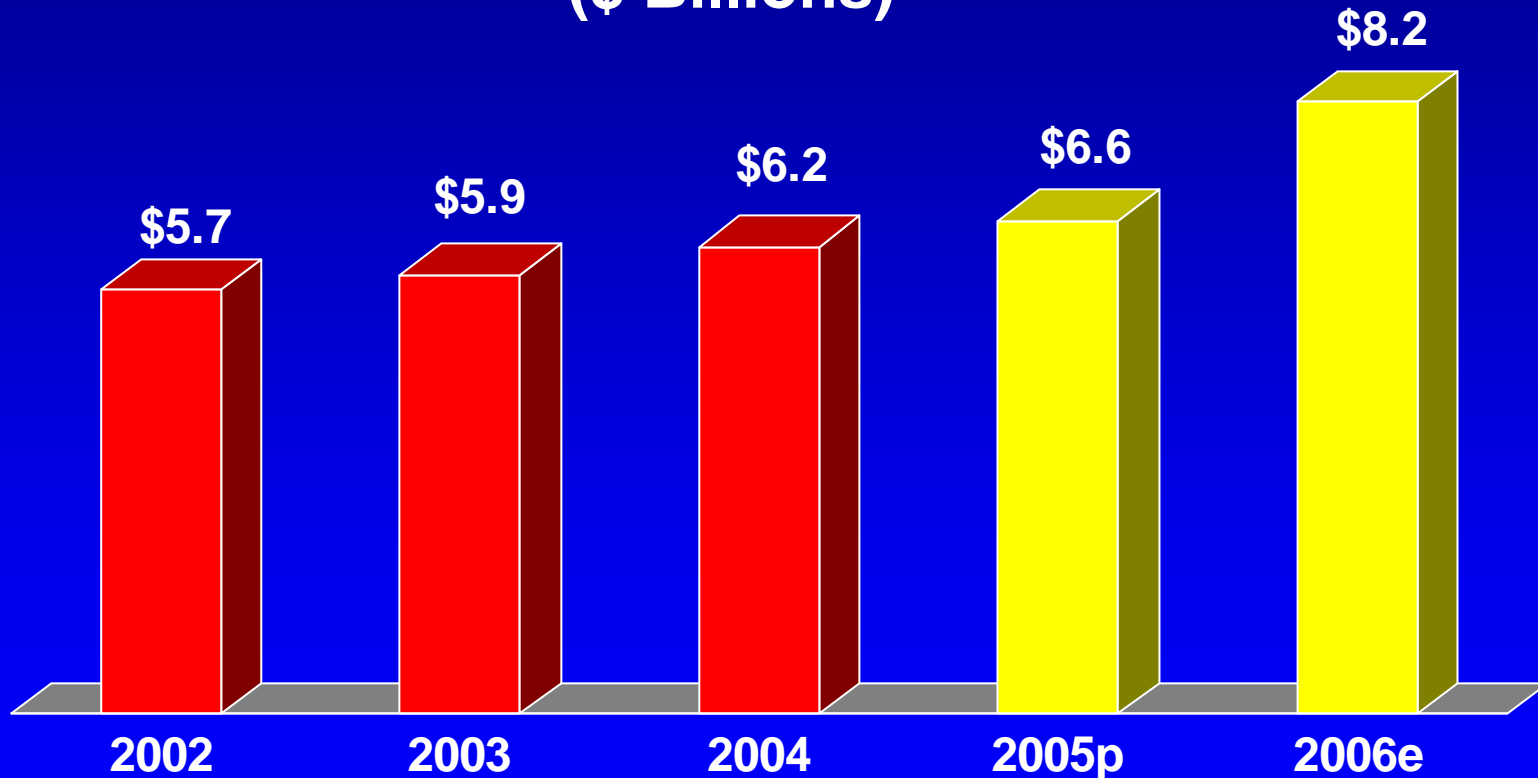


*Capital spending and maintenance expenses less depreciation

Source: AAR

...And Are Poised to Spend Even More

**Class I RR Capital Expenditures
(\$ Billions)**



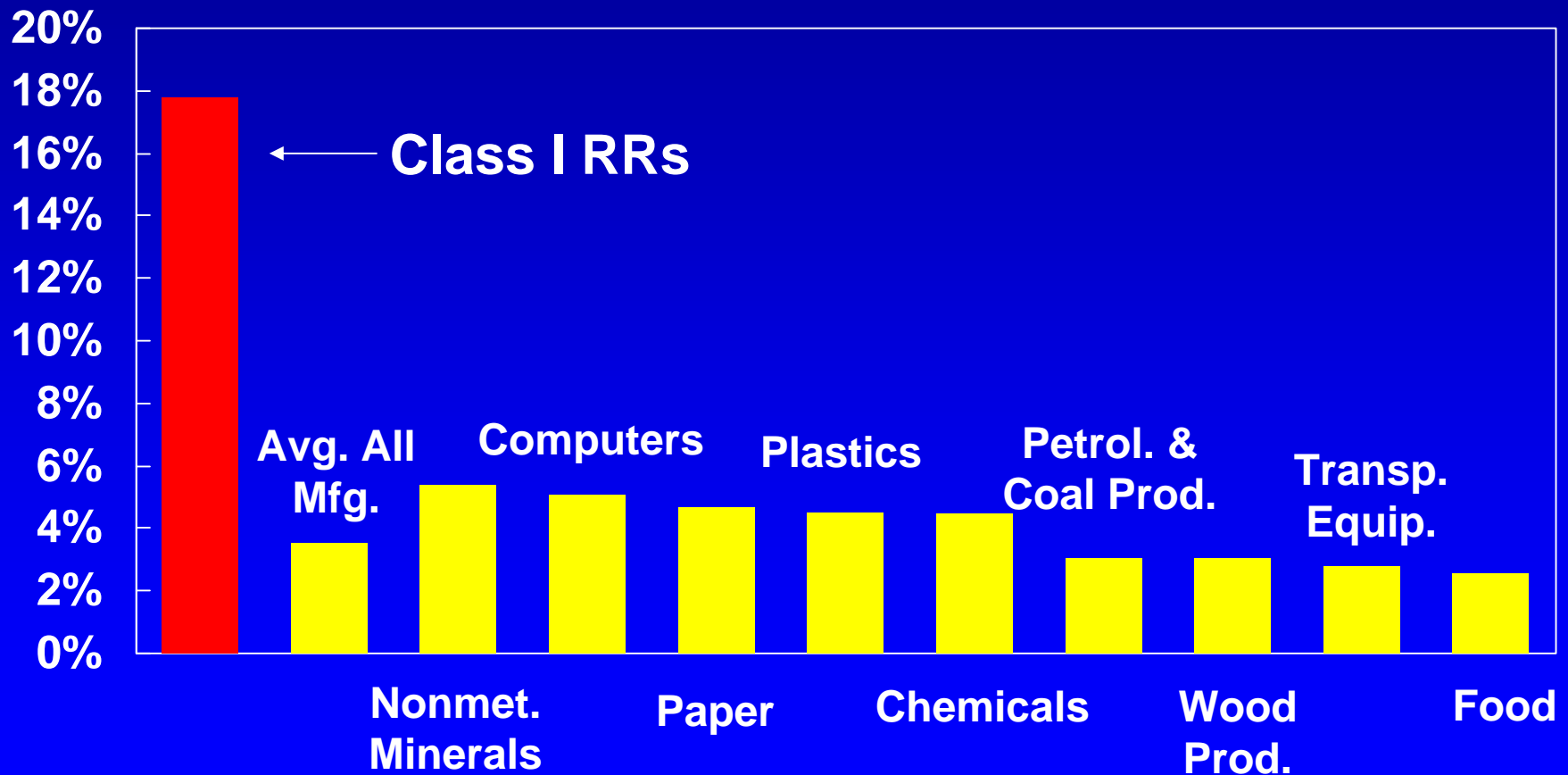
p – preliminary

e – AAR estimate

Source: AAR

Railroading is Immensely Capital Intensive

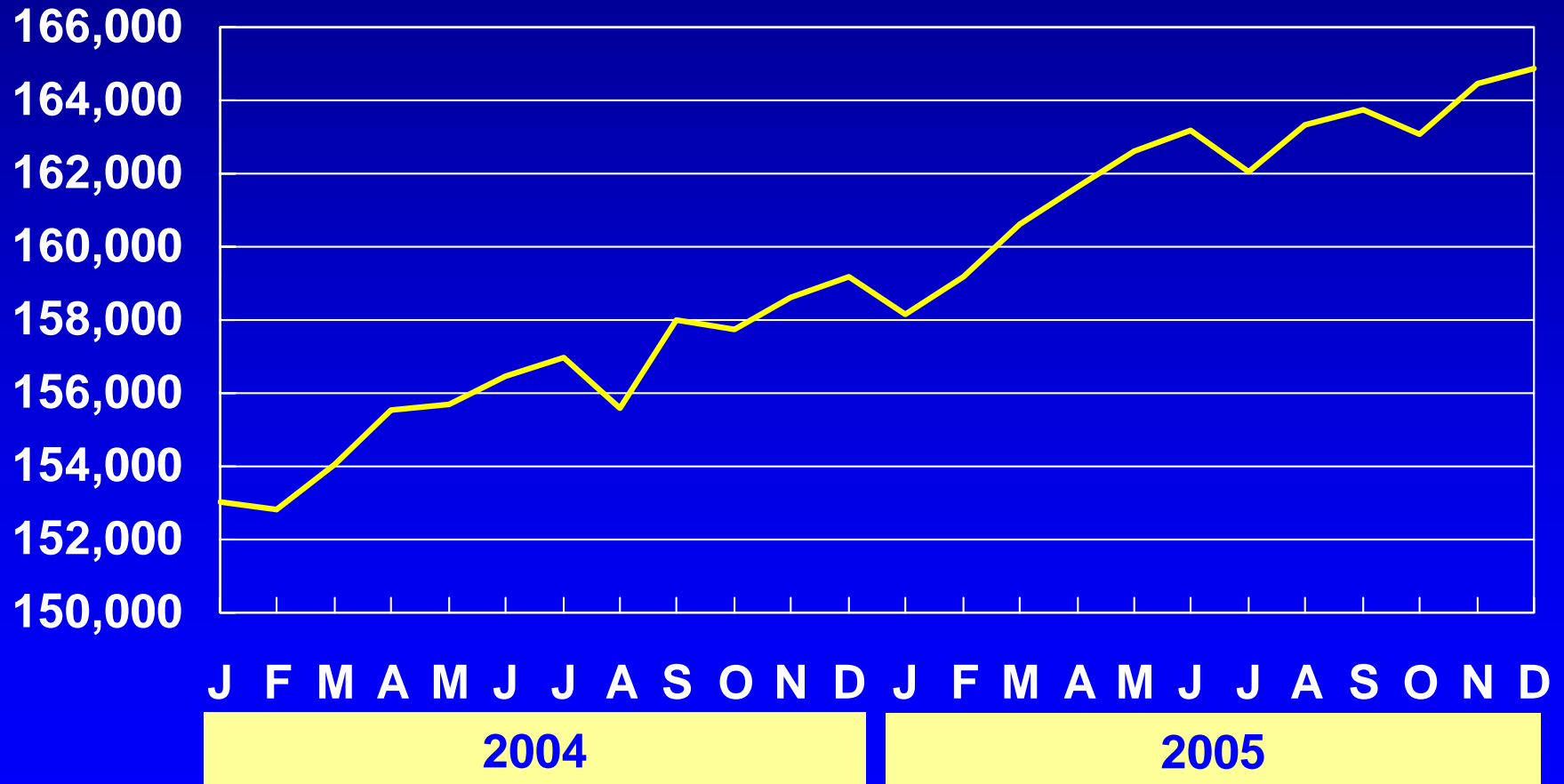
Capital Expenditures as % of Revenue: Avg. 1995–2004



Sources: Census Bureau, AAR

Rail Employment is Up Too

Total Class I Employment



Source: Surface Transportation Board

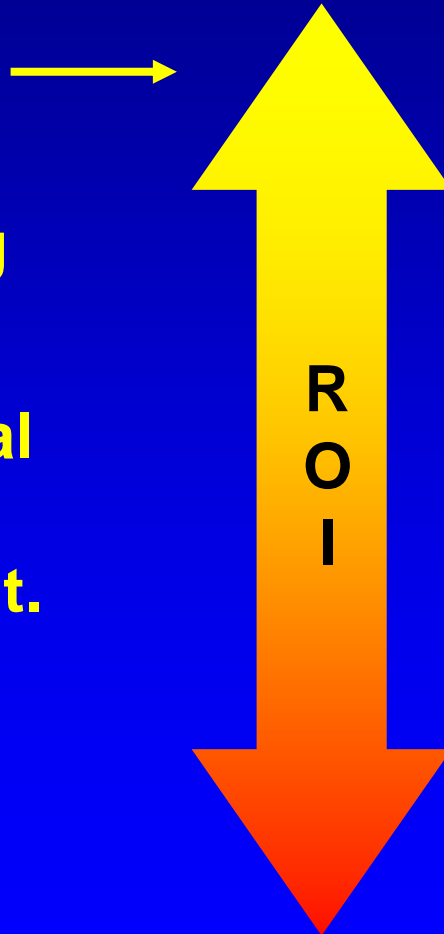
First, Do No Harm

- Don't Reregulate
- Reregulation looks to the past, not the future
- Staggers Act spurred investment, efficiency, innovation, safety

Return on Investment is Crucial

If ROI > cost of capital:

- Capital spending expands
- Stronger physical plant; more and better equipment.
- Faster, more reliable service
- Sustainability



If ROI < cost of capital:

- Lower capital spending
- Weaker physical plant, equipment
- Slower, less reliable service
- Disinvestment

Public-Private Partnerships Can Help Resolve Capacity Problems

“Relatively small public investments in the nation’s freight railroads can be leveraged into relatively large benefits for the nation’s highway infrastructure, highway users, and freight shippers.” – *AASHTO*

- Best used for projects whose main purpose is to meet public needs.
- RRs pay for their benefits and public pays for public benefits.
- Not “subsidy” to RRs.

Freight Rail Provides Major Public Benefits

- Fuel efficient
- Less pollution
- Reduced congestion
- Enhanced mobility
- Safer



Examples of Rail PPPs

- Alameda Corridor
- FAST Corridor
- Shellpot Bridge
- CREATE
- Alameda East
- Heartland Corridor
- MarOps



Tax Incentives for Railroad Capacity Expansion

“The rail industry today is stable, productive, and competitive, with enough business and profit to operate but not to replenish its infrastructure quickly or grow rapidly.”

– AASHTO

- 25% tax credit for projects that *expand* rail capacity.
- Expense infrastructure capital expenditures that do not qualify for credit.
- Will help bridge funding gap.

“As demand increases, the railroads’ ability to generate profits from which to finance new investments will be critical. Profits are key to increasing capacity because they provide both the incentives and the means to make new investments.”

– *Congressional Budget Office*