

Economic And Road & Rail Industry Outlook

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Agenda

- ❑ Transportation (Road & Rail) Thesis
- ❑ Key Economic Indicators
- ❑ The Current “State of Freight” (Demand)
- ❑ Capacity Situation (Supply)
- ❑ Pricing Trends
- ❑ Company Profiles
 - Canadian National Railway
 - Canadian Pacific Railway
 - Contrans Group
 - TransForce
- ❑ Q & A

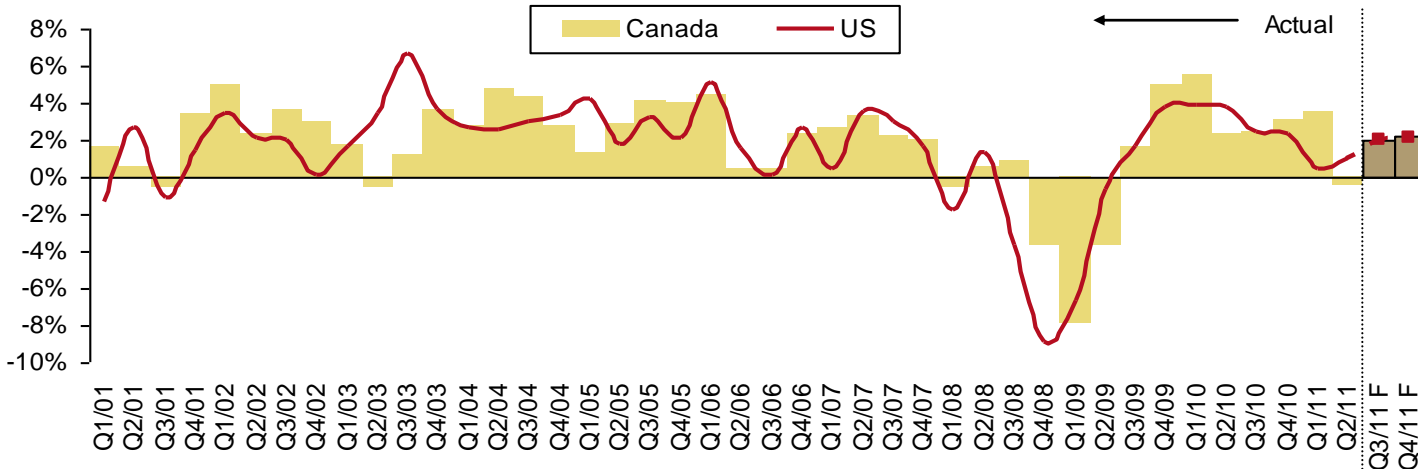
Cormark's Road & Rail Thesis

- ❑ Asia, capacity discipline and financial strength partially offsetting economic weakness
- ❑ Positives:
 - Canadian economy – expected to be amongst the strongest in the G-7, but not immune
 - Asian trade – strong import/export; intermodal; demand for commodities, e.g. coal, forest products. grain/fertilizers, etc.
 - Industry financial strength – strong free cash flows and debt reduction through the downturn; well positioned to weather another storm
 - Cost structure – costs and capex cut, capacity reigned in, focus on profitability through the downturn
 - Freight rates – increasing, aided by capacity and pricing discipline; pricing drops directly to EBT
- ❑ Negatives:
 - Economy – 70% of the US economy driven by the consumer, with high unemployment, personal debt and weak housing
 - Freight – volumes strongly correlated to GDP (88% for the rails); muted fall peak season expected
 - Leverage – small top-line fluctuations amplified down the P&L
 - Key leading indicators – Inventory/Sales ratio, ISM New Orders, ATA Truck Tonnage, border crossings, port volumes, US Trailers on Rail Car, the Baltic Dry Index, the HARPEX Index – all deteriorating
 - FX – CNR 50-55% revenue in US\$, CP ~33%, CSS 15-20%, TFI 30% transborder (more with Dynamex)
 - Regulatory environment – rates, service, safety

Key Economic Indicators

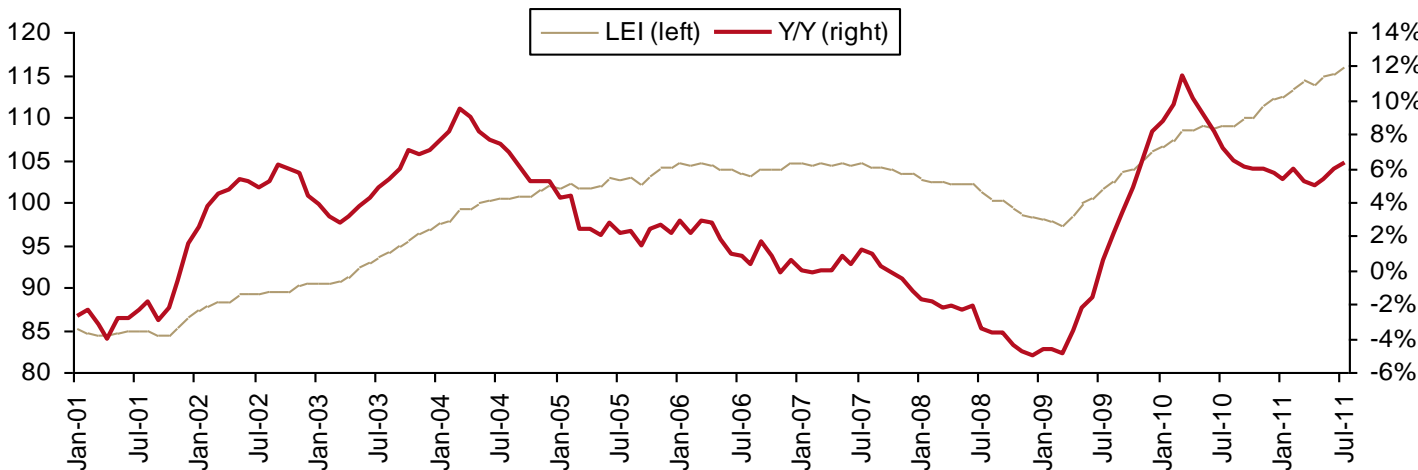
Pace of Economic Recovery – Slowing or Bottoming???

Real GDP, Q/Q Growth (Annualized), Quarterly

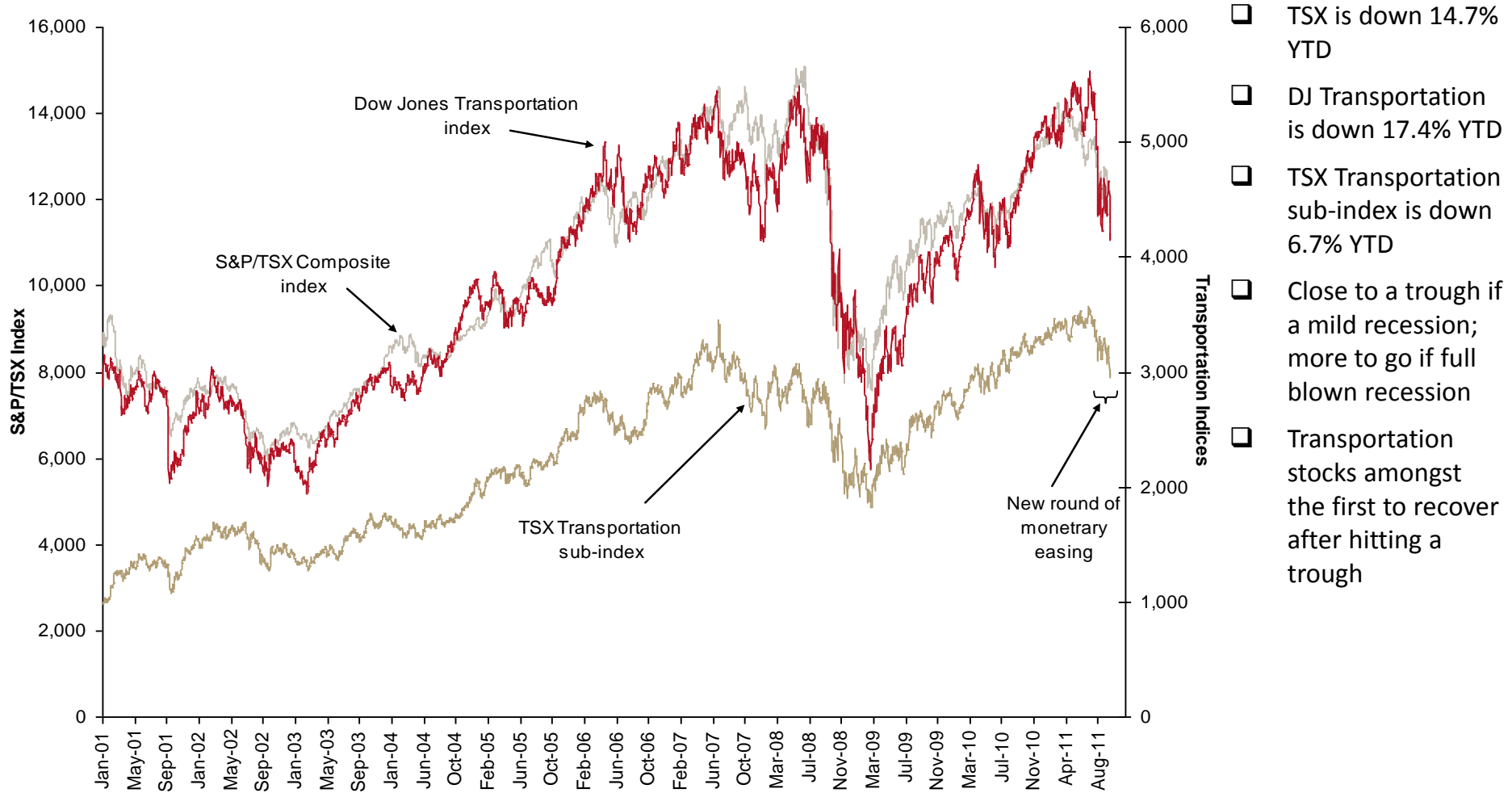


- Although we are witnessing early signs of a slowdown, economists are forecasting growth for Q3 and Q4
- Wall Street Journal's consensus for US GDP growth is 2.0% for Q3 and 2.1% for Q4
- Bloomberg consensus for Canada GDP growth is 2.0% for Q3 and 2.2% for Q4
- Our view: in a mild recession

Conference Board Leading Economic Indicator (LEI), Monthly

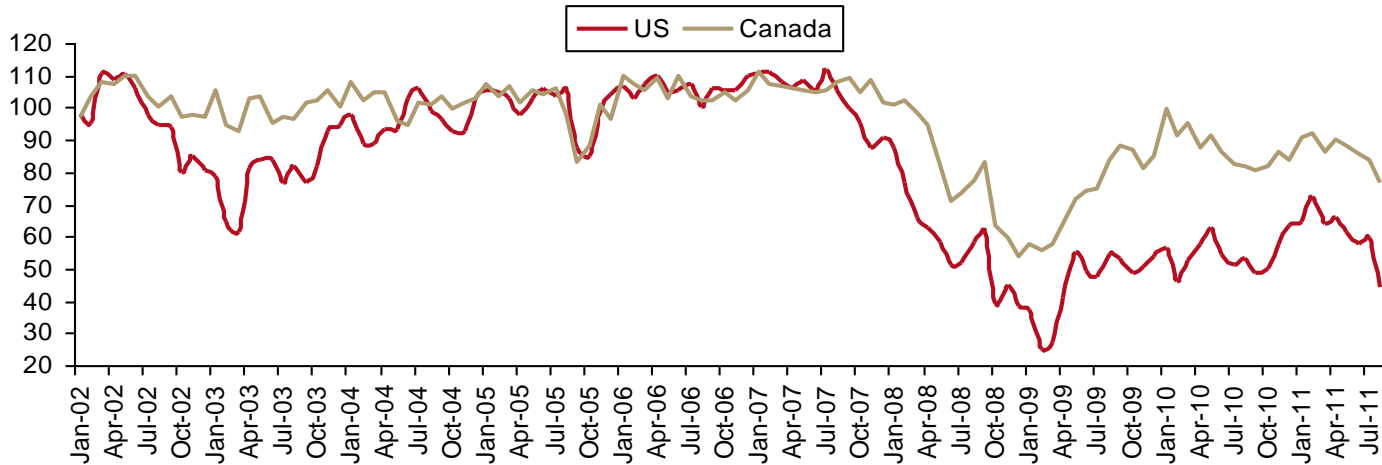


Stock Markets Tumbling – Overreaction or Correction???

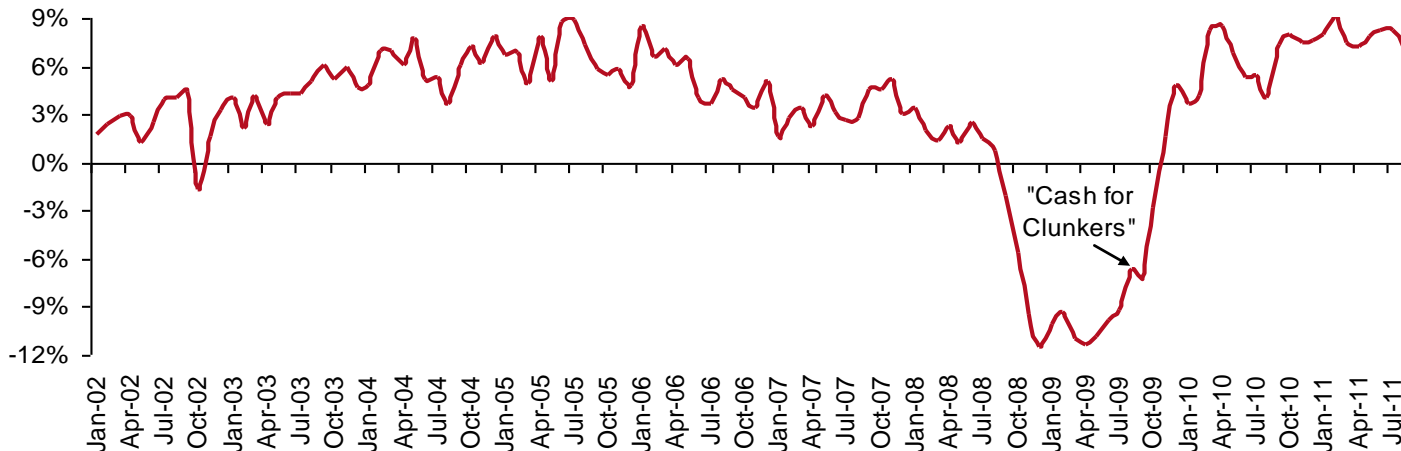


Consumer Confidence Declining – Early Signs???

Consumer Confidence Index, Monthly



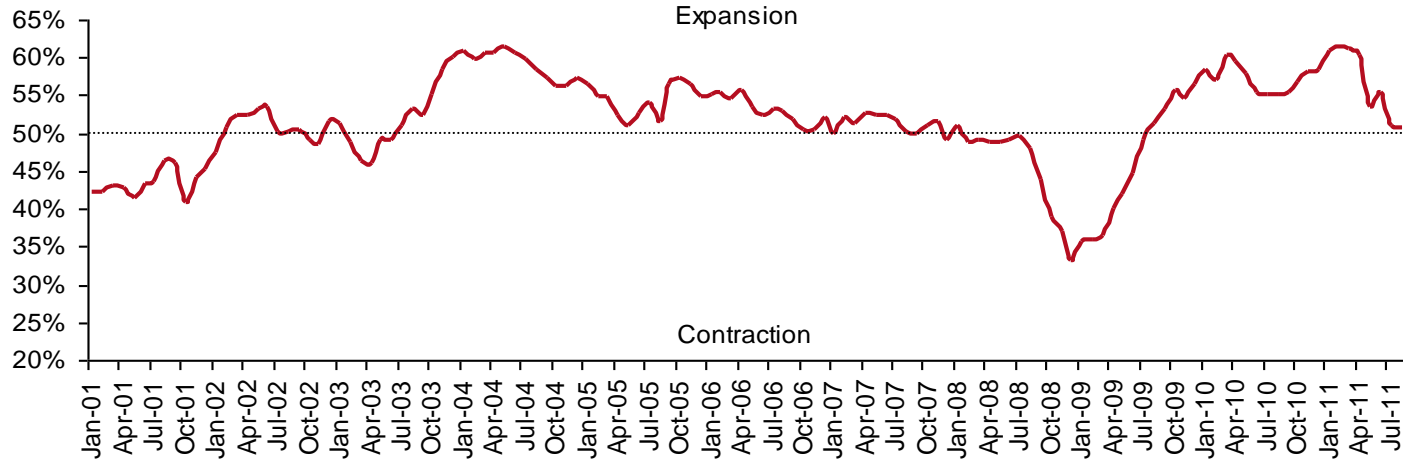
US Retail Sales, Y/Y Growth, Monthly



- ❑ Conference Board's Consumer Confidence index declined to 44.5 in August, lowest since April '09, vs 59.2 in July
- ❑ OECD's Consumer Confidence index for Canada declined to 76.9 in August, lowest since July '09, vs 83.6 in July
- ❑ Percentage of Canadian companies expecting better performance next year dropped to 61.7% in August from 68.3% in July
- ❑ High unemployment and personal debt, weak housing and waning confidence = lower retail demand and economic growth. Outsourcing to other countries does not help labour picture.

Business Confidence Slumping – Contraction???

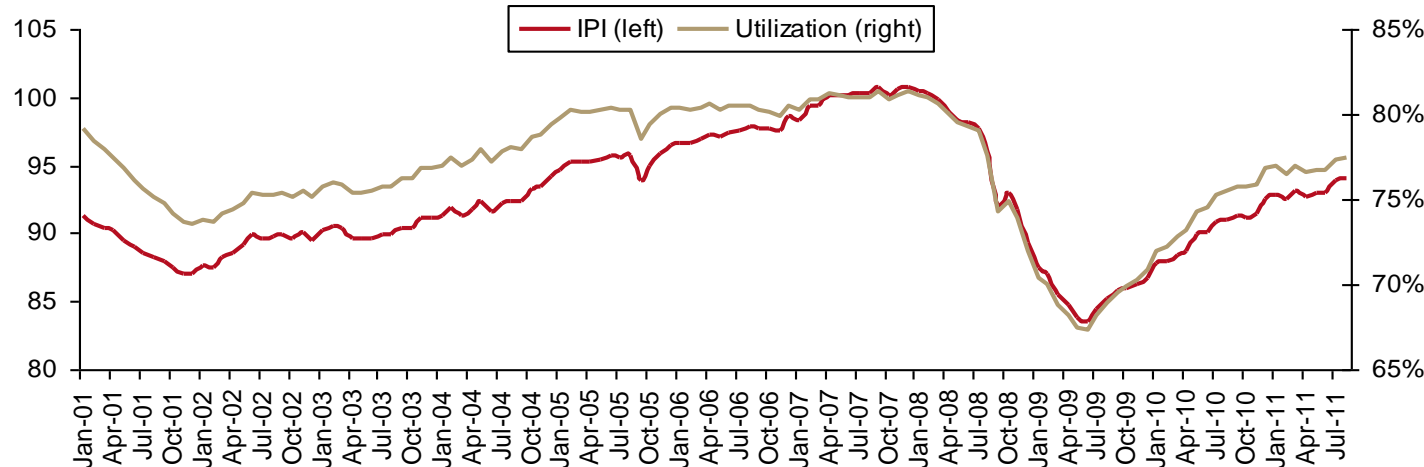
ISM Purchasing Managers Index (PMI), Monthly



- PMI declined to 50.6% in August, lowest reading since July 2009, from 50.9% in July, still indicating expansion in the manufacturing sector for 25 straight months

- Rule: PMI in excess of 42.5%, over a period of time, generally indicates an expansion of the overall economy

US Industrial Production Index (IPI) and Capacity Utilization, Monthly

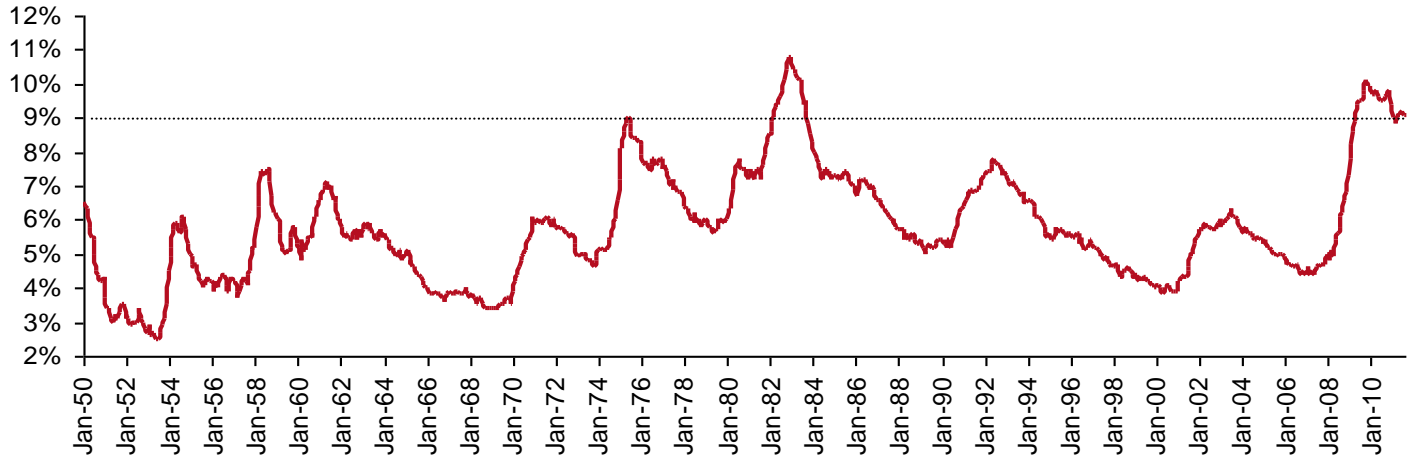


- US IPI increased 0.2% to 94.0 in August from 93.9 in July, and increased 3.4% Y/Y

- US capacity utilization increased to 77.4% in August from 77.3% in July, and was up from 75.5% last year

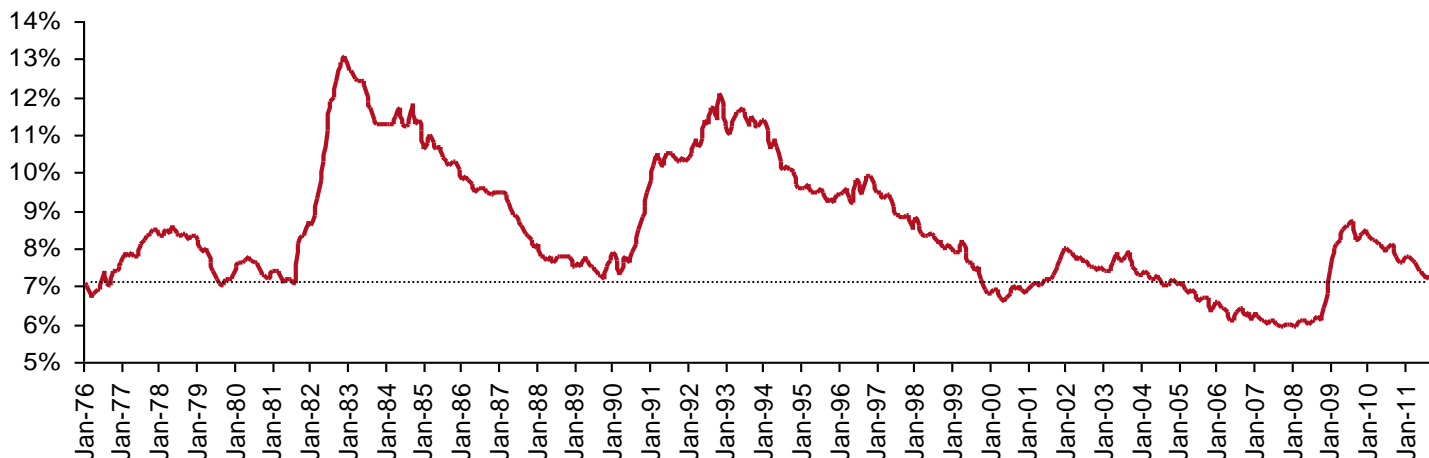
US Unemployment Too High But Canada in Better Shape – US in Trouble???

US Unemployment Rate, Monthly



- ❑ Unemployment rate in the US held steadily higher at 9.1% in August, as US employers created net zero jobs in August
- ❑ Unemployment rate in Canada remained lower at 7.3% in August, as employment was little changed for the second consecutive month

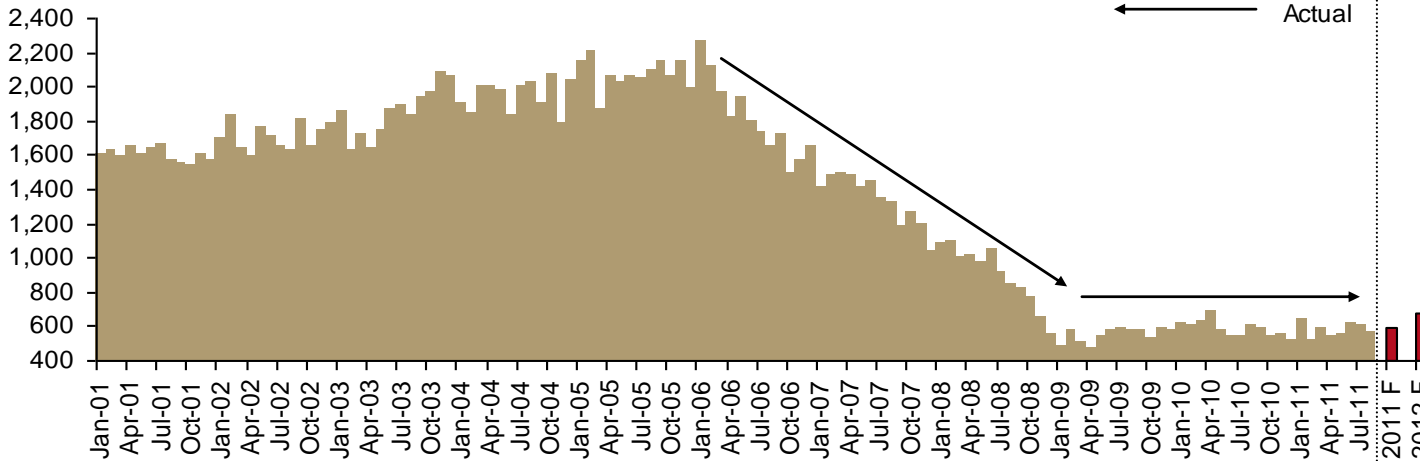
Canada Unemployment Rate, Monthly



- ❑ Importantly, employment in the Canadian transportation and warehousing industry posted the highest growth rate of all industries at 6.3% in the past 12 months

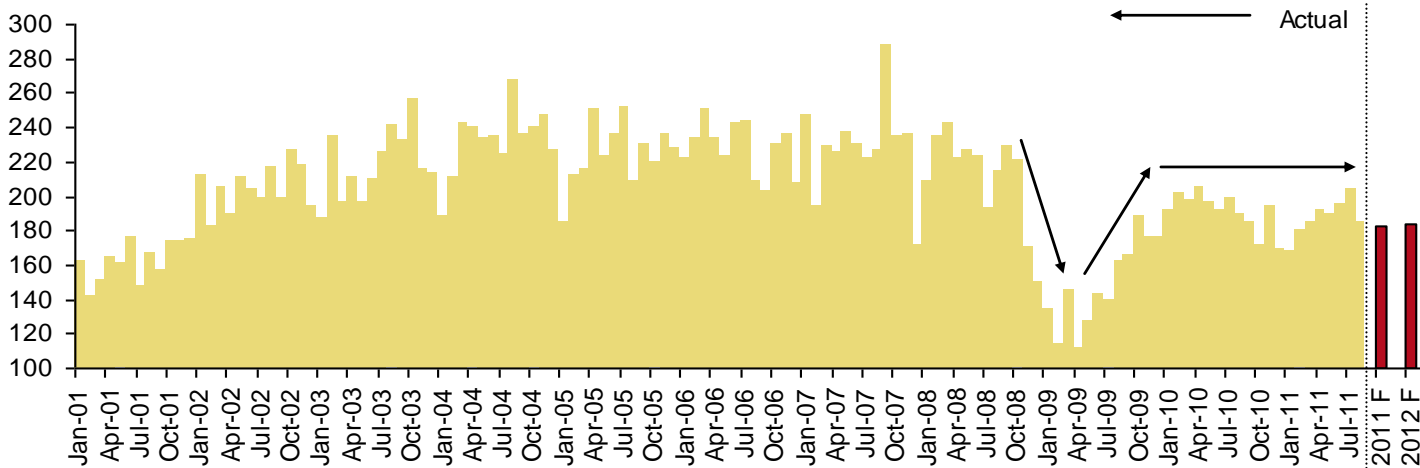
US Housing Still Depressed But Canada Stable – For How Long???

US Housing Starts (SAAR, Thousands), Monthly



US housing starts dropped to a 3-month low in August at 571K, as foreclosures, declining prices and unemployment held back residential construction

Canada Housing Starts (SAAR, Thousands), Monthly



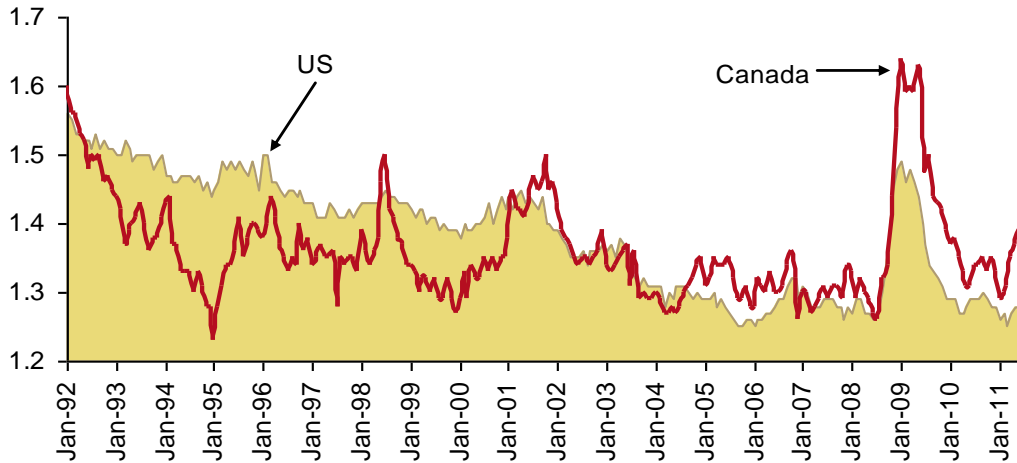
Canadian housing starts declined to 184.7K in August from 204.5 K in July, in line with demographic fundamentals and CMHC's outlook

IHS Global forecasts 598K starts in 2011 and 673K starts in 2012 in the US

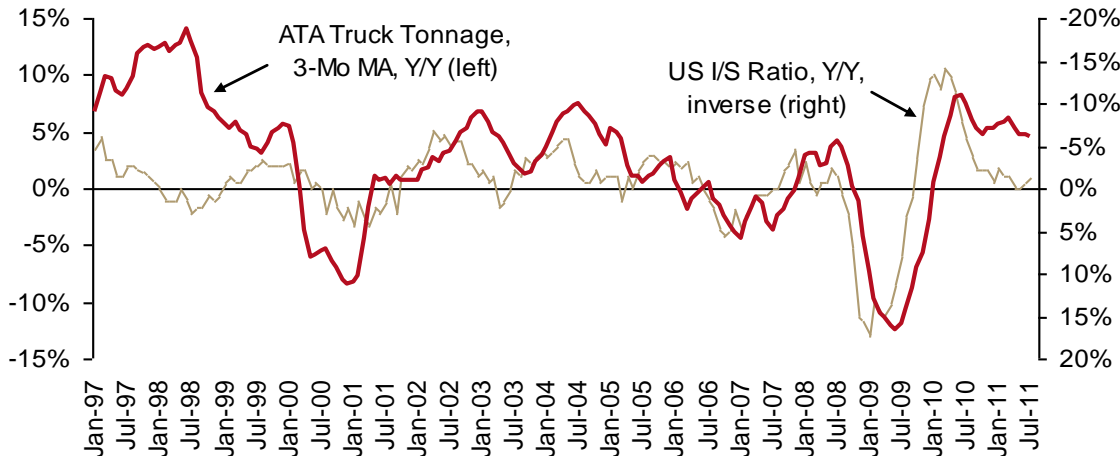
CMHC forecasts 183.2K starts in 2011 and 183.9K starts in 2012 in Canada

Inventory to Sales Ratio – Flat Fall Peak???

Inventory-to-Sales Ratio, Monthly



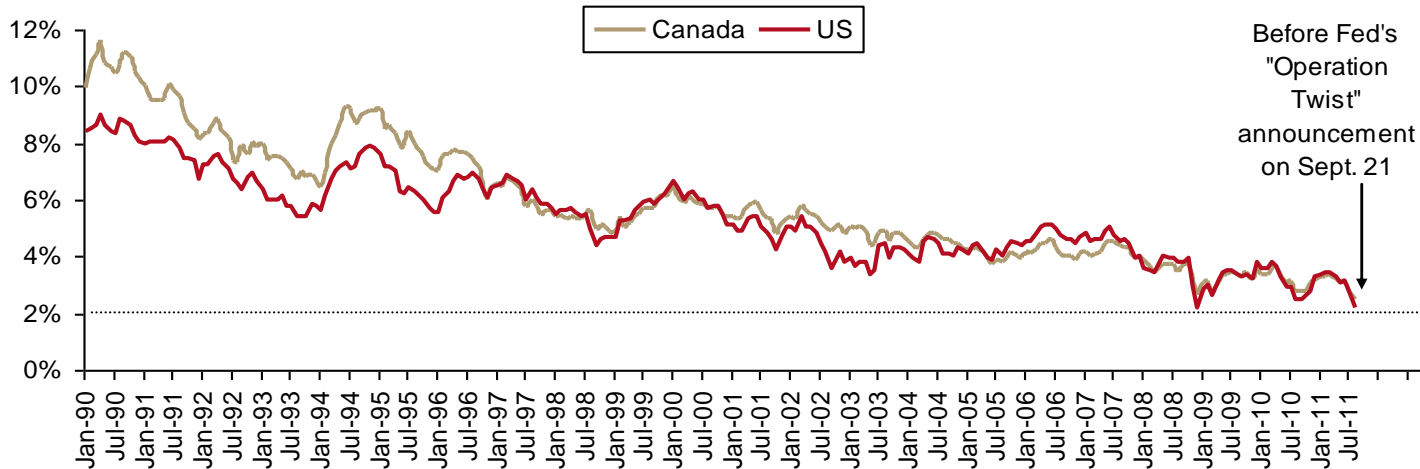
ATA Truck Tonnage Vs. US I/S Ratio (Inversed), Y/Y Growth, Monthly



- ❑ ATA Truck Tonnage is highly correlated to the inverse of I/S ratio
- ❑ A high I/S ratio typically implies sales need to recover and inventories decline before freight picks up in a material way
- ❑ After reaching an all-time high in January 2009, the Canadian I/S ratio declined substantially through January 2011, but peaked in June 2011, before falling down to 1.35 in July 2011
- ❑ Inventory levels edged down for the first time in July since September 2010, while sales increased after three consecutive monthly declines
- ❑ We do not expect inventory restocking practices of 2010 to remain strong in H2/11 and early 2012, as a more modest peak season is expected this year
- ❑ Was 2010 a head fake, based on inventory adjustment as opposed to real demand???

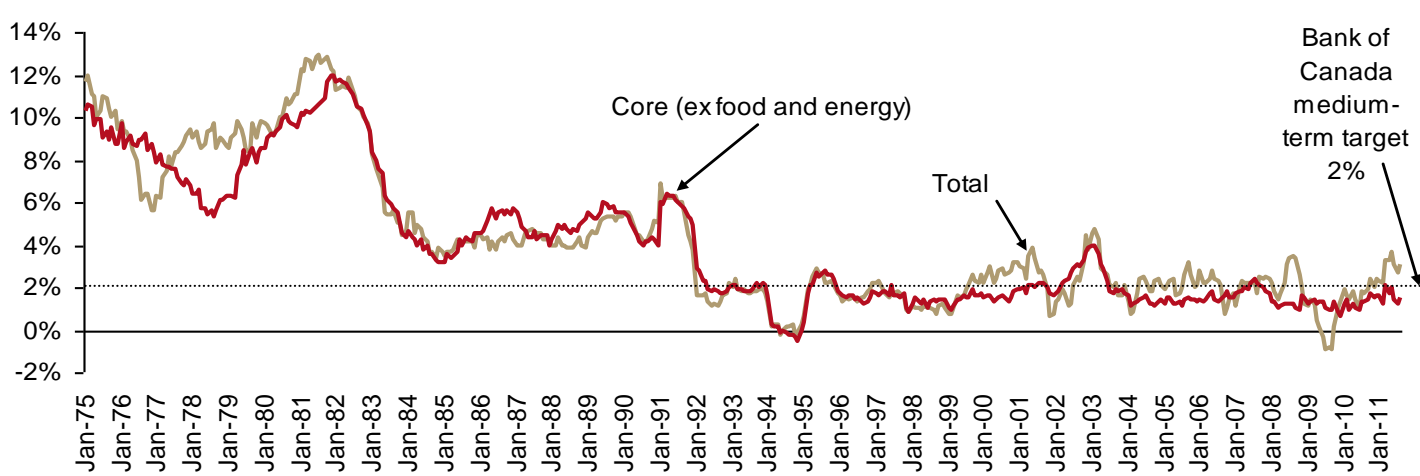
Interest Rates and Inflation Too Low – Good Time to Borrow???

10-Year Government Bond Rates, Monthly



- ❑ The 10-year benchmark US Treasury yield fell to new historic lows last week as Federal Reserve announced purchase of US\$400 BB of long-dated bonds
- ❑ The Bank of Canada is keeping short-term interest rates unchanged, and signalling that rates will remain low for many more months

Canada Annual Inflation Rate, Monthly

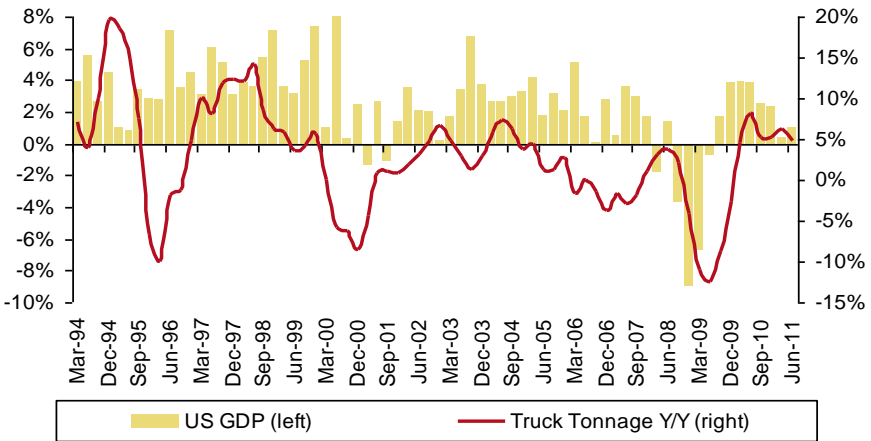


- ❑ Federal Reserve pledged for the first time to keep its benchmark interest rate at a record low at least through mid-2013

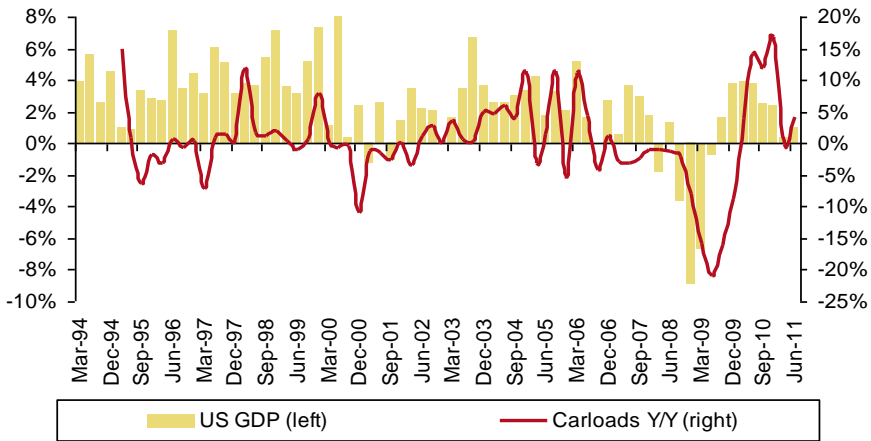
State of Freight

Slackening Freight Market Demand – Tepid Outlook, But Hanging Tough

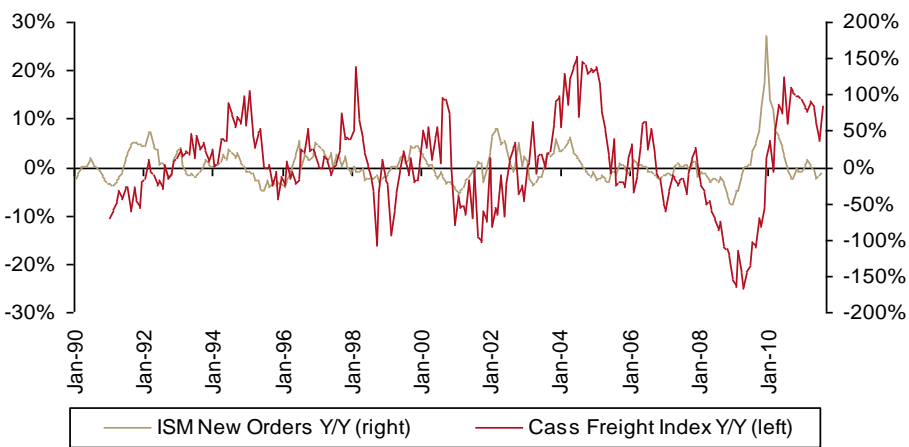
ATA Truck Tonnage Y/Y Growth Vs. US GDP, Quarterly



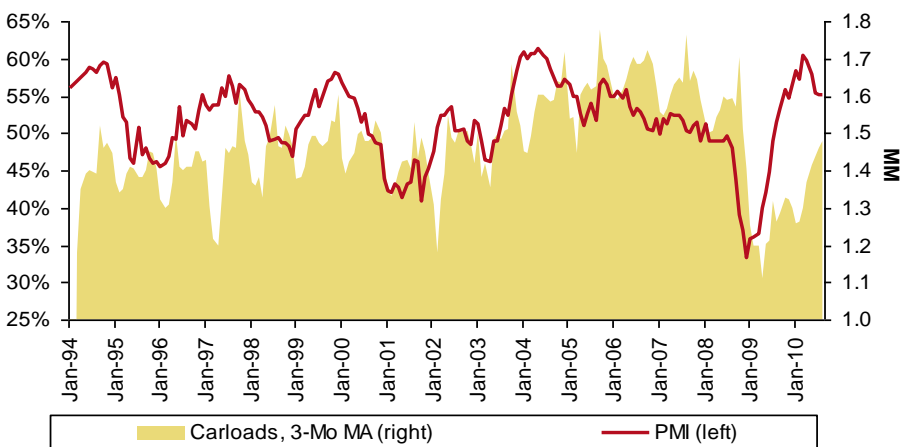
Class 1 Rail Carloads Y/Y Growth Vs. US GDP, Quarterly



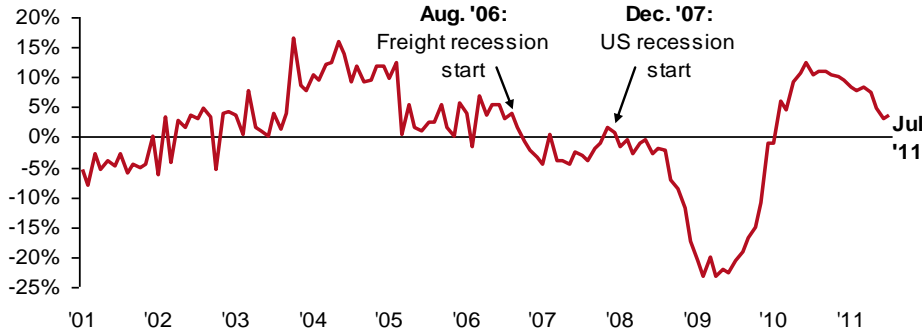
Cass Freight Index Vs. ISM New Orders, Y/Y Growth, Monthly



Class 1 Rail Carloads Vs. ISM Purchasing Managers Index (PMI), Monthly



Cormark Freight Monitor Shows Signs of Slowdown – Bottomed???



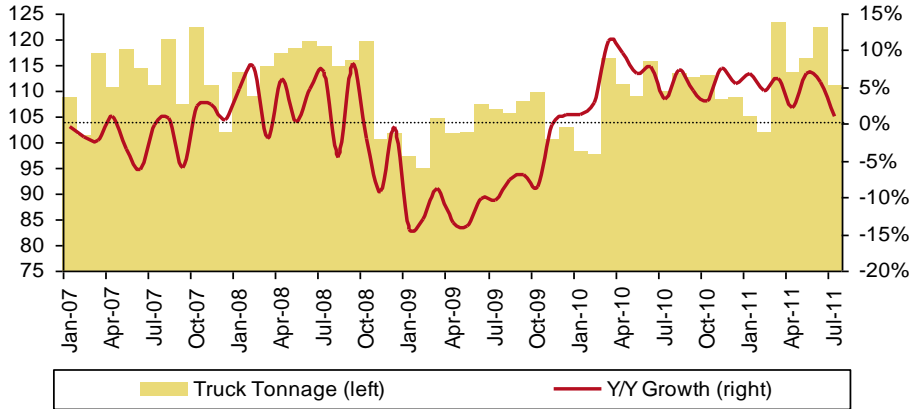
- ❑ Our Freight Monitor has declined to 3.6% in July after peaking at 12.4% in June 2010
- ❑ While it is still in the positive territory, comps have become more difficult as the industry is facing anaemic demand versus a supply chain inventory build last year
- ❑ We expect a flat H2 this year, or perhaps the impact of a mild recession

Month	ATA Truck Tonnage Index	Cass Freight Shipment Index	TSI Freight Index	Big 3 West Coast Port Volume	US Trailers on Rail Car	Average of Four Key Monitors (ex -TSI)
Jan-10	4.1%	5.6%	4.2%	7.7%	-21.6%	-1.0%
Feb-10	2.6%	-0.9%	2.5%	31.0%	-8.6%	6.1%
Mar-10	7.0%	7.6%	8.0%	6.3%	-2.5%	4.6%
Apr-10	9.3%	12.9%	9.9%	12.5%	1.8%	9.1%
May-10	7.7%	11.1%	10.2%	14.1%	10.0%	10.7%
Jun-10	7.4%	18.5%	8.9%	19.7%	3.7%	12.4%
Jul-10	7.5%	8.9%	7.4%	18.5%	5.9%	10.2%
Aug-10	2.9%	16.5%	5.4%	13.7%	10.7%	10.9%
Sep-10	5.3%	15.5%	7.1%	15.9%	6.5%	10.8%
Oct-10	6.2%	14.9%	8.1%	12.5%	8.3%	10.5%
Nov-10	4.2%	14.9%	4.3%	15.0%	6.6%	10.2%
Dec-10	5.3%	14.1%	6.2%	6.0%	12.5%	9.5%
Jan-11	7.6%	12.3%	6.7%	12.2%	1.6%	8.4%
Feb-11	4.4%	11.4%	4.0%	5.1%	10.1%	7.8%
Mar-11	6.5%	13.8%	4.8%	5.6%	7.7%	8.4%
Apr-11	4.9%	12.3%	3.7%	7.0%	6.0%	7.6%
May-11	3.0%	9.6%	1.4%	4.7%	1.8%	4.8%
Jun-11	6.5%	5.3%	4.1%	-0.6%	1.1%	3.1%
Jul-11	3.9%	13.1%	3.8%	-0.2%	-2.2%	3.6%

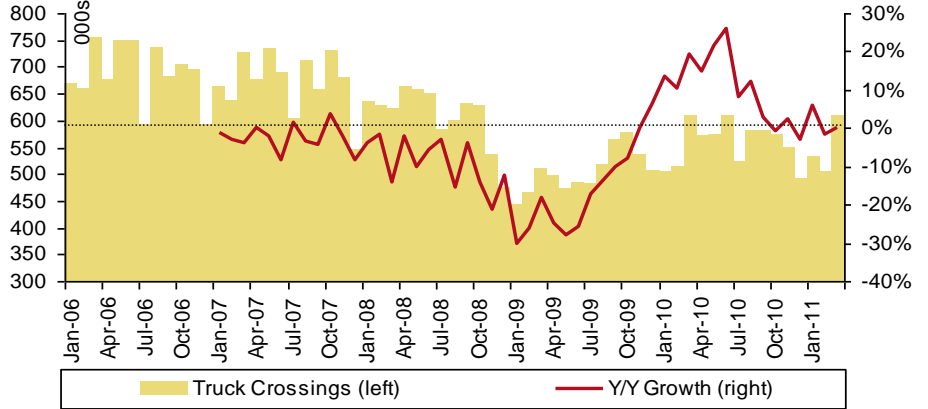
a) **ATA Truck Tonnage Index:** monthly monitor of U.S. for-hire trucking, released 8-12th of following month, b) **Cass Freight Shipment Index:** monthly index developed by processor of freight payables, released 1st week of following month, c) **TSI Freight Index:** covering for-hire truck, rail, pipeline, barge, air freight; released ~1.5 months following period, d) **West Coast Ports:** TEUs at LA, Long Beach and Oakland, reported near-end of following month, and e) **Trailers on Rail Car:** weekly trend of trailers on rail car by U.S. railroads from AAR.

Key Freight Measures – Trucks and Rails

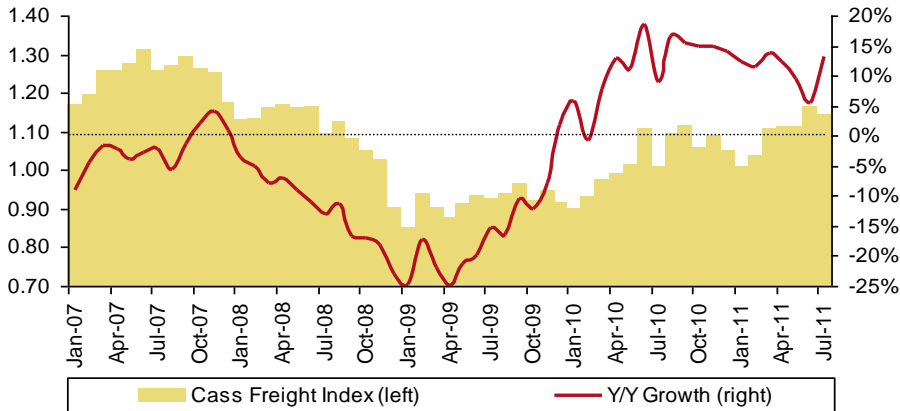
ATA Truck Tonnage, Non-Seasonally Adjusted, Monthly



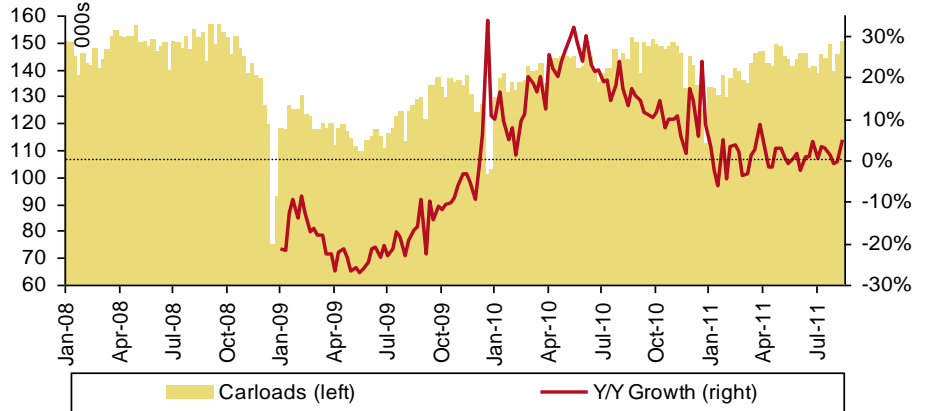
Truck Border Crossings (Ontario-Michigan/New York), Monthly



Cass Freight Shipment Index, Monthly

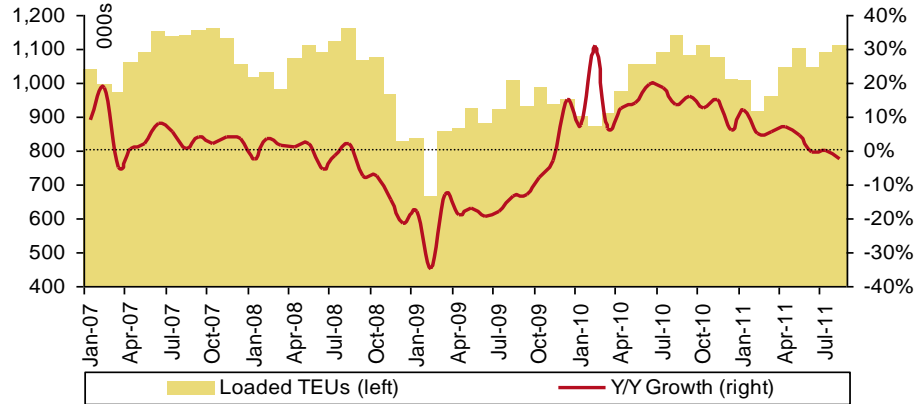


Canada Class 1 Rail Carloads, Weekly

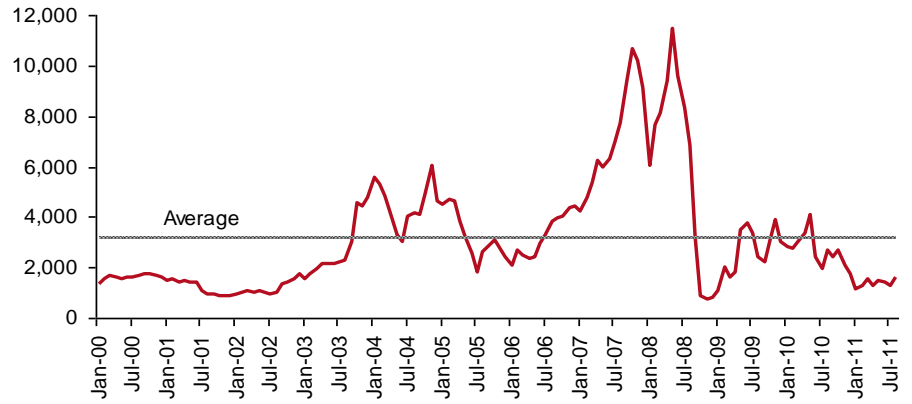


Key Freight Measures – Containerized Traffic

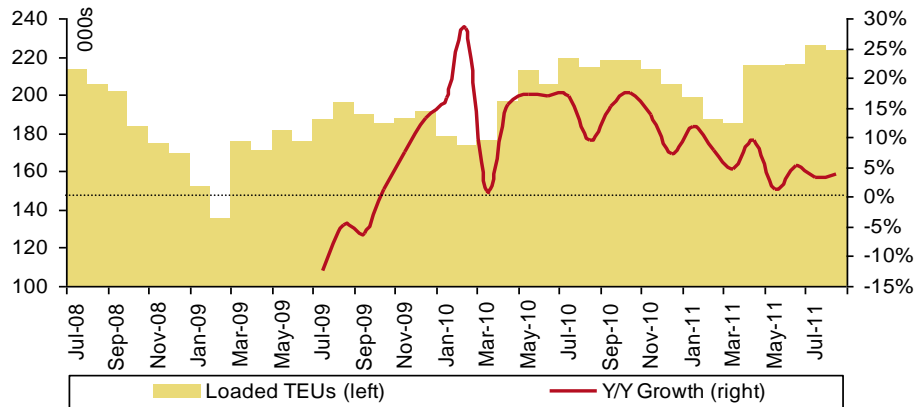
Big 3 US West Coast Port Volumes (Loaded TEUs), Monthly



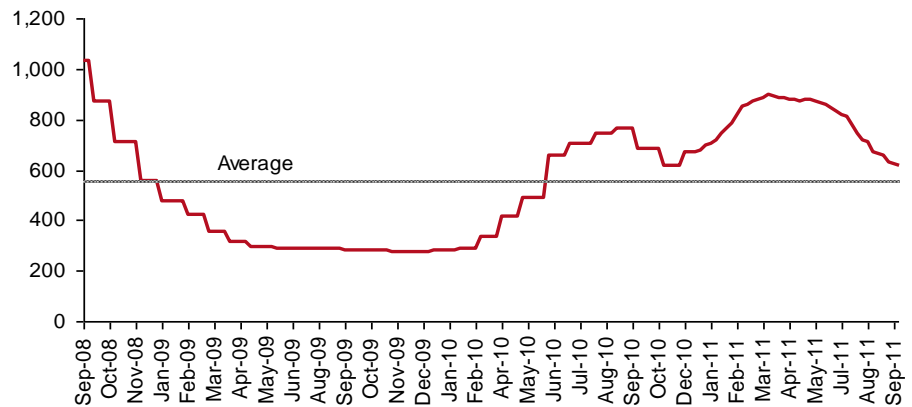
Baltic Dry Index, Monthly



Western Canada Port Volumes (Loaded TEUs), Monthly



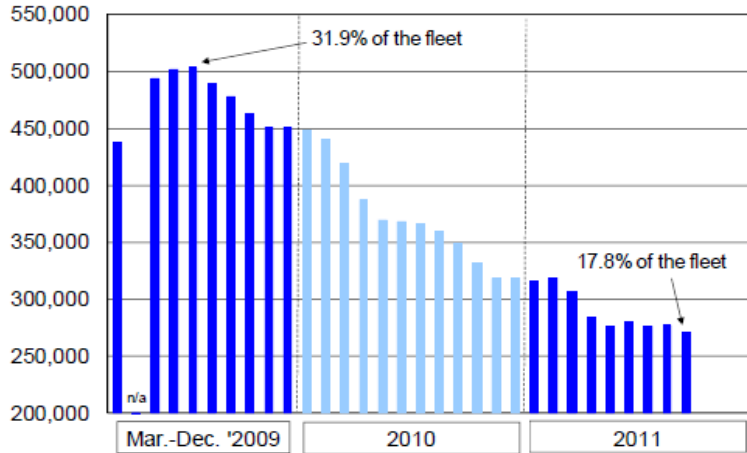
HARPEX Index, Weekly



Capacity Situation

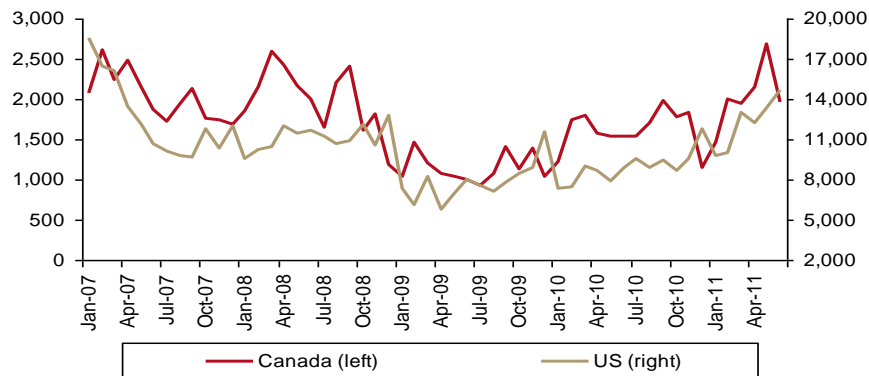
Rails Well Managed But Trucks Could Face Significant Capacity Crunch

North American Rail Cars In Storage, Monthly



Data are as of the first of the month; % are cars stored as % of total fleet. Source: AAR

North American Class 8 Truck Sales, Monthly



☐ Rails

- Cars in storage declining – down to 17.8% from 31.9% at peak (economy healthiest at ~2-3% level)
- Retirements surging over 4-5 years
- 47% retiring at CN by 2015
- 35% retiring at CP by 2014
- CN/CP hiring at less than a 1:1 basis

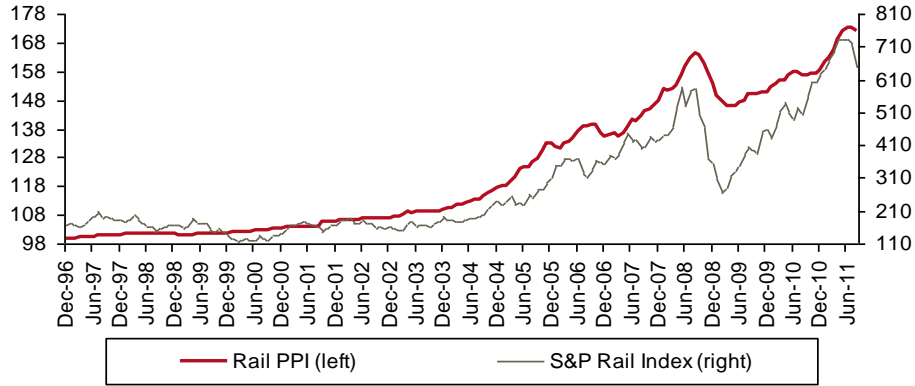
☐ Trucks

- Bankruptcies, carrier exits and M&A will drive capacity crunch
- Regulations (CSA 2010, hours-of-service, health, etc.) will drive ~10% reduction in driver pool
- Fleet shortage – from 100,000 units this year to 400,000 by 2012 across North America (FTR Associates)
- Driver shortage – from 150,000 this year to 300,000 by 2012 and 350,000 by 2013 in the US (FTR Associates)

Pricing Trends

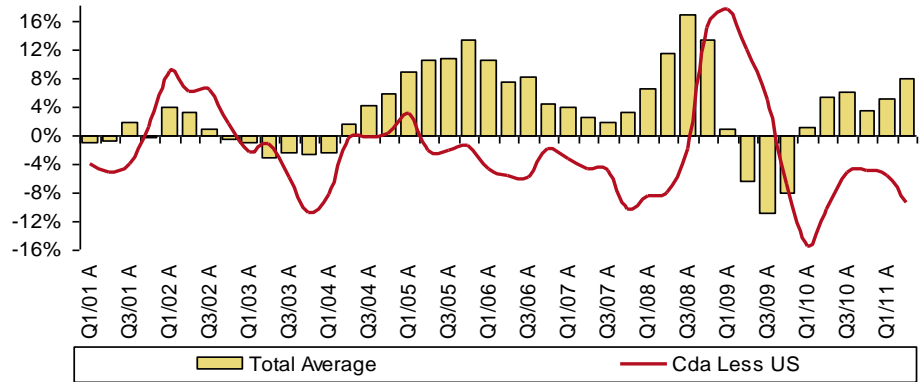
Rail Pricing Expected Above Inflation But Trucks Could Surprise

S&P Rail Index Vs. Rail PPI, Monthly

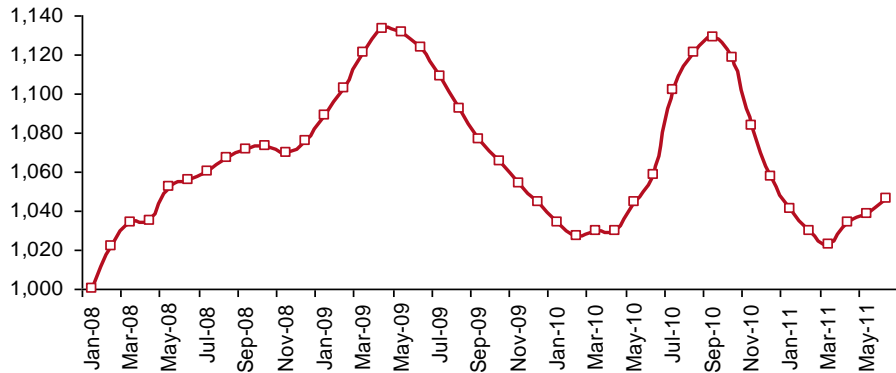


Note: S&P Rail index includes CSX, NSC and UNP

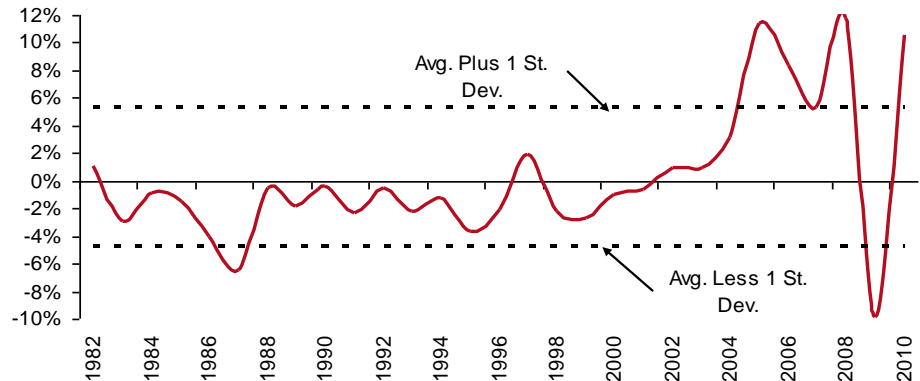
North American Class 1 Rails Freight Revenue/RTM, Y/Y Growth, Quarterly



Canadian General Freight Index, 4-Mo MA, Monthly



US Class 1 Rails Freight Revenue/RTM, Y/Y Change, Annual



Company Profiles

Canadian National Railway

North America's Premier Railroad

- ❑ Largest in Canada and 5th largest in North America
- ❑ The only transcontinental network in North America; multiple port access
- ❑ Revenue split: 24% Canada, 28% transborder, 19% US domestic, 29% int'l
- ❑ Most economically sensitive: 73% business merchandise-related (52% merchandise and 21% intermodal) and rest 27% bulk

Outlook

- ❑ Gradual economic recovery; fundamental growth in most business segments
- ❑ Solid mid single-digit volume growth in 2011 following 18% growth in 2010
- ❑ Up to 15% net profit growth in 2011 following 30% growth in 2010
- ❑ Remains disciplined on core pricing and targets above inflation (likely 3-4%)
- ❑ Free cash flow \$1.2 BB in 2011, despite more taxes, dividends and buyback
- ❑ Capital expenditure \$1.7 BB in 2011, with ~\$1 BB for track infrastructure

Positives

- ❑ Geographic and customer diversification, superior assets and three-coast network, best-in-class OR
- ❑ Leverage to economic growth given strong merchandise/intermodal focus (73% of top-line)
- ❑ Focus on greater customer engagement through "First Mile-Last Mile" initiative, taking precision railroading to next level
- ❑ Precision railroading expected to drive OR to the next level (already has 20-25% speed/time advantage over peers)
- ❑ Stellar balance sheet, strong free cash flows and industry leading management make it a core holding
- ❑ Top performer in ROE: 19% in 2010; over ~40% CAGR in ROE since IPO



Canadian Pacific Railway

Canada's Bulk Railroad

- ❑ East-West transcontinental network across Canada and into the US
- ❑ Revenue split: 23% Canada, 25% transborder, 7% US domestic, 45% int'l
- ❑ Large bulk focus (western Canada): 43% business in bulk, 29% in merchandise and 28% in intermodal

Outlook

- ❑ Strong bulk demand, especially for grain, potash and coal
- ❑ Outlook for merchandise and intermodal less certain, given economy
- ❑ Market share recovery, especially in int'l intermodal
- ❑ 2–3% CAGR in revenue ton-miles (RTM) over 3-4 years
- ❑ Above inflation core pricing growth, with 3-4% on renewals
- ❑ Low-70s operating ratio in 3-4 years, with strong productivity gains
- ❑ Capital expenditure \$1.0-1.2 BB over 3–4 years at >16–18% of revenues



Positives

- ❑ Potential earnings growth – greater exposure to export and bulk commodity (aided by Teck/Canpotex contracts)
- ❑ Strong growth pipeline – \$1 BB new business pipeline; could drive solid earnings growth over 3–4 years
- ❑ Improving balance sheet and strengthening operations
- ❑ Targeting \$100 MM in cost savings to offset higher pension expense during 2010-2012
- ❑ Longer/heavier trains, Distributed Power, yard rationalization, network consolidation, lean practices, new technology, etc.
- ❑ Among top performers in terms of returns – ROE 17% in 2007, but declined to 13% in 2010
- ❑ In a recession, prefer CN, but CP should fare well upon recovery

Contrans Group

Riding A Variable Cost Model

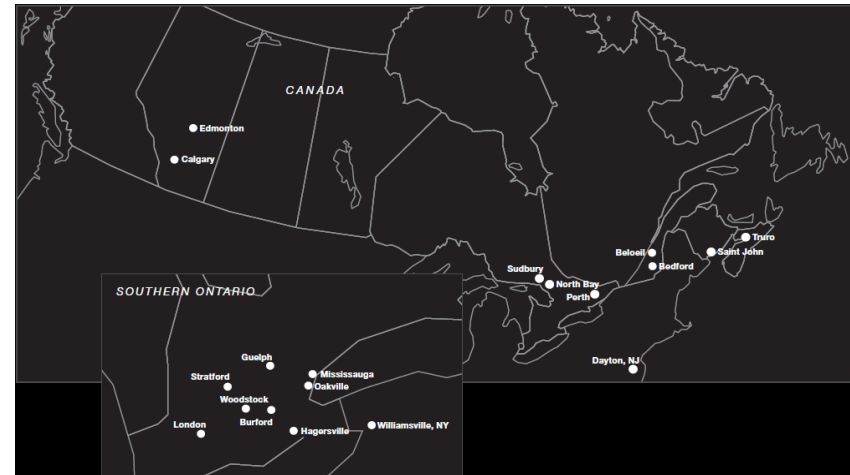
- ❑ A Canadian leader, with ~1,100 power units and ~2,000 trailers
- ❑ Nearly all truckload, with focus on specialized markets
- ❑ Flatbed (31% of revenue – largest carrier in Canada), Van (17%), Bulk (25%), Tank (19%), Logistics (7%) and Waste (1%)
- ❑ ~32% of miles driven is in the US (15-20% revenue in US\$)
- ❑ Strong market share in Ontario/Québec; building Western presence
- ❑ Skewed to eastern Canada (80% of terminals, 60% in Ontario)

Outlook

- ❑ Flat organic volume growth, modestly pricing improvement
- ❑ Three recent acquisitions add ~\$18-19 MM in sales
- ❑ Two recent bulk contracts (INCO and Xstrata) add ~\$10 MM in sales
- ❑ Capital expenditure ~\$24 MM in 2011, primarily on fleet renewal, waste collection and recent contracts
- ❑ More acquisitions in the coming months (bulk, tank, flatbed, waste)

Positives

- ❑ Leadership positions in specialized segments
- ❑ Resilient business model – focus on profitable, niche and defensible segments (flatbed, bulk, tank and waste)
- ❑ Diverse customer base – large and small companies across variety of industries, with 80% business recurring
- ❑ Flexible cost structure – ~70-75% variable costs; provides margin protection during economic weakness
- ❑ Steady margins through time – average EBITDA margin ~11.5% over eight to nine years (~11–13% range)
- ❑ Strong balance sheet with \$62 MM cash \$109 MM debt (June 30, 2011)



TransForce

Largest And Most Diversified Fleet In Canada

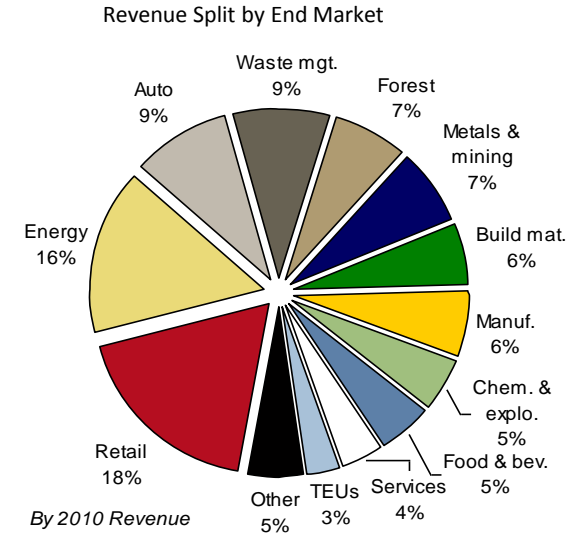
- ❑ A North American leader, with 7-9% share in the for-hire market (~4% of total market)
- ❑ #1 in LTL, #1 in TL, #2 in Package & Courier in Canada
- ❑ 339 terminals in Canada and 63 in the US; ~11,000 power units and ~11,500 trailers
- ❑ 70% sales in Canada and 30% US transborder (before Dynamex and DHL)
- ❑ Dynamex – a leader in same-day delivery and logistics in the US and Canada
- ❑ Loomis Express – domestic operations of DHL Express Canada

Outlook

- ❑ Strong growth in 2011, driven by acquisitions; flat organic volume; modest pricing improvement
- ❑ Growth in P&C and Specialized Services, with slow recovery in TL and lagging LTL
- ❑ Loomis contribution marginal in 2011 but over \$275 MM in sales in 2012
- ❑ Focus on debt reduction despite \$100-125 MM investment on acquisitions in the remainder of 2011

Positives

- ❑ Leadership position, size, scale and geographic footprint – help win business, increase network utilization, and M&A
- ❑ Growing parcel and waste business – offset weakness in the TL and LTL through economic downturns
- ❑ Significant operating leverage – strong upside on an economic recovery, given business and industry mix
- ❑ Diversification – business, geography, end-market and customer (75,000 customers; no single customer >10%)
- ❑ Exposure to US energy – Marcellus shale gas drilling through EnQuest/Speedy deal
- ❑ Shift to owner-operators – reduces fleet costs and increases utilization
- ❑ Fairly steady margins – average EBITDA margin ~13% over the past 12 years (12.0–15.5% range)
- ❑ Improving balance sheet – reduced debt throughout 2009 and 2010 but expects some increase in 2011 due to M&A



Questions?

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