



AVONDALE PARTNERS

What does NA energy mean to rail equipment?

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Rail Trends 2013**

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Where are we?

- The Economy

- US economy is in slow growth mode.
- Globally, industrial end markets generally remain weak. But Europe and China could be at a bottom.
- Oil and gas has fundamentally changed industrial NA.
 - Generational low in natural gas is next leg?

- The Equipment Cycle

- Companies have cash \$
- Capex largely ignoring historical replacement cycles and could mean pent up demand in the future (with a little economic growth)
- Impending regulatory changes are ‘game changers’
- Greed will happen. At what point do we over capacitize?
Nearly every car builder is manufacturing tanks now.



Rail Equipment...

- Shale crude development is a game changer.
 - Inbound products to drill sites (frac sand, pipe, etc).
 - Crude
 - Refined products. \$1b in refinery expansions occurring: Valero Houston, Flint Hills Corpus Christie, Marathon Cattletsburg
 - Import activity falling to zero...what is the export opportunity?
 - Pipelines will be built, but CBR (and tangent biz) has room to exist and grow
- Lease rates are still very strong, just not insane anymore.
- Diversification of orders beginning.
- Pent up replacement largely ignored.
- Regulatory impacts spur mandated capex: PTC and...now tank cars.



Rail Equipment Has Outperformed the Market...But Are Fundamentals Strong Enough for Rally to Continue?

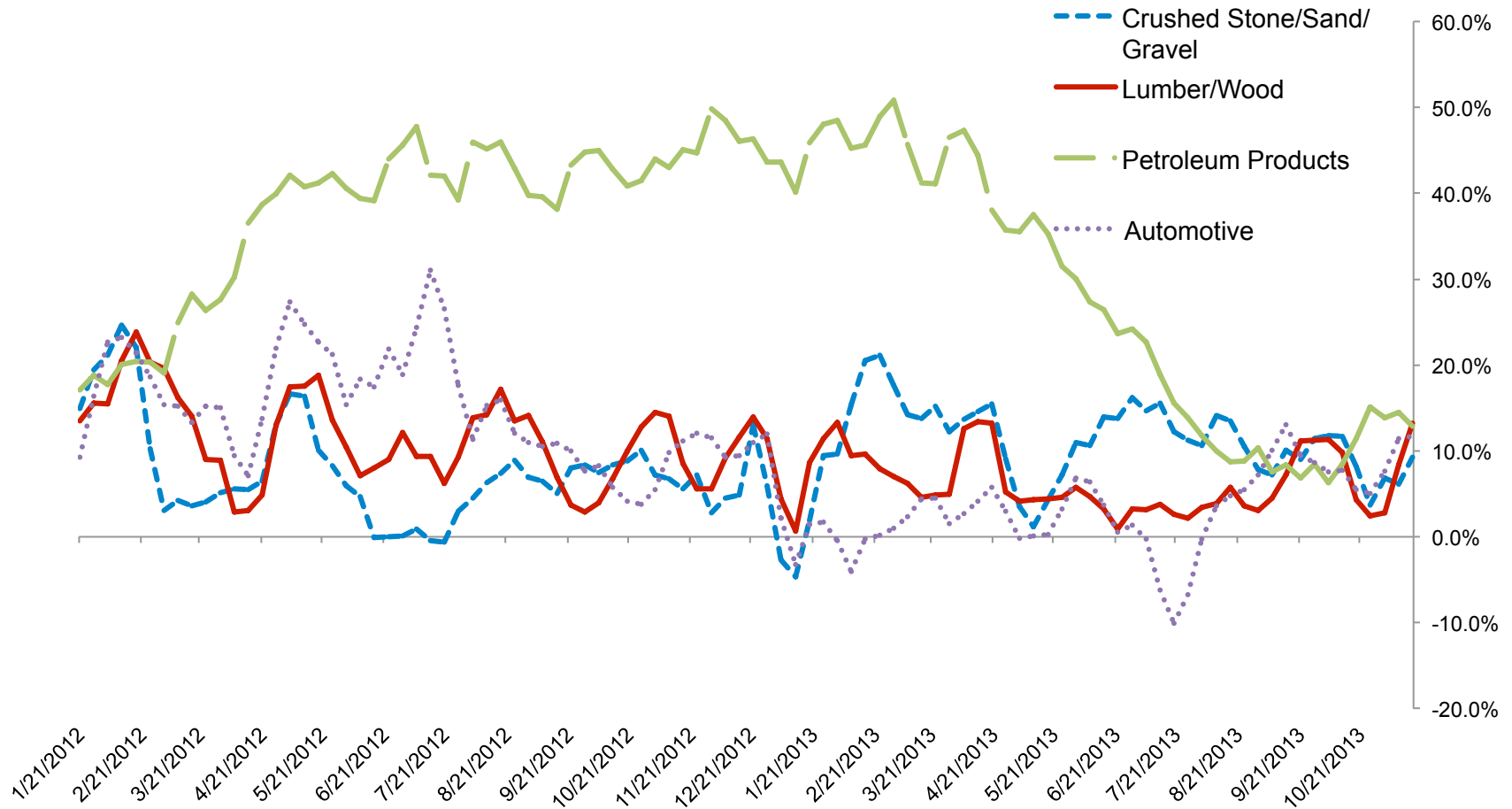
Rail Equipment Stock Index Vs. S&P Index

Source: Avondale Partners LLC



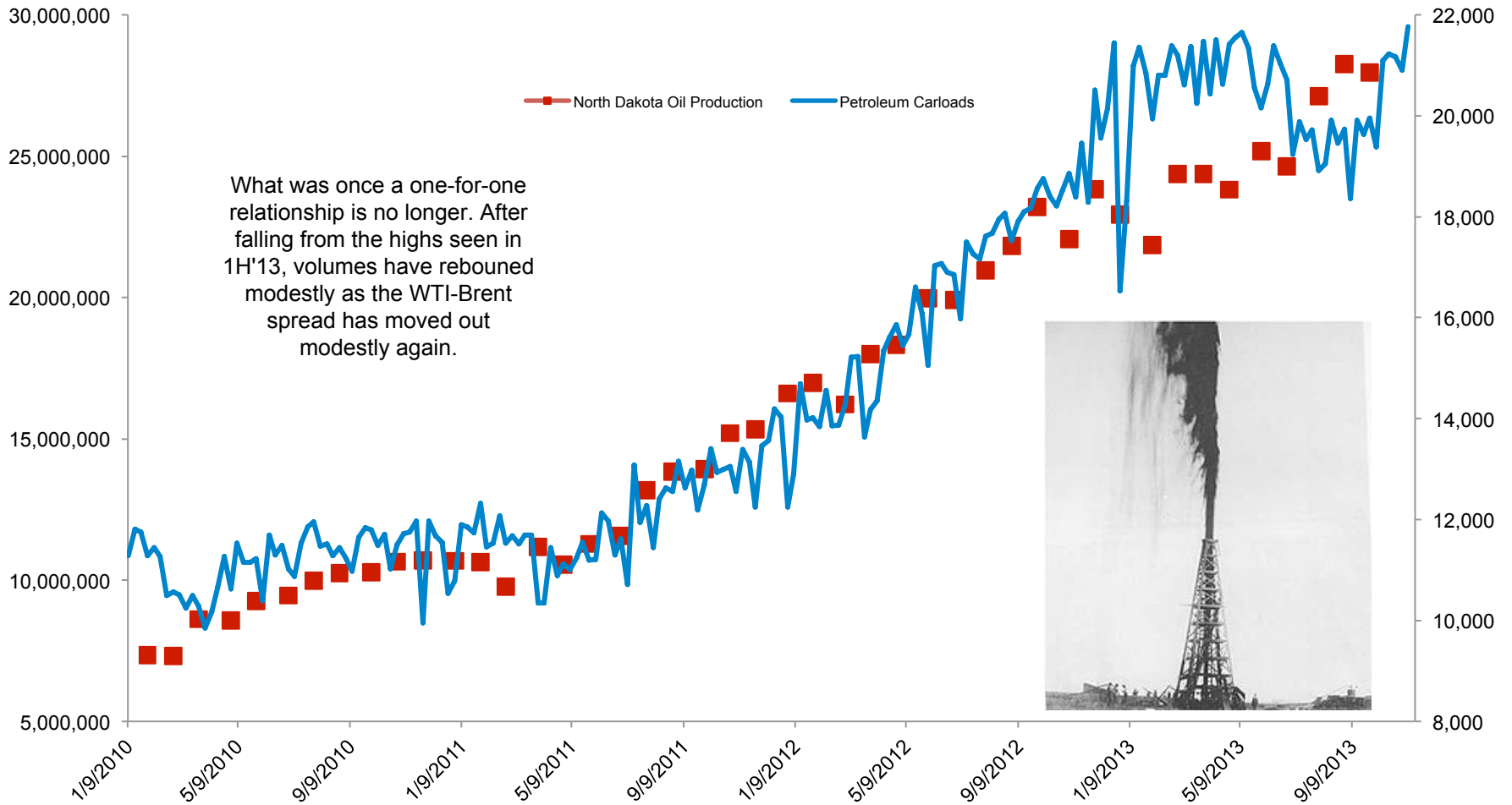
End-Markets Remain Choppy but Encouraging

What's Been Hot? Autos, Petroleum, Housing



Crude by rail: That Spread Is Important

Petroleum Carloads vs. North Dakota Oil Production

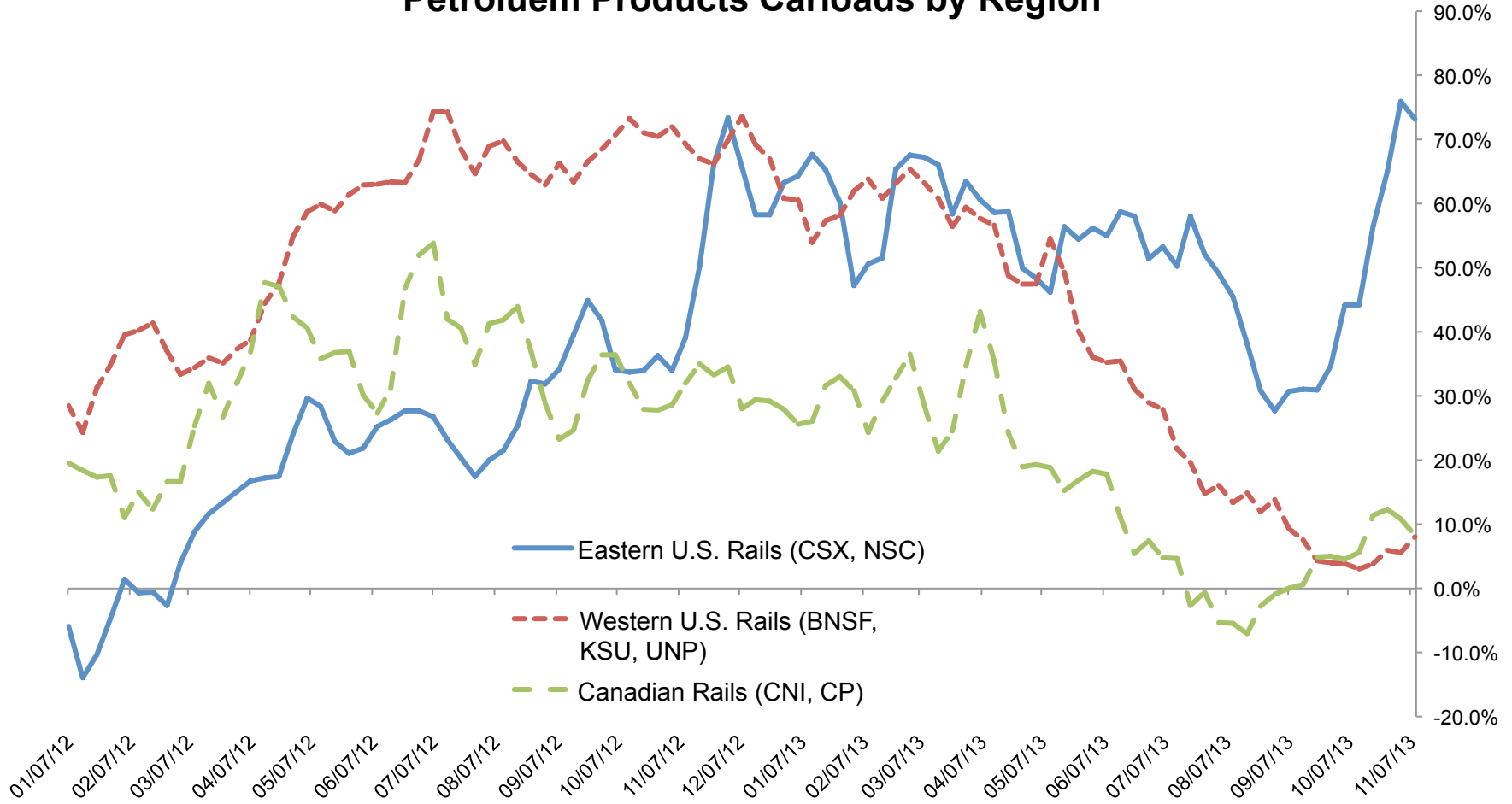


What was once a one-for-one relationship is no longer. After falling from the highs seen in 1H'13, volumes have rebounded modestly as the WTI-Brent spread has moved out modestly again.



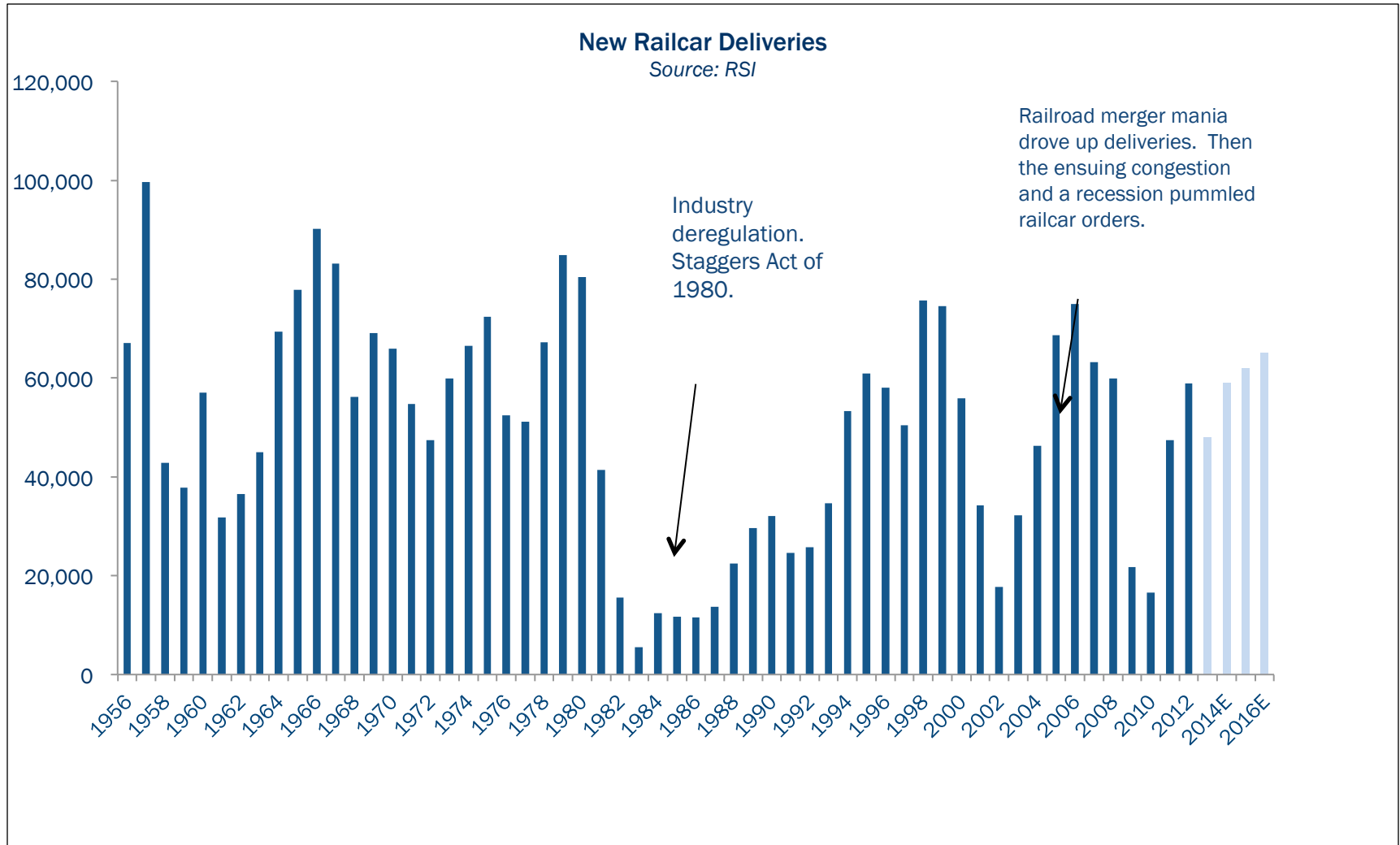
Growth where there aren't (and won't be) pipelines...

Petroleum Products Carloads by Region

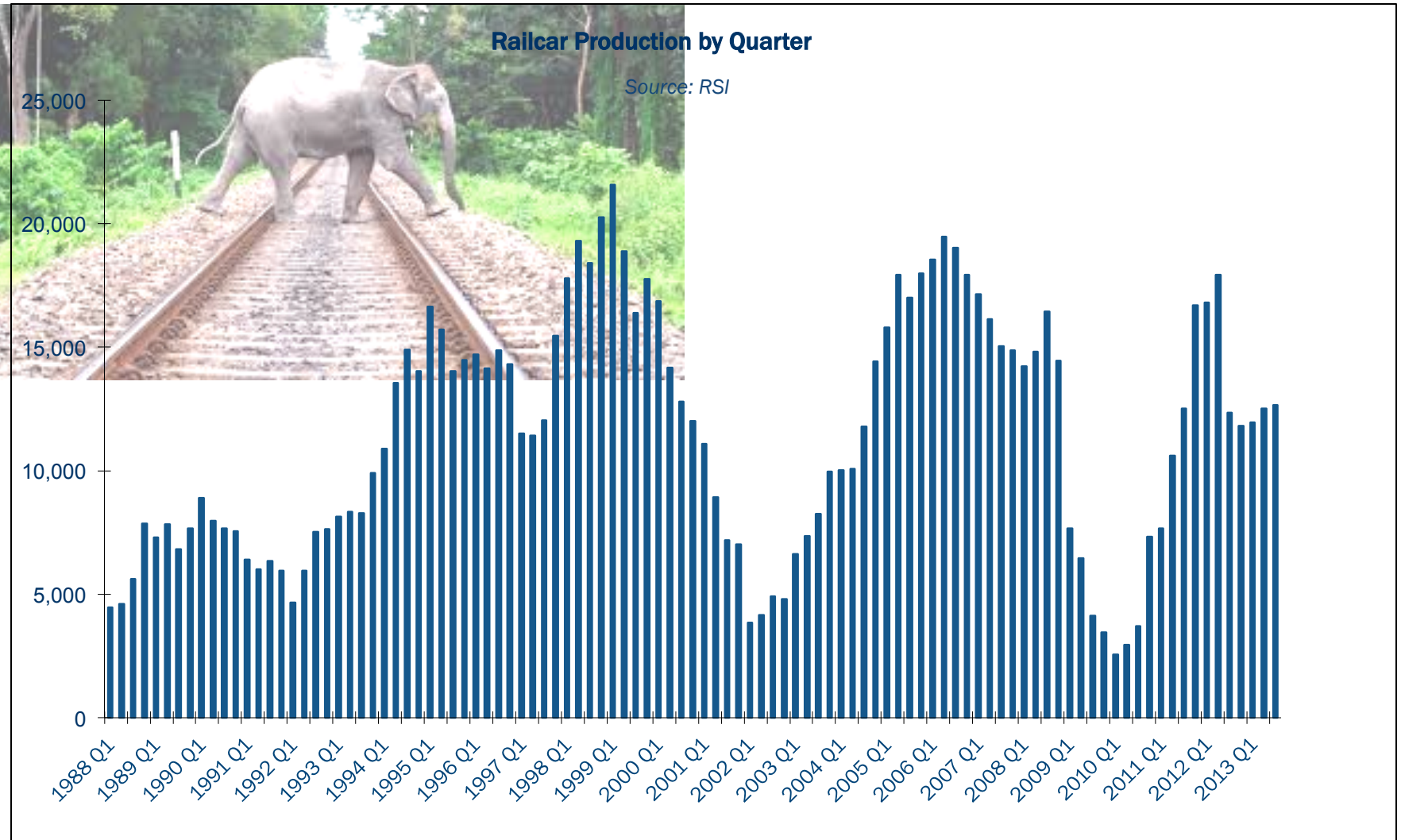


Source: AAR and Avondale Partners

Resumption of Growth in 2014? Long-term NA Rail Story Positive



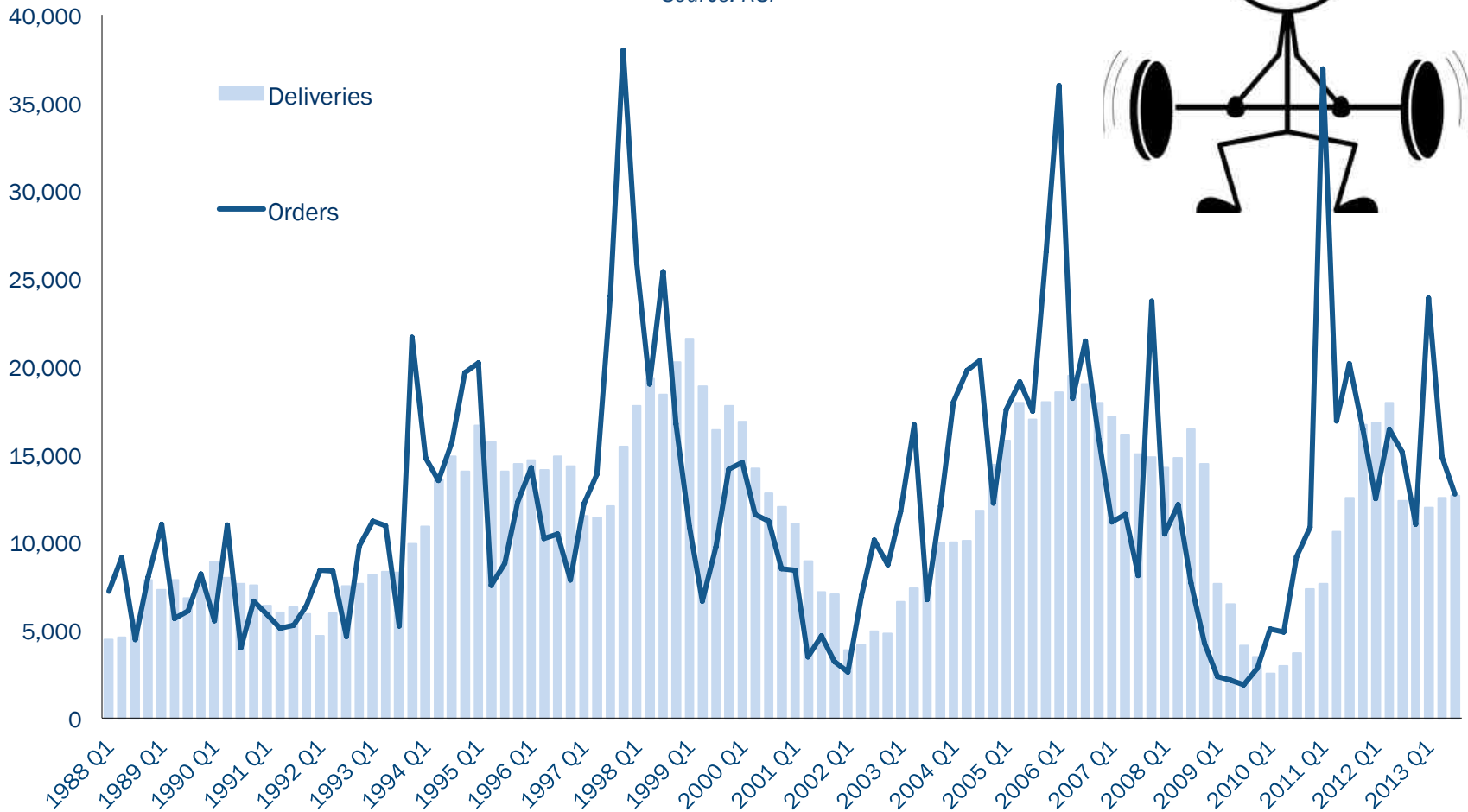
Backlog Stable, but Only on Lower Deliveries



Order Trends About to Pause...but could reaccelerate?

Railcar Orders vs. Production by Quarter

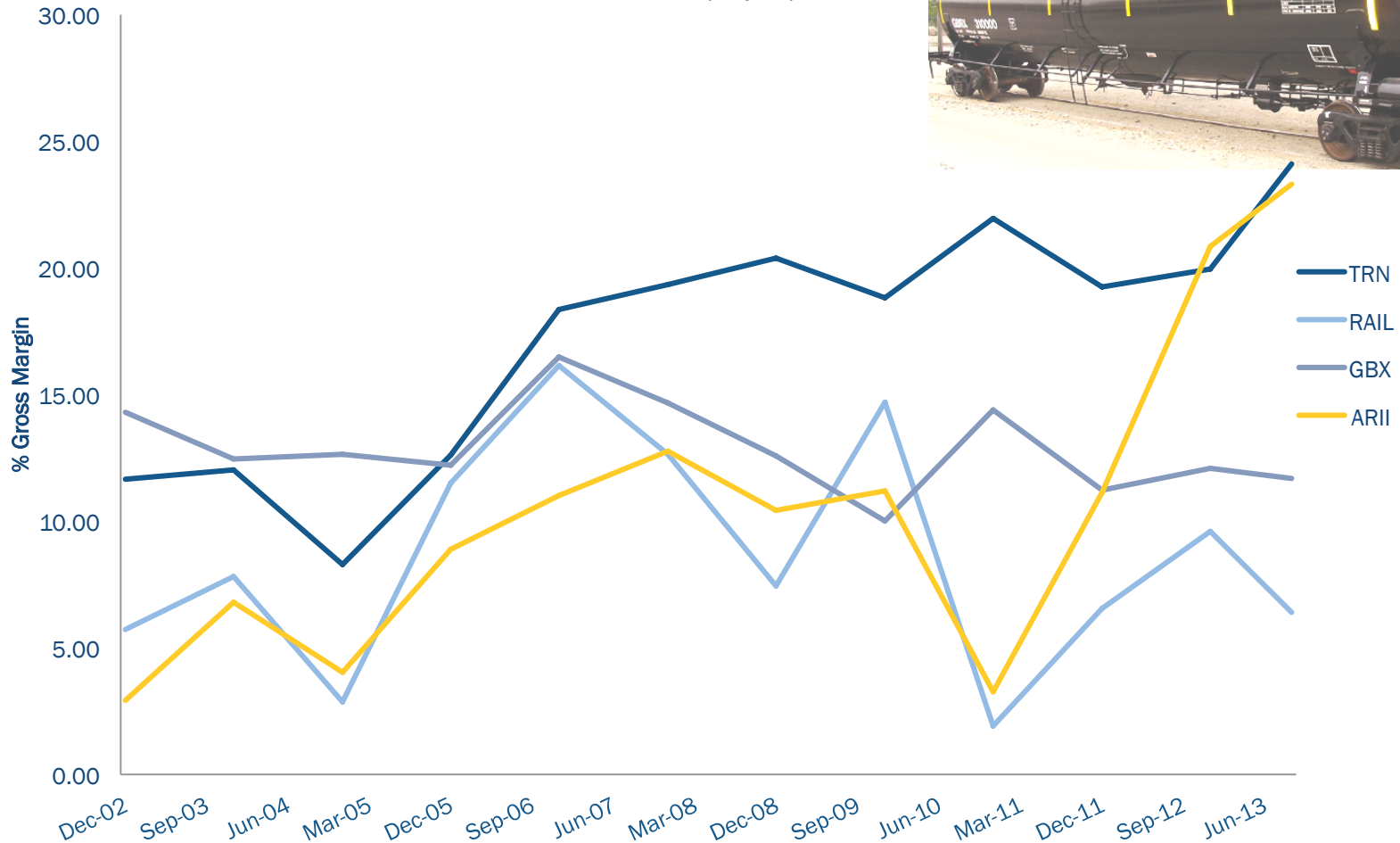
Source: RSI



What has tank car production meant for margins?

Railcar Builders Annual Gross Margin

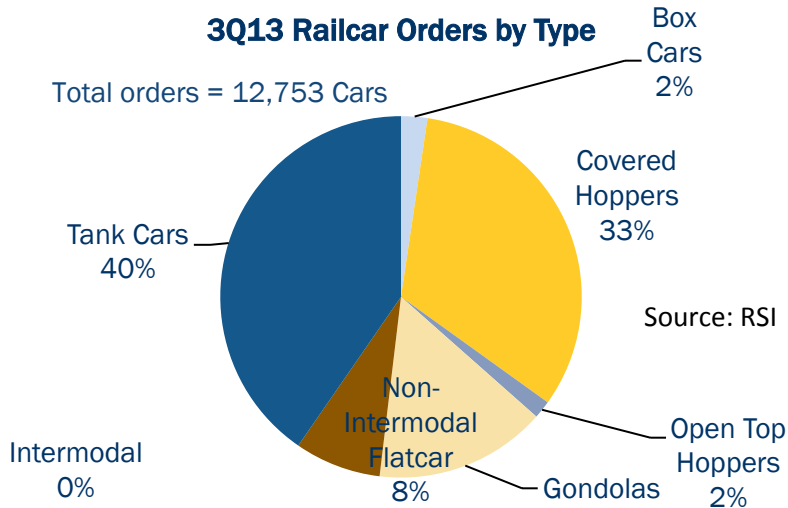
Source: Company Reports



The Street Fears One Dimensionally Driven Markets...

3Q13 Railcar Orders by Type

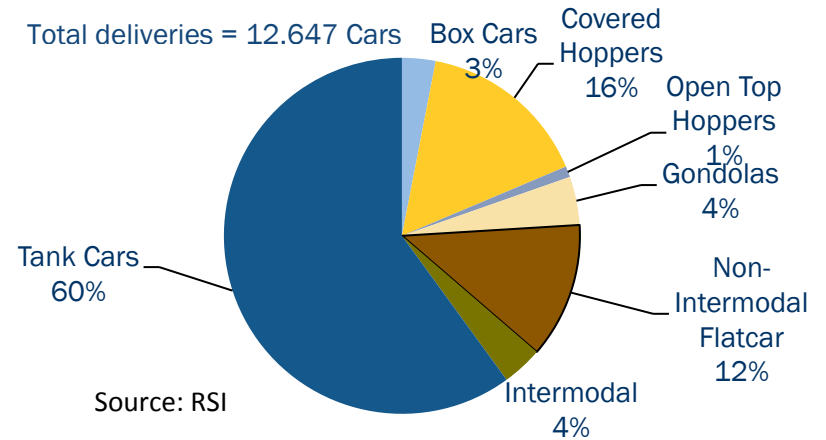
Total orders = 12,753 Cars



Source: RSI

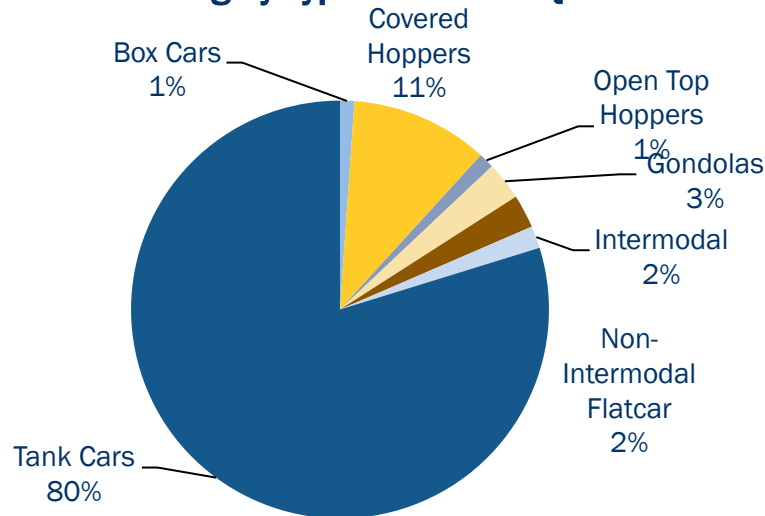
3Q13 Deliveries by Type

Total deliveries = 12,647 Cars



Source: RSI

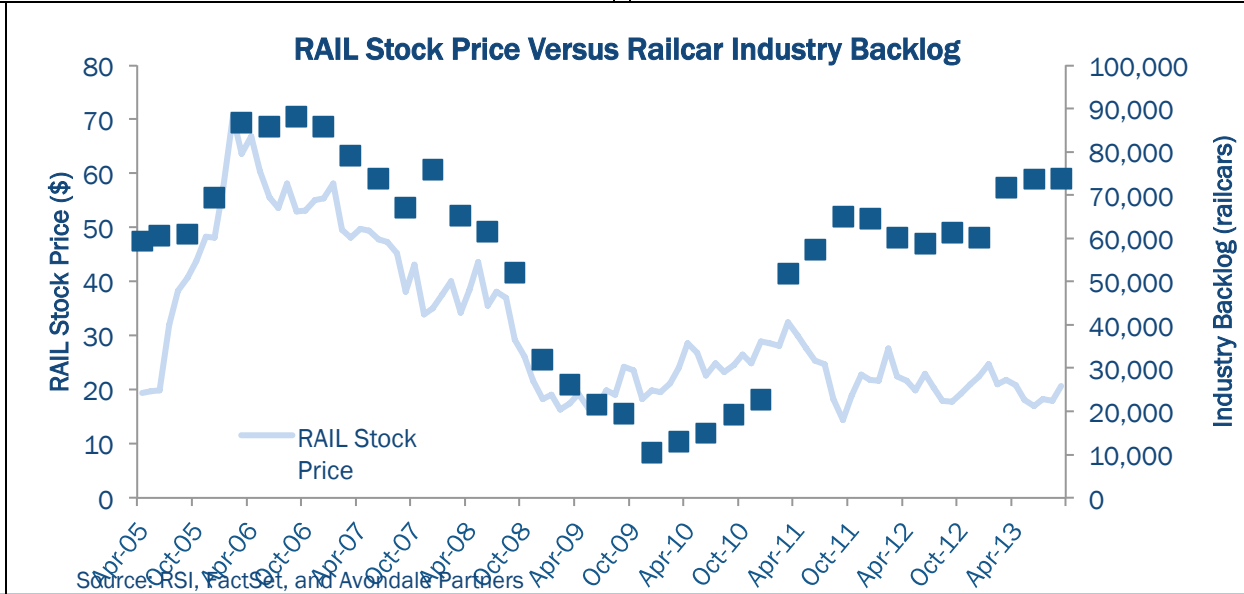
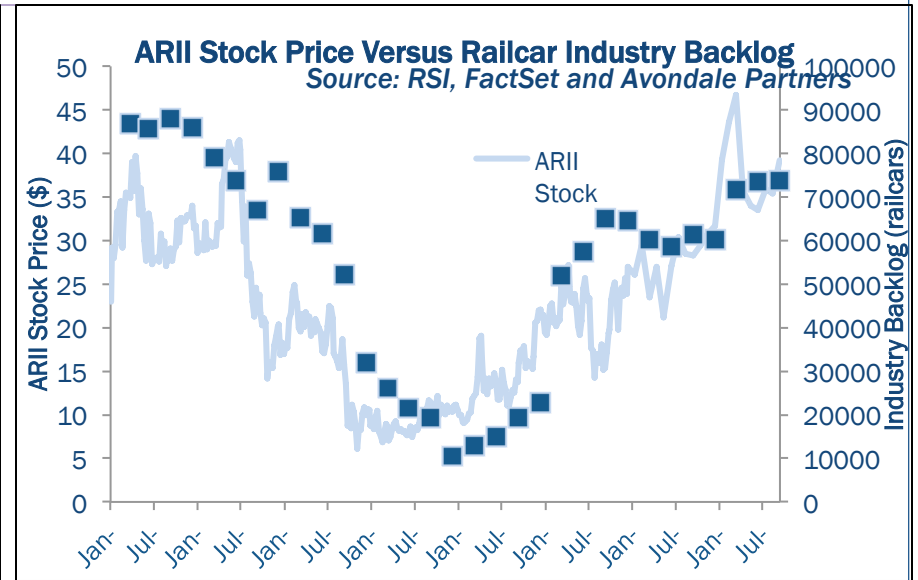
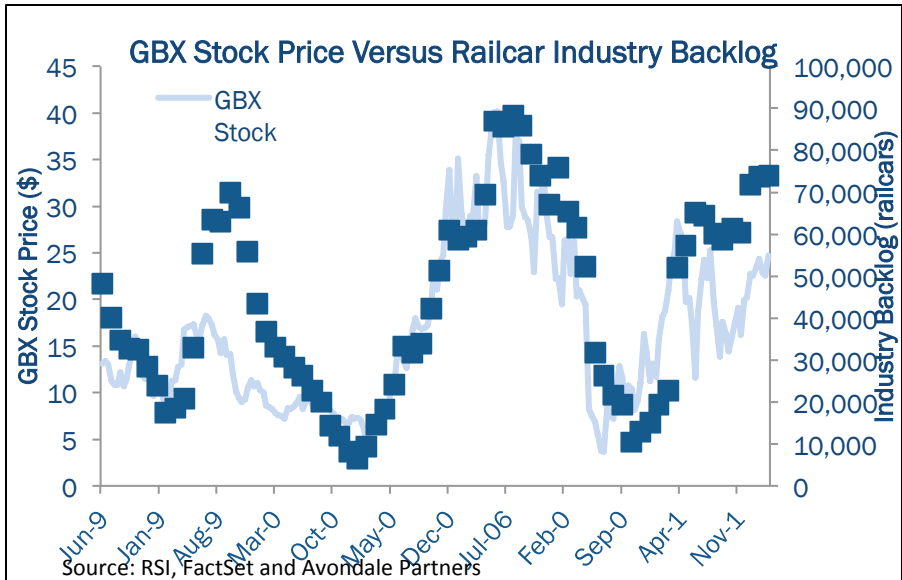
Railcar Backlog by Type at End of 3Q13



Total backlog = 73,848 cars

Source: RSI

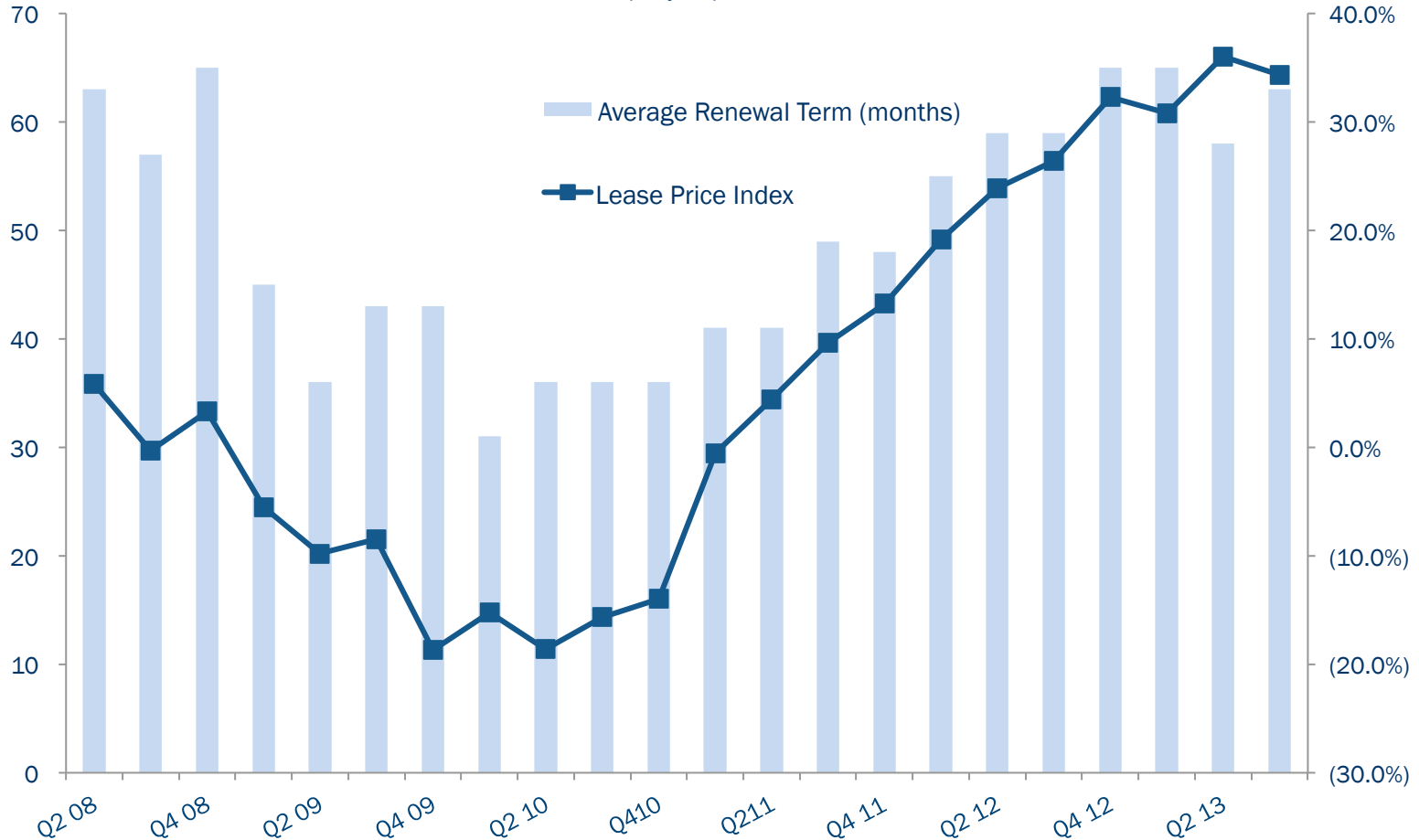
Backlogs And Stock Prices



A snap shot of lease rates...

GATX's Lease Price Index and Average Renewal Term

Source: Company Reports



We are from the gov' t and we are here to help...

- Impending tank car regulatory changes:
 - Media is putting every railcar fire on primetime news since summer accident.
 - Constituents are not aligned on how much regulation. This is not a PTC like situation: railroads, car owners and shippers all have different concerns.
 - AAR comments last week “stunned” the equipment industry.



Tank car mania continues...

- AAR desires to increase safety standards beyond stricter voluntary specs adopted in July 2011 for tank cars carrying haz mat materials.
- How much of the fleet will be impacted? AAR estimates that 92,000 cars (of a 330K fleet) will be impacted in some way.
- AAR estimates \$1b in retrofit costs. Could likely be higher on \$20-40K per car retrofit estimates.
- Backlogs on tank cars are out at least two years.
- Major questions:
 - Phase in timing?
 - Was impending tank car bubble erased, as we force out older cars?
 - Shop capacity? (on top of other previously mandated service, ie HM201)
 - Who ultimately pays?
 - Does this change the economics for crude by rail?



Thoughts about the future...

- Shop and manufacturing capacity tightening...car prices remain high.

- Greed: When do we start adding too much capacity? It will happen.

- Tank cars are treated as they never have before:

 - Maintenance cost of manifest versus unit train service.

 - Corrosion:

 - Do we know the acidity of the crude?

 - Car lining an expensive proposition \$7-10K/car

 - Lessor versus lessee on who pays and how to measure.

- Providing safer equipment, but not killing the CBR value proposition.

- Figuring out how much equipment is needed is a complex equation of network efficiency, production, pipeline availability and new finds.

- Regulatory changes could impact order trends on tanks in near-term, but the bubble might not be forming after all.

