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Chartered Institute of Logistics and Transport

Road & Rail Trends – an Analyst Perspective

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RBC Dominion Securities Inc.

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All values in U.S. dollars unless otherwise noted.

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RBC Capital Markets

Speaker Profile – Walter Spracklin

- **Research Analyst – Transportation & Industrials Sector**
  - 17 years in Research at RBC Capital Markets
  - Provide stock selection advice to institutional investors (mutual fund companies, pension plans, hedge funds) and RBC Investment Advisors
  - Focus on the Transportation & Industrials Sector
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    - Company analysis
    - Industry analysis / Competitive positioning
    - Revenue, profitability and cash flow forecast
    - Valuation / Recommendation

- **Research Coverage List**
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  - Bombardier / TSX: BBD
  - Canadian National Railway / TSX: CNR
  - Canadian Pacific Railway / TSX: CP
  - Cargojet / TSX: CJT
  - Chorus Aviation / TSX: CHR
  - CSX / NYSE: CSX
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  - Stella-Jones / TSX: SJ
  - TFI International / TSX: TFII
  - Union Pacific / NYSE: UNP
  - WestJet / TSX: WJA
  - Westshore Terminals / TSX: WTE

Key Message

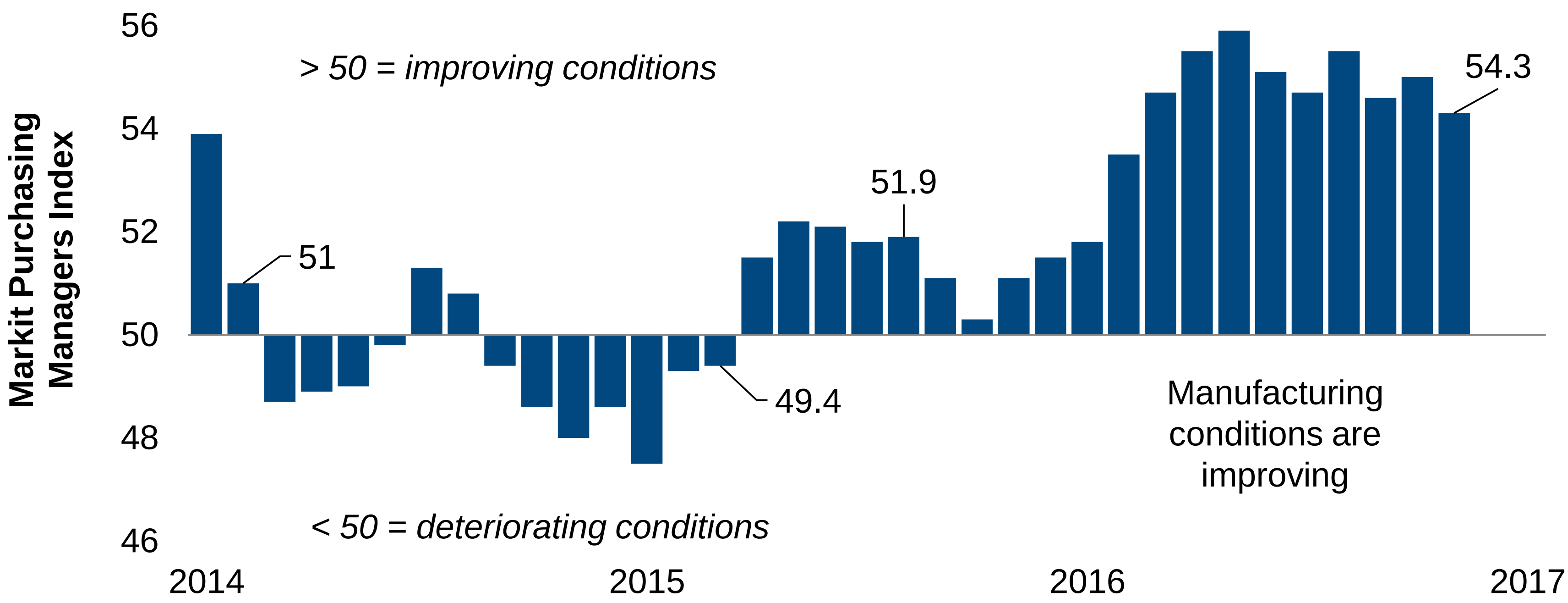
- The Canadian economy has been strong, since mid-2016; and the outlook is positive
- In the Canadian freight market:
  - Rails have been enjoying growth acceleration since the end of 2016 and growth is expected to continue
  - The Canadian Trucking market has been challenging during this time, but looks to be turning a corner
    - The US trucking market improvement provides signs of optimism for Canada

Leading indicators include consumer, manufacturing, and industrial health in the U.S. and Canada

- ISM, PMI, manufacturing output
- Business investment (capex) and inventory levels
- Consumer sentiment, income, spending
- Housing sector / construction activity

IHS Markit Purchasing Manager's Index signals Canada's manufacturing sector is expanding

- At the beginning of 2015, Canada's manufacturing sector suddenly slowed and the sector began to contract
  – An energy sector malaise and manufacturing slowdown created sapped demand freight services
- In early 2016, conditions began rebounding and entered a period of expansion, supporting a freight sector recovery



Source: IHS Markit; RBC Capital Markets

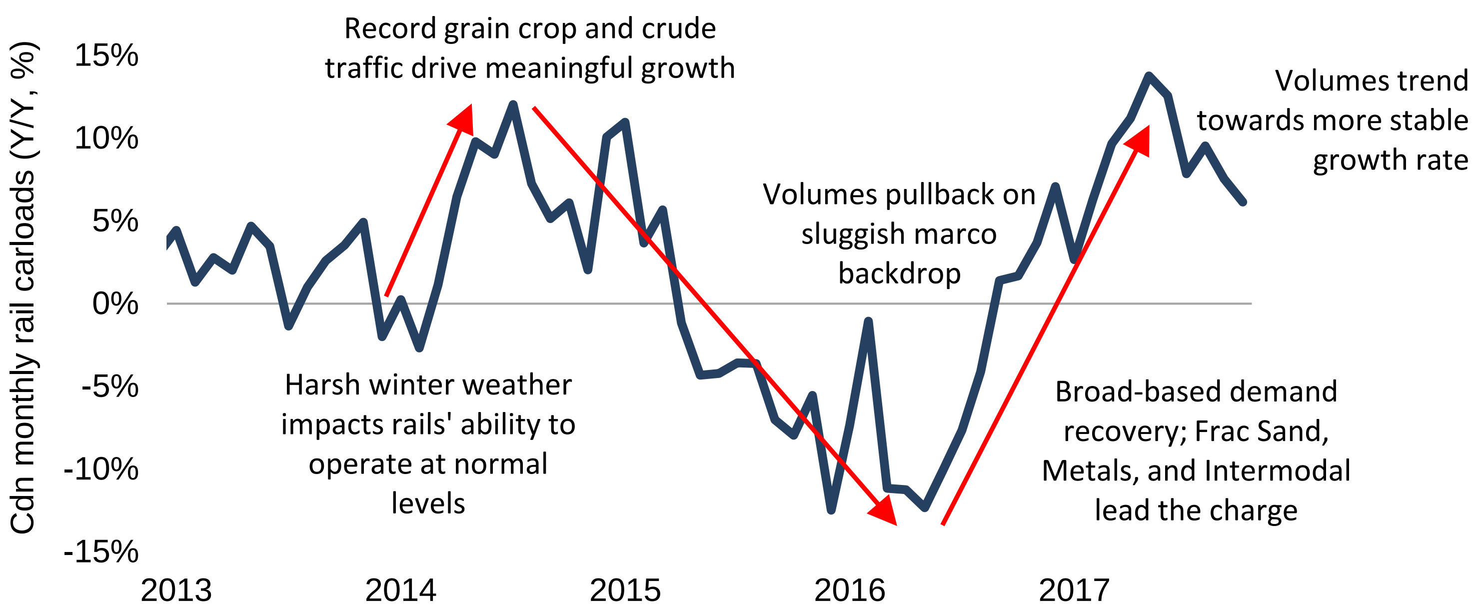
Railroad sector: recent volume trends and expectations for 2018

- In 2014, though extreme weather early in the year led to tough operating conditions and soft volumes, overall demand was strong and volume growth for the year was a solid +6% Y/Y
- In 2015, easy comps early in the year gave way to a tough macro backdrop and volumes fell -3% Y/Y
- The macro backdrop worsened in 2016, leading to a broad-based decline in rail volumes (-5% Y/Y)

TODAY

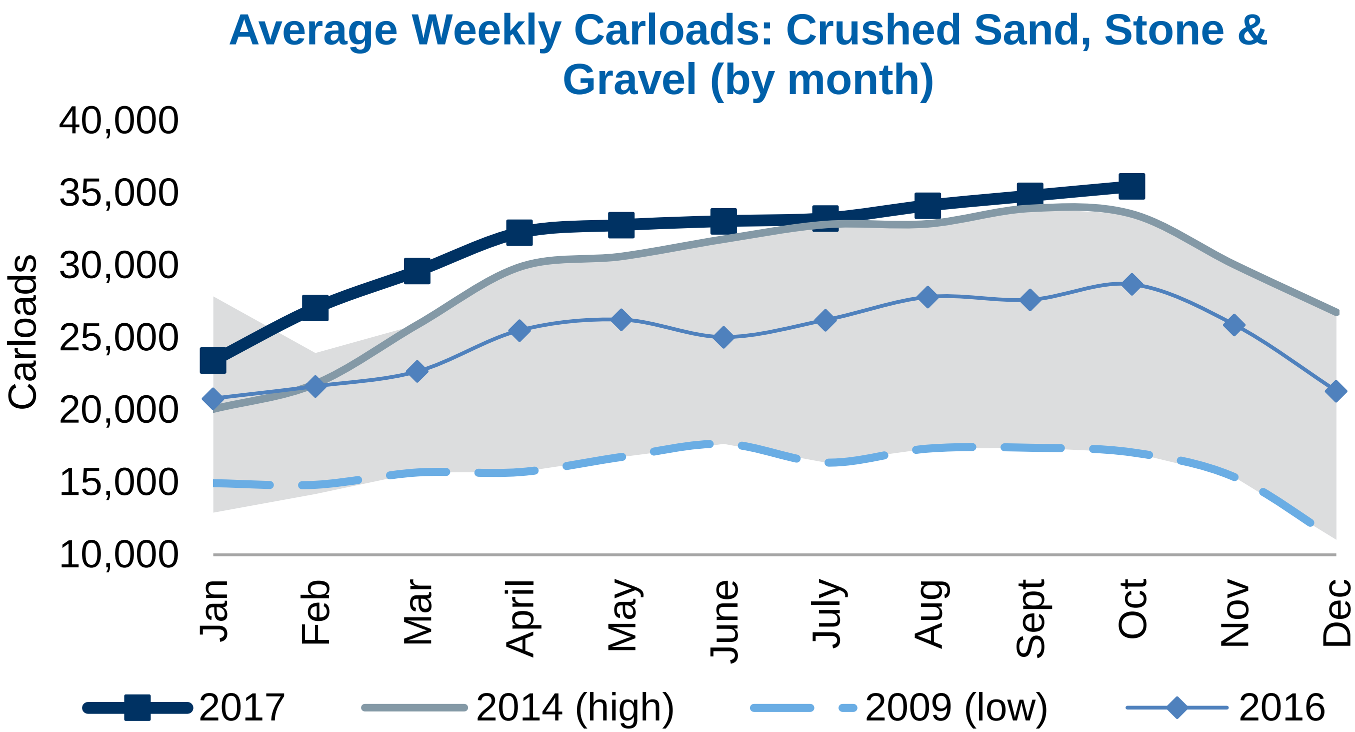
- Volumes inflected higher into 2017, indicated a stronger macro backdrop
  – **Drivers:** Nonmetallic Minerals (+39% Y/Y); Metals (+22% Y/Y); Intermodal (+11% Y/Y); Grain (+5% Y/Y)
- Risks from trade negotiations would be a mild negative to Railroads
  – **Commodities most at risk:** Finished autos, Lumber Products

Our Outlook: We are forecasting volume growth of +5.1% for 2017 and 2.3% for 2018

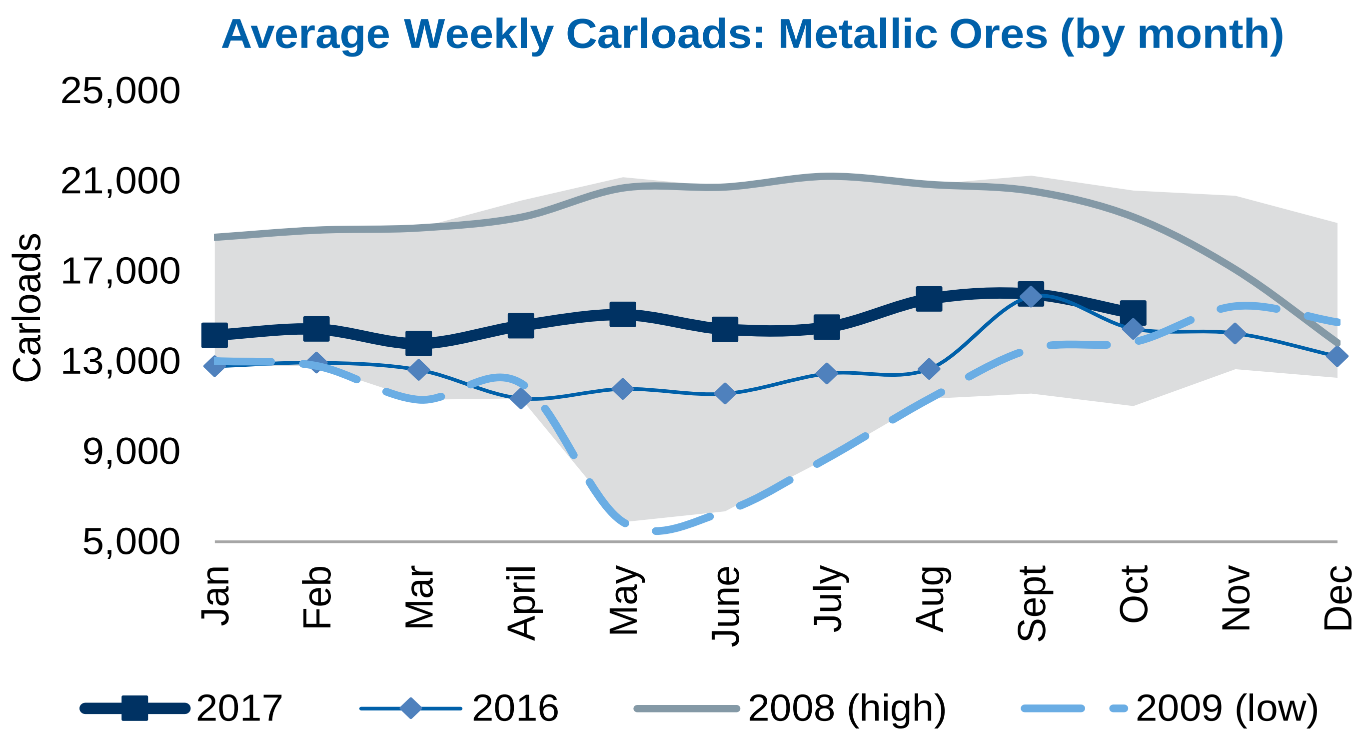


Source: AAR, Company reports, RBC Capital Markets estimates

Trend driver: Frac Sand carloads are running at a record annual pace

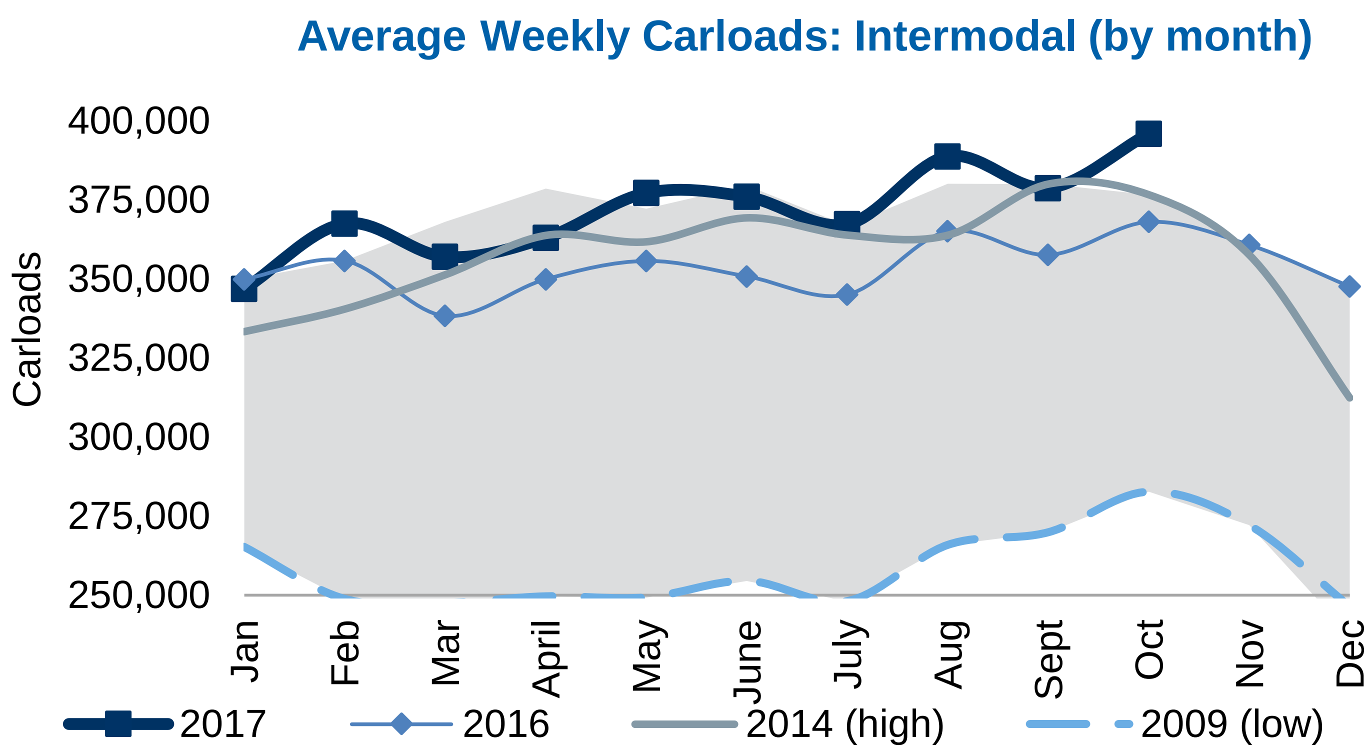


Source: AAR, RBC Capital Markets



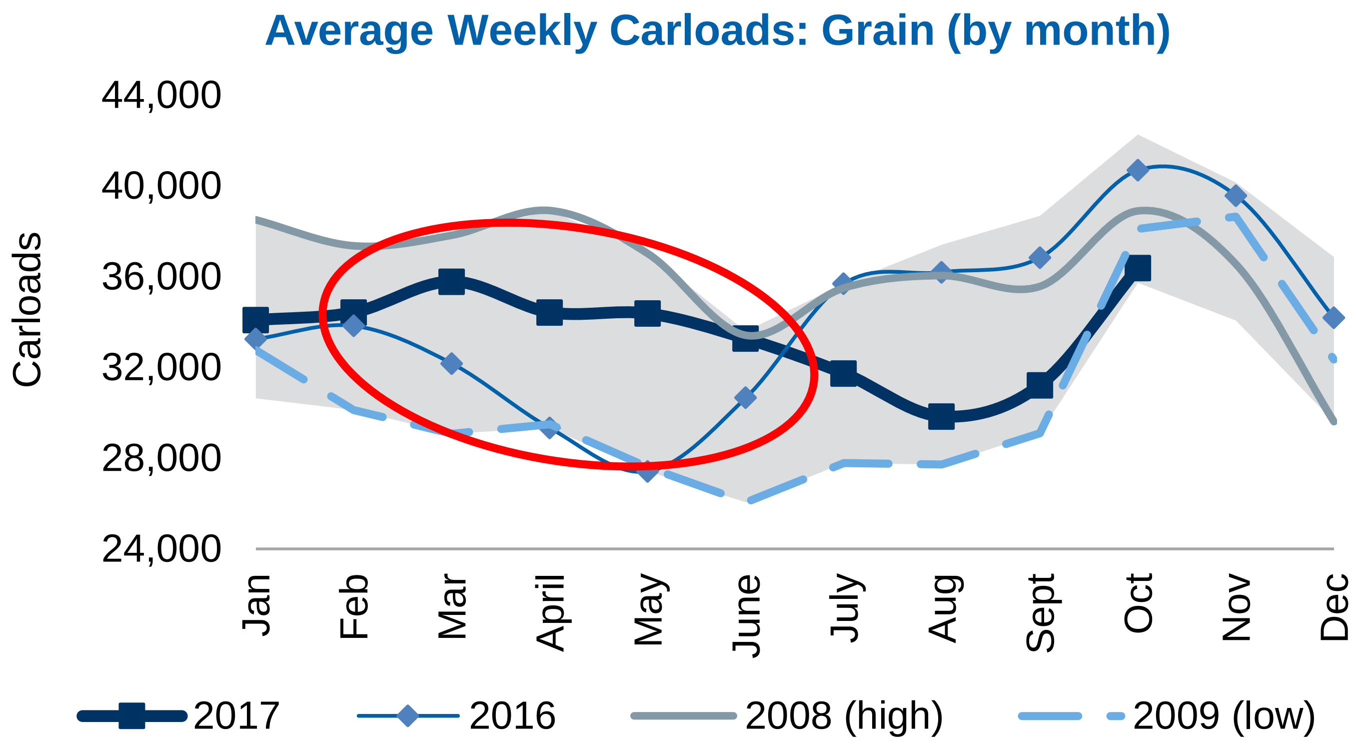
Source: AAR, RBC Capital Markets

Trend driver: Intermodal volumes tracking at record levels



Source: AAR, RBC Capital Markets

Trend driver: Grain is normalizing after strong 1H17 after the bumper crop

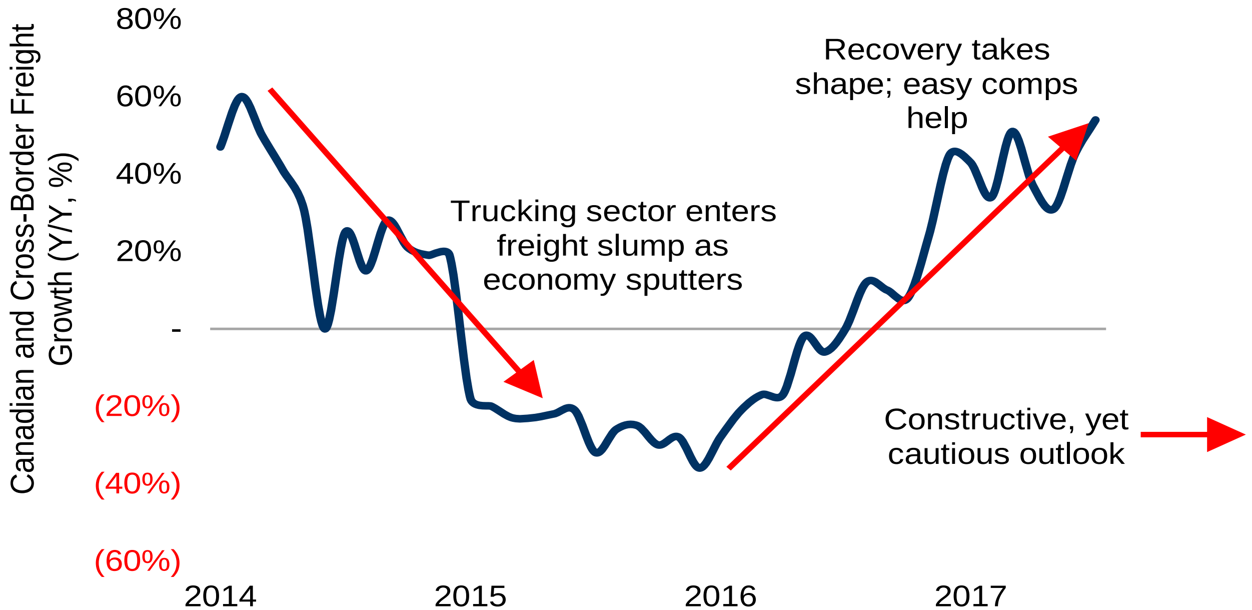


Source: AAR, RBC Capital Markets

Trucking Sector: volume trends as we head into 2018

- Trucking volumes fell across all CAN markets in 2015-2016 (intra-CAD, southbound, and northbound)
- In 2017, volumes appear to have reached a bottom and are showing signs of improving; but recent CAD$ strength is a headwind to southbound volumes
- In Canada, Parcel & Courier (P&C) demand is being buoyed by e-commerce; however, competition is elevated
- Less-than-truckload (LTL) and specialty truckload (TL) up against demand headwinds
- Volumes in US have recovered more quickly than in CAN

Our Outlook: We are constructive on CAN trucking volumes, looking for a more pronounced volume recovery in 2018; US volumes are on a stronger footing



Source: TransCore LinkLogistics; RBC Capital Markets estimates

Railway freight rates grow at steady rate

Quarterly Core Price Increases (ex. Fuel)					
	CNR	CP	CSX	NS	UP
Q1/11	4.0%	N/A	7.0%	N/A	4.5%
Q2/11	4.0%	2.5%	7.2%	N/A	4.5%
Q3/11	3.8%	2.0-3.0%	7.1%	N/A	4.5%
Q4/11	4.0%	5.0%*	6.9%	N/A	5.0%
Q1/12	4.0%	5.0%+*	5.9%	N/A	5.0%
Q2/12	4.0%	5.0%*	1.7%	N/A	4.5%
Q3/12	3.5%	3.0%*	1.5%	N/A	5.0%
Q4/12	4.0%	3.0-4.0%*	1.6%	N/A	4.0%
Q1/13	3.5%	3.0-4.0%*	0.3%	N/A	4.0%
Q2/13	3.4%	3.0-4.0%*	2.3%	N/A	4.0%
Q3/13	3.0%	3.0-4.0%*	1.0%	N/A	3.5%
Q4/13	<3.0%	3.0-4.0%*	1.6%	N/A	3.5%
Q1/14	3.0%	3.0-4.0%*	0.5%	N/A	2.0%
Q2/14	<3.0%	3.5%*	-0.6%	N/A	2.5%
Q3/14	3.2%	4.0%*	0.2%	N/A	2.5%
Q4/14	4.0%	4.0%*	0.7%	N/A	3.0%
Q1/15	3.9%	3.8%*	2.0%	N/A	4.0%
Q2/15	3.9%	2.9%*	3.5%	N/A	4.0%
Q3/15	3.3%	3.0%*	4.6%	N/A	3.5%
Q4/15	3.0%	3.0%*	4.1%	N/A	3.5%
Q1/16	2.5%	3.0%*[1]	3.1%	N/A	2.5%
Q2/16	2.2%	2.0%*	2.9%	N/A	2.0%
Q3/16	2.2%	3.0%*	2.3%	N/A	1.5%
Q4/16	2.7%	3.0%*	2.8%	N/A	1.0%
Q1/17	2.7%	2.5%-3.0%	3.9%	N/A	1.0%
Q2/17	2.3%	2.5%*	3.7%	N/A	1.5%
Q3/17	2.3%	2.5% - 3.0%	3.5%	N/A	2.0%

[1] RBC pricing estimate; *company did not provide a breakdown between price and mix

Source: Company reports; RBC Capital Markets estimates

- Rail rates have generally risen by +3% to +4%
- The rail industry target is inflation-plus pricing

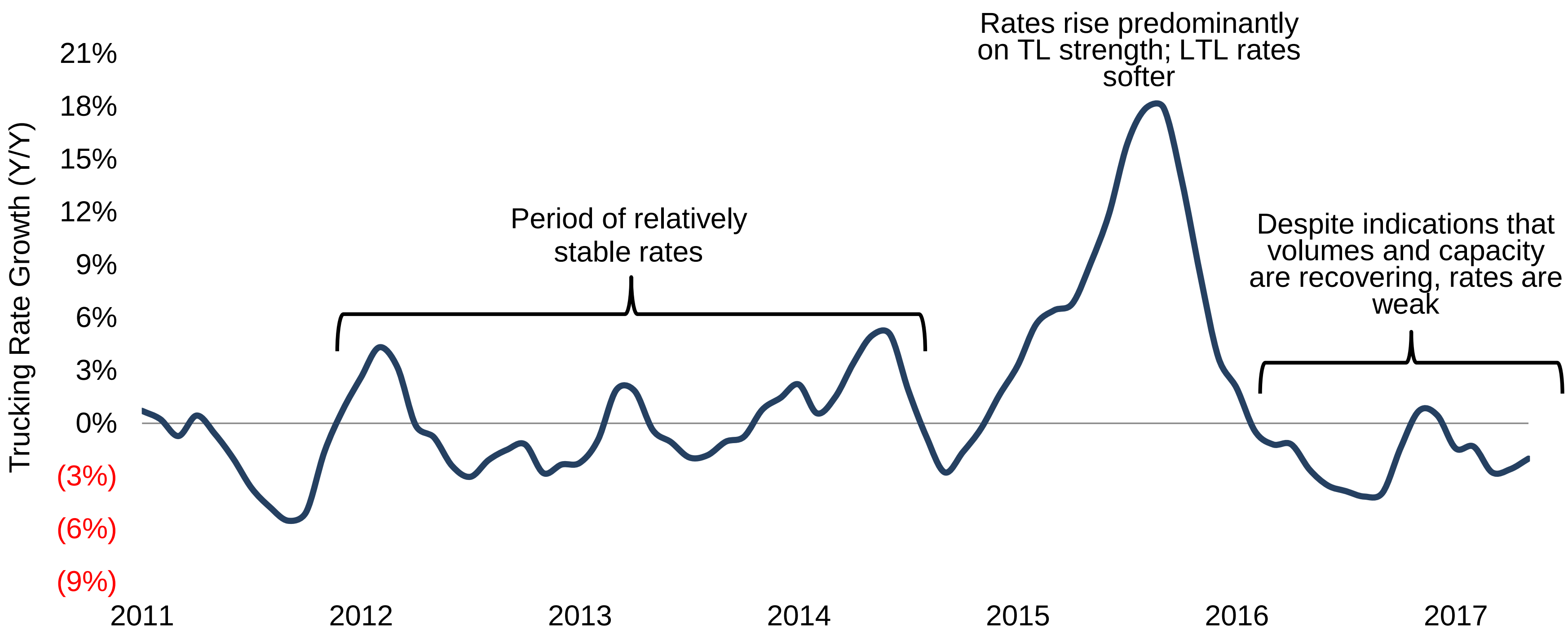
- Prior shipper commentary:
- *“In the 15 years I have worked in this industry, I have never seen the rates go down.”*
- *“The 3%-6% increase I am expecting is typical when we tender freight for bid.”*

Our Outlook: We believe rail pricing will grow near inflation for 2017 (2.0% to 2.5%); stronger inflationary pressures in the US

Trucking freight rates still volatile; mixed by lane and segment

- Given the tightness in short-haul freight capacity and the demand in P&C, we suspect rates may be highest in that segment
- Truckers are cost competitive against rail at 500 miles or lower

Our Outlook: We see continued strength in P&C, soft expectations for long-haul LTL and specialty TL



Source: Nulogix; RBC Capital Markets

Transportation sector: Key regulatory trends

- **Key Trucking regulation: Implementation of electronic logging devices (ELD)**
  - Requires that truckers install devices that ensure adherence to driveable hours, mandate driver breaks, and reduce the number of improperly licensed drivers
  - ELDs could strip trucking capacity out of the supply chain
  - Canada may be 12 to 24 months behind US in implementation of ELDs

- **Key Railroad regulation: Transportation Modernization Act**
  - **Measure #1**: New data reporting requirements for railways on rates, service and performance, to enhance system transparency.
  - **Measure #2:** A new mechanism, Long-Haul Interswitching, to provide captive shippers across all sectors and regions of Canada with access to a competing railway, to ensure they have options.
  - **Measure #3:** A definition of “adequate and suitable” rail service that confirms railways should provide shippers with the highest level of service that can reasonably be provided in the circumstances.
  - **Measure #4:** The ability for shippers to seek reciprocal financial penalties in their service agreements with railways, to enhance accountability.
  - **Measure #5:** More accessible and timely remedies for shippers on both rates and service

- **Key Airline regulation: Transportation Modernization Act**
  - Foreign ownership levels set to rise, as expected
  - Add the Minister of Transportation to approve applications for joint ventures between two or more air carriers
  - Clear standards of treatment for air travelers in common situations as well as financial compensation under certain circumstances
  - A more flexible framework for the Canadian Transport Security Authority (CATSA) to provide new or additional screening services on a cost-recovery basis.

Source: AAR, Company reports, RBC Capital Markets estimates

Wrapping up: prospects are positive for the Cdn freight industry

- **Overall, the outlook for the Cdn freight industry is positive**
  - **Volume outlook:** stable and positive for rails; constructive for trucking
  - **Rates:** inflation-plus for the rails as expected; would like to see more firming in trucking
  - **Capacity:** rail are ramping up; trucking capacity is moving in the right direction

Outlook	Railroads	Trucking
Volumes	Positive	Constructive
Rates	Positive	Constructive
Capacity	Positive	Improving

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