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# Project Copper

Trustee Meeting Presentation

September 14, 2020

## Executive Summary

- BMO and Cincinnati Southern Railway (“CSR”) have been working closely to examine CSR’s current lease agreement in place with Norfolk Southern (“NS”). This lease agreement allows NS to operate over the CSR, expanding Norfolk Southern’s network and connecting Chicago, IL to key southern markets.
- BMO and CSR have been focused on determining what a more equitable allocation of economic interests would be in a renegotiated lease agreement. The current economic deal with NS to CSR does not reflect the value of this line to NS, nor does it reflect the considerable expansion of volumes and revenues NS has enjoyed.
- To best inform an analysis of potential economic terms for a new lease, CSR made enquiries to NS for necessary data to understand the economic value of the CSR to Norfolk Southern. NS has provided limited data to date, but has provided enough information for BMO to perform certain high-level valuation approximations.
- With this information, BMO and CSR have attempted to triangulate NS’s economic benefit through three different valuation techniques, which are presented later in this document.
- As a result of these analyses, BMO advises CSR to proactively approach NS with a drafted lease agreement reflecting improved economic terms over the coming weeks in order to dictate the starting point of negotiations and ensure sufficient time remains to reach a timely agreement before the existing lease expires.

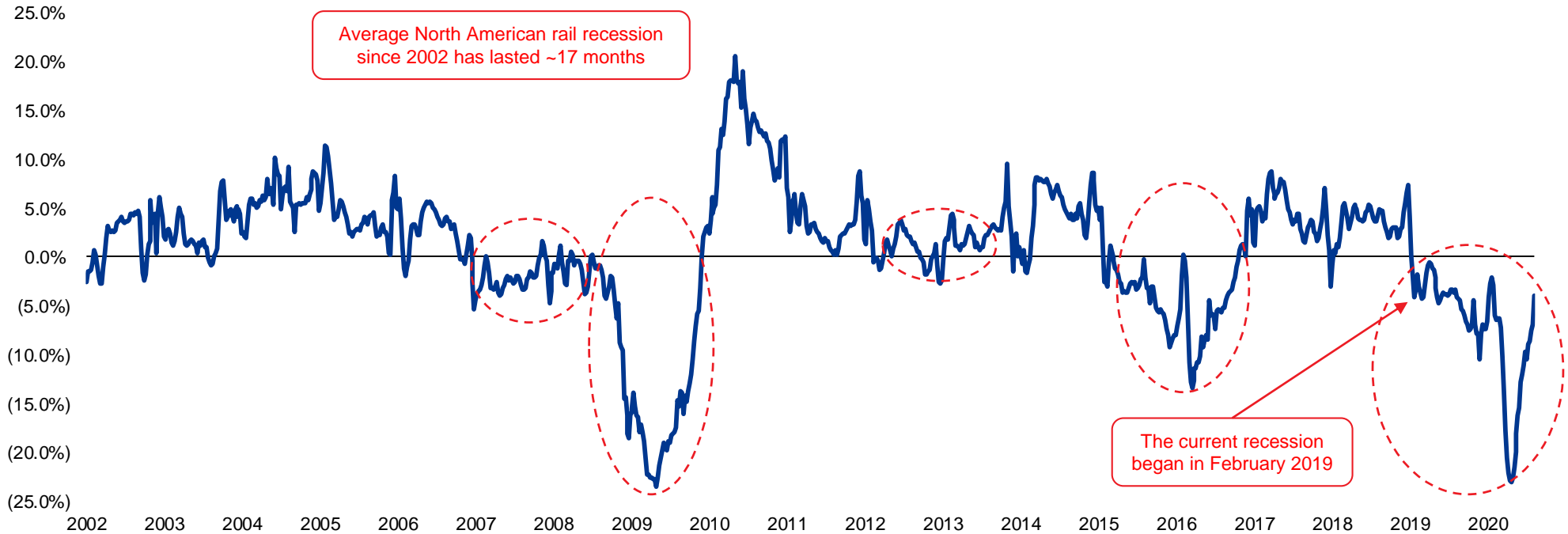
## Section 1: Rail Industry Market Update

Section 1	Rail Industry Market Update
Section 2	Lease Valuation Perspectives
Section 3	Next Steps

# Rail Recession Historical Comparison / Context

## North American Rail Volume

(y-o-y %, trailing 4-wk avg.)



	Beginning	End	% Months Contracting	Length (Months)
<b>2006-08</b>	Nov-06	Jan-08	86%	15
<b>2008-10</b>	Mar-08	Jan-10	94%	23
<b>2012-13</b>	Feb-12	Jan-13	42%	12
<b>2015-16</b>	Feb-15	Nov-16	95%	21
<b>2019-</b>	Feb-19	TBD	100%	18+
<b>Average</b>	-	-	<b>83%</b>	<b>17.8</b>

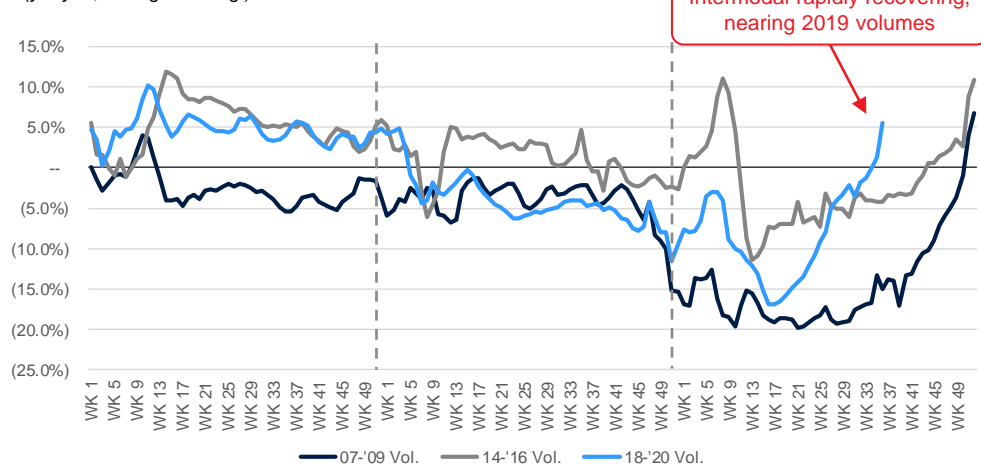
Source: AAR, BMO Research

Note: North American Class 1 Rail Volumes Include Burlington Northern, Canadian National Railway, Canadian Pacific Railway, CSX Corp, Norfolk Southern, Union Pacific and Kansas City Southern.

# Rail Recession Volume Analysis by Trade Flow

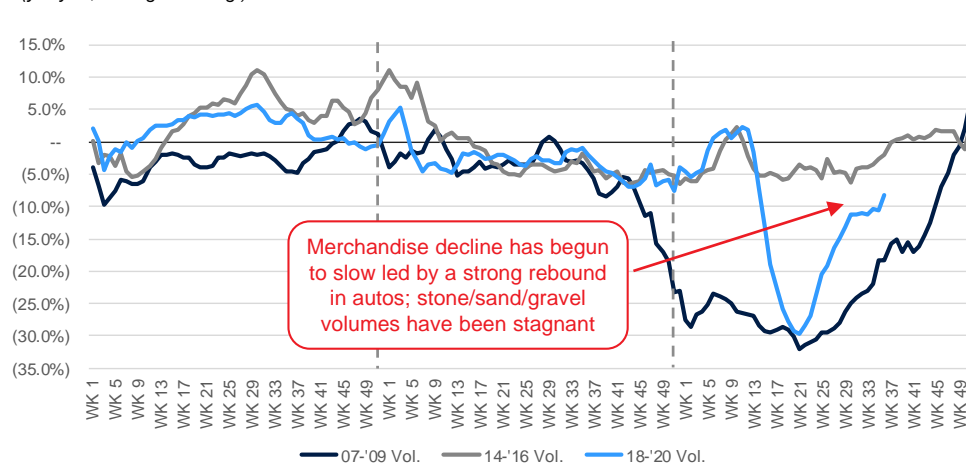
## North American Intermodal Rail Volume<sup>(1)</sup>

(y-o-y %, trailing 4-wk avg.)



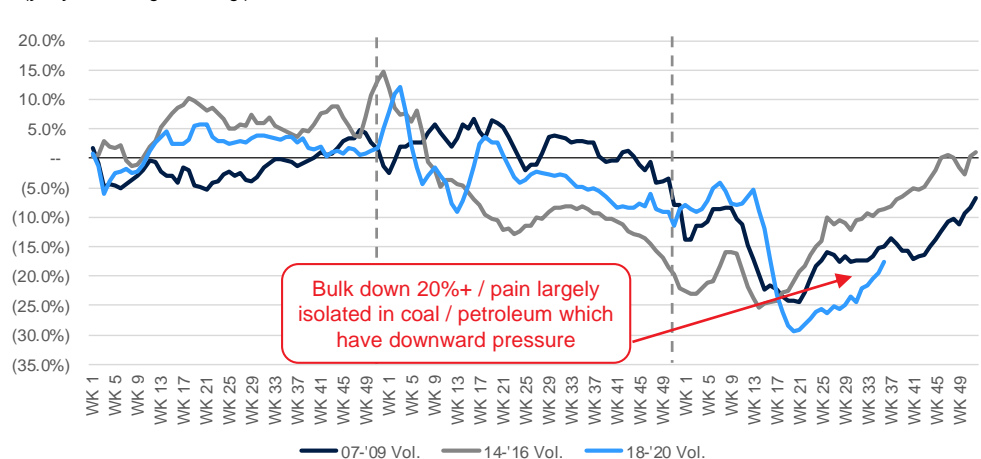
## North American Merchandise Rail Volume<sup>(2)</sup>

(y-o-y %, trailing 4-wk avg.)



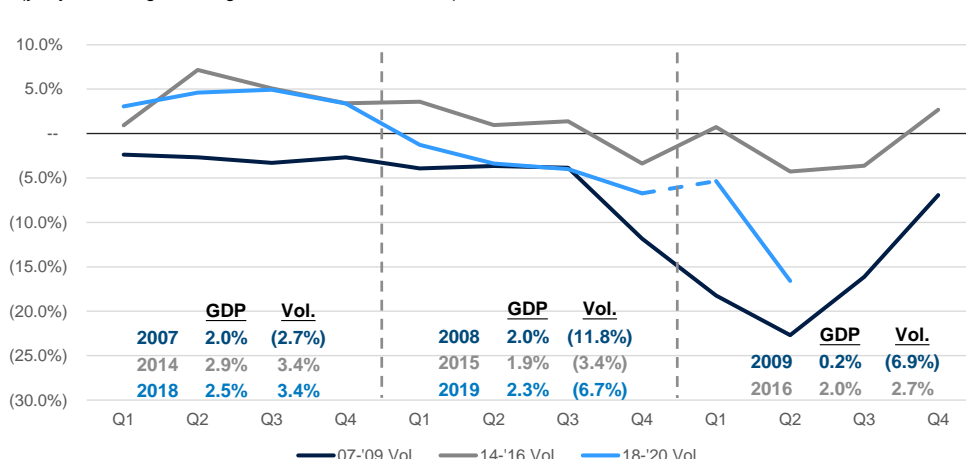
## North American Bulk Rail Volume<sup>(3)</sup>

(y-o-y %, trailing 4-wk avg.)



## North American Non-Bulk Rail Volume vs. Real GDP<sup>(4)</sup>

(y-o-y %, trailing 4-wk avg vs. annual Ch. U.S. GDP.)



## Current Market Correction Tracking In-Line with Prior Recessions

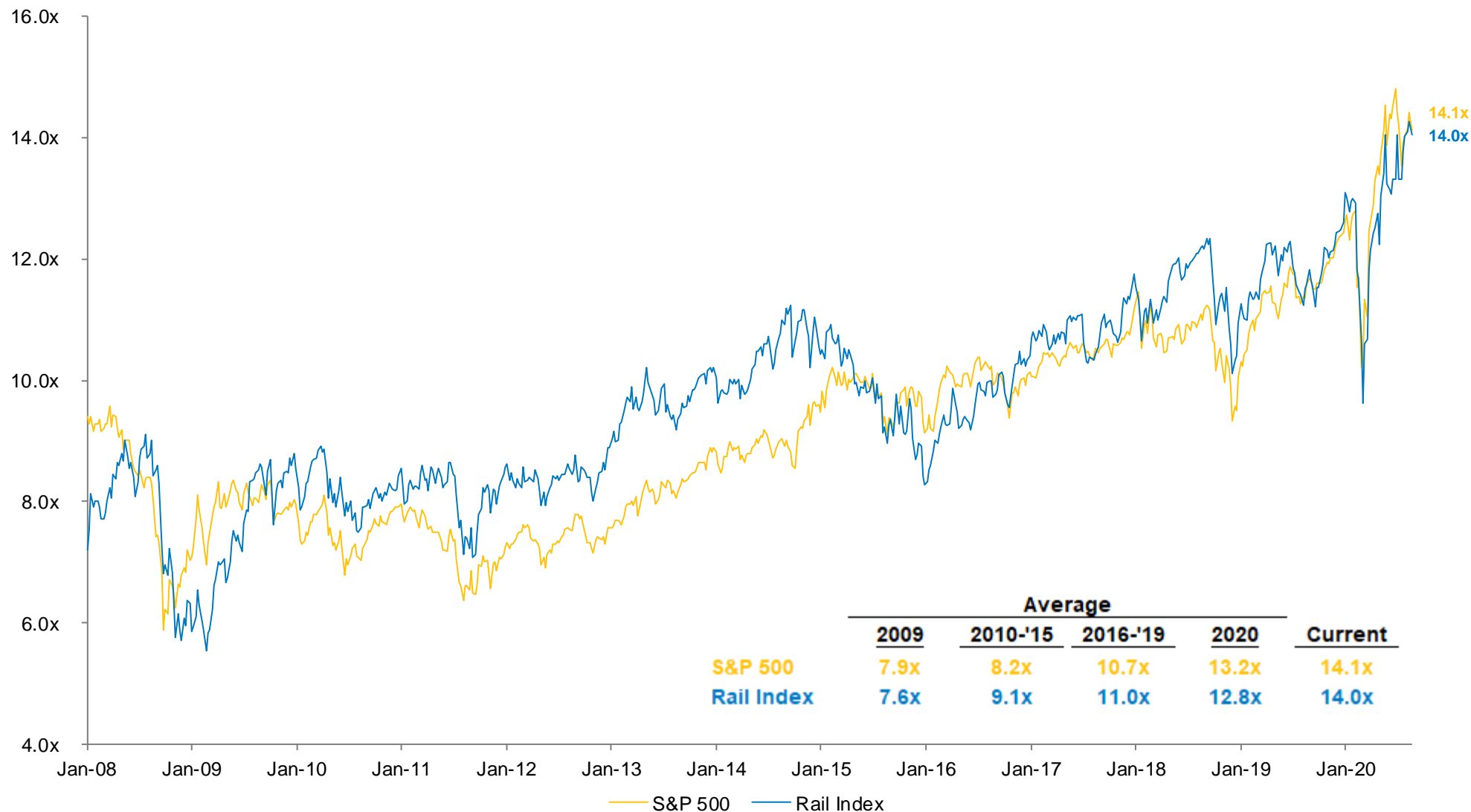
Source: AAR, FRED, BMO Research

Note: North American Class 1 Rail Volumes Include Burlington Northern, Canadian National, Canadian Pacific, CSX Corp, Norfolk Southern, Union Pacific and Kansas City Southern.

1. Intermodal Rail Volumes defined as the sum of trailer and container volumes.
2. Merchandise Rail Volumes defined as the sum of farm products, forest products, chemicals, motor vehicles and parts, metallic ores, non-metallic ores and other volumes.
3. Bulk Rail Volumes defined as the sum of grain, metallic ores, coal, petroleum and non-metallic minerals.
4. Non-Bulk Rail Volumes defined as the sum of total rail volume less bulk rail volume.

# Rail Sector Valuations Since 2009

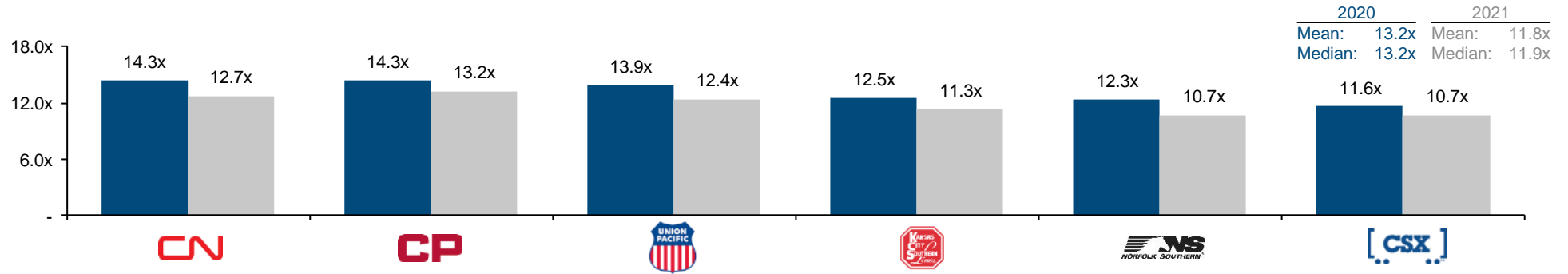
EV / NTM EBITDA Over Time



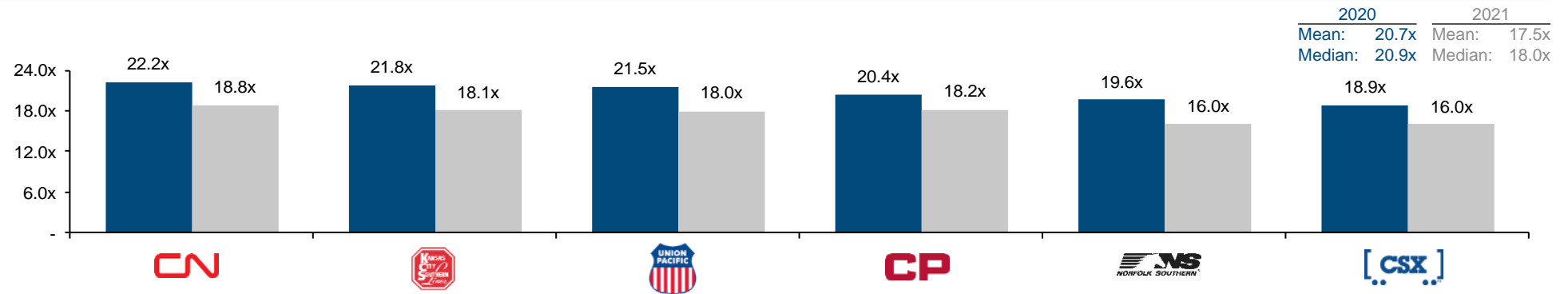
Class 1 Rail Index: Canadian National Railway, Canadian Pacific Railway, CSX Corporation, Kansas City Southern, Norfolk Southern, Union Pacific

# Rail Peer Valuation Comparables

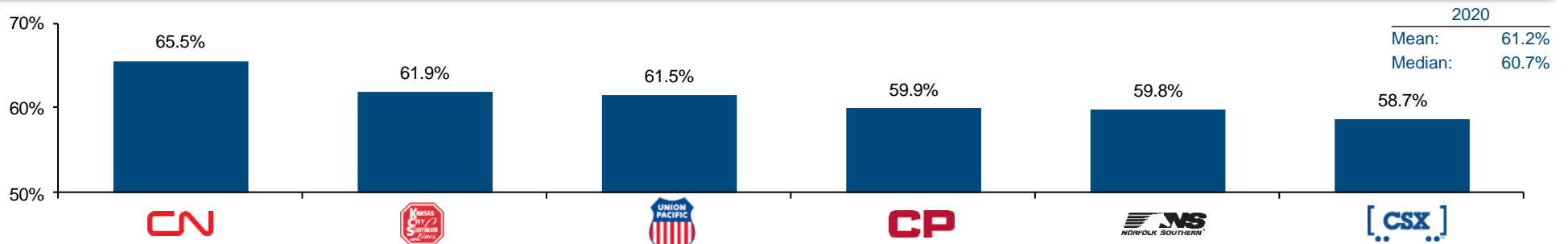
## EV / EBITDA Multiples



## P / E Multiples



## 2020 Forecasted Operating Ratio



## Section 2: Lease Valuation Perspectives

Section 1	Rail Industry Market Update
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# Summary of Information Utilized

## Public Information

- 2019 STB Filing Form R1 (Railroad Annual Report)**
  - Financial results and position for year 2019
  - Property and equipment owned and/or leased
  - Investments in property and equipment
  - Taxes
  - Railroad-level operating statistics
- 2019 STB Form 250**
- SEC Filings (10-Ks, 10-Qs and other filings)**

## Non-Public Information Received from Norfolk Southern

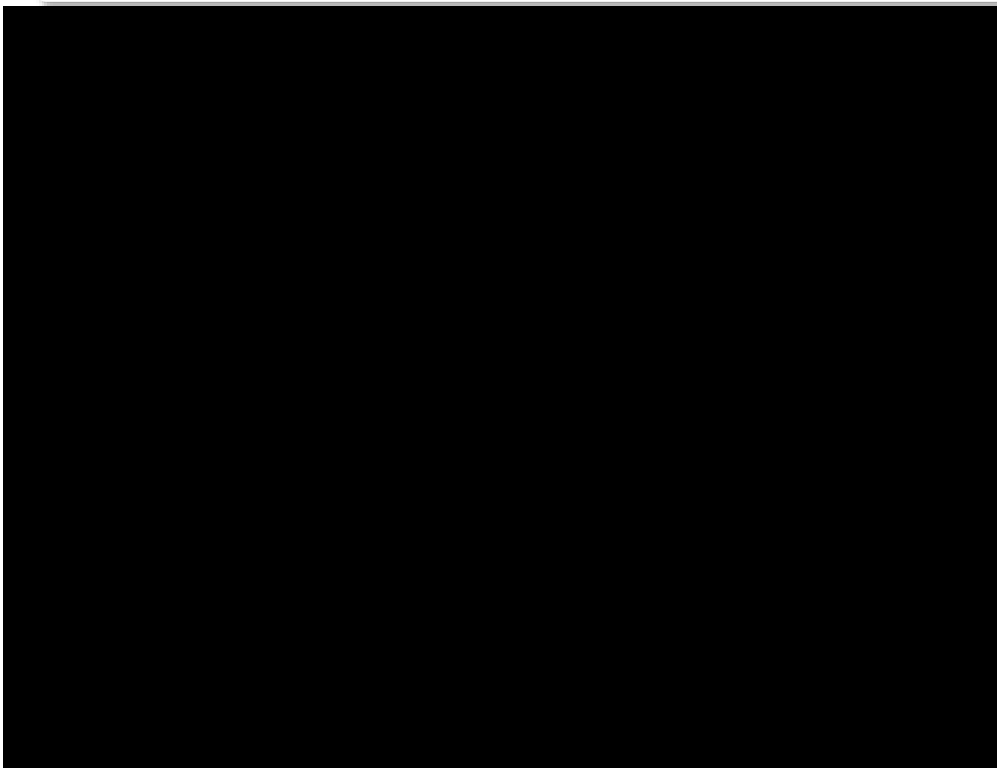
- NS Track Charts (Lake, Georgia, Alabama divisions)**
- NS Timetables (Lake and Alabama divisions)**
- CSR Tonnage Summary**
  - Total RTMs (2006, 2018 and 2019)
  - 2018 and 2019 RTM Detail (overhead vs. on/off branch and by sector)
- Ongoing NS reporting to CSR / City of Cincinnati**

## Information Recently Requested

- Norfolk Southern overall revenue per 1k ton miles by commodity type for 2018 and 2019**
- CSR non-operating revenue amounts for 2018 and 2019 (e.g., demurrage, storage, real estate/easements, etc.)**
- Norfolk Southern overall direct expense / contribution profit per 1k ton miles for 2018 and 2019**
- CSR capital expenditures / depreciation by type (e.g., bridge, track, etc.) for 2018 and 2019**

# Summary Financial Model and Direct Valuation

## Summary Financial Model



- BMO has estimated the economic value of CSR to Norfolk Southern through a blend of actual CSR-specific data and publicly-available metrics on Norfolk Southern's entire operations
- BMO's estimates for CSR is that it contributes nearly \$800 million in operating revenue and >\$250 million in operating income for NS
- In determining what this implies for a lease payment, BMO estimated the lease payments that would result from a lease rate that captures 15%-25% of segment EBITDA before lease expense
- At the midpoint of that range, the implied annual lease payment is **~\$60 million**

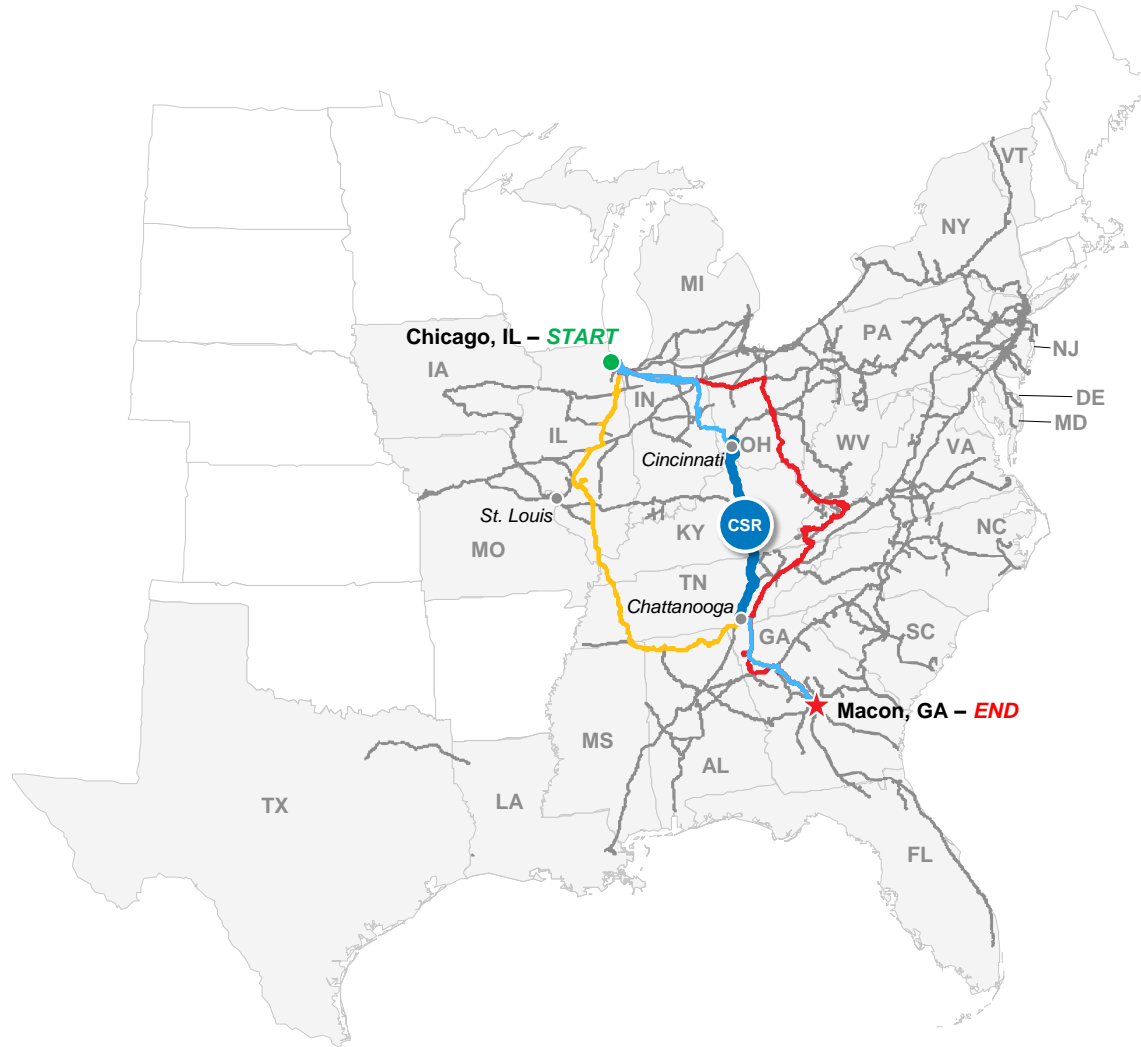
## Implied Lease Payment Derived from Segment EBITDA Capture

	% of Implied Segment EBITDA				
	15.0%	17.5%	20.0%	22.5%	25.0%
Implied Lease Payment	\$43.9	\$51.3	\$58.6	\$65.9	\$73.2

# The CSR is a Vital Component of Norfolk Southern's Network

## Few Efficient Alternative Routes Exist...

## ...And Each is Cost-Prohibitive



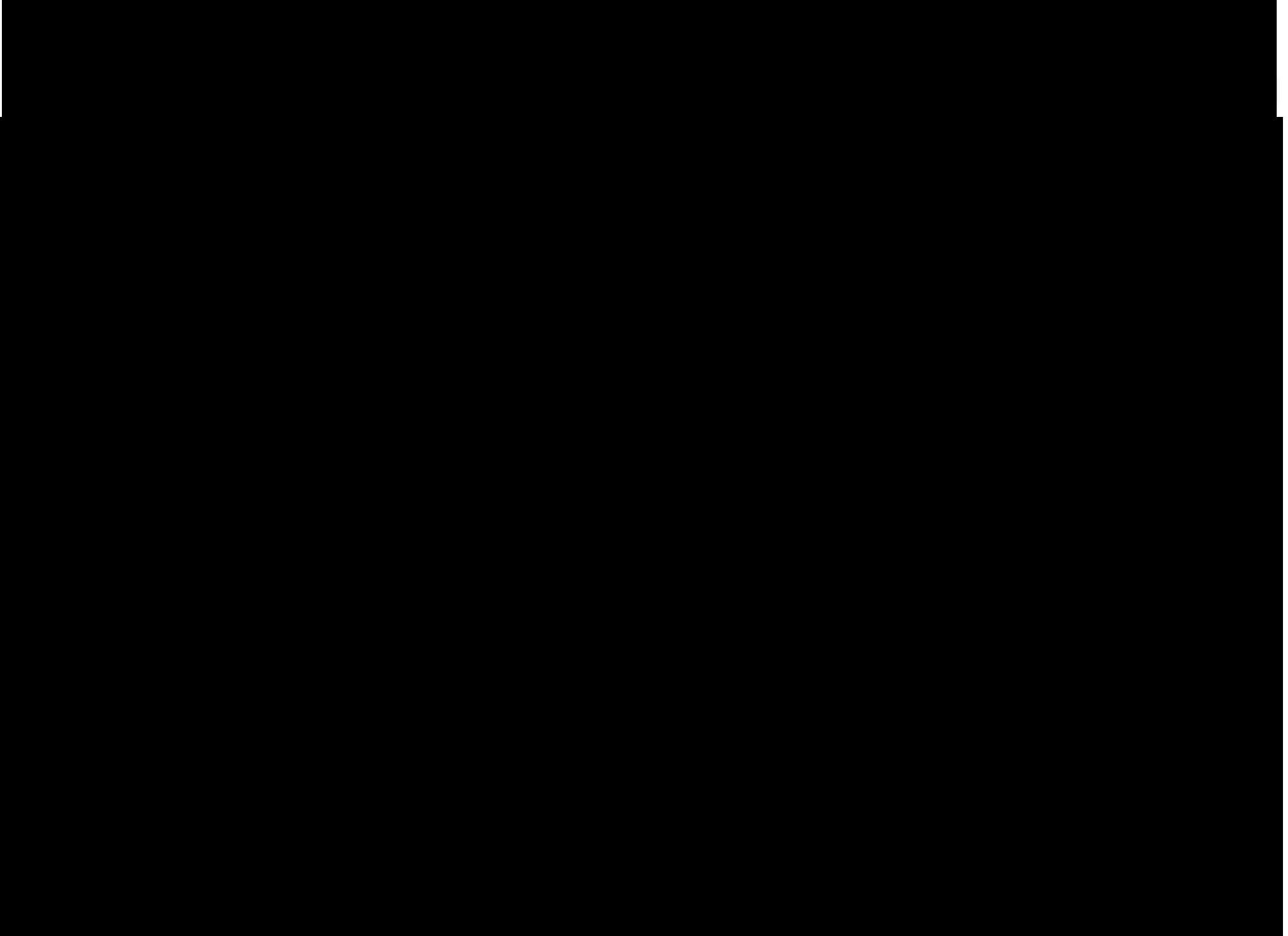
Route	Miles	Implied Incremental Annual Cost vs. CSR <sup>(1)</sup>
<b>CSR</b>	~895	--
<b>A</b>	~990 ~90 Miles Longer	~\$50 - \$80mm
<b>B</b>	~1,180 ~290 Miles Longer	~\$50 - \$160mm

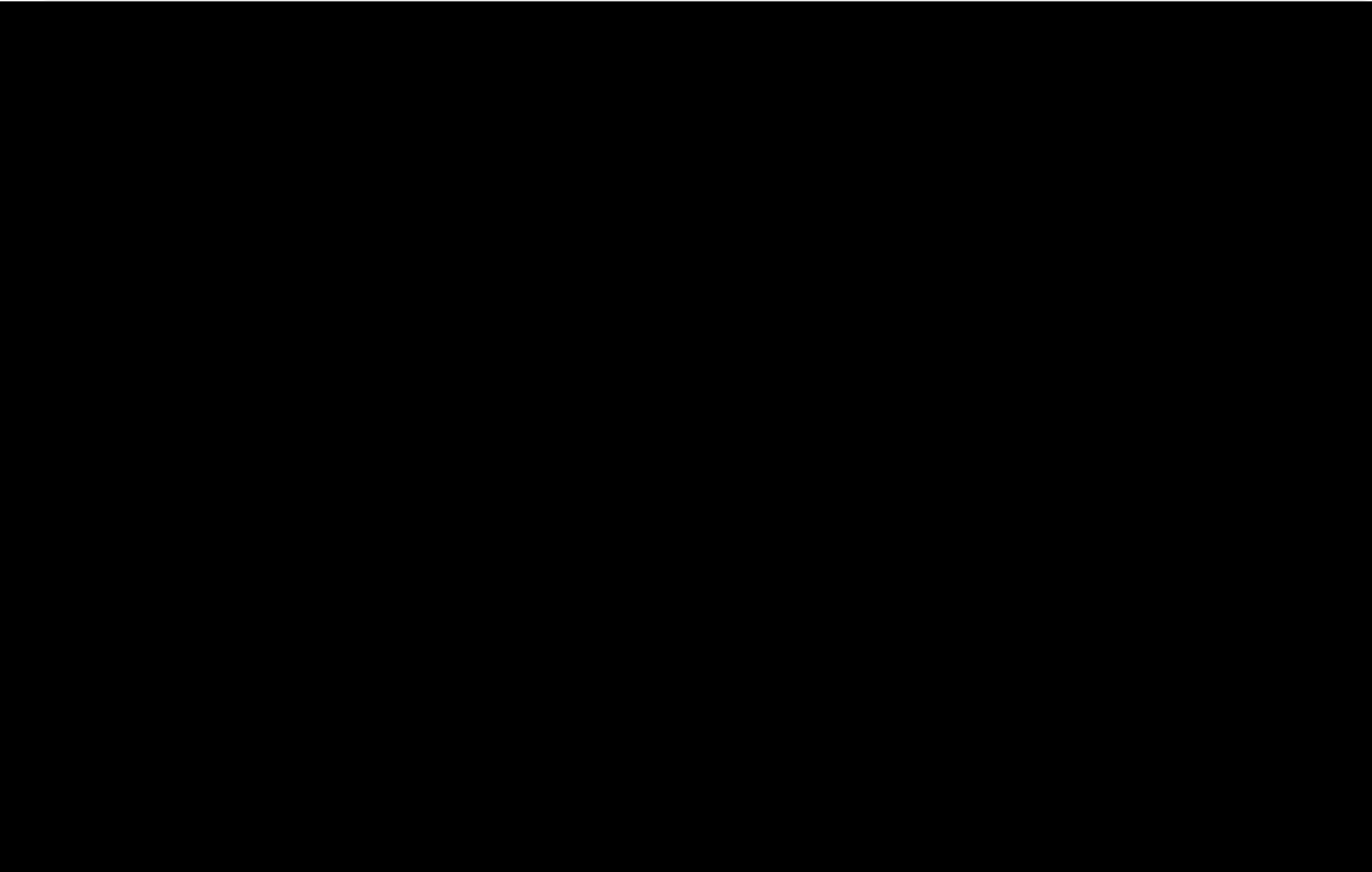
### Alternative Route A

- ~90 incremental miles implies an additional cost of ~\$50 - \$80mm / year based on illustrative analysis
  - Relies on trackage / haulage rights with CN and WTNN in IL and MS, resulting in the need for revenue sharing
- Likely requires substantial investment in additional track capacity, especially on the WTNN

### Alternative Route B

- ~290 incremental miles implies an additional cost of ~\$50 - \$160mm / year based on illustrative analysis
- Likely requires substantial investment in additional track capacity





# Illustrative Implied Lease Payment – 2009 Offer Annuity Methodology

## Illustrative Savings from Current Route and Implied Lease Payments

	\$mm
<b>2009 Offer</b>	<b>\$500.0</b>
Times: CPI Factor from 2009-2019	1.191
<b>Implied Market Value in 2020</b>	<b>\$595.7</b>
Assumed Discount Rate	12.0%
Annual CPI Adjustment	2.0%
<b>Implied Annual Lease Payment in 2020</b>	<b>\$58.4</b>

- Norfolk Southern's 2009 offer of \$500 million for the CSR implied an estimated 30 year lease payment of ~\$30 – ~\$75 million at the time
  - Adjusting this value for inflation provides an estimate of current equivalent lease payments
- Illustrative sensitivity analysis supports lease payments ranging from ~\$40 – ~\$85 million today*

\* Assumes a perpetual lease with 2% annual accelerator

## Assumed Discount Rate Impact on Implied Lease Payment

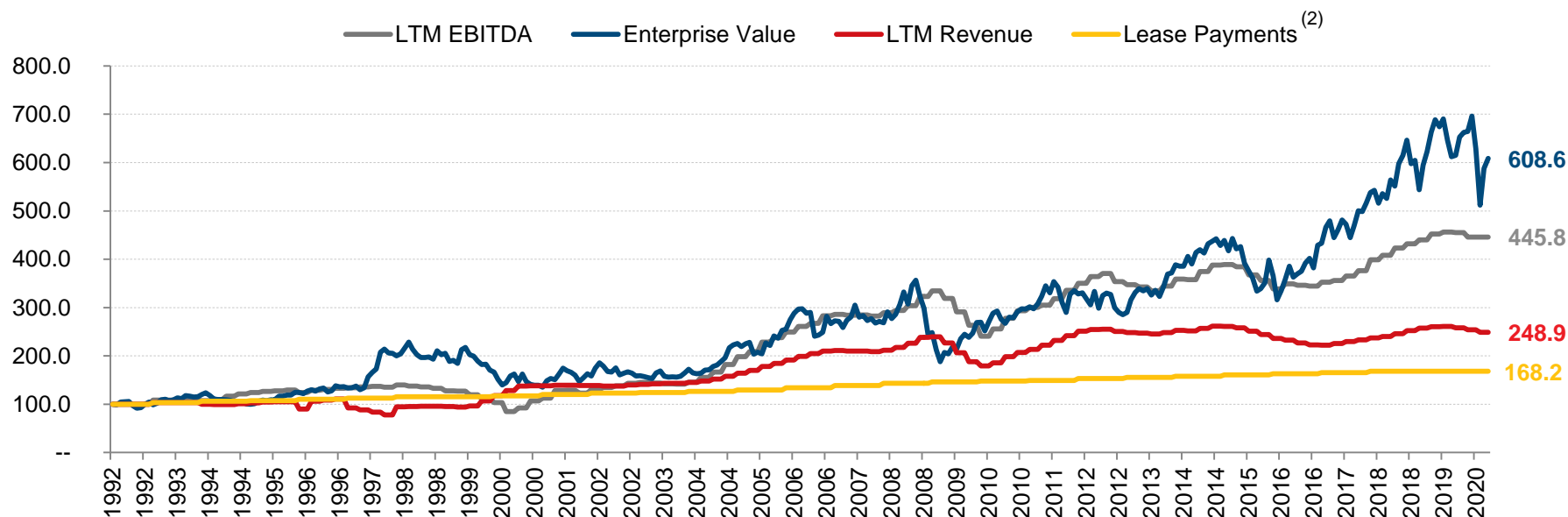
	Assumed Discount Rate				
	8.0%	10.0%	12.0%	14.0%	16.0%
<b>Implied Lease Payment</b>	\$35.0	\$46.7	<b>\$58.4</b>	\$70.1	\$81.8

## Assumed Discount Rate and CPI Adjustment Impact on Implied Lease Payment

	Assumed Discount Rate				
CPI Adjustment	8.0%	10.0%	12.0%	14.0%	16.0%
<b>3.0%</b>	\$28.9	\$40.5	\$52.1	\$63.6	\$75.2
<b>2.5%</b>	\$32.0	\$43.6	\$55.2	\$66.8	\$78.5
<b>2.0%</b>	\$35.0	\$46.7	<b>\$58.4</b>	\$70.1	\$81.8
<b>1.5%</b>	\$38.2	\$49.9	\$61.6	\$73.4	\$85.1
<b>1.0%</b>	\$41.3	\$53.1	\$64.9	\$76.7	\$88.5

# Lease Payments Have Not Kept Pace with Economic Performance of NS

## Indexed Financial Metric Growth<sup>(1)</sup>



- NS has been rewarded for consistent financial growth by the market with its **EV expanding by over 500%** since March 1992<sup>(1)</sup>, even after the COVID related economic shock
  - LTM EBITDA has grown ~350%** over this same time period
  - LTM Revenue has grown ~150%** since March 1992
- The City of Cincinnati has not participated in NS's impressive financial performance, with **CSR lease payments expanding only 68.2%** since 1992<sup>(2)</sup>

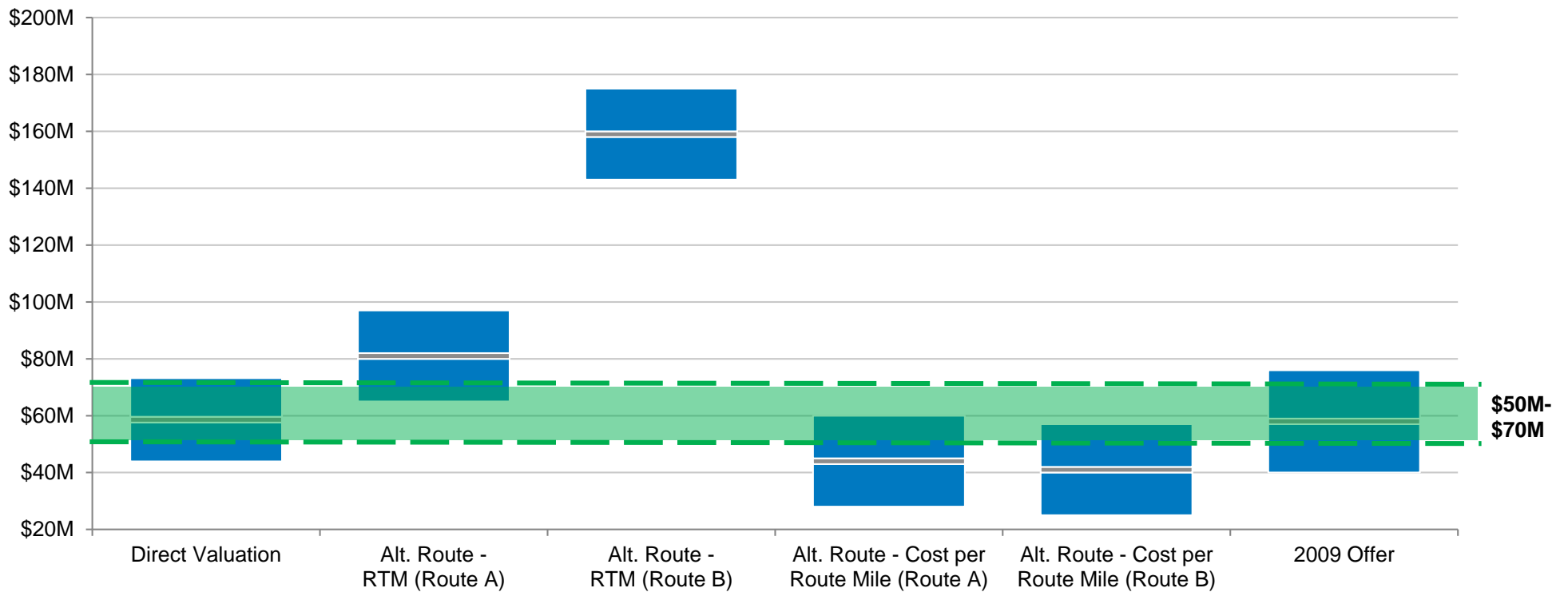
1. Source: CapitalIQ financial data from March 1992 to June 2020. Period for which market data is most readily available and produced on a comparable basis. March 1992 LTM metrics and EV set equal to 100.  
 2. Source: Cincinnati Southern 2018 audit. Time period reflects comparability with readily available NS financial information. Lease payment for 2019 assumed equal to 2018 as the 2019 audit has not yet been published. Lease payment in 1992 set equal to 100.

# Preliminary Proposed Annual Lease Rate

## Preliminary Annual Lease Rate Reset

- Annual lease rate paid by Norfolk Southern to the CSR should be revised upward to better reflect the value this route has to NS's operations
- Based upon BMO's analysis of alternative route options and Norfolk Southern's prior valuation, preliminary suggest ~\$50-70mm annual lease rate as an initial point of negotiation
- This proposal has been informed by BMO's efforts to triangulate a valuation based upon the limited information received to date
- While fundamental analysis is important, BMO believes NS will approach negotiations with an eye towards the next-best alternative. This makes the outputs of the alternative routing analyses particularly informative

## Lease Rate Analyses Comparison





## Section 3: Next Steps

Section 1	Rail Industry Market Update
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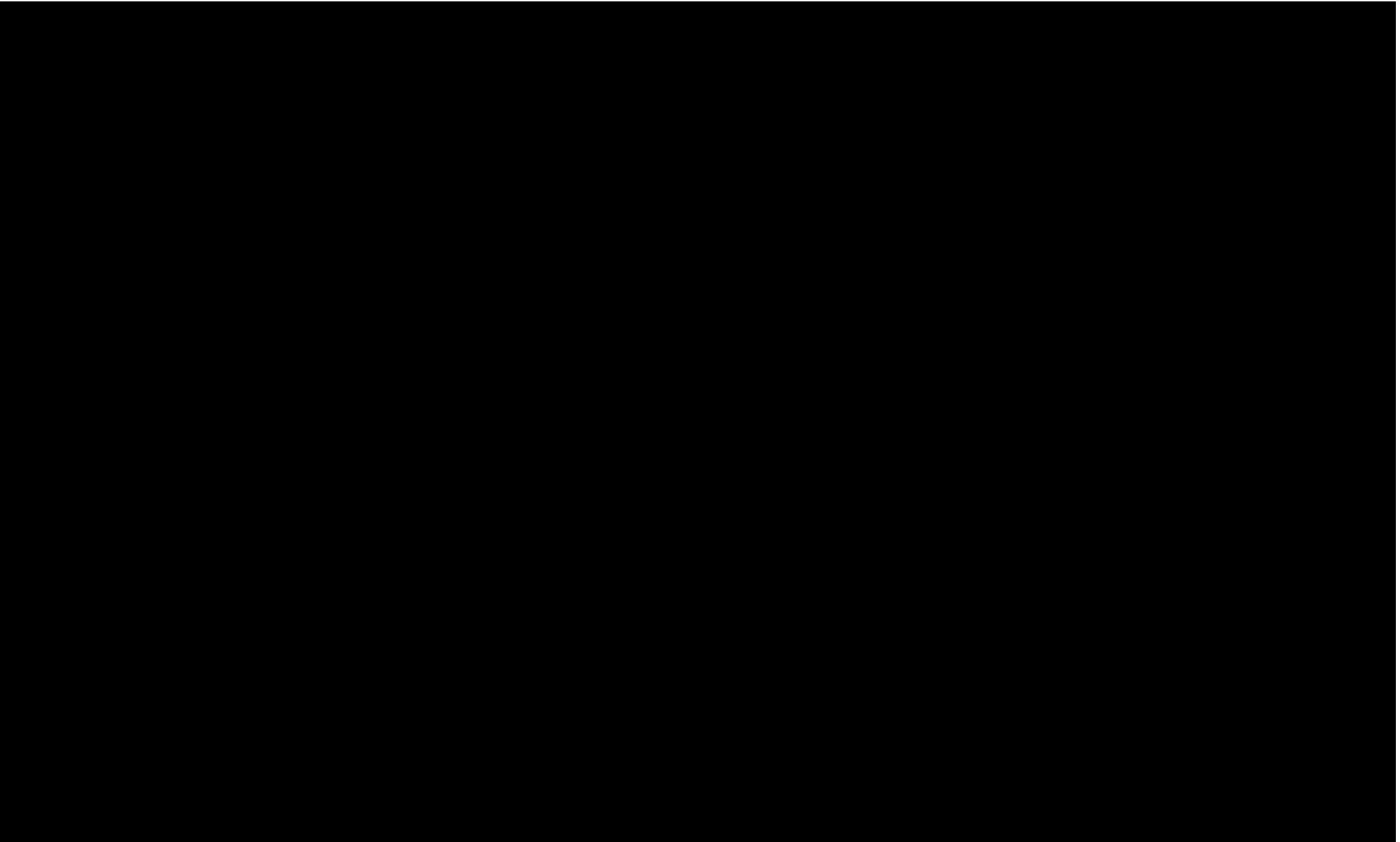
## Next Steps / Timeline

### Step #1: September-October 2020

- Determine the content, form, and timing of proposal to share with Norfolk Southern
  - Summary of proposed economic terms (e.g., lease payments, escalators, etc.)
  - Summary of other key non-economic lease terms
- Present proposal and determine next steps

### Step #2: November-December 2020

- Prepare executive summary / descriptive memorandum describing the situation / asses and approach a small number of qualified financial investors
  - Solicit preliminary feedback concerning alternative transaction structures / valuations
- Present Norfolk Southern with full draft of new lease agreement
- React to Norfolk Southern's feedback to proposal (as appropriate)



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