EDGEPOINT

RAIL INDUSTRY
Q1 ’16 UPDATE

HIGHLIGHTS

- Freight markets impacted by lower commodity shipments, particularly coal and frac sand
- Impact of economic conditions was softer earnings, equity valuations, and lower M&A activity in Q1
- Class I operators announce smaller capital budgets, but Maintenance of Way budgets deemed to have fewer cuts than equipment budgets
- Announced passenger funding for projects contributing to upbeat view on the sector for 2017 and 2018, with large scale projects in Chicago, Boston, and New York , as well as continued implementation of HSR

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Q1 2016 Overview

Business activity in the first quarter of 2016 generally followed the rail industry trend that started in early 2015, with lower reported operating metrics, revenue, valuations, and short-term industry outlook. The major freight market metrics, including freight car ton miles, declined YOY as low oil and natural gas prices have tempered the demand for frac sand, coal, and other commodities. Of the 20 commodities tracked by Association of American Railroads (“AAR”), 17 were lower in Q1 2016 than the prior year. The only significant commodities with higher freight volumes were chemicals and motor vehicles and parts.

The result of industry deterioration in Q1 2016 is that the volume of M&A transactions have declined. Q1 2016 was a slow quarter from a historical perspective as unimpressive earnings contributed to an already limited supply of available acquisition candidates. With freight volumes down, the capital budgets of the Class I Railroad Operators declined, which in turn impacted the revenue opportunity for products and service suppliers. In reaction to the lower volumes, several of the Class I Railroad Operators reduced headcount significantly. For example, BNSF reduced headcount by 4,600 in March 2016, representing a decrease in workforce of approximately 10%. Additionally, CSX and Norfolk Southern announced cuts of over 1,000 employees each. EdgePoint expects that these headcount reductions will strain the maintenance and field crew departments of Railroad Operators, creating opportunities for outsourced service providers to Railroad Operators (for example, contractors).

Passenger miles declined in Q1 2016 due to continued concern over safety after derailments by Amtrak, Altamont Corridor Express, and Tri-Rail. Furthermore, lower fuel prices make automotive travel less expensive. Nevertheless, the overall passenger transit market has been more stable, supported by a variety of public and private initiatives and activities that fund project development. The outlook for the sector is stronger, as evidenced by the valuations of publicly-traded companies that support the sector. Announcements for a number of projects, including the CTA, BART’s Fleet of the Future, and High Speed Rail in California suggests 2017 and 2018 will be good years for companies that have exposure to public transit.

North American Merger & Acquisition Activity

Q1 2016 M&A activity was down significantly compared to previous periods, with only a handful of announced or completed transactions. EdgePoint postulates that the transaction softness is directly related to 1) the freight market declines as suppliers focused on "right-sizing" their organizations, particularly relative to headcount and 2) eliminating lines that the Railroad Operators deem to be unprofitable.

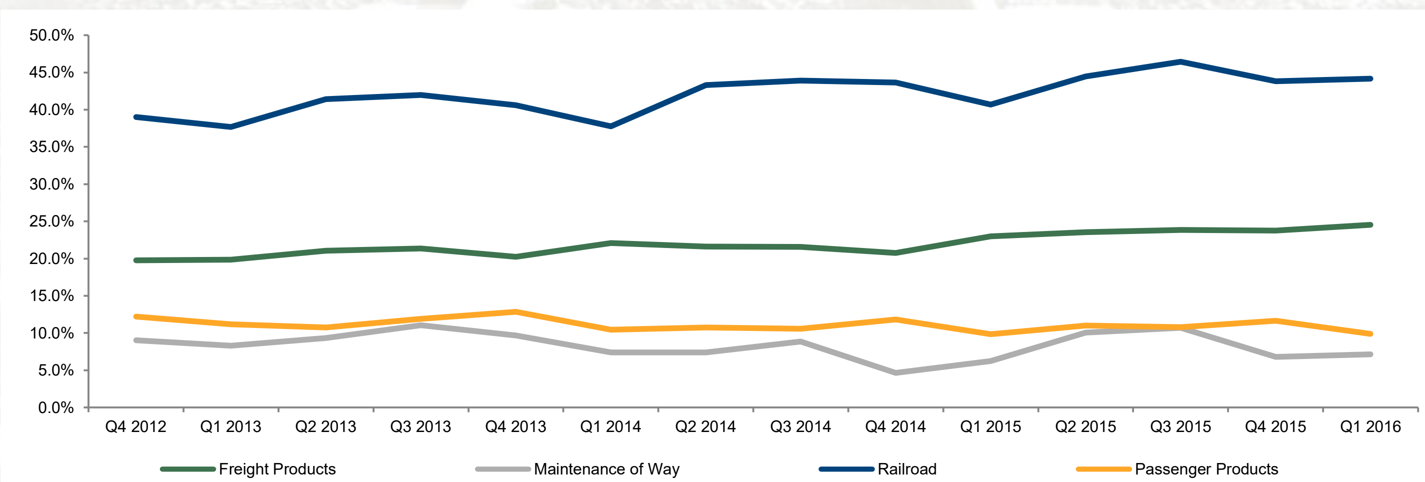
The two most notable transactions of the quarter involved private equity firms. Shortline Iowa Northern Railway Company was acquired by private equity firm Trive Capital. Located in Dallas, Trive is an experienced and respected private equity investor with an impressive portfolio of companies. The investment in Iowa Northern is interesting as private equity firms have not historically been as active in this industry, due to the capital intensity inherent in the industry. This, along with other deals and market insight, signals a change in traditional thinking about railroad investment. Furthermore, the concentration of corn and ethanol customers along the line causes EdgePoint to believe that Trive Capital is bullish on those sectors as well.

In a similar fact pattern, Allied Track Services, which is owned by private equity firm Kenex Holding, acquired AV Rail Contracting Ltd. in Q1 2016. This investment is particularly insightful to EdgePoint, illustrating the willingness of private equity firms to invest in construction and rail infrastructure exposure, two highly cyclical sectors. This supports the investment premise that rail infrastructure has solid long-term fundamentals.

Quarterly EBITDA Margin Growth

Profitability for the Rail industry, as measured by function of the EBITDA margins reported for the publicly-traded industry participants, have generally trended upwards over the historical period. Despite the significant YOY volume freight shipments declines, the profitability of the freight products sector has increased from 19.8% in Q4 2012 to 24.5% in Q1 2016.

Rail Industry Quarterly EBITDA Margins



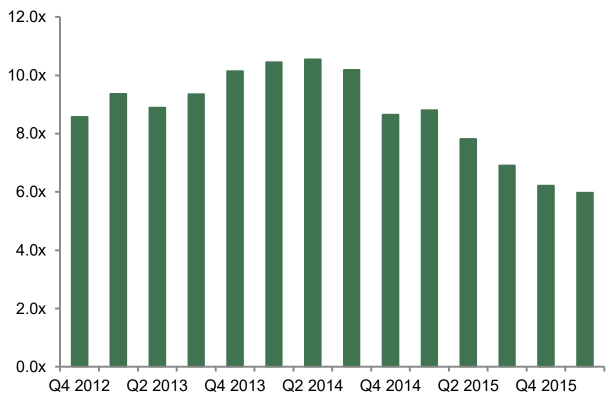
According to Equity Analysts, the improved profitability is a function of formidable headcount reductions at several of the Class I Railroad Operators. Another contributing factor to profitability was a conscious effort to streamline or eliminate less profitable lines. Norfolk Southern, for example, announced plans to abandon service on approximately 1,000 track miles, or approximately 5% of its total track miles, which the company deemed unprofitable.

Source: CapIQ, Company Press Release

Equity Valuation

Valuation declines in freight-focused rail sectors that started in Q1 2015, largely corresponding to lower frac sand and coal shipments, continued into Q1 2016. Market valuations held steady in Q1 2016, creating the prospect of valuation "bottoms" at the end of Q1 2016.

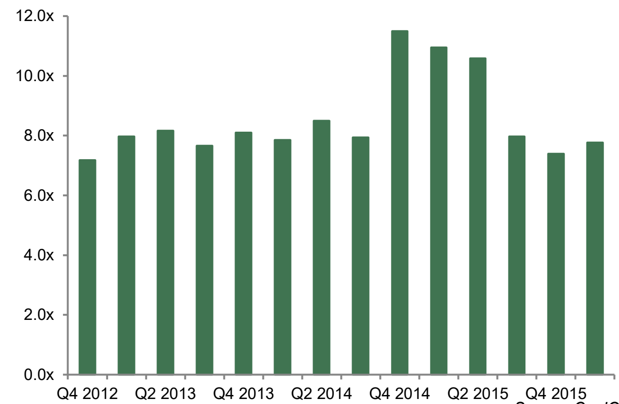
Freight Products EV / EBITDA



Source: CapIQ

The ongoing declines in valuations of freight product suppliers reached, in the opinion of EdgePoint, an unsustainable level in Q1 of 2016. The freight products industry index traded at 6.2x its TTM EBITDA in Q1 2016, a valuation level not seen since 2010. The market valuation for this sector seems too draconian, particularly when considering that sector revenues were robust in the quarter. Investor punishment of these stocks is directly related to the outlook for lower Class I Railroad Operator spending over the next two years.

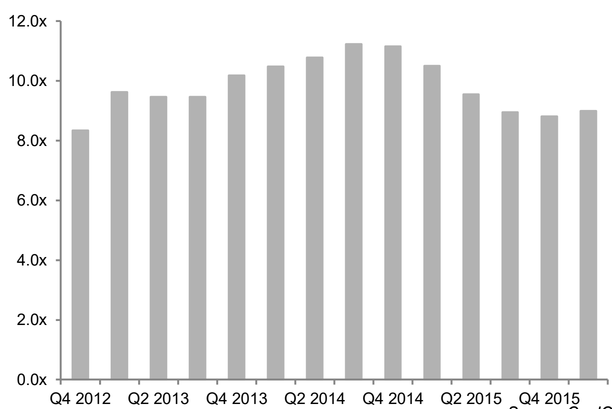
Maintenance of Way EV / EBITDA



Source: CapIQ

After spiking in 2015, the result of record-levels of capital spending from the Class I Railroad Operators, valuations for companies that supply the MOW sector remained at historic levels. Compared to the other disciplines, valuations for public registrants that service the MOW market have been stable, reflecting the market perception that MOW is a more secure rail discipline than locomotive or freight product supply. With on-going PTC implementation, wide need for continued upgrading of the rail network, and a number of transit-focused initiatives in progress, this outlook is seemingly warranted.

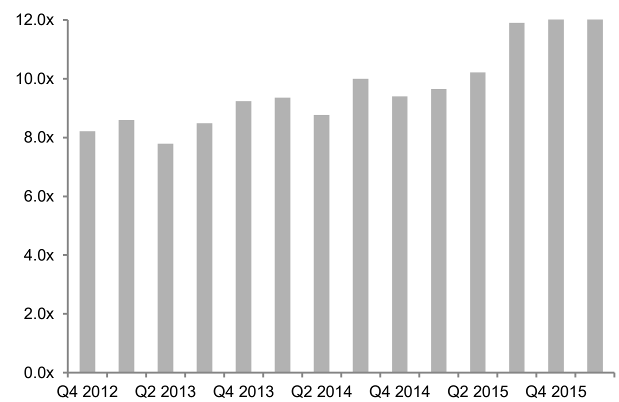
Freight Railroad Operator EV / EBITDA



Source: CapIQ

Consistent with the trends in the freight products sector, the valuations of publicly traded Railroad Operators declined from their peaks in late 2014. Despite the formidable declines in volume and revenues, which are down nearly 22% from 2014 peaks, valuations have remained reasonable for this sector.

Passenger Products EV / EBITDA



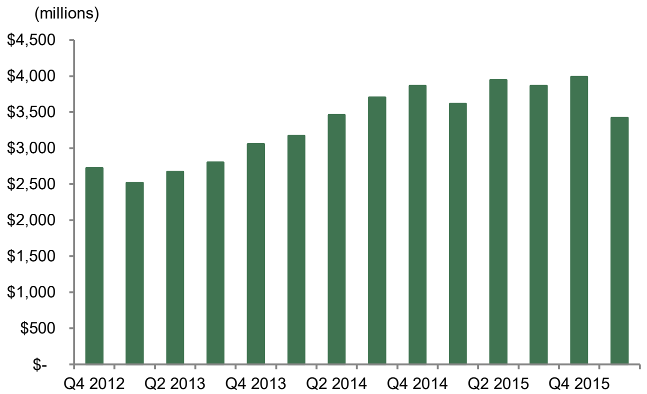
Source: CapIQ

Valuations for industry participants that service the passenger transit industry have largely increased through the last several quarters, running counter-cyclical to trends in the freight-focused sectors. With a number of high profile transit improvement projects announced in 2016, including MBTA, CTA, BART, and WSDOT, as well as increased pressure for PTC implementation at Transit Authorities, the outlook for the sector is the most favorable it has been in years.

Quarterly Revenue Growth

Publicly-traded participants in the Rail industry largely reported lower revenue year-over-year and quarter-over-quarter based upon decreased frac sand and coal shipments.

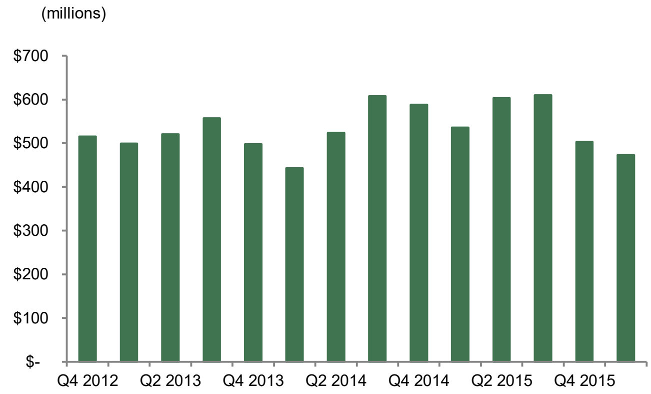
Freight Products Revenue



Source: CapIQ

Revenue in the Freight Products sector declined in Q1 2016, driven by decreases in the budgets of Class I Railroad Operators, as well as seasonality. Announced capital budgets decreased by $2.2 billion from 2015 to 2016, with a disproportionate amount of cuts hitting the equipment sector.

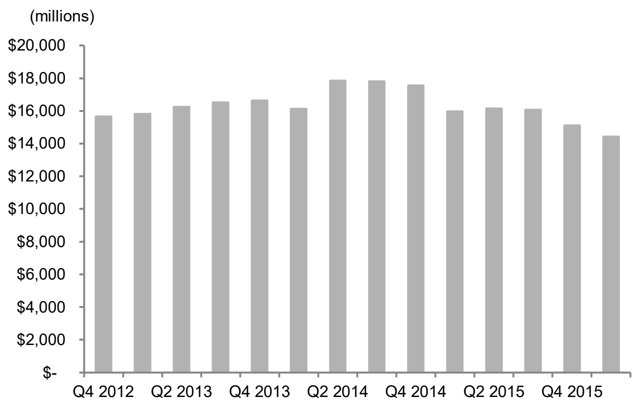
Maintenance of Way Revenue



Source: CapIQ

Revenue for Maintenance of Way sector participants continued their revenue decline in Q1 2016, the result of lower capital budgets and seasonality. Quarterly revenue in Q1 2016 is down 13% from the peak in Q2 2015. While uncomfortable, EdgePoint nevertheless recognizes that Q1 2016 revenue is on par with revenue in Q1 2014 and that Q4 2015 and Q1 2016 declines represent normal years relative to the extraordinary 2015.

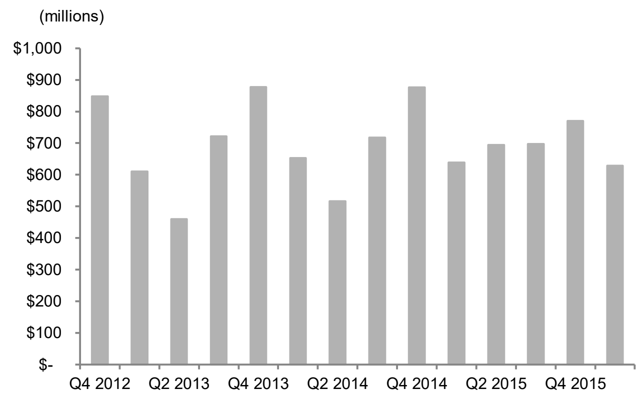
Freight Railroad Operator Revenue



Source: CapIQ

Revenues reported by the publicly-traded Railroad Operators declined in Q1 2016, largely the result of lower frac sand and coal shipments. Frac sand and coal shipments decreased 20.9% and 32.5%, respectively, on a YOY basis, from Q1 2015 to Q1 2016. This trending has translated into a number of operational changes at the Class I railroads, including headcount reductions and lower capital budgets, which have largely impacted the rest of the rail industry.

Passenger Revenue



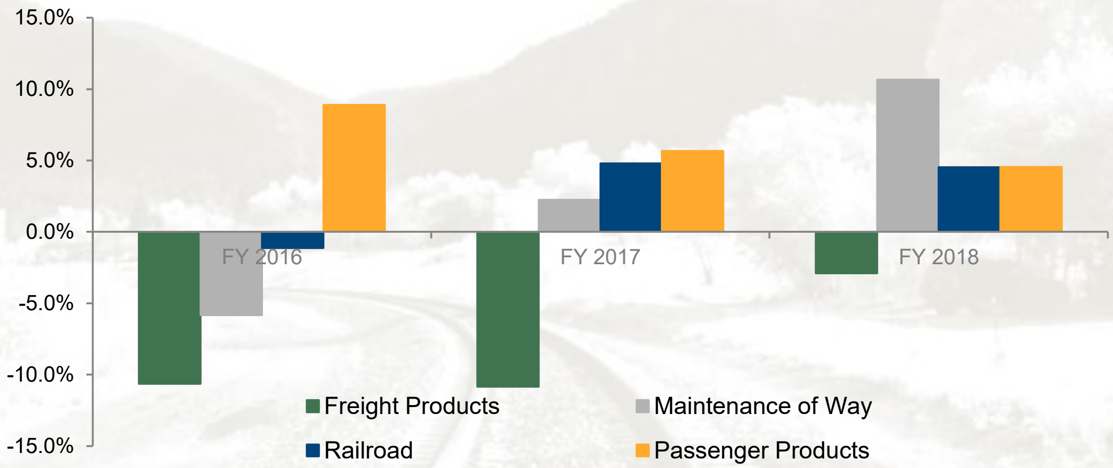
Source: CapIQ

Revenue reported by the publicly-traded passenger sector is traditionally seasonal. Q1 2016 revenue is consistent with the results reported in the first quarter of the previous four years.

2016—2018 Revenue Outlook

Rail industry analysts project negative growth rates in 2016 for all sectors (excluding passenger products), driven by lower commodity shipments (particularly frac sand and coal), smaller budgets from the Class I Railroad Operators, and a slow start to FY 2016. All sectors, besides freight products, are projected by analysts to recover in 2017 as oil and gas prices recover.

Rail Industry Index Forecasted Growth Rates, 2016-2018



Source: CapIQ, Analyst consensus

Freight Products

The Freight Products sector is expected to decline through the projection period, largely driven by the expected reduction of freight miles. It should be noted, however, that the 2016 declines occur after growth of 9% in 2015. With 2015 representing a record year for capital spending, EdgePoint considers the volumes in 2016 to represent normalized growth from 2014 levels.

Maintenance of Way

Equity Analysts forecast the Maintenance of Way sector to grow again in 2017 and 2018 for the reasons cited herein. EdgePoint observes that the decline in 2016, while uncomfortable for the industry, represents a correction after a record 2015. Even with the 7% decline, 2016 sector revenue represents only a 3% decrease from 2014.

Railroad Operators

According to Equity Analysts, revenue reported by Railroad Operators are expected to recover in 2017 as fuel price increases spur demand for more commodities, such as frac sand.

Passenger Transit

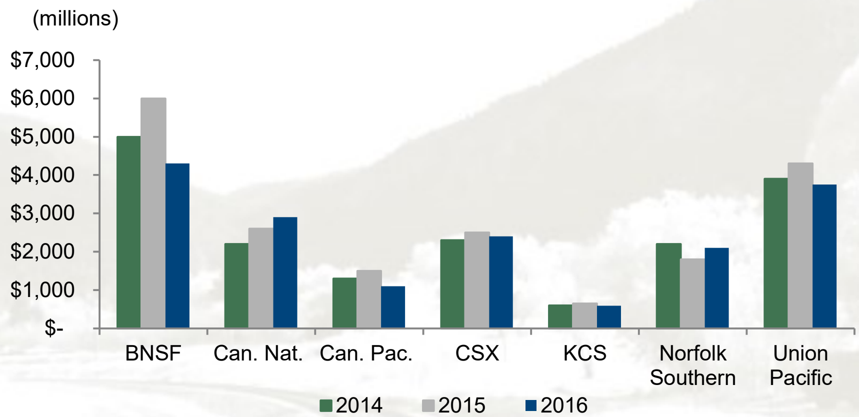
Passenger Transit growth between 2016 and 2018 is largely projected to be driven from new, high profile projects. For example, High Speed Rail, CTA, and the Regional Transportation District of Denver which represent $72.3 billion in additional sector spending.

Source: CapIQ, Morningstar

Railroad Maintenance of Way Capital Spend

Based upon Q1 announcements, EdgePoint expects that overall capital spending by the Class I Railroad Operators in FY 2016 will be approximately 11% lower than 2015 levels. BNSF announced that its capital budget in 2016 will be 26% lower than the prior year. On the other hand, Canadian National intends to increase its capital budget in 2016. A common theme for all Class I Railroad Operators is that they have allocated significant portions of their budgets towards PTC projects. For example, Union Pacific announced an allocation of 10% of its total capital budget in 2016 towards PTC implementation.

Class I Maintenance of Way Projected Budgets



Source: Progressive Railroading

BNSF Railways

- $2.8 billion to replace and maintain core network and related assets
- $600 million for locomotives, freight cars and other equipment
- $300 million for continued implementation of positive train control

Canadian National

- $1.5 billion allocated towards track infrastructure
- $600 million to be spent on rolling stock
- Approximately $400 million allocated towards positive train control implementation

Canadian Pacific

- $1.1 billion of capital expenditures expected in 2016
- Decrease is in capital expenditures is to "right-sizing" capital expenditures to revenue

CSX Transportation

- $2.1 billion for infrastructure work, equipment and growth/productivity projects
- PTC spending would receive $300 million of the projected budget

Genesee & Wyoming

- $63 million on equipment and other expenditures
- $35 million for new investments and business
- $15 million for grant matching

Kansas City Southern Lines

- Projected to build or extend sidings
- Begin two year storage-in-transit yard project for Sasol Chemicals (USA) LLC
- Continue three-year expansion at Sanchez Yard

Norfolk Southern

- $817 million for roadway maintenance
- $351 million for locomotives
- $246 million of its budget is allocated for Positive Train Control

Union Pacific

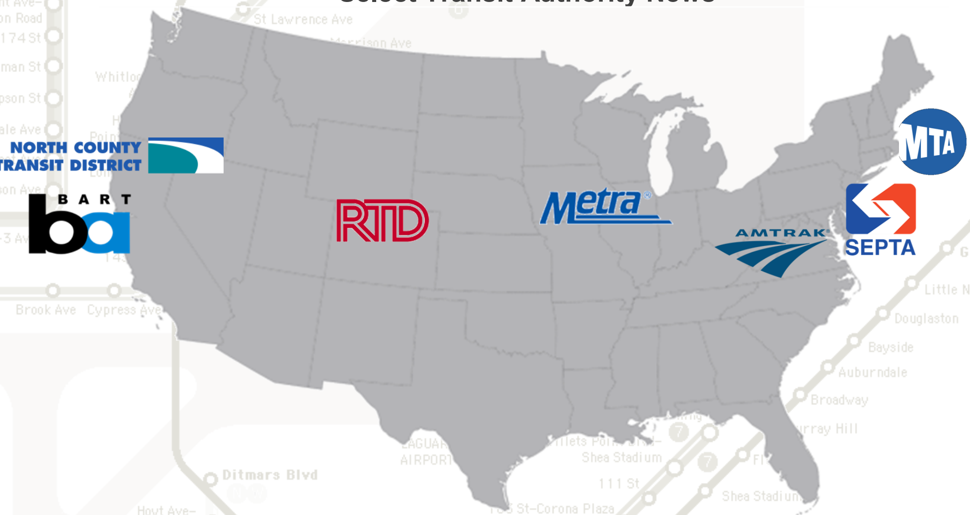
- $1.8 billion for infrastructure upgrades
- $965 million for equipment, including locomotives
- $375 million for Positive Train Control implementation

Source: Progressive Railroading

Q1' 16 Transit Authority News

Based upon announcements from leading transit authorities, EdgePoint estimates that announced funding for public transit investment is 3.4% higher than FY 2015, after adjusting for one-time purchase of new rail cars by CTA. This is driven by P3 partnerships, larger capital programs in for CTA, MTA, Metra, High Speed Rail, and the popular sales tax initiative in California, that will fund a number of transit projects.

Select Transit Authority News



BART

- The Bay Area Rapid Transit ("BART") identified $15 billion in "State of Good Repair" maintenance needs over the next 30 year
- BART has ordered 775 new cars, part of the Fleet of the Future initiative, to be phased in by 2021
- $51 million of 2016's budget is earmarked for track, stations, and other assets repairs

Metra

- Capital spending budgeted for $251 million in 2016
- 10-year $2.4 billion capital plan to overhaul rolling stock began in February 2015 ($2.1 billion for rolling stock, $400 million for PTC)

cta

- $366 million capital budget for 2016
- Decrease of $437 million from 2015 budget due to new rail cars being purchased in 2015

AMTRAK

- $980 million 2016 capital budget
- $50 million renovation plan for D.C.'s Union Station

RTD

- 2016 capital budget of $456 million
- Budget provides guideway and track elements, stations, terminals, stops, support facilities, site work, systems, vehicles and rights of way, and land improvements

SEPTA

- 2016 capital budget of $134 million
- Budget increase from 2015 of approximately $35 million due to passage of state transportation funding bill

MTA

- $360 million capital budget in 2016, which is the same as it was in 2015
- Continue all projects began in 2016, including rehabbing, replacing, and installing 18.78 miles of track

NORTH COUNTY TRANSIT DISTRICT

- $1 billion required for projects in 2016 that are scheduled to be completed by 2019
- Add, replace, and refurbish track, bridges, stations, and facilities throughout California

Source: Transit Authority Websites, Progressive Railroading

About EdgePoint

EdgePoint is a leading investment bank and advisory firm specializing in middle market merger, acquisition, divestiture, and corporate financing services for private business owners and corporations. EdgePoint is a registered broker dealer and member of FINRA and SIPC. With professional backgrounds in the country's largest investment banks, commercial banks, corporate development departments, and financial advisory firms, EdgePoint professionals offer sophisticated transactional services to the middle market.

EdgePoint is a member firm of the Alliance of International Corporate Advisors ("AICA"), an integrated global network of middle-market advisory and finance firms. With 200 professionals in 59 offices throughout the Americas, Europe and Asia, EdgePoint offers its clients global perspective and capital market access.

To learn more about EdgePoint and our services, or to discuss the content in this newsletter, please contact Paul Chameli at 216-342-5854 or at pchameli@edgepoint.com

ALLIANCE OF INTERNATIONAL CORPORATE ADVISORS

Representative EdgePoint Transactions

Sell-Side Advisory	Sell -Side Advisory	Sell-Side Advisory	Sell-Side Advisory
North Shore Track Services, Inc. *has sold to* Members of Management	General Electric *has sold its* Rail Transit Parts Business to Wabtec	ZefTek, Inc. *has sold to* Standard Car Truck Company	ImageMap, Inc. *has sold to* Mer Mec S.P.A.

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