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RE: Docket No. EP ~~661~~ 761– Hearing on Revenue Adequacy
Docket No. EP 722 – Railroad Revenue Adequacy

Dear Board Members:

Enclosed please find an Overview of my Hearing Testimony as requested by the Board in its Notice of Public Hearings issued on September 12, 2019 in the above referenced proceedings.

Sincerely,

Scott H. Group
Managing Director; Senior Transportation Analyst
Wolfe Research

Enclosure

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BEFORE THE SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 761 HEARING ON REVENUE ADEQUACY

DOCKET NO. EP 722 RAILROAD REVENUE ADEQUACY

OVERVIEW OF WOLFE RESEARCH HEARING TESTIMONY

Wolfe Research appreciates the opportunity to present before the Surface Transportation Board. The following is a summary of Scott Group's hearing testimony regarding Railroad Revenue Adequacy. Mr. Group is a Managing Director and Senior Transportation Analyst at Wolfe Research.

- **Long-term comparison of Rail vs. Truckload (TL) and Less-than-Truckload (LTL) pricing.** Since de-regulation in 1980, Rail rates are down significantly and have materially underperformed TL pricing. More recently over the past five years, Rail pricing increases have notably lagged both TL and LTL pricing increases.
- **Changing commodity mix.** Over the past 20 years, rail exposure to coal has effectively been cut in half, while intermodal now represents nearly 50% of total rail volumes (up from a third of the business 20 years ago). Thus, the rails are inherently more truck competitive today than historically.
- **Rail capital intensity.** Railroads consistently spend more capital than any other transportation industry or the broader market represented by the S&P 500. Moreover, railroad capital expenditures far exceed their depreciation costs every single year, implying that reported returns on capital are materially overstated relative returns on a replacement basis.
- **Rail comparison vs. Trucks.** Rails are significantly more fuel efficient than TLs carriers. Rails are also 10%-15% cheaper than trucks where competitive, and thus, we expect that the Rails will gain share from the highway over time, especially with recent strong rail service levels. Rails are also much more capital intensive than TL carriers as rails are responsible for maintaining their own infrastructure in addition to all rolling stock. Thus, we believe the regulatory backdrop must be supportive of the rails ability to attract private capital in order to maintain and grow their capacity.
- **Shareholder views.** Wolfe Research surveyed nearly 200 of its largest institutional clients that represent many of the largest institutional investors in railroad stocks. These investors overwhelmingly noted that they would be less likely to invest in railroad stocks if the STB were to enforce pricing caps on railroads that are revenue adequate.