

311737

ENTERED
Office of Chief Counsel
July 7, 2026
Part of
Public Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

RAILROAD COST OF CAPITAL –	)	EP 558 (Sub-No. 29)
2025	)	

**REPLY STATEMENT
OF THE WESTERN COAL TRAFFIC LEAGUE**

WESTERN COAL TRAFFIC LEAGUE

Josefina Walker
President

William L. Slover
Robert D. Rosenberg
Slover & Loftus LLP
1828 L Street, N.W., Suite 1000
Washington, D.C. 20036
(202) 347-7170

Attorneys for the
Western Coal Traffic League

Dated: July 7, 2026

BEFORE THE
SURFACE TRANSPORTATION BOARD

RAILROAD COST OF CAPITAL -	)	EP 558 (Sub-No. 29)
2025	)	

REPLY STATEMENT OF THE WESTERN COAL TRAFFIC LEAGUE

Pursuant to the notice that the Surface Transportation Board (“STB” or “Board”) served in the above-captioned proceeding on March 20, 2026, and its subsequent decision served June 10, 2026, the Western Coal Traffic League (“WCTL”)¹ hereby replies to the opening statement that the Association of American Railroads (“AAR” or “Railroads”) originally submitted on May 22, 2026, as refiled on June 17, 2026.

I. INTRODUCTION AND SUMMARY

WCTL appreciates that the Board afforded the AAR an opportunity to correct its beta calculation and related values for the cost of equity (“COE”) under both the Capital Asset Pricing Model (“CAPM”) and the hybrid CAPM/MSDCF (Multi-Stage Discounted Cash Flow model) and the overall cost of capital (“COC”). Each value increased due to the AAR’s correction of its spreadsheet errors. WCTL has consistently advocated for an accurate COC and does not object to the Board’s affording the AAR an opportunity — or

¹ WCTL is a voluntary association, whose regular membership consists entirely of shippers of coal mined west of the Mississippi River that is transported by rail. WCTL’s members are: Ameren Missouri, Arizona Electric Power Cooperative, Inc., Austin Energy (City of Austin, Texas), CLECO Corporation, CPS Energy, Entergy Services, Inc., Evergy, Inc., Lower Colorado River Authority, MidAmerican Energy Company, Minnesota Power, Nebraska Public Power District, and Western Fuels Association, Inc.

directive — for correction. But if Board affords railroads such opportunities, they should be no less available for shippers. *E.g., Intermountain Power Agency v. Union Pacific Railroad Company*, NOR 42127 (STB served Apr. 2, 2012), at 2 (denying rate complainant’s petition to supplement evidence to address, *inter alia*, technical spreadsheet linking error because “[i]t is the duty of the complainant to make its best case on opening”); *Duke Energy Corp. v. CSX Transp., Inc.* NOR 42070 (STB served March 21, 2003), at 4 (granting motion to strike portions of complainant’s rebuttal and explaining that petition to supplement evidence requires demonstration that the additional material, *inter alia*, “could not reasonably have been introduced earlier”).

For present purposes, WCTL otherwise finds no other significant errors in the AAR’s mathematical calculations implementing the Board’s established cost of capital methodology. Moreover, the AAR’s filing, even with the corrections, shows a significant decrease in the cost of capital from 2024. The overall COC of 9.79% is the fourth lowest since the Board adopted its hybrid COE methodology starting 2007, despite relatively high inflation as reflected in a cost of debt (“COD”) of 5.27% that is the second highest since 2009.

Even so, the Board’s methodology continues to yield an inaccurate and overstated COC due to its miscalculation of the cost of equity (“COE”) component. The COE error stems from flaws, especially in the continued use of the MSDCF and in the implementation of the CAPM, particularly the use of the historical market risk premium (“MRP”) that substantially exceeds the returns that investors currently expect to achieve in the current market environment.

The MSDCF is not properly specified for the railroad industry. Even if it were, its results would still be tainted by the use of improper inputs, particularly earnings per share (“EPS”) growth rates that are distorted by stock repurchases or buybacks and other defects. The degree of buyback distortion is difficult to quantify because Refinitiv conceals the identities of each analyst that provided an EPS growth estimate used in the AAR’s calculations. The resulting inability to identify and review the reports means that the data and resulting calculations lack transparency, supposedly one of the Board’s objectives in its COC methodology. The EPS growth projections are more unrealistic because the AAR’s cashflow “smoothing” calculations show that cashflow and earnings have not grown over the past five years, but have instead decreased, further confirming the unsuitability of the MSDCF’s EPS growth rates and the resulting COE.

A similar distortion is the Board’s refusal to treat operating leases as debt. Here, again, the Board deviates from the practices of the railroads themselves, as both CSX and UP include operating leases for calculating their ROIC (return on invested capital), which is equivalent to the Board’s calculation of ROI (return on net investment) for measuring revenue adequacy. *E.g.*, CSX 10-Q for 1Q26, <https://d18rn0p25nwr6d.cloudfront.net/CIK-0000277948/c8a1099f-64ef-4eec-b58e-cfef147c60fe.pdf>, at 12; UP Annual Report for 2025, <https://investor.unionpacific.com/static-files/298c6a8f-fbca-4638-ac75-f80f2b9b7d10>, at 30.

The AAR’s resulting overall cost of capital figure of 9.58% remains substantially above the 7%-range values calculated by Morgan Stanley and others, the 8% value used

by CSX in its current and recent annual reports, and the values used by UP and NS in their merger proxy materials.

The Board should not utilize a cost of capital that consistently exceeds what investors and the railroads themselves use to determine whether to invest in the railroads, to purchase another railroad, and to compensate their executive management. Review and correction of the methodology is also needed to comply with White House Executive Orders directing administrative agencies to revise regulations that reduce competition and produce anticompetitive results that harm consumers and markets, particularly for energy resources such as those that WCTL members ship by rail.

II. THE AAR'S COSTS OF EQUITY AND CAPITAL DEVIATE SHARPLY FROM RESPECTED BENCHMARKS, INCLUDING THOSE THE RAILROADS USE THEMSELVES

Railroads are said to compete with firms in other industries for investor capital. To that extent, an appropriate starting point for reviewing the railroad COE and COC is to consider the expected return that railroads and equities generally need to offer in order to attract or retain investment.²

In particular, Morgan Stanley continues to present weighted average cost of capital values for individual railroads. For the end of 2025, CSX was the only railroad of the

² The railroads in the composite sample have not needed to raise outside equity capital for many years and instead rely on revenues extracted from customers and debt issuances. The portion of those revenues devoted to shareholder distributions (dividends and buybacks) far exceeds that used for capital expenditures. Reductions in the COE are thus unlikely to result in diversion of funds from capital expenditures to non-railroad expenditures, particularly as the railroads have already reduced those expenditures through their pursuit of Precision-Scheduled Railroading ("PSR") to reduce their operating ratios, at the expense of growing their volumes. Most railroad rates are not

three in the composite sample for which Morgan Stanley provided a value since the firm was advising UP in its acquisition of NS, the two other firms in the composite sample, in their proposed merger.³ The value for CSX was 7.3%, the same that it has been in recent years.

The Form S-4 for UP's proposed acquisition of NS, available at <https://investor.unionpacific.com/sec-filings/sec-filing/s-4/0001193125-25-204376>, presents Morgan Stanley values of 9.5% for NS's COE (p. 116) and 9.0% for UP's COE (p. 120). Both these COE values are lower than the weighted average COC presented by the AAR.⁴ The Morgan Stanley values are those that UP intends for investors to rely upon in approving the proposed merger, and they are lower than what the AAR calculates using the STB's methodology.

The Morgan Stanley values are high compared to those calculated by others. For example, Professor Aswath Damodaran, the highly respected corporate finance professor

regulated (the basis for the Board's statements that "circularity" in the MSDCF growth estimates is supposedly not a concern). The extraordinary returns that the railroads continue to extract provide more than ample incentive for the railroads not to kill their "golden goose." For example, UP's return on equity in 2025 exceeded 40%. UP Annual Report for 2025 at 35, <https://investor.unionpacific.com/static-files/a2cb1cb7-48df-4487-bac5-fa0ba9cdbc03>.

³ The Morgan Stanley fairness opinion appears at page 655 of Volume I of the UPNS refiled merger application.

⁴ The Morgan Stanley S-4 also presents a range between 7.8% and 8.6% for NS's weighted average cost of capital (p. 117), and a range between 8.0% and 10.0% for UP's weighted average cost of capital (p. 142). The upper ranges of the values are highly suspect, *e.g.*, if the maximum cost of equity value for UP is 9.6%, then the overall cost of capital should be lower, not higher, as the cost of equity is the most expensive component of the cost of capital.

at New York University's Stern School of Business, identifies a cost of equity of 8.30% for United States railroads and an overall cost of capital of 7.27%. *See* https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/wacc.html.⁵ The 7.27% is very much in line with what Morgan Stanley has previously calculated for UP and NS and with what Morgan Stanley continues to calculate for CSX. For the end of 2024, Morgan Stanley had values of 7.1% for NS and 6.9% for UP, as shown in the comments WCTL filed for the railroad cost of capital for 2024. Morgan Stanley's *4Q25 Preview: Let's Try This Again* (Jan 8, 2026), shows weighted average cost of capital values of 7.3% for CSX, 7.0% for CN, and 6.5% for CPKC. Excerpts of the report are included as Exhibit A.

Goldman Sachs, in a widely reported October 2024 research note by then-chief U.S. equity strategist David Kostin, projected that the S&P 500 would deliver an annualized nominal return of just 3% over the next ten years. *See* <https://www.gspublishing.com/content/research/en/reports/2024/10/18/29e68989-0d2c-4960-bd4b-010a101f711e.html>. Goldman Sachs subsequently revised this estimate upward to 6.5% annualized in a November 2025 report. *See* <https://www.gspublishing.com/content/research/en/reports/2025/11/12/0c292cc7-ce42-4fba-a026-744231e9f4f4.html>. The 12.15% return for the market as a whole implied by the AAR's CAPM (the combination a 4.78% risk-free rate ("RFR") and a 7.37% historical MRP is nearly double the Goldman Sach's forecasted return of 6.5%. A

⁵ Professor Damodaran includes four railroads in this category.

CAPM value premised on an overall return nearly twice that projected by leading Wall Street investment firms cannot be said to provide an accurate reflection of investor expectations or depiction of the opportunity cost of capital.

For its part, CSX continues to use a long-term weighted average cost of capital of 8% in its annual report for calculating its Economic Profit for its investors. *See* https://s2.q4cdn.com/859568992/files/doc_financials/2025/ar/2025-csx-annual-report.pdf, at 46-47 (pp. 34-35 of 10-K) (specifying 8% as the “required return ... consistent with rates used for investment decisions and performance evaluation”).

Moreover, the values can be easily approximated by using the AAR’s other CAPM inputs with the current equity risk premium of 5.0% adopted by Kroll Duff & Phelps as of September 2, 2025:⁶

Table 1				
Derivation of Cost of Capital for Industry Composite Sample Using Damodaran MRP and RFR (10-year) and AAR RFR, Beta, Capital Structure, and Cost of Debt				
CAPM Cost of Equity		Industry Cost of Capital		
Risk-Free Rate	4.78%	Component	Weight	Cost
Market-Risk Premium	5.00%	Debt	17.85%	0.942%
Beta (Composite Sample)	0.7298	Equity	82.15%	6.92%
Cost of Equity	8.43%	Average COC		7.87%

The workpapers for Table 1 are at the “Table 1” tab of the electronic workpapers.

Shippers should not be burdened with a cost of capital that exceeds that utilized by the market and the railroads themselves. Requiring customers to provide a surplus return

⁶ *See* <https://edge.sitecorecloud.io/krolllllc17bf0-kroll6fee-proda464-0e9b/media/Cost-of-Capital/kroll-uk-erp-rf-table-new-2022-updated.pdf>.

to the railroads in order to obtain reasonable rates and related regulatory relief is inherently anticompetitive and monopolistic. Even though the AAR's COC is reduced by 89 basis points from the Board's 2024 determination, the AAR's value for 2025 remains overstated by at least 200 basis points.

III. THE MSDCF CALCULATIONS AND INPUTS REMAIN FLAWED BY BUYBACKS AND OTHER DEFECTS

WCTL has explained that the MSDCF COE values in the past have been flawed by unrealistic EPS growth rates that reflected the reduction in shares due to buybacks, and not growth in firm-wide earning and cashflows. Firm-wide earnings are appropriate insofar as the MSDCF otherwise utilizes firm-wide earnings, cashflow, and initial market capitalization. Additional specification problems are the absence of a true transition in the second stage of the MSDCF, which uses the simple average of first-stage growth rates, as opposed to phase-in to the terminal growth rate, and the abrupt transition to earnings for calculation of the terminal cashflow.

The specification problems are partially mitigated in 2025 because of the reduced disparity between the second stage (*i.e.*, average first stage) growth rate of 6.640% and the third stage growth rate of 5.570%. *See* Appendix O to Verified Statement of AAR Rand Ghayad ("Ghayad VS"). The reduced disparity, and the overall reduction in first stage growth rates compared to 2024 and earlier years, may be due to the reduction, perhaps fleeting, in buybacks, associated with UP's proposed acquisition of NS. *E.g.*, <https://www.investors.com/news/norfolk-southern-stock-transcontinental-railroad-union-pacific-buyout/> ("In the meantime, Union Pacific said it would halt stock buybacks, a

modest negative for near-term earnings, because the deal will push debt to about 330% of earnings before interest, taxes, depreciation and amortization. Share repurchases wouldn't resume until at least some time in 2028.”). The concealment of the identity of the analyst growth estimates forecloses a more detailed analysis of the role played by buybacks or their temporary cessation. Ghayad VS, Appendix L, at 2-4.

Even so, the 6.640% average first stage growth rate is problematic compared to the actual growth, or lack thereof, that the three railroads have achieved in recent years in both their cashflow and earnings, as the AAR’s cashflow smoothing calculations reveal:

Table 2						
Railroad Cash Flow Growth Analysis						
Railroad	Year 1	Year 2	Year 3	Year 4	Year 5	Growth
	2021	2022	2023	2024	2025	CAGR
CSX	3,577	3,603	3,144	2,611	1,861	-15.1%
NSC	2,900	2,626	749	1,770	2,339	-5.2%
UP	5,949	5,886	5,208	5,721	6,053	0.4%
Total	12,426	12,115	9,101	10,102	10,253	-4.7%

Railroad Net Income Growth Analysis						
Railroad	Year 1	Year 2	Year 3	Year 4	Year 5	Growth
	2021	2022	2023	2024	2025	CAGR
CSX	3,781	4,114	3,668	3,470	2,889	-6.5%
NSC	3,005	3,270	1,827	2,622	2,873	-1.1%
UP	6,523	6,998	6,379	6,747	7,138	2.3%
Total	13,309	14,382	11,874	12,839	12,900	-0.8%

Source: Ghayad VS, Appendix O. Values other than years and percentages represent \$ millions.

The workpapers for Table 2 are at the tab “Table 2” of the electronic workpapers.

The lack of earnings growth over a sustained period of time renders the AAR’s growth rates highly suspect. The terminal growth rate is also implicated since the composite sample failed to achieve growth over the past five years, despite both

significant inflation and real growth in the economy as a whole.⁷ The lack of growth also undermines the basis for redefining cashflow as earnings in the third stage. Since the railroads did not achieve overall earnings or cashflow growth in the past five years, and are not projected to achieve outsize growth (even on an EPS basis) in the first two stages of the MSDCF, there is no basis to posit that cashflow should suddenly surge when the railroads enter the ostensibly stable environment of the terminal stage.

Even accepting that investors act based on current expectations more than past performance, the discrepancies are too large to be swept aside.

IV. THE STB'S CAPM REMAINS FLAWED BY THE USE OF A HISTORIC MARKET RISK PREMIUM

The AAR's CAPM uses a historic MRP of 7.37% that is inherently problematic. It stems from 1926 and thus covers just under a hundred years, rendering it largely insensitive to recent trends, developments, and investor expectations, including changes in interest rates, inflation, market returns, and investor expectations. The AAR combines the 4.78% RFR (based on the yield on 20-year U.S. Treasury bonds) with a 7.37% MRP to yield a standard return for equities of 11.85%, and then adjusts the MRP downwards by the 0.7298 railroad beta for the composite sample to yield a CAPM COPE of 10.16%.

⁷ To give some data benchmarks, the AII-LF increased by 15.17% over the period from 4Q21 to 4Q25 (110.1/95.6) or a CAGR of 3.59%, the GPD-IPD increased by 15.75% (130.624/112.847) or a CAGR of 3.72%, and real GDP increased by 9.35% (24,055.749/21,998.737 or a CAGR of 2.26%. *E.g.*, <https://www.aar.org/wp-content/uploads/2026/03AII-LF-2026Q2.pdf> (AII-LF), <https://fred.stlouisfed.org/series/GDPDEF> (GDP-IPD), and <https://fred.stlouisfed.org/series/GDPC1> (real GDP). Growth rate calculations are shown at tab "Other Growth Rates" of the electronic workpapers.

Notably, the 10.16% exceeds the Morgan Stanley values presented in the UP S-4 to acquire NS, as discussed *supra*.

The key source of deviation is the historic MRP. As noted *supra*, Kroll recommends a MRP of 5.0%. Professor Damodaran uses the 10-year Treasury yield for the RFR, but his combined RFR and MRP totals 8.43%, as contrasted with the AAR's 12.15%. Professor Pablo Fernandez of the IESE Business School conducted a survey in which 1,079 responses identified an average required return (sum of RFR and MRP) of 9.6% and a median of 9.5%. As noted *supra*, Goldman Sachs projects a ten-year return for the equities marked as a whole of 6.5%, slightly less than half of that specified in the CAPM. The AAR's CAPM falls far outside the range of the other estimates.

The Board has defended its use of the historic MRP as representing a long-term average, but it uses a current RFR, rather than a historical one. The historic MRP does not reflect current conditions or expectations, which is the Board's justification for using earnings projections (of an uncertain sort) in the MSDCF, notwithstanding little or negative growth in past years.

The deviation between the cost of capital values adduced under the Board's methodology and those utilized by investors, the railroads, and the Board itself elsewhere is more than sufficient to support a Board-initiated reexamination of its deficient methodology, all the more so in view of operative White House executive orders that the Board has relied upon to initiate other rulemaking proceedings.

V. CONCLUSION

Adherence to the Board's established methodology is not sufficient to establish that the resulting COE and COC values for 2025 are accurate or even plausible. On the contrary, the CAPM values rest on an assumed return for the market as a whole that vastly overstates the equity returns that investors can reasonably expect to achieve or demand. The MSDCF inputs are even more problematic in that EPS growth rates are an inappropriate input and are contradicted by recent railroad performance. The ultimate results are not believed by analysts, respected experts, or even the railroads themselves, and the Board actually utilizes the values that WCTL recommends for other purposes.

The flaws in and lack of basic plausibility of its cost of capital methodology should command the Board's attention, especially as immunizes monopoly returns and imposes noncompetitive burdens on customers and the economy.

Respectfully submitted,

WESTERN COAL TRAFFIC LEAGUE

Josefina Walker
President

William L. Slover
/s/ Robert D. Rosenberg
Slover & Loftus LLP
1828 L Street, N.W., Suite 1000
Washington, D.C. 20036
(202) 347-7170

Attorneys for the
Western Coal Traffic League

Dated: July 7, 2026

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of July 2026, I have caused true and accurate copies of the foregoing document to be served upon all parties on the service list in EP 558 (Sub-No. 29) by first class mail, postage prepaid, or by more expeditious means.

/s/ Robert D. Rosenberg

Exhibit A

**Excerpts from Morgan Stanley Report
on Freight Transportation for North America,
4Q25 Preview: Let's Try This Again (January 8, 2026)**

January 8, 2026 05:03 AM GMT

Freight Transportation | North America

4Q25 Preview: Let's Try This Again

After 3 years of tough Transports previews, 4Q25 is likely to be a different beast, with a strong end to peak season and a surge in truck spot rates setting the stage for rare positive surprises. The key debate will be how transitory or structural the tailwinds are likely to be.

Key Takeaways

- Peak season strength and weather-driven tightness pushed TLFI and rates to multi-year highs, but expectations are elevated with transport stocks up materially.
- Mgmt. teams remain cautious on demand, leaving open the question of whether recent strength reflects a durable upcycle or another short-lived headfake.
- TL and LTL results are the key focus, with supply tightness and early 2026 rate discussions potentially supportive even without overtly bullish guidance.
- Rails, 3PLs and Parcel show mixed setups, with rail vols pressured, broker margins challenged, and parcel benefiting from peak but facing structural headwinds.
- Our key calls are KNX (+/?), CN (-/=), SAIA/LTLs (-), UPS (+/?), and RXO (+/=).

Transports stocks face a higher bar going into 4Q25 earnings. On the face of it, the circumstantial evidence looks very strong. Led by a strong end to peak season and adverse weather in late December, our TLFI index ended 2025 at the highest levels since mid-2022 and DAT spot/contract rates ended 2025 at the highest levels since 2022 and 2023, respectively. The stocks have also at least partially responded with the group up 13% since our last preview (up 6% in Dec). However, **the coast remains unclear as the debate continues as to whether this is yet another headfake** (similar to the post-election surge and weather disruptions that drove the last TLFI/rate spike in Dec 2024-Jan 2025) **or if this is something more real.** Mgmt. teams have been unwilling to bite so far with most playing down any December positives and others still flagging conditions are near-recessionary. Ultimately – as we laid out in our [2026 Outlook](#) – **Demand will need to lead us into a definitive upcycle though Supply is currently doing its best to set the stage for Demand to shine.** Similar to the strong start to 2025 that fizzled out with tariffs, the group will want to try again to retain the momentum this time. **We would be surprised if the debate was definitively resolved during the 4Q25 earnings season** given mgmt. teams are likely to remain circumspect on predicting demand but the street may actually cheer talking down trends and conservative guides. We are looking for 9 beats, 8 misses and 7 in-line prints this quarter.

Key takes by vertical:

MORGAN STANLEY & CO. LLC

Ravi Shanker

Equity Analyst

Ravi.Shanker@morganstanley.com

+1 212 761-6350

Nancy Hipp

Research Associate

Nancy.Hipp@morganstanley.com

+1 212 761-1311

Madison J Pasterchick

Research Associate

Madison.Pasterchick@morganstanley.com

+1 212 761-3787

Katherine Bell

Research Associate

Katherine.Bell@morganstanley.com

+1 212 761-5618

FREIGHT TRANSPORTATION

North America

Industry View

Attractive

Please see estimate changes in [Exhibit 2](#)

Morgan Stanley does and seeks to do business with companies covered in Morgan Stanley Research. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of Morgan Stanley Research. Investors should consider Morgan Stanley Research as only a single factor in making their investment decision.

For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.

Risk Reward – CSX Corporation (CSX.O)

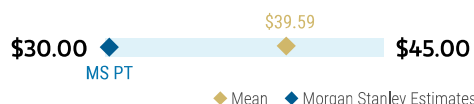
New Opportunities Meet Structural Risks

PRICE TARGET \$30.00

We use a 10-year DCF assuming 7.3% WACC and terminal cash flow perpetual growth rate of 1.5%. Our DCF valuation implies a fwd P/E of ~16x, which is modestly below CSX's historical average. We believe US rails deserve to trade at discounts to historical valuation due to structural growth and pricing headwinds relative to history.

Consensus Price Target Distribution

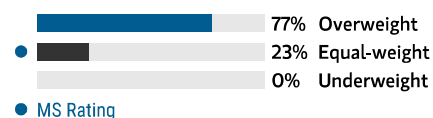
Source: Refinitiv, Morgan Stanley Research



EQUAL-WEIGHT THESIS

CSX will be on investors' radar in 2026 on two fronts. 1) New CEO Angel comes in with high expectations and with the expensive and disruptive growth projects behind them, the market will be expecting volume wins, esp. if the upcycle shows up 2) what role CSX plays in Rail M&A, both current and potential, will also impact the premium that the stock trades at. We believe the current valuation is rich on fundamentals alone so the market will need good news on both 1 and 2 above to keep the stock afloat.

Consensus Rating Distribution



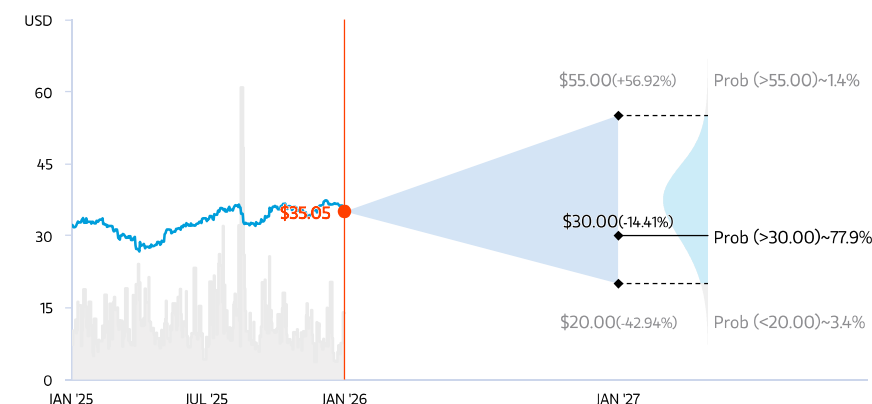
Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Contrarian: *Negative*
Secular Growth: *Negative*

View descriptions of Risk Rewards Themes [here](#)

RISK REWARD CHART AND OPTIONS IMPLIED PROBABILITIES (12M)



Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research, Morgan Stanley Institutional Equities Division. The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of 7 Jan 2026. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in either three-months' or one-years' time. View explanation of Options Probabilities methodology [here](#)

BULL CASE

\$55.00

22x Bull Case on NTM EPS

The upcycle begins. Demand snaps back in mid-2026 and freight supply continues to tighten at the same time, driving the robust upcycle we have been waiting for. Volumes see broad upside and IM is able to better compete against truck even with a sharp upcycle. Pricing accelerates and cost inflation moderates more materially at least on a per carload basis as CSX delivers operating leverage.

BASE CASE

\$30.00

~16x Base Case on normalized EPS

Supply catalysts tip the scales. The demand side remains tepid tracking normal seasonality while the supply side continues to tighten and gradually pushes rate upward. Revenues are up LSD/MSD% y/y reflecting LSD in volumes (as Rails lose share to truck as is typical of upcycles) and LSD yield growth and OR sees healthy improvement y/y, resulting in EBIT up HSD% y/y.

BEAR CASE

\$20.00

12x Bear Case on NTM EPS

Status quo continues. The cycle continues where it left off ending 2025, the freight supply side catalysts fizzle out and earnings track normal seasonality from the end of 2025. Industrial/bulk commodity end markets are hit the most while IM suffers from even more competition with truck as pricing fails to inflect materially higher. CSX falls short of revenue and EBIT expectations given volume softness and higher than anticipated cost inflation.

Risk Reward – Canadian National Railway Co. (CNR.TO)

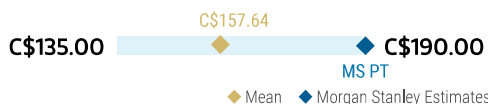
Reset Bar Brings New Opportunities

PRICE TARGET C\$190.00

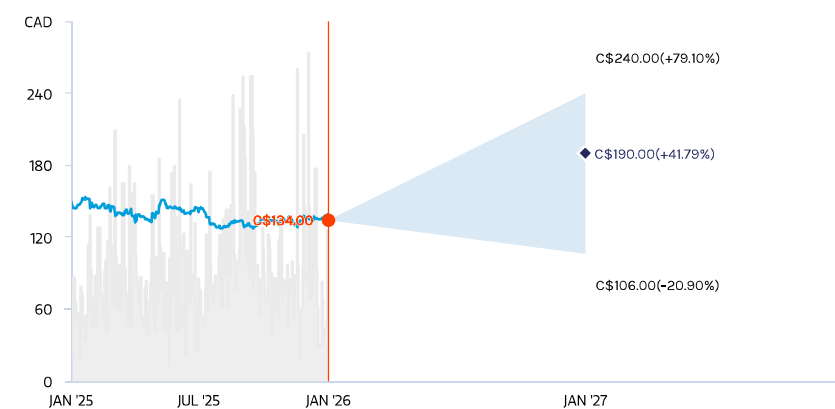
We use a 10-year DCF assuming 7% WACC and terminal cash flow perpetual growth rate of 2%. Our DCF valuation implies P/E of ~22x on normalized EPS which is above CNR's 5-year average, reflecting our view that CNR is the best positioned rail against industry disruption.

Consensus Price Target Distribution

Source: Refinitiv, Morgan Stanley Research



RISK REWARD CHART



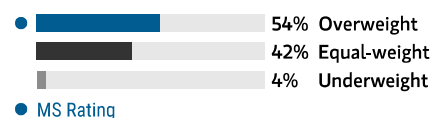
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

OVERWEIGHT THESIS

2026 will be a critical year for CNR. The last 2 years have brought much volatility and some investor frustration, which we believe is unwarranted as CNR's EPS CAGR has actually been mid pack vs. peers. Following mgmt.'s reset expectations in late 2025, the stock goes into 2026 with the best bar that it has had in years. The upcycle should be able to demonstrate CEO Robinson's strategy for the first time despite being in the seat for several years (all of which were a downturn) while another noisy year of cuts could spark the call for more change. We are confident in execution and see CNR as the best risk-reward within Rails esp. given its attractive valuation vs. its historical premium.

Consensus Rating Distribution



Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Contrarian: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE

C\$240.00

24x Bull Case on NTM EPS

The upcycle begins. Demand snaps back in mid-2026 and freight supply continues to tighten at the same time, driving the robust upcycle we have been waiting for with Industrial/bulk commodity, crude, and Intl IM end markets keeping pace. Easier operating conditions and strong execution result in stronger than expected OR performance while mgmt. also grows topline above expectations on top of stronger volumes. A higher multiple proves sustainable.

BASE CASE

C\$190.00

~22x on Normalized EPS

Supply catalysts tip the scales. The demand side remains tepid tracking normal seasonality while the supply side continues to tighten and gradually pushes rate upward. Revenues grow MSD% driven by LSD volume and pricing growth as CN benefits from company specific initiatives and an easy comp. Mgmt. is able to deliver low-teens EPS growth as they achieve healthy OR improvement

BEAR CASE

C\$106.00

18x Bear Case on NTM EPS

Status quo continues. The cycle continues where it left off ending 2025, the freight supply side catalysts fizzle out and earnings track normal seasonality from the end of 2025, with industrial /bulk commodity, crude and Intl. IM end markets hit the most. Mgmt. finds some potential to cut costs but tough operating conditions and limited ability to grow topline hinders OR's ability to meet expectation. Valuation proves too elevated.

Risk Reward – Canadian Pacific Kansas City Ltd (CP.TO)

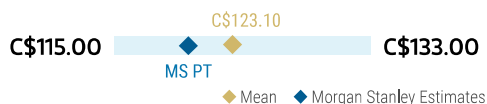
Generational Opportunity With More Realistic Expectations

PRICE TARGET C\$120.00

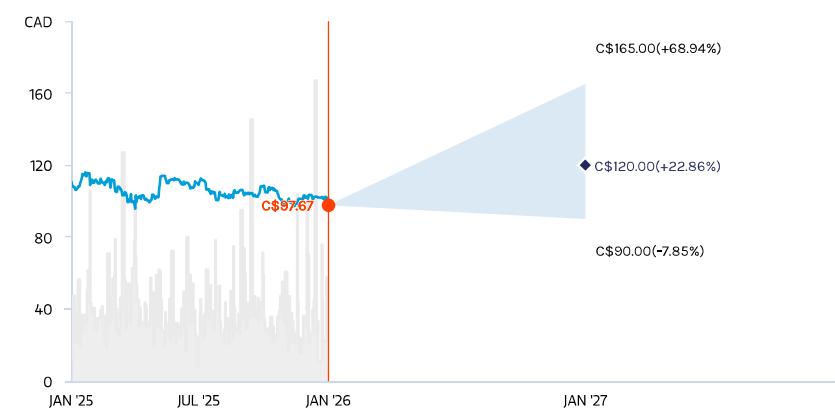
We use a 10-year DCF assuming 6.5% WACC and terminal cash flow perpetual growth rate of 2.0%. Our DCF valuation implies a 2025 P/E of ~22x, which is above CP's LT average given growth opportunities.

Consensus Price Target Distribution

Source: Refinitiv, Morgan Stanley Research



RISK REWARD CHART



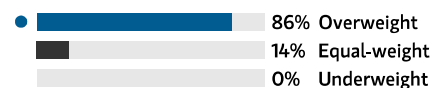
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

OVERWEIGHT THESIS

CPKC will be looking for the upcycle to demonstrate the full power of the model that was built with the merger a couple of years ago. All eyes will also be on CPKC's response to US Rail M&A and what part they will play in the (or subsequent) processes. Expectations are now lower than before, the multiple has contracted and positioning has improved, which also makes the risk-reward more attractive than before, driving our OW rating.

Consensus Rating Distribution



MS Rating

Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Secular Growth: *Positive*
Self-help: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE

C\$165.00

24x Bull Case on FY25 EPS

The upcycle begins. Demand snaps back in mid-2026 and freight supply continues to tighten at the same time, driving the robust upcycle we have been waiting for. As such, the conversion of the pipeline accelerates driving revenue growth to +LDD%. Operative leverage compounds this and EPS grows DD% comfortably.

BASE CASE

C\$120.00

22x Base Case on FY25 EPS

Supply catalysts tip the scales. The demand side remains tepid tracking normal seasonality while the supply side continues to tighten and gradually pushes rate upward. Revenues grow MSD/HSD% in FY26 as the improving freight market is further helped by mgmt.'s continued execution on the pipeline post merger. Operating leverage drives EPS +DD% in FY26 and the stock keeps its premium multiple.

BEAR CASE

C\$90.00

18x Bear Case on FY25 EPS

Status quo continues. The cycle continues where it left off ending 2025, the freight supply side catalysts fizzle out and earnings track normal seasonality from the end of 2025. A tougher backdrop is worsened by a challenged tariff environment pressuring growth in Mexico, driving revenue to a more modest +LSD%. Cost inflation lingers and EBIT growth disappoints driving the multiple back toward its LT average.