

Blackstone and GIP's Proposed Buyout of Kansas City Southern

Deal Discussion

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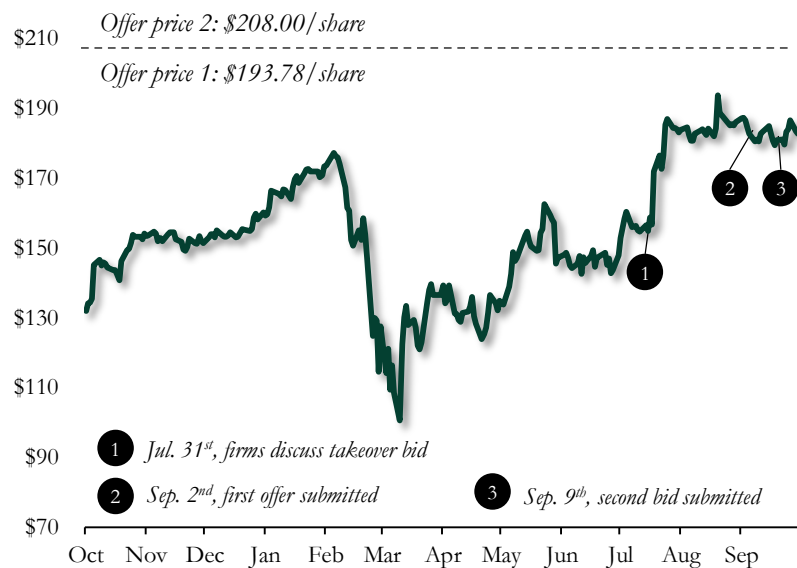
Transaction Overview

Proposed Transaction Overview

Transaction Overview

- In early September, Blackstone Infrastructure and Global Infrastructure Partners (GIP) made two formal purchase offers for Kansas City Southern Railways (KSU)
- The two offers, valuing the company at approximately \$18 billion and \$20 billion, were both rejected, as the board felt the railway was being significantly undervalued
- No more offers have been made since the second offer was rejected

LTM Stock Performance



Illustrative Transaction Analysis

(in US\$ Millions)	Pre-Announcement	31-Jul-20	2-Sep-20
Share Price	\$171.85	\$193.78	\$208.00
FD Shares O/S	94.6	94.6	94.7
Market Cap.	\$16,261	\$18,336	\$19,689
(+) Total Debt	\$3,835	\$3,835	\$3,835
(-) Cash & Cash Equivalents	\$620	\$620	\$620
(+) Minority Interest	\$325	\$325	\$325
(+) Preferred Shares	\$6	\$6	\$6
Enterprise Value	\$19,806	\$21,881	\$23,234
EV / NTM EBITDA	13.5x	14.9x	15.8x
P / NTM EPS	23.5x	26.4x	28.3x

Market Views

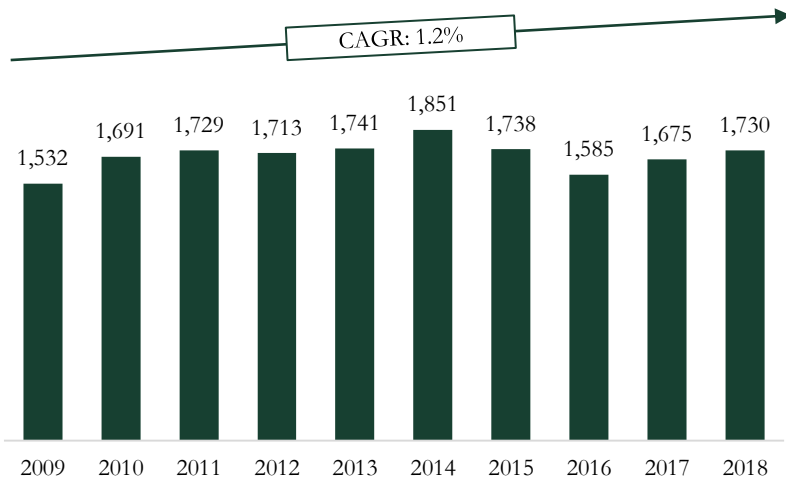
“As we have previously argued, a **very steep premium** would likely be required, and it wouldn’t surprise us if KSU commanded a **40%-50% premium** to the undisturbed price when considering upside from **both PSR as well as substantial top line growth opportunities**. This would imply a takeout price in the \$220-\$235/share range, or **~17x -18x trailing EBITDA.**”

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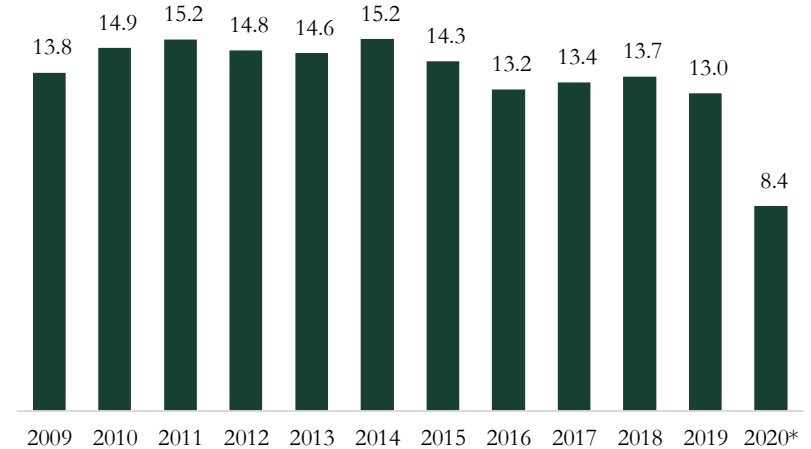
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Why Invest in the Freight Railroad Industry

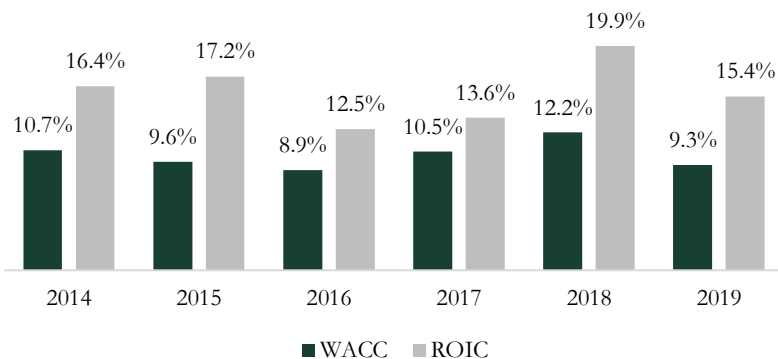
U.S. Ton-Miles of Freight (Billions) 2009 – 2018⁽¹⁾



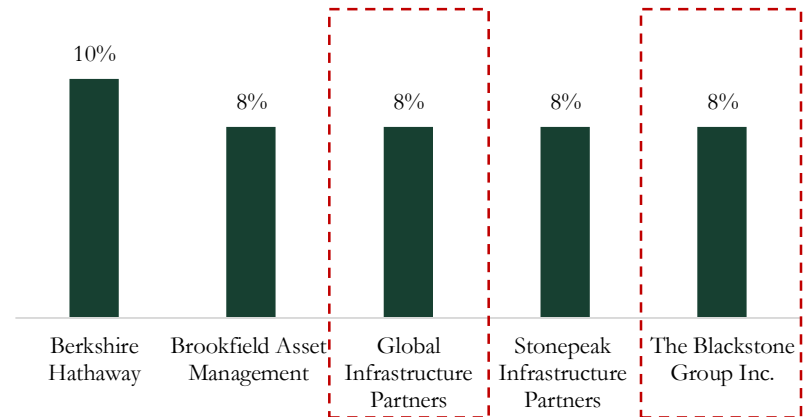
Number of carloads transported (in millions)⁽¹⁾



Industry Historic WACC⁽³⁾ vs ROIC



Hurdle Rates for investors in this space



The Freight Rail Industry Has Robust Growth Supporting It With Consistent Value Creation Above The Cost Of Capital

(1) Source: United States Department of Transportation

(2) Source: U.S. Surface Transportation Board

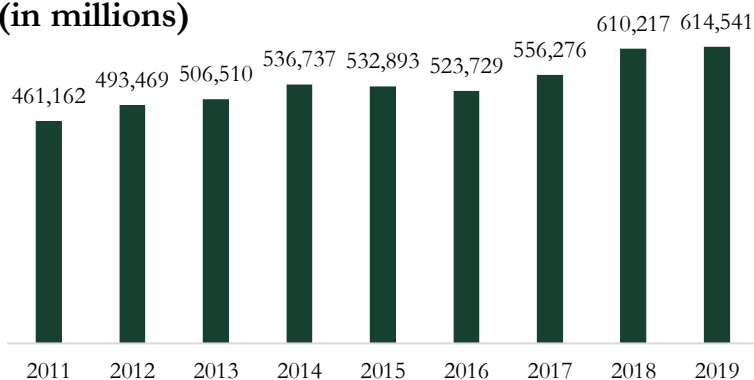
(3) Source: NYU Stern

Potential Thesis Points of Financial Sponsors

Implementation of Precision Scheduled Railroading

- During 2019, KSU started implementing the principles of PSR which focus on operational excellence and are intended to drive customer service, facilitate growth, improve asset utilization and improve the company's cost profile
- The PSR initiatives provided cost savings of approximately \$58.0 million during 2019 with an expectation of providing incremental cost savings of approximately \$95.0 million during 2020
- As revenues declined during 2020 because of COVID-19, KSU implemented additional PSR initiatives by further consolidating trains. This equated to longer trains, which increased capacity and reduced crew costs

U.S. trade in goods with Mexico 2011 to 2019 (in millions)



KSU will benefit from increasing US-Mexico trade with the signing of the Canada-United States-Mexico (“CUSMA”) deal, given it operates the sole railway connection between the nations.

(1) Source: Association of American Railroads (AAR)
(2) IBISWorld

Favorable Industry Tailwinds

Increasing fuel efficiency

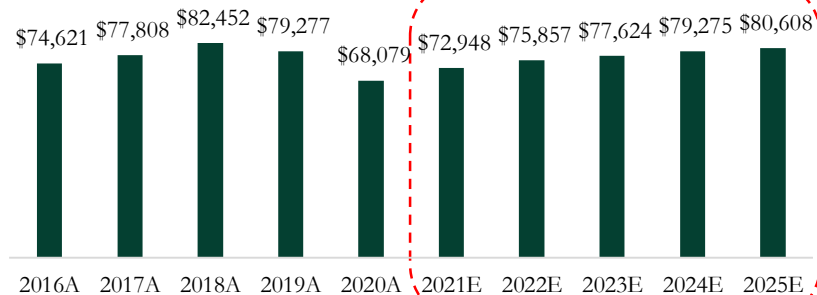
Recent equipment upgrades increase fuel efficiency, improving KSU's margins by 5% YTD

US pipeline infrastructure capacity issues

Increasing capacity issues enable operators to capture a greater share of oil transportation needs

Loosening regulations

Deregulation in transportation of certain commodities creates revenue generation opportunities



Industry tailwinds will underpin U.S. railroad revenue (\$mn USD) and profitability growth, allowing KSU to benefit from increased demand and higher margins.

Overview of Financial Sponsors

Blackstone Infrastructure Fund

- Blackstone launched its \$40 billion open-ended infrastructure vehicle in May 2017 alongside PIF, Saudi Arabia's sovereign wealth fund
- The fund aims to invest in assets across Energy Infrastructure, Transportation, Water and Waste, Communications primarily in North America
- Blackstone boasts an exceptional track record in infrastructure investing having made over 25 investments in the space through its LP funds

Why Blackstone?

- Management has experience owning and operating railroad companies
 - Exited its stake in intermodal operator Gateway Rail in April 2019
- Blackstone currently has \$55bn of Transport & Rail deals in the pipeline, with a mandate to improve infrastructure quality, margins and growth
- Infrastructure is one of the most successful and active areas at Blackstone with a 45% gross IRR and 2.4x gross MOIC
 - Cheniere Energy investment in 2012 is currently proposed to be sold at a 4.67x MOIC

Investment Criteria

- ✓ **Core+ Investments**
 - Assets that have moderate revenue / demand risk; in many cases, these assets will operate under shorter-term contracts
- ✓ **Core Investments**
 - Mature, stable assets and cash flows in well-located markets that require little or no development; often, these assets are supported by long-term contractual arrangements or favorable regulatory frameworks
- ✓ **Public Private Partnerships**
 - Investments that include a long-term contract or concession with a government entity in exchange for providing a public asset or service

Recent Transactions

Company	Location	Year of Investment	Total Transaction Value
 CHENIERE	USA	2020	\$7.0 Billion
 TALLGRASS ENERGY	USA	2019	\$6.3 Billion
 Carrix	USA	2019	\$0.7 Billion

Source: Corporate Disclosures

Global Infrastructure Partners (GIP)

- GIP is a global infrastructure fund manager headquartered in New York City
- The fund currently manages \$69 billion USD in assets with 31 publicly disclosed investments
- Investments generate more than \$45 billion in annual revenue and employs more than 62,000 people
- Investments are often run by GIP's own ops. team

Why GIP?

- Management has experience owning and operating railroad companies
 - Pacific National in Australia and Nuovo Trasporto Viaggiatori in Italy⁽¹⁾
- GIP has a proven track record of creating operational value with 52% and 36% median EBITDA growth across its GIP I and GIP II funds respectively⁽¹⁾
- With KSU implementing the PSR principles to focus on operational excellence, GIP can help with growth, margin improvement, capital efficiency and risk reduction of the business

Investment Criteria

- ✓ **Secure Market Positions**
 - High barriers to entry
 - In most cases, natural or regulated monopoly
- ✓ **Downside Protection**
 - Limited risk of technological obsolescence
 - Provide indispensable services, with relatively inelastic demand
 - Highly predictable, resilient cash flows
- ✓ **Upside Potential**
 - Traditionally undermanaged asset class

Select Investments

Company	Location	Year of Investment	Total Transaction Value
 Hornsea 1	UK	2018	\$5.9 Billion
 Port of Melbourne	Australia	2016	\$2.8 Billion
 Edinburgh Airport <small>Where Scotland meets the world</small>	Scotland	2012	\$1.0 Billion
 EAST INDIA PETROLEUM	India	2007	Unavailable

Source: Corporate Disclosures

Source: (1) https://www.pcr-ma.org/sites/default/files/fileattachments/general/page/2411/gip_fund_in_plymouth_rf.pdf

Company Overview

Kansas City Southern (NYSE:KSU)

Company Overview

- Kansas City Southern is the smallest of the seven largest North American railroads by revenue and operates across 10 states in the Midwest and Southeastern U.S
- KSU is the only major railroad providing transport to Mexico from the U.S.A, and operates the shortest distance of rail to the Gulf of Mexico from many important southern states

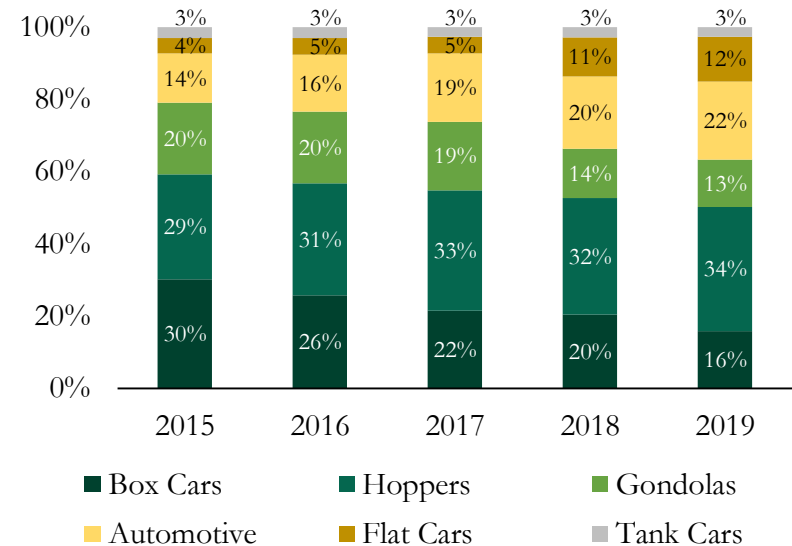
Rail Network



Capitalization

Share Price	\$179.01
52 Week Low-High	\$92.86 - \$200.00
Market Capitalization	\$16.76 B
Net Debt, Pref. Shares, NCI	\$3.51 B
Enterprise Value	\$20.27 B
EV/ NTM EBITDA	13.9x
P/NTM EPS	23.7x

Freight Breakdown



Industry Overview

Kansas City Southern Revenue by Commodity Segment

Chemical & Petroleum (26%)

- Inputs for automotive, housing, and packaging
- Dependent on U.S refinery output

Industrial & Consumer (21%)

- Incl. forest products, metals and scrap
- Dependent on lumber mills, U.S and Mexico imports and exports

Automotive (9%)

- Transports intermediate and finished goods
- Dependent on U.S auto demand and exports/imports of cars

Agriculture & Minerals (17%)

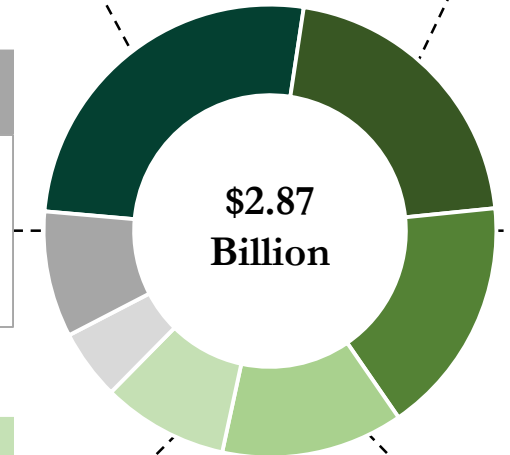
- Affected international market prices/producer demand
- U.S and Mexico imports and exports

Energy (9%)

- Include coal, frack sand, petroleum, crude oil
- Affected by demand for electricity, supply of goods, U.S and Mexico trade

Intermodal (13%)

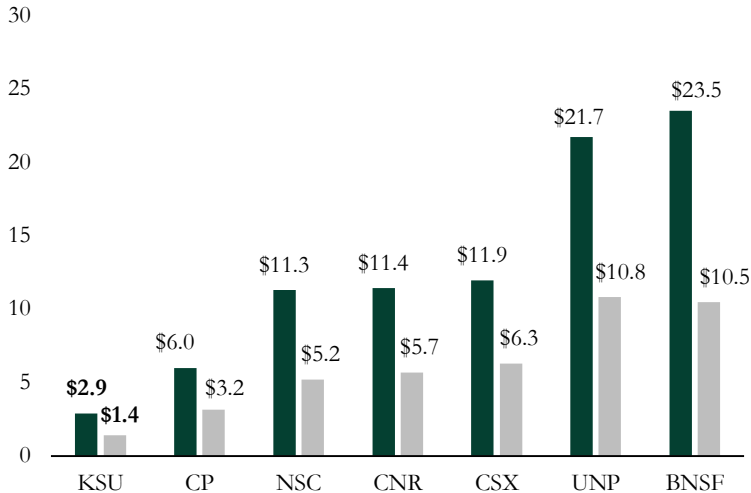
- Freight and truck trailer shipping
- Affected by U.S, Mexico trade, FDI into Mexico, number of shipments in port of Lazaro



**\$2.87
Billion**

Freight Railway Industry Overview

N.A Railways by Revenue, EBITDA (US\$B, 2019)



Key Metrics and Trends

Metric	Measures
Revenue ton-miles (RTM)	<ul style="list-style-type: none"> Income generated per volume of freight Metric does not include cost of each mile
Gross ton-miles (GTM)	<ul style="list-style-type: none"> Total weight times total miles travelled
Tonnes per carload	<ul style="list-style-type: none"> Efficiency of trains

Trends

- Rails are expected to shift towards fewer trips while increasing tons per carload; there is a low return on capex in the industry
- Revenue by commodity will change: Intermodal container shipments are expected to grown while coal has declined as a % of revenue

COVID-19 Impact on the Kansas City Southern

Economy Stalled

Freight volumes were severely:

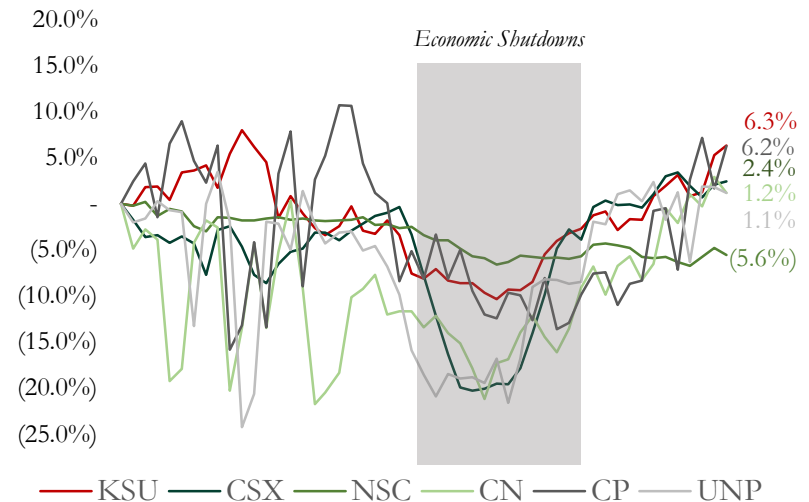
- Declines in port-volume affected intermodal volumes
- Stalling demand for inventories led to decreases in other freight carloads

Post-Shutdowns

Backlogged imports and inventory orders led to a V-shaped recovery in freight volumes

- Following Q2, KSU revised earnings guidance to reflect pre-COVID expectations

Kansas City Southern Weekly Freight Volumes



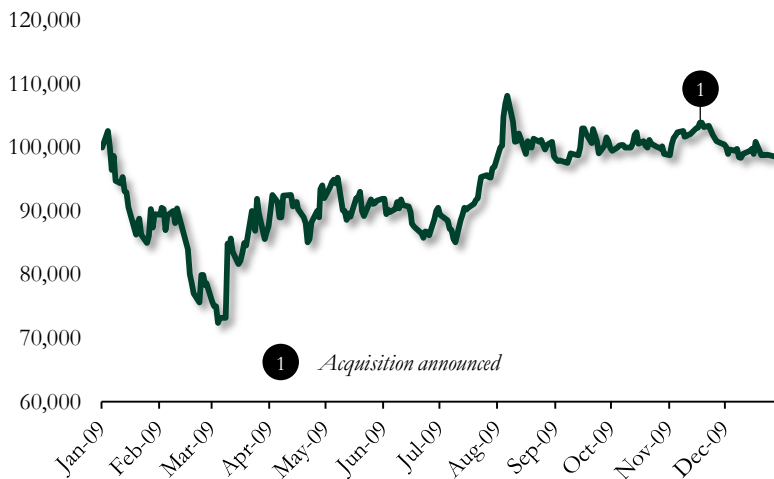
Transaction Case Studies

Case Study: Berkshire Hathaway Acquires BNSF

Transaction Overview

- In November of 2009, Warren Buffet and Berkshire Hathaway purchases Burlington North Santa Fe Corp (BNSF) for \$26.3 billion
- This marks Berkshire Hathaway's second largest acquisition and largest at the time
- Buffet acquired 77% of the outstanding shares (the rest already owned by Berkshire) for \$100 per share

Berkshire Stock Performance



Why Did Buffett Buy A Railroad?

- ✓ **Essential for Economic Growth**
 - Demand for rail transport is linked to and necessary for economic growth
 - Berkshire likes to make long term bets
- ✓ **Barriers to Entry**
 - The railroad industry is highly concentrated following centuries of consolidation
 - Players have achieved significant economies of scale, deterring any new entrants
 - BNSF is the largest N.A railroad by revenue
- ✓ **Stability and Competitive Advantage**
 - Railroads provide predictable and stable free cash flow
 - BNSF's owns a strong network of rail from east coast inner-cities to the west coast

Market Views

“It’s an all-in wager on the economic future of the United States” “We’re going to own it forever”

BERKSHIRE HATHAWAY

3-Nov-2009

“The deal will create a lot of value for Berkshire”



3-Nov-2009

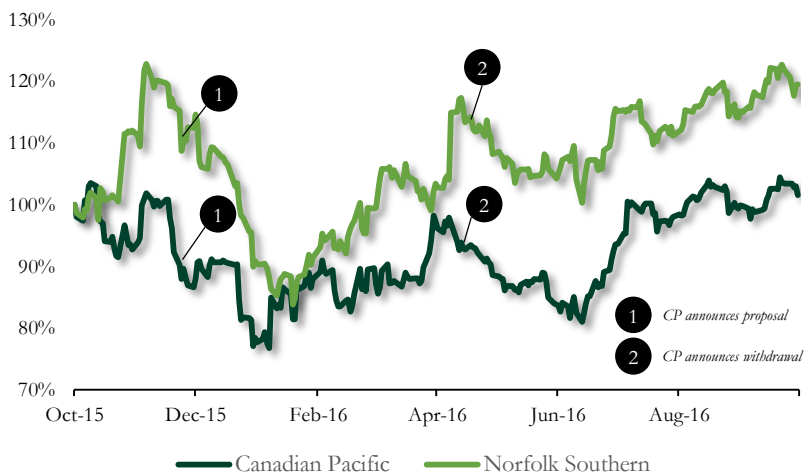
Case Study: Failed Merger Example



Transaction Overview

- In April of 2016, Canadian Pacific Railroad (CP) withdrew its proxy vote to merge with Norfolk Southern Railway (NS), ending their four-month effort to conduct a hostile takeover
- The proposed merger would have combined the 4th and 6th largest N.A railroads at the time, with the merger value estimated to be around \$30 billion
- CP was met with immediate rejection from NS, and efforts from CSX and Union Pacific were allegedly made to block the merger

Stock Performance



Illustrative Combination Analysis

(in US\$ Millions)	CP Railway	Norfolk Southern	Offer	MergeCo
Share Price	\$138.72	\$43.00	\$46.87	\$138.72
Debt	50.0%	-	\$1,825	
Equity	50.0%	-	\$1,825	
Premium	-	-	9.0%	
FD Shares O/S	155.2	77.9	77.9	168.3
Market Cap.	\$21,525	\$3,349	\$3,651	\$23,350
(+) Total Debt	\$8,745	\$3,152	\$3,152	\$13,723
(-) Cash & Cash Equivalents	\$661	\$116	\$116	\$777
(+) Minority Interest	-	\$38	\$38	\$38
(+) Preferred Shares	-	-	-	-
Enterprise Value	\$29,609	\$6,423	\$6,724	\$36,333
EV / NTM	8.5x	10.8x	11.3x	8.9x
EBITDA				
P / NTM EPS	12.4x	19.3x	21.1x	12.3x

Market Views

“The proposals are grossly inadequate, **substantially undervalued** Norfolk Southern, and would face substantial **regulatory risk** and uncertainties that would be highly **unlikely to be overcome.**”



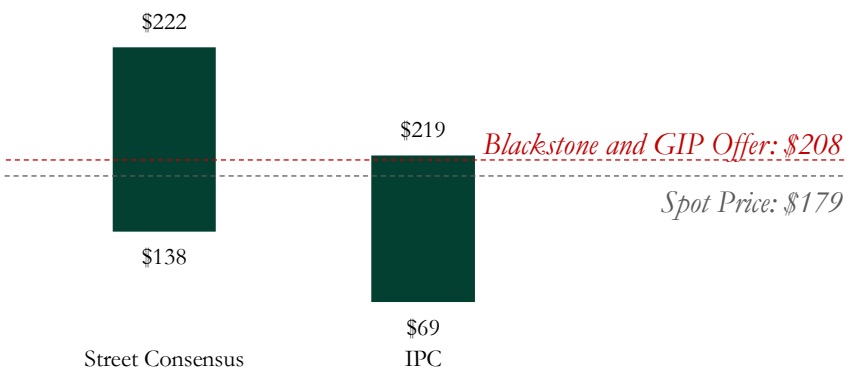
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Preliminary Views on Value

Football Field

Type	Description	Valuation		Implied Price (US\$/share)	Upside / (Downside)
EV / LTM EBITDA	13.2x - 16.2x	\$146.05	\$186.27	\$166.16	(7.2%)
EV / NTM EBITDA	13.9x - 17.0x	\$158.94	\$202.02	\$180.48	0.8%
P / LTM EPS	23.0x - 28.2x	\$138.38	\$169.13	\$153.76	(14.1%)
P / NTM EPS	20.2x - 24.7x	\$61.87	\$75.62	\$68.75	(61.6%)
DCF: Exit Multiple (Base)	Exit Multiple 14.2x, WACC of 6.8%	\$186.04	\$251.70	\$218.87	22.3%
DCF: GGM (Base)	Perpetuity Growth of 3.0%, WACC of 6.8%	\$134.80	\$182.38	\$158.59	(11.4%)

IPC Target Price



Commentary

- IPC believes that KSU will see slower declines in revenue into 2021 driven by a weak Energy and Automotive outlook, partially offset by Chemical & Petroleum and Agriculture & Minerals growth
- A recovery to pre-COVID levels has been modelled in for 2022 given the likelihood of an economic slowdown should the pandemic worsen; forecasts being in line with street consensus
- IPC believes that the market is slightly underpricing KSU allowing the financial sponsors to make higher offer prices between July and September

Source: Capital IQ, IPC Model as at October 18, 2020

Valuation & Returns Analysis

LBO Scenario Analysis

Blackstone Returns (50% of Equity)

<i>(in US\$ Millions)</i>	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	\$2,573	\$2,459	\$2,675	\$2,898	\$3,132	\$3,392
<i>% Growth</i>	<i>(10.2%)</i>	<i>(4.5%)</i>	<i>8.8%</i>	<i>8.3%</i>	<i>8.1%</i>	<i>8.3%</i>
Free Cash Flow	\$454	\$506	\$539	\$612	\$704	\$808
<i>% Margin</i>	<i>17.7%</i>	<i>20.6%</i>	<i>20.1%</i>	<i>21.1%</i>	<i>22.5%</i>	<i>23.8%</i>
Initial Investment	(\$3,798)					
(+) Cash	-	(\$49)	(\$49)	(\$49)	(\$49)	(\$49)
(-) Debt	-	\$7,787	\$7,769	\$7,713	\$7,609	\$7,450
(+) Exit Proceeds	-	\$9,471	\$10,685	\$11,990	\$13,408	\$15,008
Net Cash Flow	(\$3,798)	\$1,635	\$2,867	\$4,228	\$5,749	\$7,509

IRR 14.6%

Sources & Uses

Sources

Equity:		
Blackstone Infra.	\$3,798	2.9x
GIP	\$3,798	2.9x
Total Equity	\$7,596	5.9x
Debt:		
Term Loan B	\$4,673	3.6x
Other LT Notes	\$10,904	8.4x
Total Debt	\$15,577	12.0x
Total Sources	\$23,173	17.9x

Uses

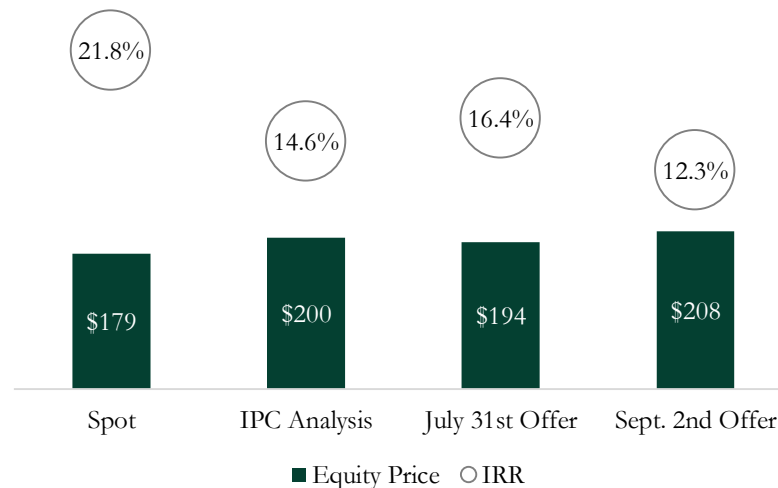
Purchase Price	\$18,948	14.6x
KSU Existing Debt	\$3,566	2.7x
Transaction Fees	\$348	0.3x
Financing Fees	\$312	0.2x
Total Uses	\$23,173	17.9x

GIP Returns (50% of Equity)

<i>(in US\$ Millions)</i>	2020E	2021E	2022E	2023E	2024E	2025E
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Scenario Analysis



Final Thoughts

IPC Commentary

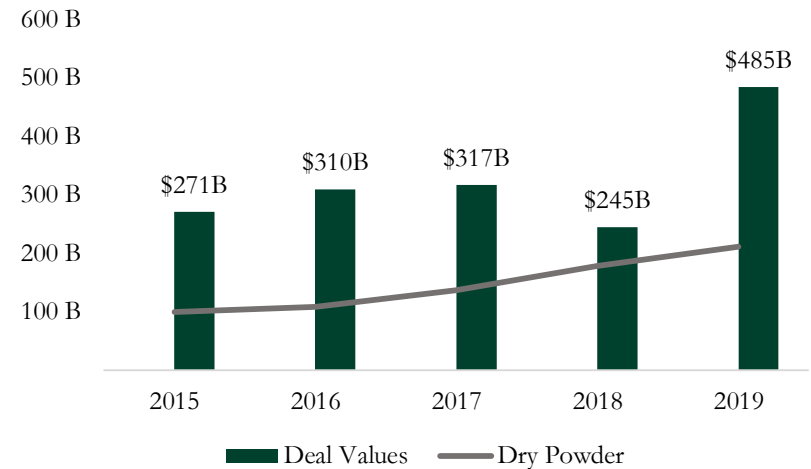
Deal Commentary

- IPC concludes that Blackstone and GIP's strategy for buying KSU must've been buy and hold as opposed to a traditional LBO given the low return profile
 - This fits with the strategy Berkshire Hathaway used when purchasing BNSF
- Given IPC valued KSU at ~\$200/share, we believe that the financial sponsors backed down from the offers given that a purchase price above \$208/share would be too expensive and leave material returns on the table
- Acquiring a freight railroad company will be expensive

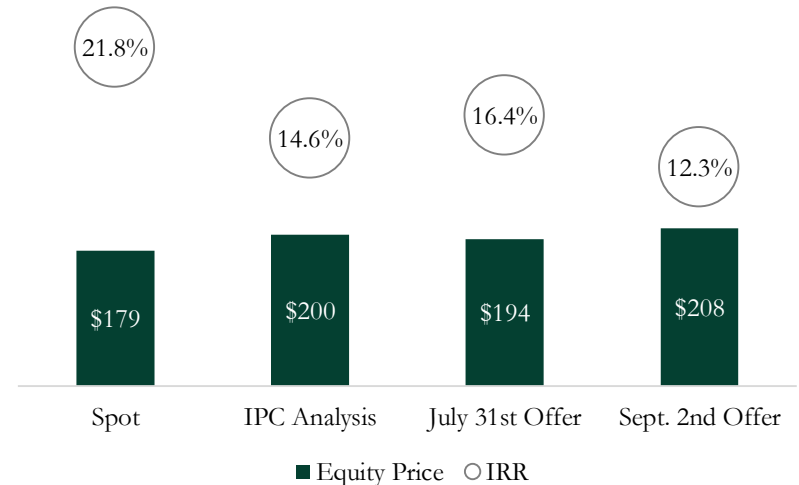
Key Questions Going Forward

- Will there be another financial sponsor, or a group, willing to pay a 40-50% premium for KSU?
- Will KSU be able to successfully implement Precision Scheduled Railroading (PSR) organically?
- Where will Blackstone and GIP jointly or separately look to deploy dry powder?
- Will a strategic sponsor be willing to take a large risk and make a bid for KSU, hoping to successfully drag it through the regulatory review process?

Infra Funds: Deployed Capital vs. Dry Powder



Returns Analysis



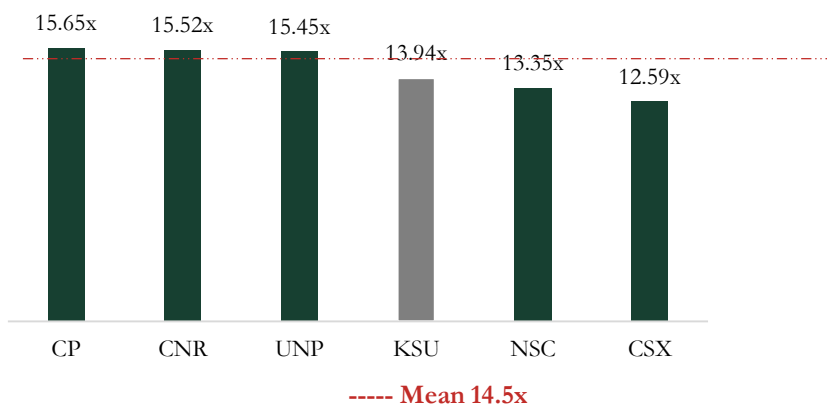
Appendix

Valuation: Comparable Companies Analysis

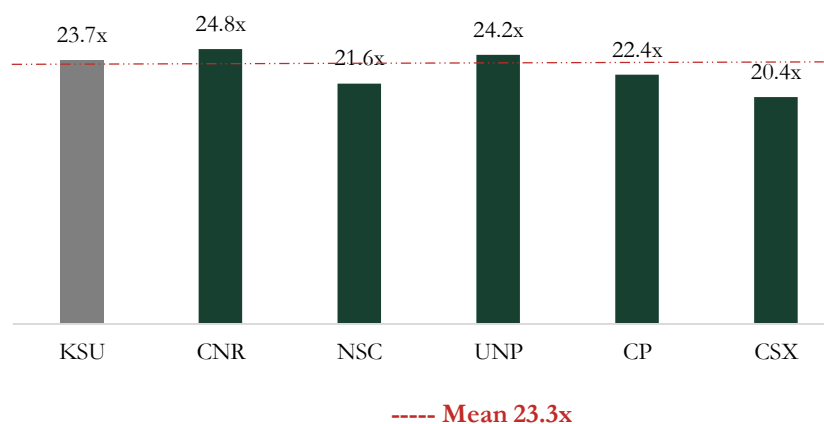
Comparable Companies

Company Name	Market data			Trading Multiples				
	Share Price	Market Cap	Enterprise Value	EV/ LTM EBITDA	EV/ NTM EBITDA	P/ LTM EPS	P/ NTM EPS	Net Debt/ LTM EBITDA
	(US \$)	(US\$mm)	(US\$mm)	x	x	x	x	x
Canadian National Railway Company (CNR)	\$111.8	79377	90177	15.6x	15.7x	28.6x	24.8x	2.0x
Norfolk Southern Corporation (NSC)	\$218.8	\$55,805	\$67,639	14.2x	13.4x	27.0x	21.6x	2.5x
Union Pacific Corporation (UNP)	\$209.9	\$142,454	\$169,756	15.6x	15.5x	25.6x	24.2x	2.6x
Canadian Pacific Railway Limited (CP)	\$325.2	\$44,072	\$51,104	14.7x	15.7x	24.3x	22.4x	2.1x
CSX Corporation (CSX)	\$80.1	\$61,288	\$75,694	12.0x	12.6x	21.4x	20.4x	2.5x
Mean		\$76,599	\$90,874	14.9x	14.8x	27.4x	23.3x	2.3x
Median		\$61,288	\$75,694	14.7x	15.5x	27.0x	23.7x	2.5x
Kansas City Southern (KSU)	\$179.0	\$16,756	\$20,267	14.3x	13.9x	31.4x	23.7x	2.3x

EV / NTM EBITDA



P/ NTM EPS

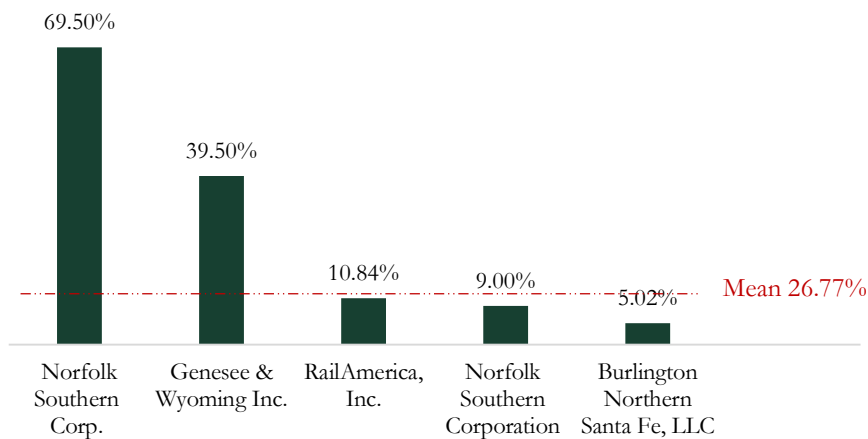


Valuation: Precedent Transactions Analysis

Precedent Transactions

Date	Acquirer	Target	Status	Implied Price/Share	Premium	Transaction Value	Implied EV/EBITDA
				(US\$)	%	(US\$M)	(US\$M)
12-16-2015	Canadian Pacific Railway	Norfolk Southern	Cancelled	\$133	69.50%	\$28,000	7x
07-01-2019	Brookfield	Genesee & Wyoming Inc.	Closed	\$112	39.50%	\$9,556	54x
07-23-2012	Genesee & Wyoming Inc.	RailAmerica	Closed	\$27.50	10.84%	\$2,046	11x
01-11-2000	Canadian National Railway	BNSF	Cancelled	\$29.80	5.02%	\$17,600	2x
Mean					31.2%	\$14,301	18x
Median					25.2%	\$13,578	9x

Premiums Analysis



Commentary

Failed Transactions	Commentary
Canadian Pacific Railway Limited Proposed Acquisition of Norfolk Southern Corp.	“...the U.S. Justice Department urged the Surface Transportation Board to reject a voting trust arrangement Canadian Pacific Railway had proposed as part of its bid. ¹ ”
Canadian National Railway Company Proposed Acquisition of Burlington Northern Santa Fe	“In 2000, BNSF and CN voluntarily cancelled merger plans after US regulators imposed a fifteen-month freeze on railroad consolidations while new rules were written. ⁽²⁾ ”

Valuation: Discounted Cash Flow Analysis Summary

Free Cash Flow Build

Discounted Cash Flow Analysis						
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Revenue	\$2,573	\$2,459	\$2,675	\$2,898	\$3,132	\$3,392
<i>% Growth</i>	(10.2%)	(4.5%)	8.8%	8.3%	8.1%	8.3%
EBITDA	\$1,318	\$1,325	\$1,494	\$1,677	\$1,875	\$2,099
<i>% Margin</i>	51.2%	53.9%	55.9%	57.9%	59.9%	61.9%
EBIT	\$967	\$961	\$1,099	\$1,248	\$1,412	\$1,597
<i>% Margin</i>	37.6%	39.1%	41.1%	43.1%	45.1%	47.1%
NOPAT	\$677	\$673	\$769	\$874	\$988	\$1,118
(+) Depreciation	\$352	\$364	\$396	\$429	\$463	\$502
(-) CapEx	\$586	\$560	\$609	\$660	\$713	\$772
(-) Increase in NWC	(\$12)	(\$29)	\$17	\$31	\$35	\$39
Unlevered Free Cash Flow (UFCF)	\$454	\$506	\$539	\$612	\$704	\$808
PV of UFCF	\$454	\$466	\$465	\$494	\$532	\$572

Enterprise Value

Exit Multiple Method	
Terminal Year EBITDA	\$2,099
Exit Multiple	14.2x
Terminal Value	\$29,805
PV of TV	\$21,099
<i>Implied Perpetuity Growth Rate</i>	4.0%
<i>% of EV</i>	87.6%
Sum of PV UFCF	\$2,984
Enterprise Value	\$24,084
(-) Net Debt	\$3,314
Equity Value	\$20,769
FD Shares O/S	94.9
Implied Share Price	\$218.87

Sensitivity

		Exit Multiple				
		13.2x	13.7x	14.2x	14.7x	15.2x
WACC	7.8%	\$192.57	\$200.03	\$207.49	\$214.94	\$222.40
	7.3%	\$197.82	\$205.46	\$213.10	\$220.74	\$228.38
	6.8%	\$203.21	\$211.04	\$218.87	\$226.70	\$234.53
	6.3%	\$208.76	\$216.79	\$224.81	\$232.84	\$240.86
	5.8%	\$214.48	\$222.70	\$230.93	\$239.15	\$247.37
		Exit Multiple				
		13.2x	13.7x	14.2x	14.7x	15.2x
WACC	7.0%	16.9x	17.5x	18.0x	18.6x	19.2x
	6.5%	17.3x	17.9x	18.5x	19.0x	19.6x
	6.0%	17.7x	18.3x	18.9x	19.5x	20.1x
	5.5%	18.1x	18.7x	19.3x	19.9x	20.5x
	5.0%	18.6x	19.2x	19.8x	20.4x	21.0x