Let me begin by saying that this is a PowerPoint presentation, which means that everything I’m about to say is right—right? For example, this is a Soviet-era graphic which highlights how the “October Revolution is The Bridge to a Glorious Future”. So just because I’m saying something with PowerPoint doesn’t necessarily mean it’s true.

First I’ll provide some background about our company, Railroad Development Corporation (RDC); then discuss four case studies and how they translated into our investment philosophy; and then draw some conclusions based on economics and, in particular, the tradeoff between risk and reward.

**Background on RDC**

RDC is a small company in Pittsburgh with five employees; we are able to do things that nobody else has any interest in touching largely because everything we do is based on Joint Ventures.

The following table is an overview of where we are today and where we were in the past. I urge you to focus on the countries as opposed to the details. Currently RDC is in the USA (Iowa), Latin America and Europe. In the past we were in Africa and the Former Soviet Union (in Estonia, which became part of the EU while we were there), and other places in Latin America. Our investments are highly diverse in terms of company size, their markets, and our particular shareholding—generally, the “better” the deal, a smaller percentage; the “worse” the deal, the larger our participation.

**RDC Investments:**

<table>
<thead>
<tr>
<th>CURRENT:</th>
<th>Entity</th>
<th>Length (Km)</th>
<th>Employees</th>
<th>Avg. Annual Tons (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>Iowa Interstate</td>
<td>954 (592)</td>
<td>215</td>
<td>14.0</td>
</tr>
<tr>
<td>Peru</td>
<td>Ferrocarril Central Andino</td>
<td>535 (332)</td>
<td>588</td>
<td>1.8</td>
</tr>
<tr>
<td>Germany</td>
<td>Hamburg-Köln-Express</td>
<td>450 (280)</td>
<td>60</td>
<td>Passengers—start 7/2012</td>
</tr>
<tr>
<td>Colombia</td>
<td>Ferrocarril del Pacifico</td>
<td>196 (122)</td>
<td>135</td>
<td>Start 7/2012</td>
</tr>
<tr>
<td>France</td>
<td>RegioRail</td>
<td>Various</td>
<td>40</td>
<td>Start 12/2012</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>PAST:</th>
<th>Entity</th>
<th>Tons Last Yr of Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malawi</td>
<td>Central East African Railways</td>
<td>797 (495)</td>
</tr>
<tr>
<td>Mozambique</td>
<td>CDN-Nacala Corridor</td>
<td>873 (542)</td>
</tr>
<tr>
<td>Estonia</td>
<td>Eesti Raudtee</td>
<td>693 (431)</td>
</tr>
<tr>
<td>Argentina</td>
<td>ALL Central</td>
<td>5,690 (3,535)</td>
</tr>
<tr>
<td>Argentina</td>
<td>ALL Mesopotamica</td>
<td>2,704 (1,680)</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Ferrovías Guatemala</td>
<td>322 (200)</td>
</tr>
</tbody>
</table>
**CASE STUDY: USA / Iowa Interstate Railroad**

The Iowa Interstate Railroad (IAIS) is our Flagship, and it was formed from the ashes of the bankrupt Rock Island Railroad. The rail industry hit bottom in 1980 and, while deregulation killed the airline industry (and which I would argue is responsible for the misery that travelers suffer today), it was the salvation of the rail industry. In 1977 when I entered the industry, we were basically there to turn the lights off with dignity. Suffice it to say, the IAIS at the time was an insolvent company, but now we’re doing pretty well. RDC has been invested in the IAIS since 1991.

An interesting fact is that there are four railroads from Chicago to Omaha—there used to be six—but there is still enough room in the market for four railroads which is quite remarkable.

Now let’s transition from anecdote to the numbers, with a word of caution: the graphic (left) shows the train going from Socialism to Communism. This is just a reminder that just because it’s PowerPoint, it doesn’t necessarily mean it’s right.

Let’s start first and foremost with our safety performance. The IAIS won two Gold Harriman Safety awards; safety really is the #1 objective of the Iowa Interstate Railroad. Safety is more important than profitability for the following reasons:

- If you have a safe railroad, you’re more likely to have good service; and
- if you have good service, you’re more likely to have more business; and
- If you got more business, you’re more likely to be profitable.

We focus on safety because it is easy to measure, it’s an important focus, and ultimately it translates into profits which allow you to, among other things, stay in business.
Please note that the traffic graph starts at zero. It's easy to display a dramatic performance by starting the graph at 40,000 and showing an increase to 100,000 carloads. But this graph actually starts at zero and shows the growth in traffic between 1991, when RDC made its initial investment, and to where we are in 2013.

For the first 10 years these numbers were flat. So what did we do in order to transform this railroad to the higher-volume operation that it is today? Actually, not a lot. Our initial strategy was to tread water and survive and hope that things got better as opposed to worse. But make no mistake, we did not invent the key driver of what transformed the IAIS, which was the evolution of ethanol and the Corn Belt market that we serve in Iowa. Better to be lucky than good, and hopefully lucky and good. But this is an example of being lucky simply by having a strategy based on survival.

These photos show what the IAIS looks like today. We have a substantial investment in traffic that you would not normally associate with a railroad our size, such as intermodal traffic. We've been able to buy new locomotives, which I never thought that we'd ever be able to do, simply based on the fuel savings and our ability to finance them, which in part was driven by a federal program of low-interest loans to railroads, but could not have happened if we did not present a good security risk. These locomotives came from the GE plant in Erie, PA; GE is the world's number one locomotive producer and is a good example of how American manufacturing has been competitive and continues to be competitive. There are literally GE locomotives all over the world, and we pride ourselves as being one of their smallest customers.

The last photo shows two steam locomotives that we brought from China, which were based on a Soviet design; the Soviet design was based on a U.S. design, an interesting example of globalization.
CASE STUDY: Estonia / Eesti Raudtee

Let’s discuss the EU, in particular, the country of Estonia. Estonia is now a member of the European Union, but at the time of our initial investment it wasn’t. As a former Soviet railway, Estonian Railways was and is a European railway that goes to Moscow, not Brussels. It is Soviet gauge and really is nothing more than a port railway that is contiguous to the Russian Railway system. In fact, this photo was taken in Russia and note the Russian border guards standing on the walkway above the tracks.

Estonian Railways was privatized in 2001 and in the time it was in private hands, we decreased the personal injuries by 75%; we increased the traffic; and completely replaced the locomotive fleet. But two years after our investment, the government changed and the regulatory environment was substantially rewritten to the benefit of one of our customers who found it cheaper to buy legislation than to buy transportation.

The result was that we were forced to invoke an arbitration clause against the Estonian government; we were not naïve investors, and had negotiated the clause in advance. The government was going to lose, so we sold the railroad back to the Estonian people. In 2007, Eesti Raudtee was renationalized after being in private hands for 5.5 years. The result was, I believe, a win for the politicians; a draw for us (we made a profit, but this was not how we hoped to make a profit); but more importantly, it was a big loss for the Estonian people. At the time it was renationalized, the ruling party had the top poster, “We bought the Railway back!” Others saw it as, “The re-Sovietization of a Former Soviet Railway.” (bottom)

Five months after we sold the railway back to the Estonian people, the government took some political actions against Russia which caused the railway to lose half of its business virtually overnight. The whole point of the legislation was directed against us because we were a so-called monopoly, so my question is, how could a monopoly lose half of its business overnight? That’s a question for the Estonian people to deal with. The fact is that when it was in private hands, we were moving 45 million tons, and today in public hands it is handling approximately 16 million tons.
**CASE STUDY: Guatemala / Ferrovías Guatemala**

Looking at the map, this looks like an international railway running from the Atlantic to the Pacific, etc. with connections to Mexico and El Salvador; a truly strategic rail network. The problem was that it was a private sector company until the 1960s; then it was nationalized and eventually shut down by the Guatemalan Government. After it was shut down, they went to the private sector looking for bidders and were quite surprised to find that there was only 1 interested party, which was us.

The conditions were quite extreme. Basically the government said that you can have our national railway but you have to put it back and run it at your cost and at your risk. It was the best deal that they were offered, and that was the deal that we made. It also included the opportunity to use the right-of-way for electricity distribution, pipelines, etc.

Going into Guatemala we recognized that it wasn’t Switzerland. The first photo was our track rehabilitation program, using local labor and local cross ties. It was a highly locally-sourced solution and adequate for the circumstances. Running a freight service at 25 mph was fine. Most of the railroad lines in central Pennsylvania run approximately at that speed and for Guatemala’s market, it was adequate.

The center photo was our freight train operating through an open-air market which was typical of the challenges we face when operating in developing countries. I was in Cambodia last week and I took a photo that was virtually identical to this one of our main line. You can find this type of scene all over the world in urban areas; coming into the main terminal in Mumbai, for example, there are people living within 6 inches of the passing trains. It is just a fact of urban life in the developing world.

The last photo is our main line through Guatemala City which looks like one of the Conrail lines that I was responsible for in New York City in the late 1970s. And yet in this environment, we were able to operate 1½ years without any personal injuries. We measure ourselves by small victories and the fact that were able to operate in that environment was a testament to our safety culture.

The problem though is that most railroads, even in the USA, are worth more dead than alive. The real estate is almost always worth more than a functioning railroad. Countries need to decide if they want a shopping mall with the maximum amount of money up front, or have a form of transportation that is strategic and benefits the economy, which the railroad itself really can’t capture. There is a whole economic school of thought about...
“capturing externalities.” It is very difficult for a railroad to get paid for all of the value it creates. So you have this tension between wanting to provide transportation and liquidating yourself so you can sell your assets to a shopping mall developer, and in fact that is one of the reasons there is no longer a railroad coming to State College. The Bellefonte Central was worth more as real estate than it was as a railroad, and that is one of the reasons there is no longer a railroad to this community.

In this photo, this is a sugar truck running on our railroad, without paying. The electricity poles were installed by private sector companies, without paying. There is an underlying culture of theft at the highest level of the business community and this was the downfall of the Guatemala railroad. A business oligarch offered us the opportunity to remain 50% shareholders in our own company. We declined, and as a result the government issued a decree of “Lesividad,” which is a Spanish word for “against the interests of the State”. We were forced to shut down in 2007.

However, there was a solution for us but unfortunately not for the railroad. After the railroad was shut down, the bridges were stolen in broad daylight. These were not our bridges; they belonged to the government and therefore to the Guatemalan people. We never owned this railroad; and like many deals in the USA, you can lease a railroad where someone else is the landlord. The SEDA-COG railroads in central Pennsylvania are owned by a local government authority, and leased to an operator. Norfolk Southern is different; they own their own assets. But for marginal railroads, quite often there is a public sector entity that owns the assets with a private sector operator running the railroad, secure in the knowledge that the private sector operator will not steal the rails and the bridges. But in Guatemala, these photos show steel bridges that in some cases were 300 feet high that disappeared literally in broad daylight.

Just to review the timeline:

- 1996 – abandoned by the public sector
- 1999 – restored to operation by the private sector with NO public funding
- 2005 – oligarch “offer” to become 50% shareholder in our own company
- 2006 – “Lesivo” was declared against us in an effort to get those real estate assets, etc. that we had cleaned up
- 2007 – (June) the Guatemalan government forgot that the month before Lesivo was declared, they signed the Central American Free Trade Agreement (CAFTA)
- 2007 – (Sep) operations suspended; we took them to arbitration
- 2008 – 2012 – infrastructure stolen
- 2012 – CAFTA arbitration award
- 2013 – six years later we were paid for our investment plus what the tribunal decided what our profit “should have been.” It did not cover our legal costs, which were close to what we recovered from the investment, but the point is that a company from Pittsburgh with five employees took on a country of 13 million people for justice. Everybody lost, but we lost less than they did.
Germany: Hamburg-Köln-Express (HKX)

Let’s go back to the title, “Scarier Parts of the World”. Why is Germany on this list? One could argue that from a financial risk perspective, the scariest thing that you can do is try to compete with a government company, especially where the rules are made by the government.

Nonetheless, we are now in the intercity passenger rail business in Germany and we run, by US standards, what would be high-speed service between Hamburg and Cologne. We run up to 3 trips per day at roughly 100 mph. We started running this service in July 2012 after a lot of start-up complications. For those of you that have read that passengers never make money, we hope that is not the case. There is no subsidy but we are after a different market than the incumbent national railway Deutsche Bahn which runs every hour. Our demographic customer base looks remarkably like Megabus with college students, retirees, etc., but not business people. We found these customers in nontraditional ways since we are not permitted to use the ticket offices of German railways so we had to find other ways.

We bought some passenger coaches from Austria five years ago and we hope soon that we will be permitted to run them in Germany once it has been proven that they’re not dangerous. These coaches actually ran into Germany in the past, but recently we were told that we needed to prove that the new curtains we installed won’t burst into flames and endanger the lives of the traveling public. So we are in the process of doing that.

One of the neat things about being in the passenger business is that it allows for one-on-one interaction with the passengers. For example, these are sample birthday cakes that our passengers made for HKX’s first birthday. This is not the type of treatment you get on the freight side; these people genuinely like us and it is reflected in these birthday cakes.

A word of caution, however; with all the talk about the EU and how they’re moving forward, the EU is the Tower of Babel, a hall of mirrors, a mine field and a quagmire all wrapped up in one. We realize the environment that we’re going into, but this is why Europe is so scary: there is wealth and the financial capacity to do things for ideological reasons as opposed to economic reasons. You don’t do this in developing countries because they have less
capacity to do things purely based on ideology. I would argue that this is why Europe is just as scary as Central America, the Former Soviet Union, etc.

**RDC Investment Philosophy**

A lot of what RDC has done is the legacy of my father Henry Posner, Jr. who was the wisest person that I've ever met, and for those who worked with him many felt him to be the wisest person they had ever met. A couple key things that will serve you well in your business career are the following:

- Work with partners
- Never make too good of a deal
- Encourage disagreement
- Choose your battles
- Recognize that “You don’t know what you don’t know”

Note the last bullet point. Whenever we have a particular quagmire-type problem, it is always good to hit the reset button and reflect on what we know and don’t know.

Over the years we’ve developed an investment philosophy. In descending priority it is:

1. Is the country serious?
2. Can you find local partners who are capitalists and entrepreneurs as we would define them? If you can’t satisfy at least these two conditions, you should probably move on.
3. Who are the competitors for the market? If your competition is a government railway or someone who is irrational, then you are unlikely to succeed.
4. Who are the competitors in the market? That usually means trucks or other passenger operators, etc.
5. Can you structure something for the market that makes sense? Our point is that you must satisfy all 5 of these in order to really have something.
6. Even in the USA, you must answer the question, “Is the price right?” Because if you overpay, then by definition you are locking yourself in for failure.

What is the consistent theme of investing? There are other companies in the USA that own short line railroads, etc., but if you compare RDC with our peers in the U.S. rail industry, RDC is different. We do not see operational synergies among our various companies; we do not see commercial synergies; each company is a stand-alone with their own stand-alone management. Also, RDC is the “Investor of Last Resort”. People do not call us when there is a great deal that is highly profitable and they’re looking for the highest price; we usually get called when no one else will talk to them. That has served us well and is actually how our investment in the Iowa Interstate began. And finally, focus on local partners. If you don’t have the right local partners, you are not likely to succeed. Everything that RDC has accomplished outside of the USA has been more about who our partners were or weren’t than who we are. As I pointed out at the beginning, everything RDC does is with Joint Ventures. This is not “The RDC Show”. Rather it is a locally constructed joint venture with local partners, structured to meet local needs.
Unique Characteristics of RDC

What is unique about RDC in terms of how we identify investments? After 23 years internationally, we have a certain amount of experience in identifying, screening and structuring transactions. It usually begins with a phone call or E-mail. We are flexible culturally—we have passports and speak some foreign languages. Additionally, we have a broad base of resources. A classic example is the startup of our investment in Colombia where our general manager was South African, the chief mechanical officer was South African, the maintenance manager was from Guatemala, and the operations manager was from Peru. Why? Because the locomotives were like Mozambique, the mountains were like Peru, and the track gauge was like Guatemala. More importantly, when you work with these people, each of them has been battled-tested under different circumstances. That is how we got a dead railroad on the Pacific side of Colombia back up and running.

Risk vs. Reward

RDC gets asked all the time if we’re in it for the macho thrill, etc. Not really. If we weren’t making money doing this, we would have been out of business a long time ago.

Looking at the graph (red =bad; green=good), the anticipated risk for Estonia was traffic because we were competing for port business coming out of Russia. All of Estonian Railways’ business is coming out of Russia looking for competitive ports, i.e. oil going to the Baltics. There are Estonian ports, Lithuanian ports, Latvian ports or Russian ports. But even though we thought the risk was traffic, the actual risk was expropriation. In the EU it is kind of perverse. When Estonia joined the EU, that created additional risk because any time you add layers of regulation to wealth, it is a Petri dish for corruption. The solution in Estonia was the backup of the Privatization Agreement, and if necessary, taking the country to arbitration. The result was that we were able to sell the company with a good financial result.

In Guatemala, we did not anticipate that expropriation would be the result. Fortunately, CAFTA (Central American Free Trade Agreement) was there for us.

In Mozambique, it worked out more or less like we anticipated. We cleaned up the railroad and got it stabilized, and along came some local investors who were fronting for Brazilians, who were fronting for Chinese. So we actually made money in Africa with the sale, which is quite unusual in our business.

But even in the USA, there is the threat of re-regulation and the prospect for a backdoor expropriation. However, on future presentations of this topic, I’m going to replace the USA’s actual risk from threat of expropriation to overpaying. The reason is that there is a trend in the USA with so many companies paying high prices for railroads. And the mitigation in the USA is, for example, the state of Pennsylvania, who loves to give money away; they will take over your track budget if you have overpaid for your railroad. These are some mitigating factors.
But what is the cultural root of this type of risk? I would argue that is a Combination Cause. As a railroad operating officer, when you have an accident, there is no such thing as a combination cause. It is either a rules violation or a track or mechanical cause. It is not acceptable to blame a combination cause, but what you can say is that there is a primary cause and a contributing factor.

In many cases, I believe that the root cause of events from places like Estonia to Princeton, New Jersey, (where the station has been donated to the university by Governor Christie, who just happens to be on the university’s board) is value. And if you mix that with a Culture of Impunity, the combination of the two results in things like Estonia changing the rail regulatory law, Guatemala doing the expropriation, and the Princeton station being donated. So how do you deal with that? The primary defense is usually the Rule of Law: with Estonia it was the privatization agreement; in Guatemala it was CAFTA; and in the case of New Jersey, once you get outside of the New Jersey legal system, there are things such as the Surface Transportation Board. A secondary defense in each case is a reputational thing that can be quite valuable. For example, Estonia is now a member of the EU.

Conclusions

To conclude, the biggest source of risk is the public sector; railways are worth more dead than alive; we’ve seen expropriation in EU countries as well as developing countries; and finally, where there is value and regulation, it is a Petri dish for corruption.

How do you defend yourself in that environment? It is all about shareholder structure, who your partners are, and trying to introduce some aspect of Rule of Law. Most importantly, railways reflect the culture and character of their territory; that applies to the USA, Europe, the developing world, etc.

RDC takes inspiration from many sources and one of my favorites is Che Guevara: “The only struggle that is lost is that which is abandoned.” That is what kept us going in Guatemala. And the idea that we would be able to take on a country of 13 million people and win, was not part of the business plan, but is what ultimately prevailed.

This photo (right) was taken in Mozambique and consists of multi-cultural people. RDC’s motto is, “A Luta Continua...” (“The Struggle Continues…”). No doubt you’ll find us in different countries. For those of you looking at careers, railroading is a great career, and there is a need for the next generation.

Thank you.