



# Consultation on Cost of Capital Rates

CN's Response to  
CP's round 2 submission

Canadian Transportation Agency  
29 January 2021



Canadian National Railway Company's response to CP's round 2 submission pursuant to the Agency's Discussion Paper on the Methodology to Determine Net Rail Investment and Capital Structure for the Calculation of Cost of Capital Rate

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Thank you for the opportunity to comment on the new material submitted by CP in its second round of the consultation. CN appreciates your effort in making this consultation process as open and fair as possible by allowing all participants an equal chance to comment on all submissions. Since most issues have been discussed at length in our original submission, we will keep our comments brief and limited to only the discussion about issue 4 as suggested.

#### Issue 4: How to apportion general purpose long-term debt of a railway company between its Canadian rail entities and nonregulated entities?

While the CP submission in this second round, with its useful examples of calculations, seems to be new with respect to CP's first round submission, it is in line with and supports CN's previously stated position:

1. The cost of capital is most appropriately determined at the consolidated company level, which is the only entity that raises capital on the markets both through equity and debt. This would avoid all the problems, potential errors and pitfalls of allocation amongst the different operating divisions of a Company.
2. Notwithstanding the above, if allocation is still deemed necessary, then assets value is a more appropriate measure for debt allocation rather than traffic volumes in the form of revenue ton miles (RTMs). CN has demonstrated in its submission that RTMs are indicative neither of investments (capital financing needs) nor of revenues (shareholders' expected returns). CN also highlighted in its submission why Gross Book Value (GBV) is more appropriate than the CP preferred measure of Net Book Value (NBV). While CP noted that either of these asset measures would be preferable to RTMs, we note that CP did not provide any supporting arguments as to why CP prefers NBV to GBV.
3. CP's adjustments to the Regulatory Balance Sheet (RBS), that makes its debt:equity ratio more similar to that of the consolidated company, is inline with CN's first proposal of allocating enough debt to the RBS to make its debt:equity ratio equal to that of the consolidated company.

If we allocate debt based on that last point of aiming for similar debt:equity ratios, it will require slightly different treatments for CN and CP because of their different capital structures. However, the different treatments would aim for the same end-result, which is to have a similar debt:equity ratio for the Canadian rail operations as for their respective consolidated companies.

For CN, the parent company that issues the long-term debt (LTD) also operates the Canadian rail division. On its RBS, the LTD appears as an investment because the money is lent to the US rail subsidiary companies. For cost of capital (COC) purposes, CN had proposed to take enough debt out of investment and into LTD as to obtain the same debt:equity ratio as the consolidated company.

For CP, the parent company that issues the LTD does not have any rail operations. Canadian and US rail operations occur in subsidiaries. LTD would then be introduced into the RBS, following a similar aim, by allocating enough debt as to maintain the same debt:equity ratio as the consolidated company. Following this introduction of LTD, CN agrees with CP that some long-term asset needs to be created in order to maintain the RBS in balance, without affecting the RBS shareholder's equity.

It was instructive from CP to illustrate their points with example tables, and we can further emphasize our points using these very same examples.

Table 1 is the same one as presented by CP (page 15) – and we have added below the capital structure information and the calculation of the weighted average cost of capital (WACC) for the different entities. The Excel file containing all the tables presented in our document is hereby attached so that any interested party can examine the calculations in more details.

<b>Hypothetical Corporate Balance Sheets: Consolidated and Rail Divisions</b>				
	<b>Consolidated</b>	<b>Canadian Rail</b>	<b>US Rail</b>	<b>General</b>
	<b>Company</b>	<b>Division</b>	<b>Division</b>	<b>Activities</b>
Current Assets	\$5,000	\$2,500	\$2,300	\$200
Other Assets	\$9,000	\$2,000	\$1,000	\$6,000
Properties	\$86,000	\$52,000	\$34,000	\$0
<b>Total Assets</b>	<b>\$100,000</b>	<b>\$56,500</b>	<b>\$37,300</b>	<b>\$6,200</b>
Current Liabilities	\$4,400	\$2,400	\$1,800	\$200
Deferred Liabilities	\$21,700	\$15,000	\$6,700	\$0
Long Term Debt	\$36,500	\$17,000	\$15,500	\$4,000
Share Capital	\$2,000	\$0	\$0	\$2,000
Retained Earnings	\$35,400	\$22,100	\$13,300	\$0
<b>Total Equity and Liabilities</b>	<b>\$100,000</b>	<b>\$56,500</b>	<b>\$37,300</b>	<b>\$6,200</b>
Debt:Equity Ratio	1.6:1	1.4:1	1.7:1	2.0:1

Data as per CP's example on page 15 of the submission

Additional information and WACC calculations for the different entities:

<b>Capital Structure (\$)</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>
Deferred liability	21,700	15,000	6,700	0
Long term debt	36,500	17,000	15,500	4,000
Equity	37,400	22,100	13,300	2,000
<b>Total Capital Structure</b>	<b>95,600</b>	<b>54,100</b>	<b>35,500</b>	<b>6,000</b>
<b>Capital Structure (%)</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>
Deferred liability	23%	28%	19%	0%
Long term debt	38%	31%	44%	67%
Equity	39%	41%	37%	33%
<b>Total Capital Structure</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Cost of Capital</b>	<b>Cost Rate</b>			
Deferred liability	0.00%			
Long term debt	5.34%			
Equity	12.19%			
<b>WACC</b>	<b>6.81%</b>	<b>6.66%</b>	<b>6.90%</b>	<b>7.62%</b>

Table 1 - CP Hypothetical Example

We first note that both rail divisions in CP's hypothetical example already reflect some LTD debt allocation but the explanation behind the allocation was not furnished, contrary to the intent of this

whole exercise of avoiding arbitrary and subjective debt allocation. The remainder of the CP exercise concerns only the allocation of what remains in General Activities.

The 6.81% WACC of the consolidated company differs from the WACC of each of its divisions, which does not make sense since it is the consolidated company that raises the capital that is then supplied to its divisions, and one would reasonably expect the same WACC to flow through to each of the divisions.

CP then proceeds to allocate the General Activities to the two rail divisions based on their proportion of Properties, which yields *Table 2* presented in CP's document on page 16.

<b>Hypothetical Corporate Balance Sheets: Canadian Rail Division</b>			
	<b>Canadian Rail</b>	<b>Allocation</b>	<b>Canadian Rail</b>
	<b>Unadjusted</b>	<b>of General Activities</b>	<b>Adjusted</b>
Current Assets	\$2,500	\$121	\$2,621
Other Assets	\$2,000	\$3,628	\$5,628
Properties	\$52,000	\$0	\$52,000
<b>Total Assets</b>	<b>\$56,500</b>	<b>\$3,749</b>	<b>\$60,249</b>
Current Liabilities	\$2,400	\$121	\$2,521
Deferred Liabilities	\$15,000	\$0	\$15,000
Long Term Debt	\$17,000	\$2,419	\$19,419
Share Capital	\$0	\$1,209	\$1,209
Retained Earnings	\$22,100	\$0	\$22,100
<b>Total Equity and Liabilities</b>	<b>\$56,500</b>	<b>\$3,749</b>	<b>\$60,249</b>
Debt:Equity Ratio	1.4:1	2.0:1	1.5:1

*Data as per CP's example on page 16 of the submission*

Additional information and WACC calculations for the different entities:

<b>Capital Structure (\$)</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>
Deferred liability	15,000	0	15,000
Long term debt	17,000	2,419	19,419
Equity	22,100	1,209	23,309
<b>Total Capital Structure</b>	<b>54,100</b>	<b>3,628</b>	<b>57,728</b>
<b>Capital Structure (%)</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>
Deferred liability	28%	0%	26%
Long term debt	31%	67%	34%
Equity	41%	33%	40%
<b>Total Capital Structure</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Cost of Capital</b>			
<b>WACC</b>	<b>6.66%</b>	<b>7.62%</b>	<b>6.72%</b>

*Table 2 - CP Adjustment to the Canadian Rail Division*

The WACC of the Canadian Rail division is therefore adjusted from the original 6.66% to 6.72%, which appears to bring it closer to the consolidated 6.88%. But this is not a guaranteed result as it depends on the relative weights of the various components of the capital structure. To illustrate this point, we look at what happens to the U.S. Rail division using the same adjustment technique, as illustrated in *Table 3*.

<b>Hypothetical Corporate Balance Sheets: U.S. Rail Division</b>			
	<b>U.S. Rail</b>	<b>Allocation</b>	<b>U.S. Rail</b>
	<b>Unadjusted</b>	<b>of General Activities</b>	<b>Adjusted</b>
Current Assets	\$2,300	\$79	\$2,379
Other Assets	\$1,000	\$2,372	\$3,372
Properties	\$34,000	\$0	\$34,000
<b>Total Assets</b>	<b>\$37,300</b>	<b>\$2,451</b>	<b>\$39,751</b>
Current Liabilities	\$1,800	\$79	\$1,879
Deferred Liabilities	\$6,700	\$0	\$6,700
Long Term Debt	\$15,500	\$1,581	\$17,081
Share Capital	\$0	\$791	\$791
Retained Earnings	\$13,300	\$0	\$13,300
<b>Total Equity and Liabilities</b>	<b>\$37,300</b>	<b>\$2,451</b>	<b>\$39,751</b>
Debt:Equity Ratio	1.7:1	2.0:1	1.7:1

<b>Capital Structure (\$)</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>
Deferred liability	6,700	0	6,700
Long term debt	15,500	1,581	17,081
Equity	13,300	791	14,091
<b>Total Capital Structure</b>	<b>35,500</b>	<b>2,372</b>	<b>37,872</b>
<b>Capital Structure (%)</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>
Deferred liability	19%	0%	18%
Long term debt	44%	67%	45%
Equity	37%	33%	37%
<b>Total Capital Structure</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Cost of Capital</b>			
<b>WACC</b>	<b>6.90%</b>	<b>7.62%</b>	<b>6.94%</b>

*Table 3 - Applying the CP adjustment to the U.S. Division*

In this case, the U.S. Rail division's WACC moved from 6.90% to 6.94%, i.e. it moved further away from the consolidated WACC of 6.88%. Note that this could have been the result for the Canadian Rail division if the balance sheets of the two divisions were inverted in this hypothetical example.

There lies the problem of any allocation method in that there is no guarantee to arrive at a result that resembles the consolidated corporation, which is the one that is raising the capital in the markets in the first place, and the one that investors assess in their decision on whether to invest. If the purpose of the Agency's COC determination is to ensure that the railways are able to pay investors expected returns, then the determination must be representative of what investors see at the consolidated level since investors do not see nor invest independently in any of the individual operating divisions or subsidiaries.

This distortion between the consolidated company and its operating divisions creates a serious disconnect in the Agency determinations. For example, from the publicly available audited annual financial statements, the leverage of both railways on a consolidated basis is shown in *Table 4*.

<b>2018 audited annual report</b>	<b>CP</b>	<b>CN</b>
Total long-term debt (LTD)	8,696 \$M	12,569 \$M
Shareholders' equity (SHE)	6,636 \$M	17,641 \$M
Leverage (LTD/SHE)	131%	71%

*Table 4 – 2018 Consolidated Leverage of CN and CP*

Yet in its Decision No. LET-R-40-2019, the Agency determined that the railways' 2018 leverage on their respective RBS was as shown in *Table 5*.

<b>Agency Decision No.</b>	<b>CP</b>	<b>CN</b>
<b>LET-R-40-2019</b>		
RBS Leverage (LTD/SHE)	50%	219%

*Table 5 – 2018 RBS Leverage of CN and CP*

This led the Agency to determine in 2019 that CP's WACC was 7.55% whereas that of CN was 5.04%, a result that was higher by 251 basis points (bps), contrary to what would be expected from the railways public financial statements. This is largely due to the improper allocation of debt to Canadian rail operations, which leads to vastly different leverage for both railways on their Canadian-only regulatory balance sheet (RBS). Moreover, a leverage of 219% for CN is simply not credible for a corporation that maintains an A credit rating.

While we appreciate the Agency's effort in this consultation to find a better way of estimating the WACC for Canadian rail operations, we must advocate for a method that is both sound theoretically and does not produce results lacking credibility.

The only way to guarantee that a division's results are consistent with those of the consolidated entity, and consistent amongst different divisions, is to use one of the distribution methods based on the total assets of the divisions, as illustrated by Dr. Gould in the McMillan report. We will illustrate below these same methods using the CP hypothetical example. However, we must first emphasize that this theoretically sound framework does not start from the division balance sheet and then try to adjust it, but rather start from the consolidated balance sheet and allocates it based on the assets of the divisions.

When we transform *Table 1* using the following definitions:

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$\text{Net Properties} = \text{Properties} - \text{Deferred Liabilities}$$

$$\text{Debt: Equity Ratio} = \frac{\text{Long Term Debt}}{(\text{Share Capital} + \text{Retained Earnings})}$$

We obtain the results shown in *Table 6*. In this net method of allocation, only investors-supplied capital appears in the capital structure, a presentation long preferred by CN. The deferred income taxes, mostly a fiscal benefit from accelerated depreciation allowance given by governments as an incentive for investors to invest in capital goods and projects, appear as a reduction in the cost of properties.

<b>Hypothetical Corporate Balance Sheets: Consolidated and Rail Divisions</b>				
	<b>Consolidated</b>	<b>Canadian Rail</b>	<b>U.S. Rail</b>	<b>General</b>
	<b>Company</b>	<b>Division</b>	<b>Division</b>	<b>Activities</b>
<b>Working Capital</b>	\$600	\$100	\$500	\$0
Other Assets	\$9,000	\$2,000	\$1,000	\$6,000
<b>Net Properties</b>	<b>\$64,300</b>	<b>\$37,000</b>	<b>\$27,300</b>	<b>\$0</b>
<b>Total Assets</b>	<b>\$73,900</b>	<b>\$39,100</b>	<b>\$28,800</b>	<b>\$6,000</b>
Current Liabilities	\$0			
Deferred Liabilities	\$0			
Long Term Debt	\$36,500	\$17,000	\$15,500	\$4,000
Share Capital	\$2,000	\$0	\$0	\$2,000
Retained Earnings	\$35,400	\$22,100	\$13,300	\$0
<b>Total Equity and Liabilities</b>	<b>\$73,900</b>	<b>\$39,100</b>	<b>\$28,800</b>	<b>\$6,000</b>
<b>Debt:Equity Ratio</b>	1.0:1	0.8:1	1.2:1	2.0:1

<b>Capital Structure (\$)</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>
Deferred liability	0	0	0	0
Long term debt	36,500	17,000	15,500	4,000
Equity	37,400	22,100	13,300	2,000
<b>Total Capital Structure</b>	<b>73,900</b>	<b>39,100</b>	<b>28,800</b>	<b>6,000</b>
<b>Capital Structure (%)</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>
Deferred liability	0%	0%	0%	0%
Long term debt	49%	43%	54%	67%
Equity	51%	57%	46%	33%
<b>Total Capital Structure</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Cost of Capital</b>	<b>Cost Rate</b>			
Deferred liability	0.00%			
Long term debt	5.34%			
Equity	12.19%			
<b>WACC</b>	<b>8.81%</b>	<b>9.21%</b>	<b>8.50%</b>	<b>7.62%</b>

*Table 6 - Balance Sheets for the Net Method of Allocation*

The distribution of the consolidated company balance sheet to each of its divisions is then performed based on the ratio of Total Assets. Thus, the percentage allocation to the Canadian Rail division would be as follows:

$$\text{Canadian \%} = \frac{\$39,100}{(\$39,100 + \$28,800)} = 57.58\%$$

Applying the above percentage to the consolidated balance sheet, we obtain the adjusted Canadian Rail division's balance sheet as shown in *Table 7*.

<b>Hypothetical Corporate Balance Sheets: Canadian Rail Division</b>	
	<b>Canadian Rail</b>
	<b>Adjusted</b>
Working Capital	\$346
Other Assets	\$5,183
Net Properties	\$37,027
<b>Total Assets</b>	<b>\$42,555</b>
Current Liabilities	\$0
Deferred Liabilities	\$0
Long Term Debt	\$21,018
Share Capital	\$1,152
Retained Earnings	\$20,385
<b>Total Equity and Liabilities</b>	<b>\$42,555</b>
Debt:Equity Ratio	1.0:1

<b>Capital Structure</b>	<b>\$ Thousands</b>
Deferred liability	0
Long term debt	21,018
Equity	21,537
<b>Total Capital Structure</b>	<b>42,555</b>
<b>Capital Structure</b>	<b>Weight</b>
Deferred liability	0%
Long term debt	49%
Equity	51%
<b>Total Capital Structure</b>	<b>100%</b>
<b>Cost of Capital</b>	
<b>WACC</b>	<b>8.81%</b>

*Table 7 - Canadian Balance Sheet Adjusted by the Net Method*

It is instructive to note two important factors:

1. The WACC of the Canadian Rail division is the same as for the consolidated corporation, which is both reasonable and expected;
2. The leverage (debt:equity ratio) of the Canadian Rail division is identical to the leverage of the consolidated corporation, which is again reasonable and expected.

The percentage allocation to the U.S. Rail division would be:

$$US \% = 1 - Canadian \% = 1 - 57.58\% = 42.42\%$$

Applying the above percentage to the consolidated balance sheet, we obtain the adjusted U.S. Rail division's balance sheet as shown in *Table 8*.

<b>Hypothetical Corporate Balance Sheets: U.S. Rail Division</b>	
	<b>US Rail</b>
	<b>Adjusted</b>
Working Capital	\$254
Other Assets	\$3,817
Net Properties	\$27,273
<b>Total Assets</b>	<b>\$31,345</b>
Current Liabilities	\$0
Deferred Liabilities	\$0
Long Term Debt	\$15,482
Share Capital	\$848
Retained Earnings	\$15,015
<b>Total Equity and Liabilities</b>	<b>\$31,345</b>
Debt:Equity Ratio	1.0:1

<b>Capital Structure</b>	<b>\$ Thousands</b>
Deferred liability	0
Long term debt	15,482
Equity	15,863
<b>Total Capital Structure</b>	<b>31,345</b>
<b>Capital Structure</b>	<b>Weight</b>
Deferred liability	0%
Long term debt	49%
Equity	51%
<b>Total Capital Structure</b>	<b>100%</b>
<b>Cost of Capital</b>	
<b>WACC</b>	<b>8.81%</b>

*Table 8 - U.S. Balance Sheet Adjusted by the Net Method*

We also note that for the U.S. Rail Division, the WACC and the leverage are both identical to the Canadian Rail division and the consolidated corporation.

Allocating the consolidated balance sheet based on the proportion of total assets produces a fair and consistent result for all divisions, a result that is also consistent with the consolidated company.

If we want to show the deferred income taxes as part of liabilities rather than as a reduction in the cost of assets, we get what is called the Gross Method, illustrated in *Table 9*.

<b>Hypothetical Corporate Balance Sheets: Consolidated and Rail Divisions</b>				
	<b>Consolidated</b>	<b>Canadian Rail</b>	<b>U.S. Rail</b>	<b>General</b>
	<b>Company</b>	<b>Division</b>	<b>Division</b>	<b>Activities</b>
<b>Working Capital</b>	\$600	\$100	\$500	\$0
Other Assets	\$9,000	\$2,000	\$1,000	\$6,000
Properties	\$86,000	\$52,000	\$34,000	\$0
<b>Total Assets</b>	<b>\$95,600</b>	<b>\$54,100</b>	<b>\$35,500</b>	<b>\$6,000</b>
Current Liabilities	\$0			
Deferred Liabilities	\$21,700	\$15,000	\$6,700	\$0
Long Term Debt	\$36,500	\$17,000	\$15,500	\$4,000
Share Capital	\$2,000	\$0	\$0	\$2,000
Retained Earnings	\$35,400	\$22,100	\$13,300	\$0
<b>Total Equity and Liabilities</b>	<b>\$95,600</b>	<b>\$54,100</b>	<b>\$35,500</b>	<b>\$6,000</b>
<b>Debt:Equity Ratio</b>	1.0:1	0.8:1	1.2:1	2.0:1

<b>Capital Structure (\$)</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>	<b>\$ Thousands</b>
Deferred liability	21,700	15,000	6,700	0
Long term debt	36,500	17,000	15,500	4,000
Equity	37,400	22,100	13,300	2,000
<b>Total Capital Structure</b>	<b>95,600</b>	<b>54,100</b>	<b>35,500</b>	<b>6,000</b>
<b>Capital Structure (%)</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>	<b>Weight</b>
Deferred liability	23%	28%	19%	0%
Long term debt	38%	31%	44%	67%
Equity	39%	41%	37%	33%
<b>Total Capital Structure</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Cost of Capital</b>	<b>Cost Rate</b>			
Deferred liability	0.00%			
Long term debt	5.34%			
Equity	12.19%			
<b>WACC</b>	<b>6.81%</b>	<b>6.66%</b>	<b>6.90%</b>	<b>7.62%</b>

*Table 9 - Balance Sheets for the Gross Method of Allocation*

For distributing the balance sheet to the Canadian and U.S. Rail Divisions, the ratios of Total Assets are 60.38 % for the Canadian Rail division, and 39.62% for the U.S. Rail division. Using these percentages, we obtain the results illustrated in *Table 10*.

<b>Hypothetical Corporate Balance Sheets: Canadian Rail Division</b>		<b>Hypothetical Corporate Balance Sheets: U.S. Rail Division</b>	
	<b>Canadian Rail Adjusted</b>		<b>U.S. Rail Adjusted</b>
Working Capital	\$362	Working Capital	\$238
Other Assets	\$5,434	Other Assets	\$3,566
Properties	\$51,926	Properties	\$34,074
<b>Total Assets</b>	<b>\$57,723</b>	<b>Total Assets</b>	<b>\$37,877</b>
Current Liabilities	\$0	Current Liabilities	\$0
Deferred Liabilities	\$13,102	Deferred Liabilities	\$8,598
Long Term Debt	\$22,039	Long Term Debt	\$14,461
Share Capital	\$1,208	Share Capital	\$792
Retained Earnings	\$21,374	Retained Earnings	\$14,026
<b>Total Equity and Liabilities</b>	<b>\$57,723</b>	<b>Total Equity and Liabilities</b>	<b>\$37,877</b>
Debt:Equity Ratio	1.0:1	Debt:Equity Ratio	1.0:1

  

<b>Capital Structure</b>	<b>\$ Thousands</b>	<b>Capital Structure</b>	<b>\$ Thousands</b>
Deferred liability	13,102	Deferred liability	8,598
Long term debt	22,039	Long term debt	14,461
Equity	22,582	Equity	14,818
<b>Total Capital Structure</b>	<b>57,723</b>	<b>Total Capital Structure</b>	<b>37,877</b>
<b>Capital Structure</b>	<b>Weight</b>	<b>Capital Structure</b>	<b>Weight</b>
Deferred liability	23%	Deferred liability	23%
Long term debt	38%	Long term debt	38%
Equity	39%	Equity	39%
<b>Total Capital Structure</b>	<b>100%</b>	<b>Total Capital Structure</b>	<b>100%</b>
<b>Cost of Capital</b>		<b>Cost of Capital</b>	
<b>WACC</b>	<b>6.81%</b>	<b>WACC</b>	<b>6.81%</b>

*Table 10 - Canadian and U.S. Balance Sheet Adjusted by the Gross Method*

We again note that both divisions have the same WACC and the same debt:equity ratio as for the consolidated corporation.

## **Conclusion**

The consolidated balance sheet is the bedrock of the financial status of a railway. Investors rely on it for their decisions on whether to invest in a railway, both through equity and debt. It stands to reason that the determination of the cost of capital should be based upon the same information that investors consider in their investment decision and that shapes their determination of expected returns.

The appropriate allocation of liabilities across divisions, based on their total assets, yields WACC results that are identical across divisions and the consolidated company. It therefore stands to reason that the use of the consolidated results is the most ideal and appropriate method, as it would avoid the unnecessary allocation step and avoid inexplicable differing results across divisions.