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Burlington Northern's 1994 Texas Intermodal Business Withdrawal

The Bad, the Ugly and the (Very) Good

October 28, 2025

BN's 1994 Texas Intermodal Withdrawal

- Background
- Setting the Stage
- The Bad
- The Ugly
- The (Very) Good
- Lessons (Re)Learned



Background

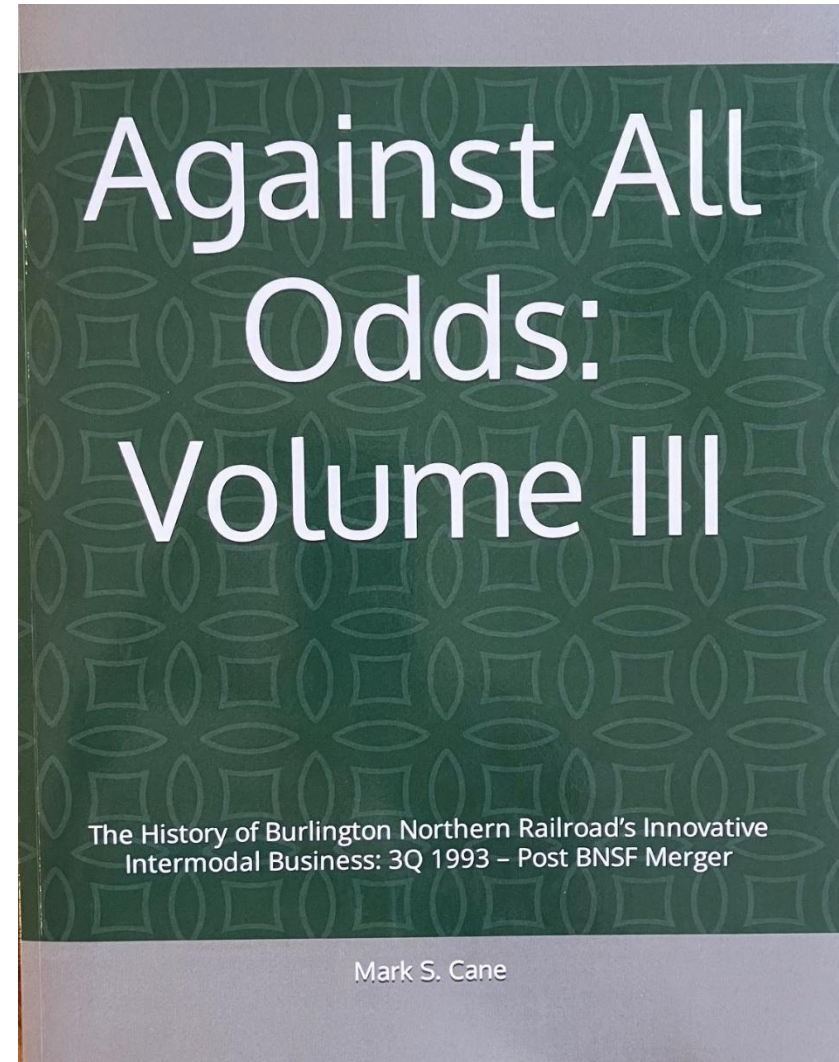
- Burlington Northern Railroad - VP Intermodal and BN-Santa Fe Merger Team
- Amtrak - President Amtrak Intercity
- Menasha Material Handling Corporation – President
- Author

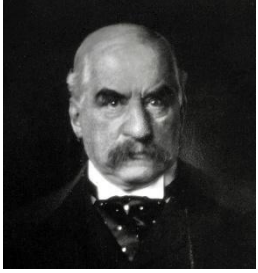
Background (contd.)

I wrote *Against All Odds* and *Wow! Did We Ever Make a Difference* to document the history of BN's Intermodal and Grain Businesses.

Sandhouse veteran Ed Mosser told me he thought the Sandhouse Group would be fascinated by stories in both books.

Bon French connected me with Norm Carlson and I suggested this story.





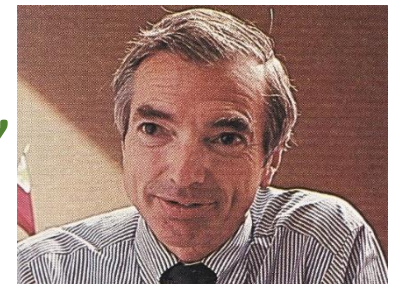
Setting the Stage



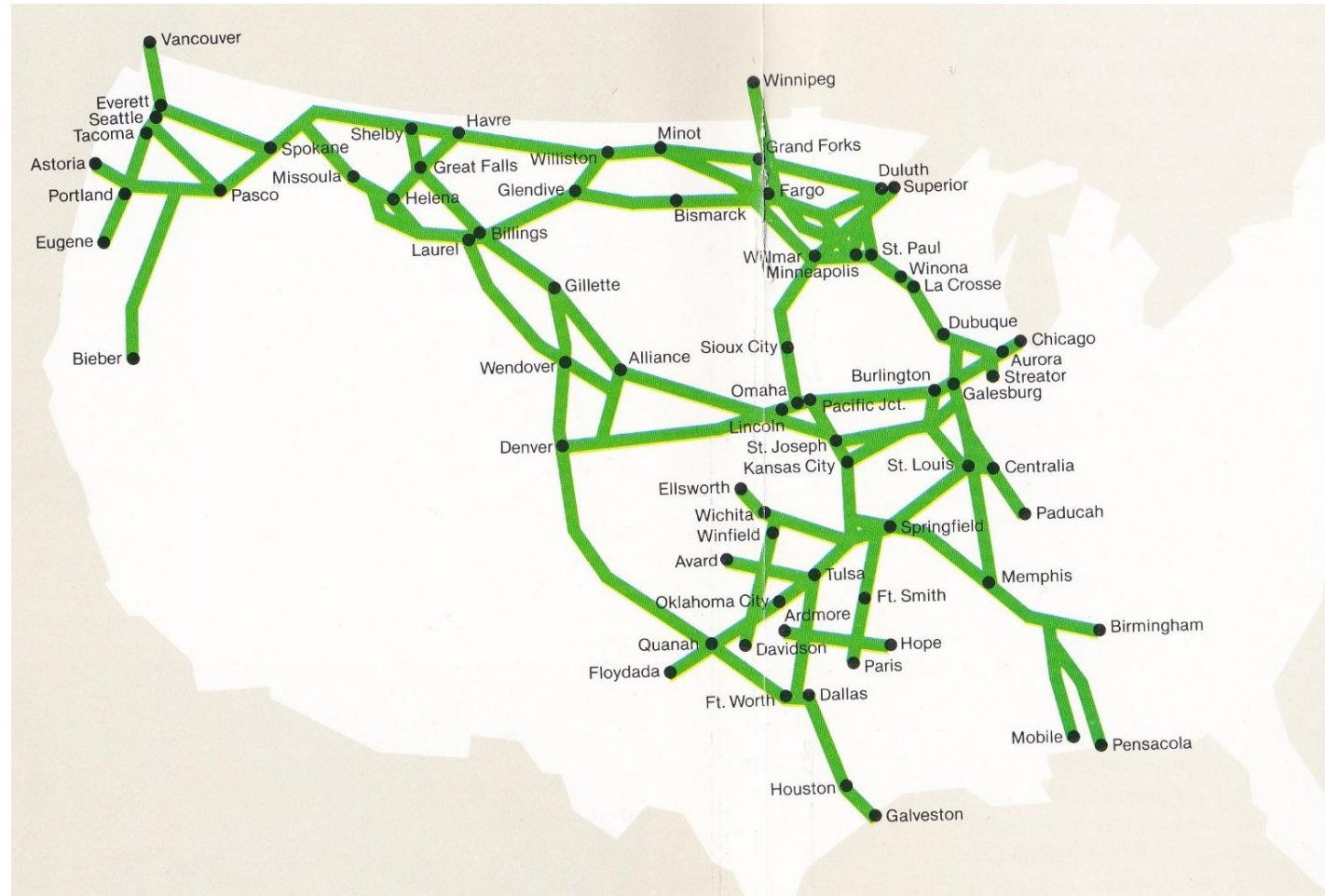
- In 1896, J.P. Morgan reorganized BN-predecessor Northern Pacific Railway bonds into two classes maturing in 1996 and 2046.
- Both restricted income from NP grant land to railroad improvements.

Critical BNRR Events: 1970s - 1980

- 1970s Powder River Basin coal investment boom accelerated
- BN revenue grew 289% and operating income grew 310% between 1970 and 1979
- 1979 operating ratio was 95.3% and return on net investment was 3.8% while the prime interest rate hit 15.75% in December
- The 1980 BN-Frisco Railroad merger, and ...
- BN hired Atlantic Richfield executive Richard Bressler, as CEO. “The railroad is a “sh---y business.”



BN's Route System Post-Frisco Merger



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BN Created the BN Inc. Holding Company and the Intermodal Business Unit (IBU)

- Response in 1981 to the Staggers Act, poor railroad profitability, and underinvestment in resource businesses
- BN's IBU was the first fully integrated Strategic Business Unit in the industry: terminals, equipment and marketing, led by Bill Greenwood
- Intermodal was treated as a corporate step-child

Initial IBU Accomplishments

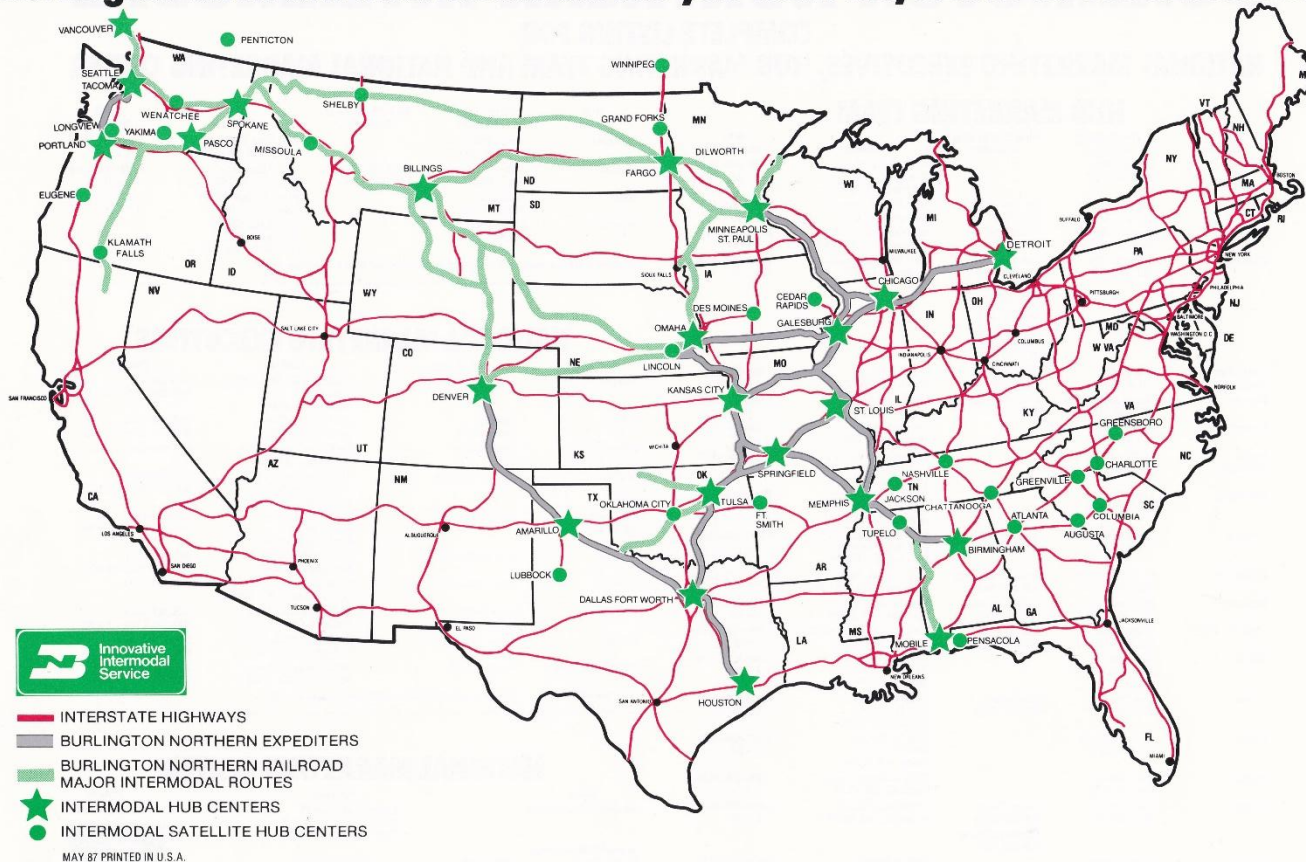


- Reduced from 144 piggyback (96% circus) ramps in 1981 to 22 mechanized Hubs, run by truckers, by March, 1985 (total industry ramp mechanization level was only 32% in 1985)
- Aggressively tested and adopted new technology equipment. Introduced common-user double stack services, dedicated trains (90% of business) and  by the end of 1986
- Introduced *BN AMERICA* as the first railroad-controlled domestic container business in April, 1988 to restructure the domestic and international U.S. intermodal supply chains



1988 BN Intermodal Infrastructure

Burlington Northern Intermodal serves you from anywhere across the nation.



Contact your transportation company to put BN Intermodal to work for you.

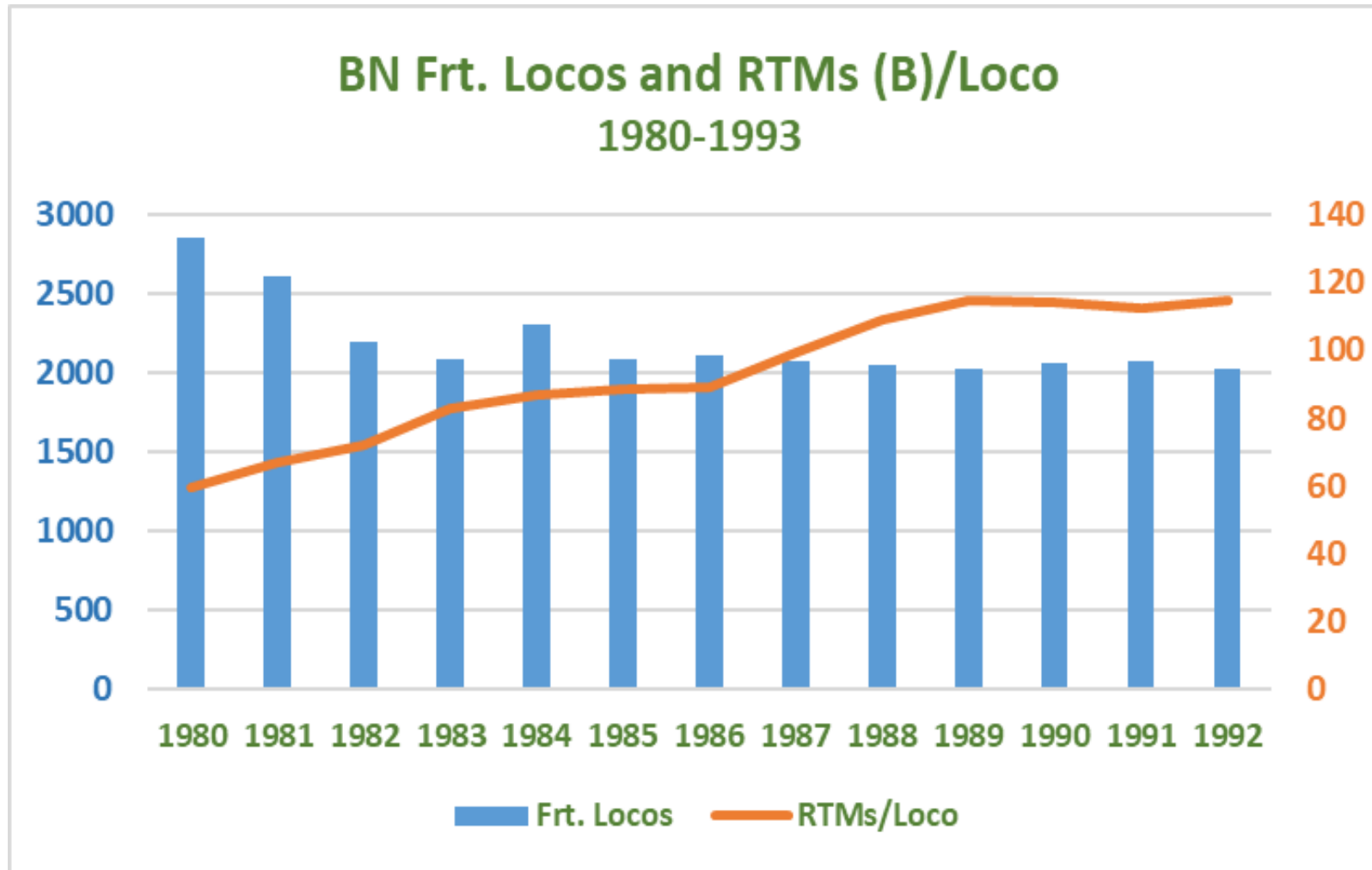
The Bad

- UP-CNW entered the Powder River Basin in late 1984. Coupled with subsequent coal rate case losses and the ETSI settlement, BN's coal market share and profits were progressively whacked
- A court-approved defeasement of NP/Morgan bonds, on January 12, 1988, detached land and mineral rights from the railroad
- BN Inc. split Burlington Resources from the railroad in 1988. BNRR (the new BN Inc.) assumed \$2.8 billion LT debt including \$1.5 billion related to acquisitions of El Paso Energy and Southland Royalty Trust
- Post-split BNI debt/equity ratio increased to 76% versus only 27% for the combined company in 1982

The Bad - Continued

- BN's Board and CEO adopted debt paydown as the top company priority, effective 1989, and locomotive investment lagged
- BN's current-dollar cash from rail operations fell from \$1.092 billion in 1984 to only \$393 million in 1991
- BN's Board and CEO adopted operating ratio and debt pay down as the two top corporate priorities in 1992
- A majority of BN executives believed it should be a “bulk” railroad
- BN's Intermodal business lost focus and the IBU was disintegrated in Sep. 1991 – the step child became a ‘bastard’

The Bad - Continued



The Ugly – Task Force Reveals the 1991 Intermodal Financial Situation

For the year 1991

IML PROFITABILITY BY MARKET GROUP (Millions)

<u>Group</u>	<u>Revenue</u>	<u>Short Term Margin</u>	<u>Mid Term Margin</u>	<u>Long Term Margin</u>
Domestic	\$ 282.1	\$ 70.1	\$ 13.0	\$ (18.7)
BNA	164.4	25.5	(.5)	(15.4)
International	<u>260.6</u>	<u>83.7</u>	<u>38.6</u>	<u>9.1</u>
Total	\$707.1	\$ 179.3	\$ 51.1	\$(25.0)

1991 Intermodal Return on Assets

RETURN ON ASSET CALCULATION (Millions)

Formula:

Net Profit Margin (Operational Efficiency)	X	Asset Turnover (Asset Utilization)	=	Return on Assets (Asset Earning Power)
$\frac{\text{Long Term Margin} * (1-\text{Tax Rate})}{\text{Revenue}}$	X	$\frac{\text{Revenue}}{\text{Market Value of Intermodal Owned Assets}}$	=	$\frac{\text{Long Term Margin} * (1-\text{Tax Rate})}{\text{Market Value of Intermodal Owned Assets}}$

1991 Performance:

$\frac{\$-25 * .624}{\$707.1}$	X	$\frac{\$707.1}{\$357.1}$	=	$\frac{\$-25 * .624}{\$357.1}$
-2.2%	X	1.98	=	-4.4%

Note: Market value of Intermodal Owned Assets is equal to the Market Value of BN-Owned Intermodal Assets Employed Less Roadbed.

BN's 1992 Intermodal Challenge

**Return on Assets Target is 10.2% Plus a Senior Management
Directed Financial Return**

- 1991 Return was -4.4%
- To earn 10.2%, income has to increase by \$83 million (to \$58 million) before tax, assuming the assets owned by Intermodal remain the same.

I Assumed Leadership of Restored IBU in Sept. 1992, and Accountability for the Financial Challenge

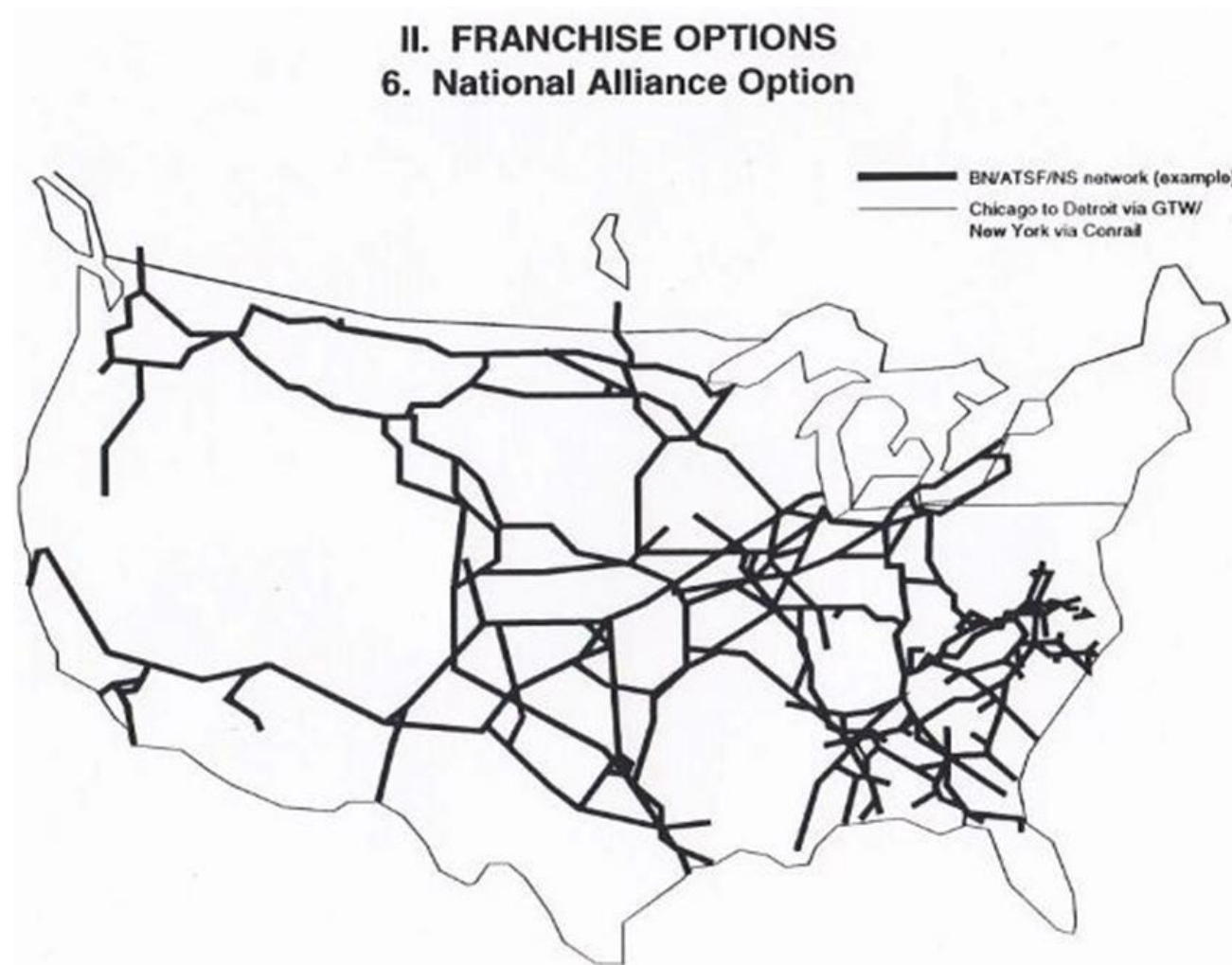
- Directive was to exceed the 10.2% ROA target by the end of 1995
- Comparable after-tax 1991 BN Railroad ROA was 4.6%
- Immediate actions were taken to enhance IBU service and profitability while formulating a multi-pronged strategic plan that was accepted in September, 1993

BN IBU's 1993 Business Plan Summary

BUSINESS PLAN SUMMARY

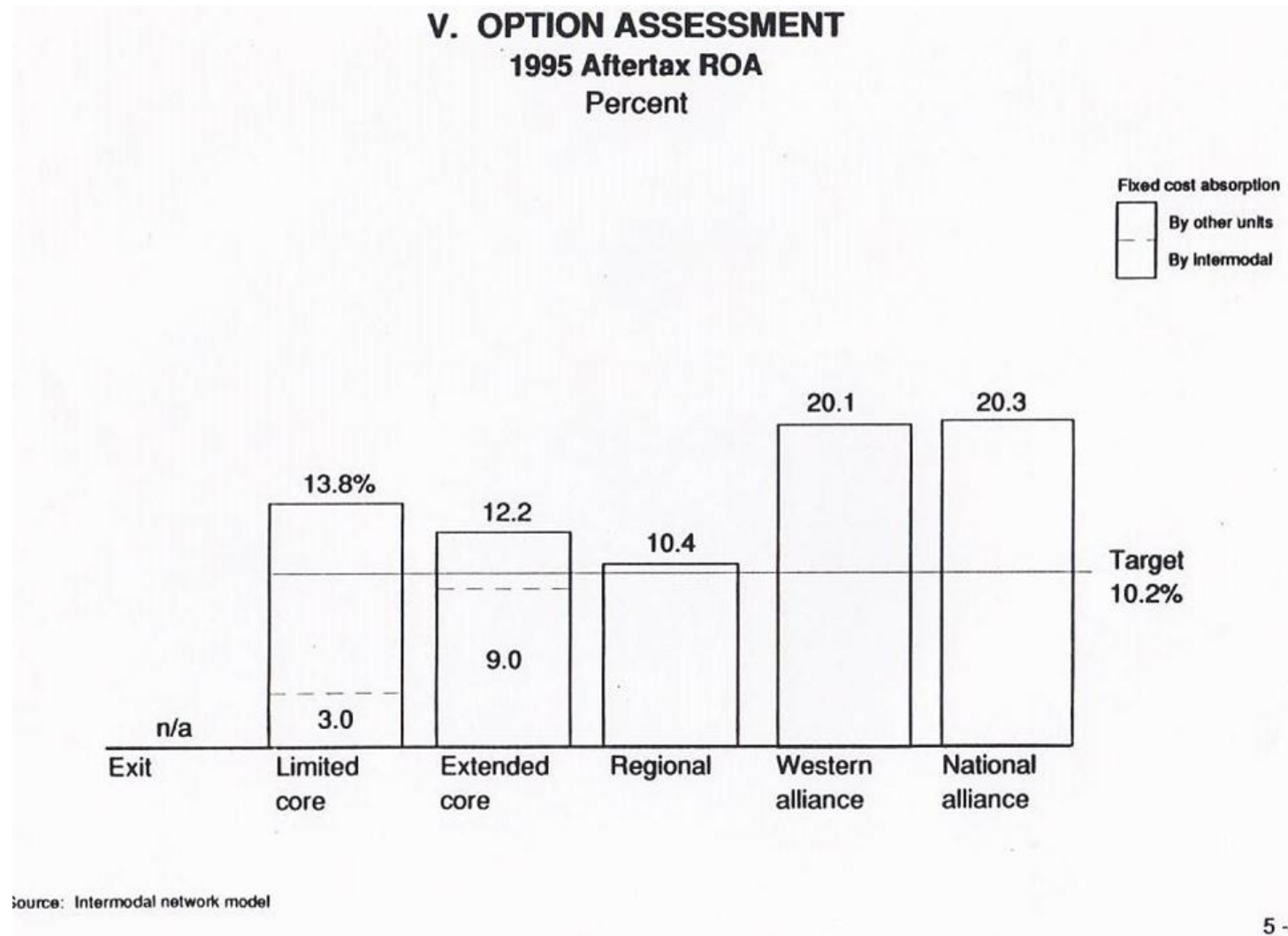
- I. We have significantly improved the profitability of the existing Intermodal franchise
- II. We have evaluated six franchise downsizing and expansion options
- III. The Intermodal business is ripe for growth
- IV. Our competitors are expanding their franchises through targeted alliances
- V. Alliance options generate higher shareholder value than a stand-alone BN franchise
- VI. We should continue targeted rationalization of our regional franchise while rapidly pursuing a western, then national, Intermodal alliance

Targeted Intermodal Footprint to Enable Nationwide BN Viability to Compete Like a Major TL Motor Carrier



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Financial Evaluation of Alliance Options



Significant Progress was Achieved in 1993

INTERMODAL OVERVIEW					
Recent Profit Improvement					
	Task Force <u>1991</u>	<u>Restated</u> <u>1991</u>	<u>1992</u>	<u>1993</u>	
Revenue \$ Millions	\$707	\$717	\$750	\$780	+\$63
Short-term avoidable costs	<u>528</u>	<u>529</u>	<u>536</u>	<u>552</u>	
Cash margin	179	188	214	228	
Mid-term variable costs	<u>128</u>	<u>128</u>	<u>127</u>	<u>113</u>	
Mid-term (PRISM) margin	51	60	87	115	
Fixed (allocated) costs	<u>76</u>	<u>76</u>	<u>75</u>	<u>75</u>	
Fully allocated operating income \$ Millions	<u>-25</u>	<u>-16</u>	<u>12</u>	<u>40</u>	+\$56
Fully allocated operating ratio Percent	104%	102%	98%	95%	
Aftertax ROA Percent	-4.4	-2.8	2.1	6.6	

IBIS 82.5 VS 86.4

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The Ugly - Continued

- BN's continued focus on debt reduction and operating ratio restricted locomotive fleet growth and intensified pressure to allocate them to coal and grain
- The devastating “500-year” floods of 1993 compounded BN's locomotive bind because of extended network disruptions that crushed productivity – it took more assets to produce the same, or less
- Efforts to combine with Santa Fe hit repeated walls
- A critical element of the Intermodal plan was to win Taiwan's Evergreen Marine's business in 1994



The **EVERGREEN** Dilemma

- Requests for the allocation of 17 additional locomotives to handle Evergreen (in the 1994 plan) were denied by BN's CEO and his "bulk-railroad" oriented C-Suite (except Bill Greenwood)
- The IBU's lowest profit segment was business on Intermodal trains to/from the Dallas and Houston hub centers
- They generated \$114 million revenue and mid-term margin of \$8.5 million in 1993
- Evergreen's business was a superb core-franchise fit

The EVERGREEN / Texas Tradeoff

- I explained the Evergreen dilemma and Texas tradeoff, including the official revenue and margin numbers, to the C-suite. I stressed it was an all-or-nothing decision because shaving Texas network segments would crush remaining Texas intermodal business profitability.
- The “bulk-railroad” biased CFO, EVP Operations and EVP Coal all said they doubted if BN’s entire intermodal business generated \$8.5 million margin
- I asked if we could retain our Texas-related locomotives (included in our “fixed” asset base) and redeploy them if we withdrew from Texas markets
- We knew our activity-based economics better than anyone in the company. I warned that a Texas withdrawal would cost BN at least \$30 million of operating income annually due to “sticky” overhead no longer absorbed by Intermodal.

The Ugly: The EVERGREEN /Texas Decision

- I stressed that, in a high fixed-cost and high shared-asset business, one could not look at such a decision through a financial accounting lens
- I stressed that an activity-based, cash-focused, managerial accounting approach was essential
- I was called parochial, indecisive, and full of “dung”
- I requested authority for the Texas withdrawal. The CEO approved it plus locomotive retention effective April 1, 1994

BN Abandoned Texas Intermodal Service Effective April 1, 1994



Immediate Texas Abandonment Actions/Effect

- Chicago - Texas locomotives were redeployed to new Seattle - Chicago service
- St. Louis - Texas locomotives were redeployed to new St. Paul - Chicago service, primarily for UPS
- Portland - Texas locomotives were redeployed to new Kansas City - Portland service with 17 still available for Evergreen
- Alternate interline Kansas City - Dallas service via KCS
- BN's financial performance immediately deteriorated

BN April 1994 Performance vs. Budget

	April 1994 Actual	April 1994 Budget	\$ Variance	Variance %
Total BN Revenue	\$392.2 mm	\$391.3 mm	\$.9 mm	0%
Coal Revenue	\$136.7 mm	\$128.3 mm	\$8.4 mm	+6.5%
Ag Revenue	\$57.2 mm	\$58.1 mm	\$-.9 mm	-1.5%
Intermodal Revenue	\$55.6 mm	\$63.5 mm	\$-7.9 mm	-12.4%
Merchandise Revenue	\$142.7 mm	\$141.4 mm	\$1.3 mm	+.9%
Operating Income	\$51.6 mm	\$65.3 mm	\$-13.7 mm	-21%
Operating Ratio	86.7	83.3	-3.3 points	
Net Income	\$23.5 mm	\$32.0 mm	\$-8.5 mm	-26.6%
EPS	\$.24 per share	\$.33 per share	\$-.09 per share	-27.3%

Finance and Operations Performed a Joint Independent Texas Post-Audit

- It confirmed that the true annual operating income impact from the Texas withdrawal was actually **\$30-35 million**, solely related to Intermodal.
- In addition, operations had been using capacity on Texas Intermodal trains for merchandise business. Operations restored service without the benefit of Intermodal business so the actual total operating income impact was **at least \$54 million per year**.
- They concluded: *“If nothing else, this reconfirms the notion of the highly leveraged cost structure of the railroad. It is, in the short run, considerably easier to shed business than it is to shed cost. If long run capacity exists, volume is essential to leverage the fixed costs and minimize unit cost.”*

Salt in the Wound

The request for 17 budgeted locomotives for Evergreen was denied

\$30-\$35 million worth of business was abandoned costing \$19-23 million of net income

Santa Fe bought 100 GE C-44 locomotives in 1993 at a cost of \$1.2 million each

They were especially suited for Intermodal service, generating 4,400 HP and consuming 80 gallons fuel per hour vs. 3,000 HP, and 180 gallons per hour, for BN Intermodal's old SD-40-2s

The forgone income from one year of Texas business could have bought 16-19 C-44 locomotives (photo: Moss Hulsey)



The Good (Very Good)

-  **EVERGREEN** notified BN on May 27, 1994 it won its business, effective July 1, 1994
- It was a critical component of the plan to successfully achieve BN Intermodal's financial turnaround
- It was a critical component for how BN's Intermodal business helped enable the BN-Santa Fe merger

INTERMODAL OVERVIEW

1991-1995 Profit Improvement

	Task Force <u>1991</u>	Restated <u>1991</u>	<u>1992</u>	<u>1993</u>	Estimated <u>1994</u>	Projected <u>1995</u>
Revenue (\$ Millions)	707	717	750	785	831	882
Short-term avoidable costs	<u>528</u>	<u>529</u>	<u>538</u>	<u>552</u>	<u>571</u>	<u>597</u>
Cash margin	179	188	212	233	260	285
Mid-term variable costs	<u>128</u>	<u>128</u>	<u>129</u>	<u>117</u>	<u>126</u>	<u>132</u>
Mid term margin	51	60	83	116	134	153
Fixed (allocated) costs	<u>76</u>	<u>76</u>	<u>74</u>	<u>75</u>	<u>77</u>	<u>78</u>
Fully allocated operating income	<u>-25</u>	<u>-16</u>	<u>9</u>	<u>41</u>	<u>57</u>	<u>75</u>
Fully allocated operating ratio	104%	102%	99%	95%	93%	91%
Aftertax ROA	-4.4%	-2.8%	1.6%	6.6%	9.8%	12.3%

BN's Comparative TAVA First Quarter 1995 vs. 1994 Business Line Performance

Unit	\$ Margin Growth	% Margin Growth	RTM Growth
Coal	\$4 million	2.0%	21.1%
Ag Commodities	\$26.4 million	29.6%	62.3%
Bulk Commodities	\$8.7 million	11.9%	5.7%
Packaged Commodities	\$-.5 million	-.1%	6.9%
Automotive	\$-.8 million	-7.9%	10.0%
Intermodal	\$11.1 million	40.6%	7.8%

Eternal Lessons Retaught by BN's 1994 Texas Intermodal Withdrawal

- Beware of attempts to abandon growth or shrink to achieve prosperity, especially in a leveraged, high fixed-cost/asset, railroad
- Beware of locomotive underinvestment
- Beware of a dependence on financial vs. activity-based managerial accounting for railroad asset allocation decisions
- Beware of an over-emphasis on operating ratios
- Beware of over-emphasizing arbitrary fixed cost allocation
- Beware of not emphasizing velocity and true returns on assets
- Beware of favoring either/or versus both/and solutions

Why say “Retaught”? This quote* relates to the early 1850s:

- *Vanderbilt sorely wanted the long-distance passengers and through freight that came from the West via the Central, no matter how little revenue he received. Unlike a steamboat and steamship line, a railroad suffers from high fixed costs. It was an immovable piece of infrastructure. Whether trains ran or not, the tracks, bridges, buildings, locomotives, and cars had to be maintained; conductors, engineers, firemen, and laborers had to be paid. At least two-thirds of a railroad's expenses remained constant no matter how much or how little traffic it carried. If the Commodore could get additional business, even at losing rates, it would improve the Harlem's outlook.*

* Stiles, T.J., *The First Tycoon – The Epic Life of Cornelius Vanderbilt*, Vintage Books, New York, 2009, p. 383.



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Questions?