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Client Profile – Burlington Northern: Humming on the rails

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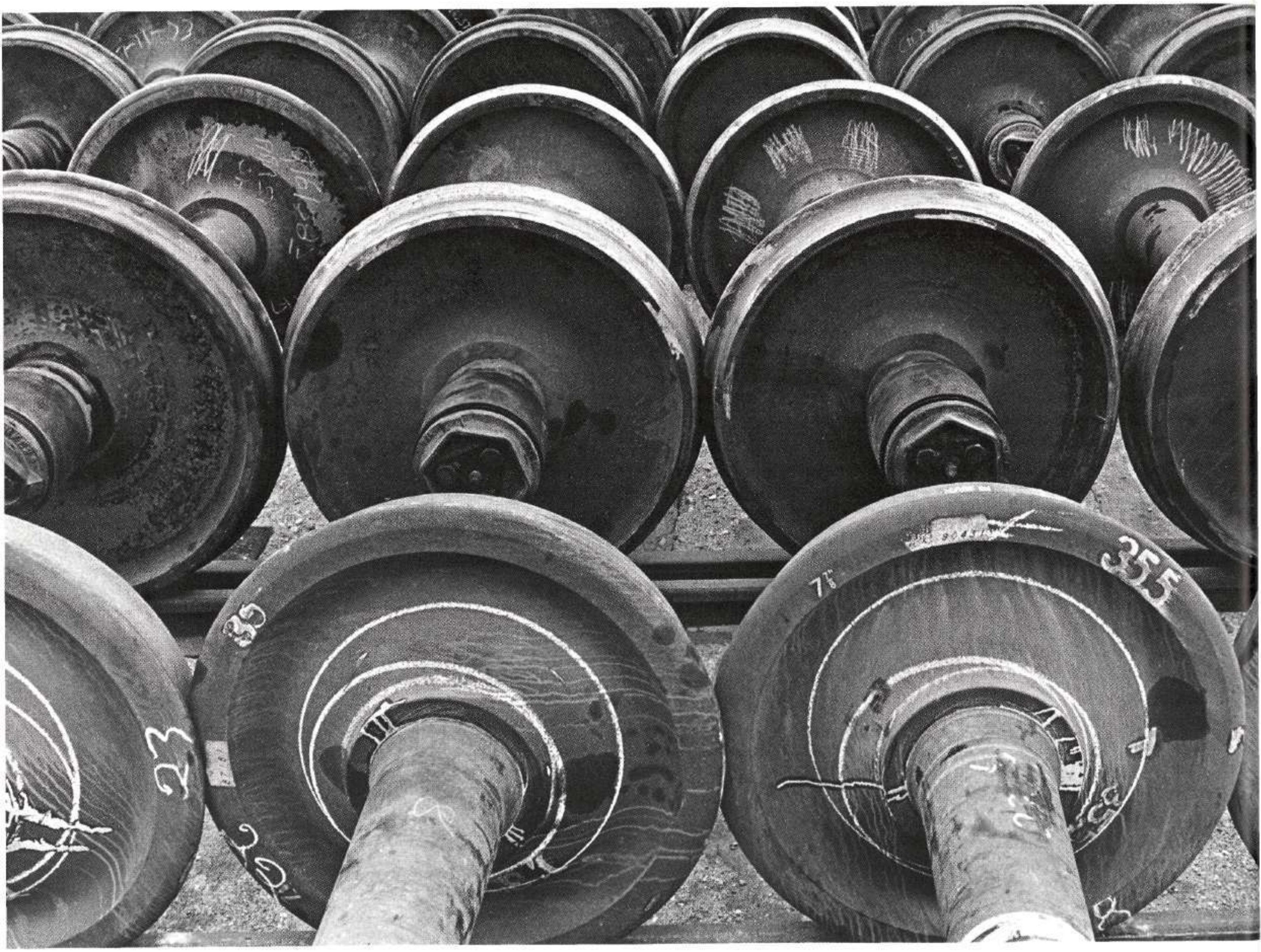
Humming on the Rails



Effie award. Miniature railroad cars seen by millions on National Football League telecasts surround prestigious "Effie" award presented to Albert M. Rung (l.), Burlington Northern's vice president of public relations and advertising.

BURLINGTON NORTHERN

A miniature railroad car bearing the distinctive BN logo and filled with plump red cherries has been rolling across the TV screens throughout most of the country during the NFL football season. As it scuttles along past woods and mountains, lakes, a waterfall, skyscrapers and an industrial area, a friendly voice points out Burlington Northern's efficient services for shippers and adds the assurance that "when Burlington Northern takes cherries to Chicago, we don't take much of a bite."

This imaginative, award-winning "cherries" commercial is actually part of a three car series which includes a railroad car with a can of salmon going to Omaha ("we only make a little dent") and a car carrying a bucket of paint to Billings ("what we charge is only a drop in the bucket"). The commercials have been scheduled on CBS telecasts of NFL football games throughout the regular season, the playoffs and the Super Bowl. BN's advertising agency estimates, in advertising parlance, that the commercial will generate over 326 million "household gross impressions" during the season—that's the number of times the little cars will appear on individual TV sets. With an average of two persons watching the game on each

set, the figure jumps to more than 652 million impressions—and that is a pretty impressive effort to make America's newest and longest railroad a lot better known.

Burlington Northern Inc. is more than a railroad. It is also a natural resources company with tremendous potential. Last year, in fact, income from the company's 2.4 million acres of western timber and farming land, owned in fee, and from mineral rights on 6.1 million acres, covering deposits of oil and gas, iron and coal, almost matched the consolidated operating income of the railroad, truck and air freight forwarding companies.

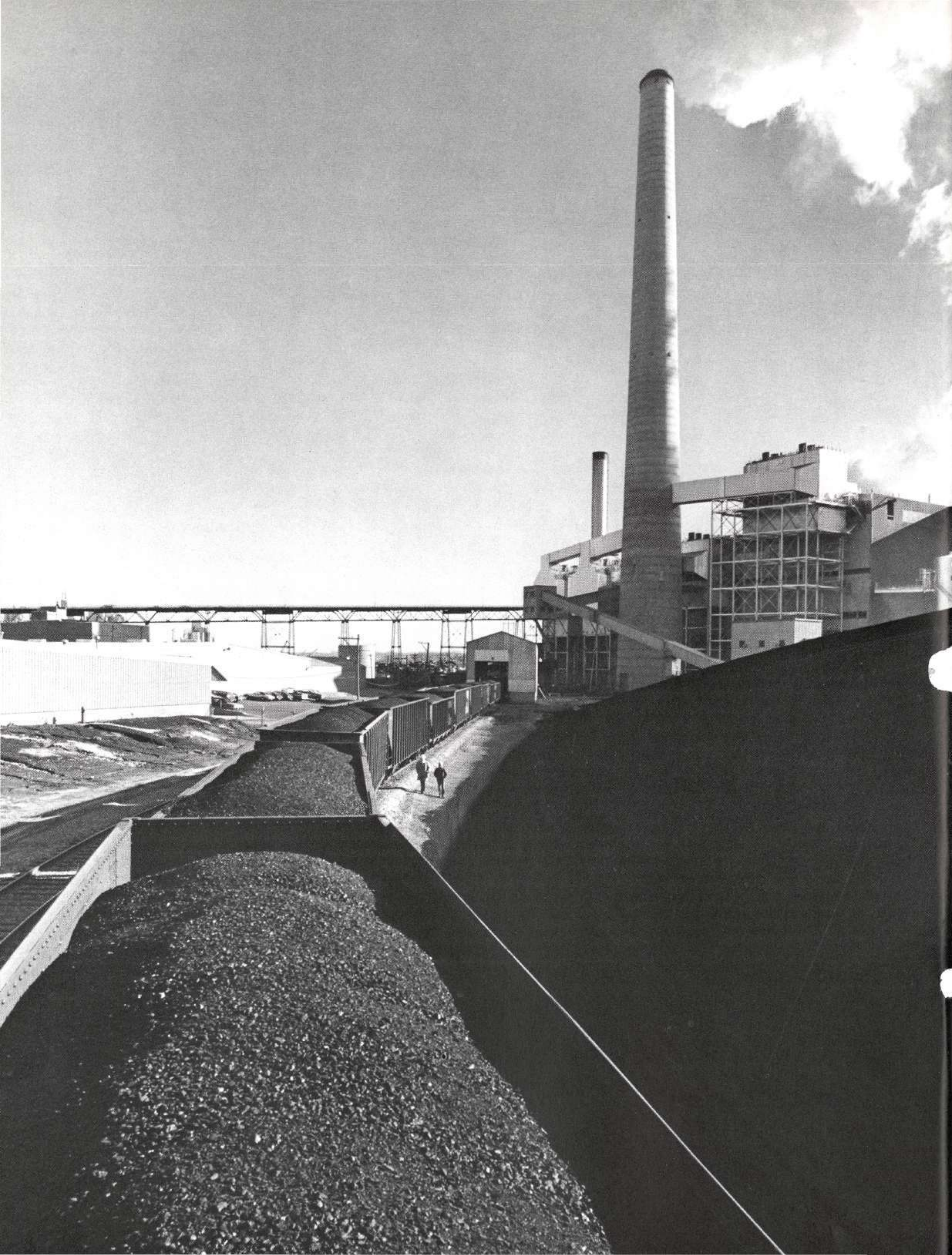
Northern Pacific had been a client of our "Twin Cities" offices for many years. Burlington Northern Inc. became a corporate entity in March of 1970 through the merger of four railroads: the Northern Pacific Railway Company; the Great Northern Railway Company; the Chicago, Burlington & Quincy Railroad Company; and the Pacific Coast Railroad Company. The Spokane, Portland & Seattle Railway Company was leased and became an integrated part of BN effective with the merger. Since 1968, H&S has been engaged by all of the predecessor companies to Burlington Northern Inc. to provide audit, tax and other accounting services. Fred Bassinger, partner in charge of our Minneapolis office, is in charge of the engagement and LeRoy Sundby is the manager in charge, working out of our St. Paul office a few blocks from BN's headquarters.

"The engagement requires a lot of work, as you might imagine," says Lee Sundby, "just from the volume of records associated with the accounting for the individual movements of freight, including divisions of revenue and other accounting situations unique to the transportation industry." Lee has devoted a portion of his time each year to this and other railroad engagements since joining H&S in 1962 and admits a preference for this specialty. "The biggest disappointment, though," Lee says, "is the failure of the Interstate Commerce Commission to update the Uniform System of Accounts for Railroad Companies so as to keep abreast of changes in the accounting profession."

In assets and revenues, Burlington Northern ranks third among the country's railroads. BN has over 25,000 route miles in its railroad system, serving 17 states and two Canadian provinces (or 19 states if one includes BN's two subsidiaries, The Colorado and Southern Railway Company, and Fort Worth and Denver Railway Company, which give shippers in the Pacific Northwest through routes to the Gulf of Mexico). The company has some 48,000 employees and approximately 60,000 shareholders.

The Burlington Northern is basically a commodity railroad. It is the largest grain carrier in the country and, in addition to cherries, the line hauls a wide range of farm products. Timber and paper and low-sulfur western coal, so much in demand for generating plants, provide a major part of freight revenues.

The idea of joining the Great Northern and Northern Pacific lines with the Chicago, Burlington & Quincy goes back to the turn of the century. In 1901 James J. Hill, builder of the Great Northern, and J. P. Morgan tried to merge the Northern roads and the CB&Q by forming Northern Securities Co. The plan was blocked by a Supreme Court decision that reversed an earlier ruling and extended the scope of the Sherman Act to include holding companies. A subsequent attempt to merge was approved by the Interstate Commerce Commission in 1930. However, the



Commission required as a condition to its approval that the Great Northern and Northern Pacific divest themselves of their stock in the CB&Q. This condition was unacceptable and therefore the merger was not consummated.

In spite of the setback, the two "Northern" lines continued to control the CB&Q, each owning 48 per cent. In 1905, they jointly formed the Spokane, Portland & Seattle Railway Company. From 1915 until the merger in 1970, the Great Northern and Northern Pacific roads shared the same headquarters building in St. Paul. Walls divided the building in half, north and south. Except for accountants who occasionally had to confer on problems arising from joint ownerships, the only people with rights of passage were the two lines' presidents, each of whom had a key to the door that separated their executive suites.

In 1955, negotiations began between Robert S. Macfarlane, the Northern Pacific's president, and John M. Budd, president of the Great Northern, which would end by finally breaking down the walls. Extensive economic studies showed that the merger of the Northern lines would improve service to shippers, stabilize employment and generate badly needed growth capital. It was estimated that improved efficiency of the merged lines would mean pre-tax savings of about $40 million a year by the fifth year of the merger. In 1961 the railroads filed an application with the Interstate Commerce Commission for permission to merge, and there the situation stood for the next seven years.

During that time a new dynamic force entered the picture: lanky, six-foot five-inch Louis W. Menk. The son of a railroader, he had worked his way up from telegrapher to chairman of the Saint Louis-San Francisco Railway Company, a road he left in 1965 to become president and a director of the CB&Q. A year later he was elected president and a director of the Northern Pacific.

Handling the planning and coordinating of details of the merger was Robert W. Downing, executive vice president of Great Northern, who served on a master committee that monitored the merger's progress.

Although the Interstate Commerce Commission approved the merger in 1968, opposition from those who somehow were fearful that it would be to their detriment, delayed consolidation until a final decision was made by the Supreme Court early in 1970. On March 2, Burlington Northern Inc. was born.

By agreement, John Budd became chairman and chief executive and Lou Menk president and chief operating officer of the company, with Bob Downing as the merged line's executive vice president. Together they began the monumental task of meshing the operations of four railroads, each with its own track, switchyards, rolling stock and personnel. The ease with which this was accomplished was due to a detailed master plan developed over a four year period prior to merger day. Messrs. Budd, Menk and Downing had divided the future Burlington Northern into six regions, each with its own authority, so that problems could be monitored and solutions devised at the local level.

There were some operating problems at first, caused by traffic imbalance and the inability of smaller yards to handle the flood of new traffic. A burgeoning demand for low-sulfur coal from southeastern Montana required the addition of many new trains, and locomotives had to be diverted from other services for them.

The fledgling Burlington Northern also found itself in an unexpected capital squeeze brought on by the failure of the Penn Central. But a banking consortium led by Chase Manhattan arranged a $100 million line of credit from which BN drew enough to cover its financial needs to continue merger related projects.

In May of 1971 John Budd retired as chairman of the board of Burlington Northern, but continued to serve as a director and chairman of the finance committee. Lou Menk succeeded him as chairman of the board and chief executive officer, and Bob Downing became president and chief of operations.

With the capital situation improving, Burlington Northern sold $60 million of mortgage bonds that spring and used the proceeds to pay off its bank debt. With improvements in operating efficiency, earnings began to increase, bringing in additional working capital to be used for acquiring locomotives, consolidating duplicate roadway and building bridges and connecting lines.

With improved prospects and the merger an obvious success, Burlington Northern had no trouble selling a $65 million convertible debenture issue, completed early in 1972. It was the first equity-oriented issue to be sold by a large railroad since the 1940s. Acceptance of the issue amounted to a resounding vote of confidence in management ability and policies.

One of the ways BN has been improving the system's operating efficiency is through the utilization of computers. When the four railroads merged, three had computer systems, all different. Modifications and conversions have now been made. Additionally, the company is working on the development or implementation of three new systems:

Unit train. Low-sulfur western coal on a Burlington Northern unit train (a train hauling one product to a single destination) unloading at the High Bridge generating plant of H&S client, Northern States Power in St. Paul.

COMPASS (Complete Operating Movement Processing and Service System) furnishes immediate information on the location of cars and trains. Now in use throughout the railroad, COMPASS has accounted for an average ten per cent increase in freight car utilization.

BEACON (Burlington Northern Earnings Accounts Control System) is a sophisticated freight revenue system, to be completely operational in 1974, which will assist in billing, maintaining accounts receivable files and performing other services. It will also perform and verify interline settlements between BN and other railroads with which it has combined in rendering service.

RACE (Reporting and Control of Expenditures) is in the design stage and scheduled for operation in 1975. It will play an important role in handling labor accounting, material inventory control, payment systems and other disbursement functions.

The implementation of these systems, the upgrading of lines and construction of new classification facilities requires enormous capital. Between the merger in 1970 and the end of 1973, BN has invested more than $628 million in its rail operations alone. The railroad has added nearly 400 locomotives, almost 10,000 new freight cars, and rebuilt around 10,000 other cars. The first in a series of major construction programs designed to realize the full benefits of the merger was the $16.2 million Spokane Line relocation project completed in 1972. Construction of a vast new $40 million classification yard, the Northtown Yard near Minneapolis, is scheduled for completion in 1975.

The management structure of Burlington Northern Inc. has also been streamlined to place resources development on an equal footing with transportation. In July 1973, former president and chief operating officer, Bob Downing, became vice chairman while retaining the latter title. A professional forester, C. Robert Binger, formerly vice president in charge of resources development, became president of the newly formed Resources Division. At the same time, Norman M. Lorentzen moved up from executive vice president to president of the Transportation Division.

In a recent speech, Mr. Lorentzen noted that some people view railroads as something of an industrial dinosaur that should be allowed to go off somewhere and quietly expire. He pointed out that, on the contrary, our country's rapid economic expansion is giving America's railroad industry its best chance in three decades to show what it can do, and that the industry stands on the brink of a new Golden Era.

Burlington Northern estimates that the demand for low-sulfur western coal, spurred by the energy shortage, will have a favorable impact on the revenues of the Natural Resources Division and will mean a steady increase in coal-hauling operations through the 1970s. Based on long-term contracts between coal producers and electric power companies, Burlington Northern economists expect coal revenues to rise to over $103 million in 1974, $174 million in 1976—when unit train deliveries to Texas begin—and to $196 million in 1977.

Another cause for optimism by Burlington Northern, and the railroad industry as a whole, is that congressional attention directed toward the plight of the northeastern railroads may lead to remedial legislation which could require the ICC to develop new standards and procedures for determining adequate revenue levels for surface carriers; prohibit unreasonable and unjust taxes on transportation property by state and local governments; establish faster procedures for closing down unproductive branch lines; and allow freight rate increases, requested by the railroad to offset wage increases, to become effective in 30 days or less.

As it looks to the future, Burlington Northern is aware of the importance of maintaining its image as a young and vigorous company, sensitive to the needs of its people and the people of the communities it serves. In 1972 a Department of Community Relations was established (believed to be the first on any railroad). Regional managers of community relations have been appointed in each of the company's six regions and employee volunteers are encouraged to participate in civic activities of all kinds. Emphasis of the program is on the support of youth activities such as 4-H, Junior Achievement and Explorer Scouting, with BN now sponsoring nearly a hundred Explorer Scout posts.

In addition to the famous "cherries" commercials, television and theatre audiences will soon get a chance for a more in-depth look at the Burlington Northern through a new 26-minute film entitled "Portrait of a Railroad." Last fall the film received the first prize in the industrial category (over 170 entries) in the American Film Festival of the Public Relations Society of America. The movie features an original score entitled "Humming on the Rails," which so aptly describes the vitality of the Burlington Northern system, where 600 separate trains are moving somewhere along the line today...and every day. □

Money talk. Frank H. Coyne, Burlington Northern's vice president, finance, reviews financing documents with H&S manager LeRoy Sundby of the St. Paul office.

Louis W. Menk (r.), board chairman and chief executive officer of Burlington Northern Inc., and Robert W. Downing (c.), vice chairman and chief operating officer, confer with H&S partner Fred Bassinger in the railroad's power operations control center in St. Paul. The schematic layout in the background represents more than 25,000 miles of BN lines. Magnetic tabs on the board indicate diesel locomotives and cabooses of trains (some 600 a day) in operation throughout the system.