INDUSTRY ANALYSIS – RAILROADS

Definition of Ratings

Buy: At least 20% undervalued
Hold: Less than 10% overvalued
Sell: At least 20% overvalued

Companies Covered:

Burlington Northern SF	(BNI)
Canadian National	(CNI)
Canadian Pacific	(CP)
CSX Corp.	(CSX)
Kansas City Southern	(KSU)
Norfolk Southern	(NSC)
Union Pacific	(UNP)

S&P 500:	889.81
10-Year Bond:	3.900%
Dow Jones RR Index	182.30

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September 18, 2002

Chugging ahead…with caution

Recommendation….**Hold**
Weight……………..**Market**

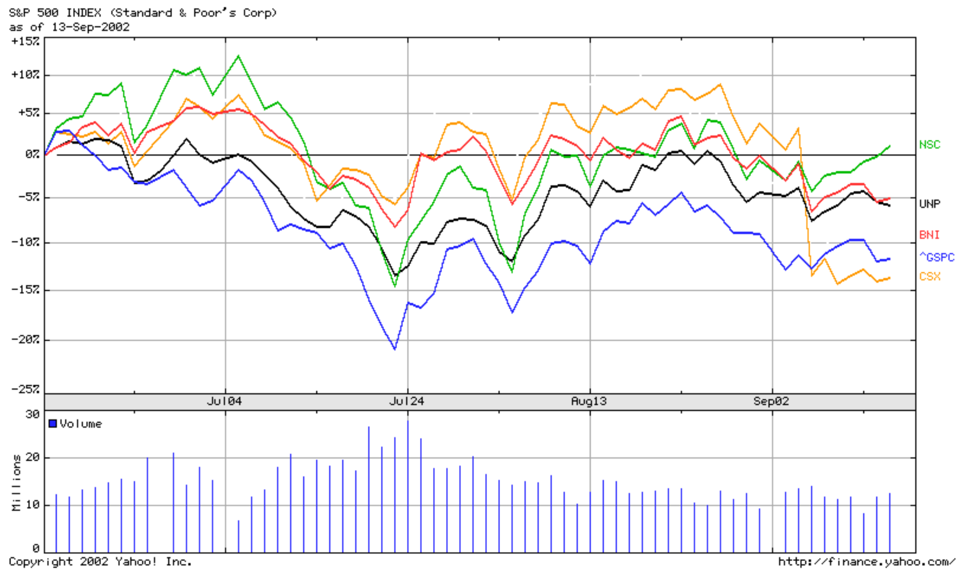
Our outlook for the Railroad Industry is neutral overall. Stocks within this industry have retreated since their all time high P/E ratios earlier this year, but have proven their relative stability through outperformance of the market. While this recent drop makes the industry attractive, our analysis is tempered by recent labor issues, the prospect of a uptick in fuel prices, and weakness in several key demand drivers. We rate this industry a Hold and recommend watching 3Q02 and year-end numbers for further guidance on critical revenue and expense issues.

Overview

Large- and mid-cap railroad stocks were a relative safe haven as the broad indices logged double-digit losses over the past three months. Helping the Railroads were factors such as continued YOY savings in fuel expenses, strong shipments of motor vehicles, and steady demand for chemical and intermodal shipments of trailers and containers.

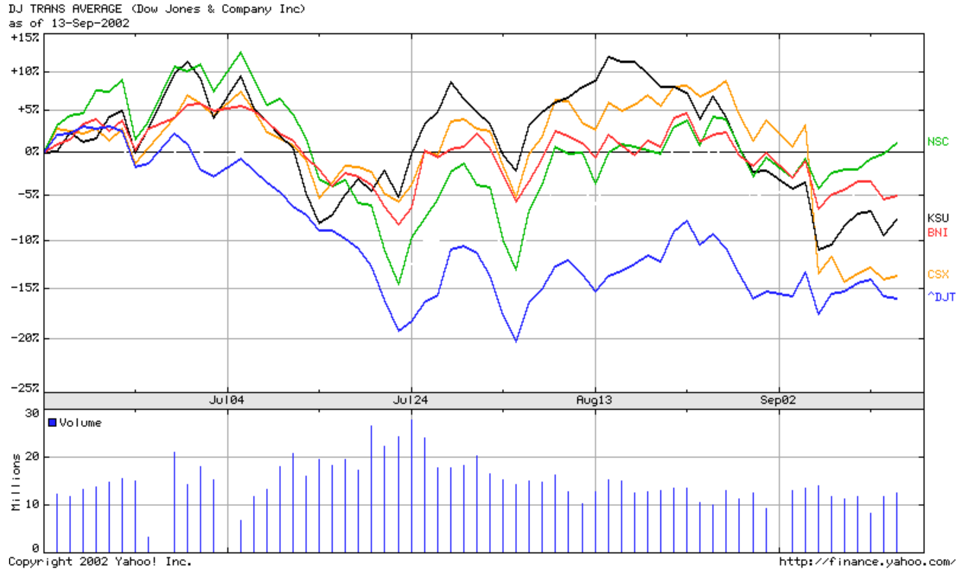
Most of the Class I railroads (NSC, UNP, BNI, CSX) have tracked the S&P 500 in terms of direction, but not in the magnitude of movement. The broader market was hit much harder in the summer months than the larger U.S. railroads.

Note: The ticker ^GSPC on the chart is the S&P 500 Index.



The Dow Jones Railroad Index, comprising eighteen large- and mid-cap railroads, has outperformed the S&P 500 by a substantial margin over the past six months.

Large U.S. Railroads have also outperformed the Dow Transports over the last three months.



Industry Participants - Financial Data (in $MM)

Company	Ticker	Sales 2000	Sales 2001	Sales 2002E	Sales Growth 2000	Sales Growth 2001	Sales Growth 2002E	Current Beta	Debt Rating *	Market Cap
Burlington Northern SF	(BNI)	9,207	9,208	9,024	0.1%	0.0%	-2.0%	0.57	Baa2	10,312
Canadian National	(CNI)	5,428	5,652	5,624	3.7%	4.1%	-0.5%	0.81	N/A	8,233
Canadian Pacific	(CP)	3,655	3,699	3,662	4.5%	1.2%	-1.0%	0.74	N/A	2,947
CSX Corp.	(CSX)	8,191	8,110	8,110	-21.1%	-1.0%	0.0%	0.54	Baa2	6,138
Kansas City Southern	(KSU)	572	577	577	-4.9%	0.9%	0.0%	1.53	Ba2	846
Norfolk Southern	(NSC)	6,159	6,170	6,170	17.5%	0.2%	0.0%	0.62	Baa1	8,161
Union Pacific	(UNP)	11,878	11,973	12,212	5.7%	0.8%	2.0%	0.44	Baa3	15,080
Mean		**6,441**	**6,484**	**6,483**	**0.8%**	**0.9%**	**-0.2%**	**0.75**		**7388**

Company	Ticker	EBIT 2000	EBIT 2001	EBIT 2002E	EBIT Margin 2000	EBIT Margin 2001	EBIT Margin 2002E	Net Income 2000	Net Income 2001	Net Income 2002E
Burlington Northern SF	(BNI)	2,108	1,755	1,715	22.9%	19.1%	19.0%	980	731	782
Canadian National	(CNI)	1,648	1,937	1,743	30.4%	34.3%	31.0%	937	1,040	848
Canadian Pacific	(CP)	845	841	842	23.1%	22.7%	23.0%	532	410	397
CSX Corp.	(CSX)	805	957	933	9.8%	11.8%	11.5%	565	293	316
Kansas City Southern	(KSU)	58	55	61	10.1%	9.6%	10.5%	381	31	30
Norfolk Southern	(NSC)	633	1,007	1,111	10.3%	16.3%	18.0%	172	375	513
Union Pacific	(UNP)	1,903	2,072	2,076	16.0%	17.3%	17.0%	842	966	988
Mean		**1,143**	**1,232**	**1,211**	**17.5%**	**18.7%**	**18.6%**	**630**	**549**	**553**

*Source for unsecured debt rating is Moodys. All other data from Company filings.

Industry Participants - Financial Ratios

Company	Ticker	P/E			ROA		Operating Expense Ratio		
		2000	2001	2002E	2000	2001	2000	2001	2002E
Burlington Northern SF	(BNI)	11.4	13.0	13.4	4.0%	3.0%	77.1%	80.9%	81.0%
Canadian National	(CNI)	12.8	12.2	15.0	5.4%	4.9%	69.6%	65.7%	69.0%
Canadian Pacific	(CP)	8.3	11.8	12.2	6.0%	4.2%	76.9%	77.3%	77.0%
CSX Corp.	(CSX)	32.8	18.5	19.5	2.7%	1.4%	90.2%	88.2%	88.5%
Kansas City Southern	(KSU)	31.9	31.2	28.1	NM	1.5%	89.9%	90.4%	89.5%
Norfolk Southern	(NSC)	46.7	23.1	15.8	0.9%	1.9%	89.7%	83.7%	82.0%
Union Pacific	(UNP)	17.4	15.8	15.1	2.7%	3.1%	84.0%	82.7%	83.0%
Mean		**23.0**	**17.9**	**17.0**	**3.6%**	**2.9%**	**82.5%**	**81.3%**	**81.4%**

Company	Ticker	Interest Coverage			Debt/Equity		Asset Turnover	
		2000	2001	2002E	2000	2001	2000	2001
Burlington Northern SF	(BNI)	3.4	3.9	4.0	2.0	1.9	0.4	0.4
Canadian National	(CNI)	5.3	5.9	4.7	1.3	1.5	0.3	0.3
Canadian Pacific	(CP)	5.1	4.0	3.3	1.1	1.8	0.4	0.4
CSX Corp.	(CSX)	1.5	1.8	2.0	2.0	2.1	0.4	0.4
Kansas City Southern	(KSU)	0.9	1.0	1.4	1.7	1.6	0.3	0.3
Norfolk Southern	(NSC)	1.1	1.8	2.1	2.0	1.9	0.3	0.3
Union Pacific	(UNP)	2.6	3.0	3.2	2.3	2.0	0.4	0.4
Mean		**2.8**	**3.1**	**3.0**	**1.8**	**1.8**	**0.4**	**0.3**

Note: Operating Expense Ratio, a key indicator for the railroad industry, is defined by industry participants as (Revenues – EBIT)/Revenues, or the mirror image of the EBIT margin. The railroads take a broader view of operating expenses than most analysts would.

Source: Company filings.

Key Drivers and Risks

Railroad prospects continue to be shaped by many common historical factors, such as traffic (measured in ton-miles), regulation, fuel costs, and labor costs. We are pleased to see the industry directing its capital expenditures towards technology as well as hard assets, but we anxiously await the results of ongoing labor negotiations and fear the YOY operating gains from lower fuel prices may be evaporating. Several key drivers of demand, such as coal consumption, intermodal transportation, and grain shipments are expected to be soft through the end of the year, while other demand drivers are mixed or flat.

Regulation

The Staggers Rail Act of 1980 lifted railroad regulations in areas with sufficient competition, enabling companies to begin to price discriminate on the basis of demand, tailor services offered to specific routes, enter into confidential contracts covering rates and services with shippers, and consider closing and selling rail lines with fewer impediments. While re-regulation discussions have emerged as a response to recent declines in passenger train profitability and viability, these discussions remain largely in the background.

We believe the threat of regulations akin to those before the passing of Staggers Act is insignificant. While substantial lobbying continues on behalf of the large shippers, economists tend to point to the availability of close substitutes to disprove claims of pricing power on single-operator routes. Our industry valuations, accordingly, assume no adverse effects of regulation.

Consolidation

Some recent merger and acquisition activity in the industry is in-line with the overall consolidation trend. As marginally profitable railroads seek future synergies that contribute to bottom line growth, smaller railroads become attractive target candidates. The following is a list of M&A activity in the last year:

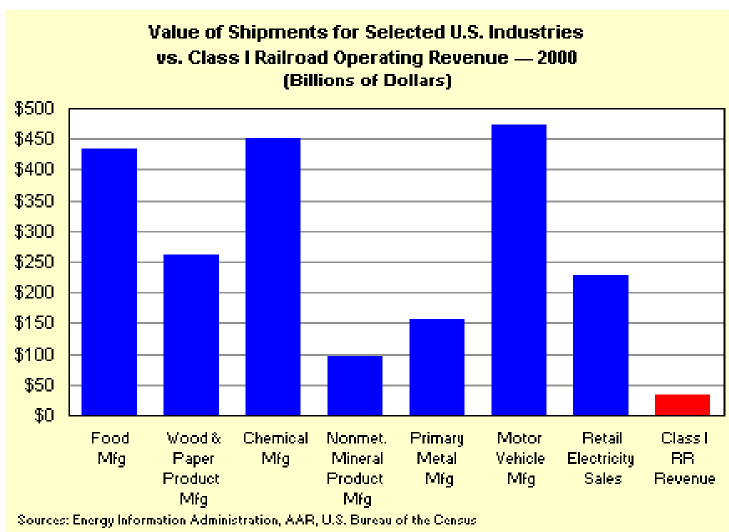
- 8/13/02 – Burlington Northern Santa Fe acquires certain assets of Clicklogistics Inc., a transport management services company, for an undisclosed price.
- 7/11/02 – Norfolk Southern acquires 20 miles of railroad track and other rail assets from Peabody Energy Corp. for an undisclosed price.
- 10/09/01 – Canadian National acquires Wisconsin Central Transport, an American railroad company, for $1,137MM in cash consideration.

Currency Effects

The Canadian dollar has weakened slightly during Q3:02 and is now at a rate of 1.5865 to the US dollar versus a Q2:02 close of 1.5173. The Q2:02 average is 1.5622 versus the current Q3:02 average of 1.5585. While the averages for the two quarters so far are relatively unchanged, these numbers indicate a weakening trend. A weaker Canadian Dollar has a negative impact for US investors owning Canadian National and Canadian Pacific as a US$-denominated investment but has a positive impact on Canadian exports hauled by rail (Morgan Stanley). Should the trend continue, the two large Canadian railroads could see a slight surge in business.

Substitutes

Shipment via trucks, barges, or pipelines is a competitive option for most shippers. While no growth is expected in the near term in the percentage of total ground transportation revenues garnered by railroads, the Class I Railroad's small share of the value chain presents significant future upside (charts below).



Capitalizing on this upside potential will require railroads to aggressively market themselves on price, while backing up those lower prices by containing costs.

Demand for Coal

Coal represents about 33% of all railroad traffic. YOY shipments through 7/27 were down 4.5%, but shipments for the 4 weeks ending 7/27 were only off 1% YOY, partially explained by mild summer weather which has reduced the demand for electricity generation. Domestic production of coal in the first six months of 2002 were down 4% YOY, but coal consumption by electricity producers was stable YOY for the same time period (DOE). Longer-term forecasts from the DOE point to steadily increasing domestic demand for coal for use in electricity generation, as well stable demand for US coal for export.

Since electricity generators are far and away the largest consumers of coal, we see coal shipments remaining steady on a YOY basis. Minor variations in either direction do not affect railroads substantially because this is their lowest priced traffic.

Intermodal Shipments

Intermodals (trailers and containers of pre-packaged goods that will require two or more forms of transportation) represent about 22% of all railroad traffic. This type of shipment was up sharply in August with a 9% gain YOY, bolstered by significant increases in container traffic. One analyst report cites a spike in Asian imports by several retailers in advance of strikes at West Coast ports as a potential contributor to this gain (Morgan Stanley).

Domestic manufactured goods production was off 2.9% YOY for July, but was up 4.7% from June. Additionally, imports of industrial supplies were off 14.9% YOY for the first six months of the year and imports of finished goods were off 5% YOY in the same period. (DOC)

The recent spike in container shipments clouds an already mixed message for intermodals. We agree with the consensus that the upward spike in container shipments was in anticipation of the strikes at West Coast ports. We further believe that caution is merited given the weakness in trailer shipments and the overall weakness in manufactured goods commerce.

Chemical Shipments

Chemicals represent about 7% of all railroad traffic. Chemical traffic was up 2.6% YOY in the 4 weeks ending 7/27. Chemical inventories were down 4% YOY in July. (DOC)

To some extent, strength in the chemicals sector will depend on strong motor vehicle sales, as chemicals are a major input to the manufacturing of automobiles. Low inventories in the chemical sector currently mimic low inventories for motor vehicles. However, if auto sales taper off, this will cascade down to the chemical sector and hurt the railroads twice.

Motor Vehicle Demand

Motor vehicles represent about 6% of all railroad traffic. As would be predicted in the current environment, motor vehicle shipments have been strong YOY, reflecting significant manufacturers' incentives for consumers of automobiles. Motor vehicle inventories were down 3.3% YOY in July (DOC), reflecting the strong unit sales.

With automakers' cards essentially already on the table, we have to wonder what else they would do to attract consumers if the recovery does not fully materialize? Until better economic numbers are available, we are cautious about projecting continued strength in motor vehicle shipments, even though most analysts believe shipments will remain strong.

Grain Production

Grain represents about 5% of all traffic. The USDA predicts low levels for both yield and production in areas such as corn and soybeans, due to persistent drought conditions in many agricultural areas. Lower soybean production in particular will reduce export opportunities for the remainder of 2002. The USDA has also reported that exports of wheat will be significantly lower throughout 2002 and 2003.

Overall, farm product inventories were down 3.7% YOY in July (DOC), which is a reflection of lower output and not higher demand reducing stockpiles. Agricultural weakness, especially with respect to exports, points to a slowdown in grain shipments by rail.

Housing Starts

Housing starts in July were off almost 1% YOY (DOC), which affects demand for lumber, paints and durable goods, all of which are hauled extensively by rail.

Labor Costs

Overall headcount at Class I railroads was reduced 5% YOY in 2Q, and labor expenses dropped by 0.3% during the same period. Both are attributable to new retirement legislation. (Morgan Stanley)

Railroads have been highly successful at reducing unit labor costs, to the tune of 2% per year in the 1990s. (DOL) With most railroads facing critical labor talks at the end of this year, we hope that the industry is not about to give back their gains. Railroad employees are already among the highest paid of any service industry, so we anticipate that the railroads will remain tough at the bargaining table. This applies especially to health and welfare costs, which have skyrocketed in recent years. (AAR)

The labor issue is a make or break proposition: Can they make a deal without breaking the bank? We anxiously await the outcome of these talks.

Fuel Costs

Diesel fuel costs for Class I railroads fell on average 16% YOY in the 2Q02 (AAR). This YOY spread has narrowed recently, as diesel fuel prices were only about 6% lower YOY for the week ending 9/10. Stocks of distillate fuel oil were 10% higher YOY for the week ending 9/7, in part due to a reduction in demand YOY of 2.5% for the four weeks ending 9/7. (DOE)

Even though fuel costs YOY have been lower throughout 2002, distillate fuel prices still have risen almost 21% since the beginning of 2002 (DOE, American Petroleum Institute). While fears of higher prices due to a possible declaration of war by the United States on Iraq have recently been reflected in crude oil prices, historically such "war spikes" have been short-lived and should not materially affect the railroad industry (WSJ).

In the short-term, we believe that railroads will continue to reflect YOY savings in fuel costs, although the magnitude of the savings will continue to decline, especially in the near-term as more details become available about U.S. war plans.

Cost Structure

Cost Structure

	BNI	CNI	CP	CSX	NSC	UNP	Average Excl. KSU	KSU
CGS (broken down further below)	42.7%	26.3%	46.1%	46.0%	62.7%	51.2%	45.8%	59.7%
SG&A	42.7%	30.0%	22.1%	33.2%	12.6%	21.7%	27.1%	20.6%
Operating Invested Capital (MM)	21,231	17,458	8,094	16,298	16,167	27,459	17,784	1,010

CGS Component

	BNI	CNI	CP	CSX	NSC	UNP	Average Excl. KSU	KSU
Fuel	26.3%	NA	14.0%	17.1%	16.5%	32.3%	21.2%	18.2%
Purchased services	29.3%	NA	49.9%	19.6%	16.9%	22.5%	27.6%	26.7%
Equipment and Building Rents	20.0%	NA	17.3%	18.3%	29.0%	32.1%	23.3%	24.7%
Materials supplies and other	24.3%	NA	18.8%	45.0%	37.6%	13.2%	27.8%	30.4%

Source: raw data from 10K Filing, calculated by the team

Operating Efficiency and Restructuring

The industry is taking strides towards cost reduction by operating locomotives in the railyard remotely, using a system called Beltpack. Kansas City Southern, in particular, hopes to be fully implemented by the end of September. One analyst believes the industry could save $200-250M per year with the Beltpack system. (Morgan Stanley)

We are encouraged to see the railroads implementing additional operational efficiencies, especially as it relates to technology. The industry's capital expenditures in the past have been mainly geared towards hard assets, and less towards raw technology. The remarkable productivity gains for railroad labor since deregulation in 1980 would be difficult to maintain moving ahead, in that the marginal benefit would necessarily decline when the same type of capital is deployed over and over. Railroads' use of technology bodes well for maintaining the productivity gains it has enjoyed for so long.

On a different note, many of the railroads have reduced headcount considerably YOY as a result of new retirement policies. We should not confuse this reduction in headcount with real activity in labor expense containment.

Outlook

Overall outlook can be characterized as mixed, neutral or down for each of the railroads considered separately. We do not find a great deal of clear upside evidence from the key indicators. There is much uncertainty to resolve through year-end. While the industry is somewhat insulated from cyclicality (beta = 0.7) in terms of magnitude, the direction of movement certainly tracks the broad economy.

Industry Performance

Over the last year, all Class I railroads except for CP have outperformed the S&P 500 by an average of 17%. With relatively low betas (except for KSU), their expected returns over the last year according to the CAPM model were in the range of -5% to -10%, compared with the actual S&P 500 return of -14.3%. Five of these companies, UNP, BNI, NSC, CNI, and KSU, have been performing quite well, commanding an abnormal return of 25.3%, 14.2%, 32.6%, 14.5%, and 42.2% respectively. CSX and CP were the under-performers among them, with an abnormal return of –4% and –37.8% respectively. The risk to investing (long or short) in these companies is whether they will sustain an abnormal return for the long haul. Therefore, we suggest a market weight holding.

Railroads had 1-year price change better than S&P 500. Their current prices are at around the midpoint between the 52 Week Highs and 52 Week Lows, whereas the S&P 500 stands at the lower end of the price range between 52 Week Highs and Lows.

Better Early-Cycle Plays:

Historically, railroad P/E ratios have declined in periods of Fed Rate tightening, moving from highs of 12-14x earnings to lows of 8-9x at the end of a tightening period. Since the end of the last period of tightening (4Q99), we have seen railroad P/E ratios climb to their all time highs of 14-15x earnings. Currently perched near these all-time highs, we feel that these stocks warrant investment caution, especially with those companies whose interest coverage is hovering around 1:1.

2Q Financial and Operating Performance

EPS in 2Q has had a positive change industry-wide. The majority of railroads have had lower operating ratios YOY in 2Q, demonstrating improved operating efficiency. All railroads except for BNI and CNI reported solid growth in both operating income and net income.

Traffic volume showed an overall growth of 1.9%. This growth was reflected in the operations of BNI, CP, CNI, and UNP, but not NSC, KSU, or CNI. Although most railroads recorded a positive change in traffic volume, only UNPR, CSX and NSC demonstrated a positive revenue change, which is attributable to declining revenue per carload in 2Q02. On a positive note, costs per carload declined more than the revenue per carload, which generated a positive change in operating profit per carload for most railroads.

Despite a total headcount decrease of 5%, the total labor expense industry-wide only declined by 0.3%. This reflects a general increase in cost per person of 4.9%.

Only CPR and CSX maintained their cost per person at the 2Q01 level. Others saw cost increases in the range of 3% to 7.5% per person.

Company Prospects

2Q02 - Indicators

Company	Ticker	Rev	**Volume**	**Rev**	**Net**
Union Pacific	(UNP)	1	↑	↑	↑
Burlington	(BNI)	2	↑	↓	↓
CSX Corp.	(CSX)	3	↑	↑	↑
Norfolk Southern	(NSC)	4	**NC**	↑	↑
Canadian National	(CNI)	5	↓	↓	↓

Canadian National	(CNI)	5	↓	↓	↓
Canadian Pacific	(CP)	6	↑	↓	↑
Kansas City Southern	(KSU)	7	**NC**	↓	**NM**

NC = no change
NM = not meaningful

Union Pacific

Union Pacific Corporation (UNP) operates its rail transportation business through its subsidiary Union Pacific Railroad Company. It is a Class I railroad that operates over 33,000 route miles connecting the Pacific and Gulf Coast ports to the Midwest and eastern United States gateways and several corridors to Mexico. It is the largest among the seven companies this report covers, with 2001 annual revenue of $11,973 MM. Coal comprises 28% of its traffic, followed by intermodal (21.2%). It also has a trucking company specializing in less-than-truckload (LTL) shipments, which provide services to 10 western states.

Second-Quarter Financial and Operating Performance:

UNP had a strong performance in terms of net income growth in 2Q02, with a YOY increase of 22.2%.

The company enjoyed a significant traffic volume increase of 5.2% YOY in 2Q, and it is one of the three companies that has had a positive revenue change despite declining revenue per carload in the industry. This was driven by its lower costs per carload (YOY –4.6% in 2Q). Accordingly, UNP's operating profit per carload is up 20%. UNP's total labor expense increased 2.8% YOY in 2Q02 as a result of significant 6.5% increase in cost per person. (Morgan Stanley)

Outlook:

On Sept. 6, CFO Jim Young said revenue growth would end up 3% higher in 2002 than 2001. (Reuters) Our report estimates that operating revenue will increase 2% for 2002, due to the optimistic revenue outlook from electricity customers and the potential traffic increase in the West Coast ports. The Operating Expense is estimated to increase slightly due to upward pressure on labor expenses. We predict the annual EPS at $3.95, a 5% YOY increase.

Burlington Northern

Burlington Northern Santa Fe Corporation (BNI) operates approximately 50,000 route miles in the Midwest, Pacific Northwest, Western, Southwestern and Southeastern regions. It has the second largest revenues of $9,208 MM in 2001. Coal traffic comprises 33.1% of BNI's total traffic, followed by 28.8% in intermodal.

Second-Quarter Financial and Operating Performance:

BNI's EPS performance for 2Q02 was relatively weak with a 2% YOY increase. While the majority of railroads improved their operating ratio, BNI's worsened slightly with a 0.6% YOY decrease. Net Income declined by 1% and operating income declined by 5.4%.

BNI also showed a 2Q revenue decline of 3% YOY. Despite its lowered Costs per Carload in 2Q 2002 compared with 2Q 2001, BNI's operating profit per carload eroded by 5.6%.

Outlook:

BNI operates with a relatively low level of cash, and its debt loads are among the highest in the industry. However, the company's interest coverage is top-notch (4x), and thus it is easily able find revolving debt.

On Sept. 6, CFO Thomas Hund spoke of "modest pickups" in shipments of lumber and chemicals. (Reuters) While this is reassuring from the top-line perspective, it does not speak to BNI's problem with controlling expenses. Additionally, we anticipate that its sales will shrink by 2% due to the projected slow coal traffic and uncertain intermodal traffic. Its Operating Ratio is likely to remain flat at 81%. We estimate its annual EPS to be near $2.03, a -3% YOY change.

CSX

CSX Corporation provides a variety of freight transportation including rail, intermodal, domestic container-shipping, and international terminal operations. CSX focuses on eastern US, intermodal services in North America, and domestic container shipping between ports in US mainland and Alaska, Guam, Hawaii, and Puerto Rico. International Terminal Operations are in Hong Kong, China, Australia, Europe, Russia and Latin America. It is the third largest player with revenues of $8,110 MM in 2001. Intermodal is its biggest source of traffic (28.1%), followed by coal (22.5%)

Second-Quarter Financial and Operating Performance:

CSX had a strong EPS performance in 2Q02 with a YOY increase of 17.8%. Net Income grew at about 20% YOY.

Although CSX had only a minor 2Q traffic increase (0.7%), it was one of three companies that saw its revenues rise (0.4%). CSX was one of two Class I companies to maintain its cost per person at the 2Q01 level.

Outlook:

On Sept. 5, the company stated that coal revenues for 3Q would be $35 million less YOY because of weak demand from utilities. However, it also said revenues from other sectors such as merchandise and automotive shippers were on the rise. (Reuters) We project its overall revenue to be at last year's level while its Operating Expenses increase slightly. We estimate EPS at $1.48 (-5% YOY).

Norfolk Southern

Norfolk Southern Corporation (NSC) is composed of two major railroads, Norfolk and Western Railway Company and Southern Railway Company. It operates 21,500 route miles in the east half of the US and the Province of Ontario, Canada. Its revenues were $6,170 MM in 2001. Coal is its major traffic type (33.5%), followed by Motor Vehicles (14.7%).

Second-Quarter Financial and Operating Performance:

NSC increased YOY EPS in 2Q by 10.3%. Traffic grew 1.8% YOY in 2Q. Additionally, NSC was one of three companies to report positive revenue growth (0.1%).

NSC reported a lower total labor expense (-1%) YOY in 2Q02, despite the significant increase in reported cost per person. The reduction was achieved in part by a 7.5% cut in headcount from last year.

NSC also reported the biggest YOY fuel expense reduction (-20.8%) in the industry.

Outlook:

Norfolk Southern Railway and Union Pacific Railroad recently announced a new service that trims up to three days from current transit times on intermodal shipments from eastern cities to Laredo, Texas, and to Mexico. (Company Release) The effect of this initiative remains uncertain and we suggest a conservative sales growth projection (0% YOY change). We believe that NSC's track record for cost-savings will allow it to lower its operating expenses further and achieve higher EPS for 2002.

Canadian National

Canadian National Railway (CNI) operates across the North American continent, serving ports on the Atlantic, Pacific and Gulf coasts. 2001 revenues were $5,652 MM. CNI's biggest source of traffic is Chemicals (18.7%), followed by Intermodals (17%), Coal (14%) and Motor Vehicles (10%). It also operates outside of North America, in England and Australia.

Second-Quarter Financial and Operating Performance:

CNI's EPS declined by 7% YOY in 2Q. CNI had a slightly higher operating ratio (68.4%) in 2Q02 than 2Q01 (0.2% YOY increase). As a result, BNI's operating income declined by 1.3%.

Although most railroads recorded a positive change in traffic, CNI reported slightly lower YOY volumes (-0.4%) in 2Q. It was the only railroad to have a higher cost per carload this year and thus reported an operating profit per carload that was 1.3% lower YOY in 2Q.

Outlook:

We believe that CNI's current rate of revenue growth will hold for the rest of year 2002 (-0.5%) and that its operating expense will increase to 69%. Thus, we estimate EPS for 2002 to be $2.74, a -18% YOY change.

Canadian Pacific

Canadian Pacific Railway Company (CP) provides services in Canada and US. It serves major Canadian ports and cities from Montreal to Vancouver, as well as key centers in the US Midwest and Northeast. The company was spun-off from Canadian Pacific Ltd. in October 2001. CP's revenue in 2001 was $3,698 MM. The company's traffic mainly comprises Intermodal (23%), Chemicals (13%), and Coal (10%).

Second-Quarter Financial and Operating Performance:

CP has had a solid EPS performance in 2Q2002, with a YOY increase of 14%. Its Operating Income also improved by 5.2%, although revenues declined by about 3%.

CP is one of two companies among the seven covered that maintained its cost per person at 2Q01 level.

Outlook:

Despite our EPS projections, we are encouraged by CP's cost containment efforts. The company achieved a growth in net income even while revenues were declining.

CP's revenue is estimated to be 1% lower than last year. We believe that operating expenses will be maintained at the 2001 level of around 23%. Thus, we project that 2002 EPS will be $1.52 (-3% YOY change).

Kansas City Southern

Kansas City Southern (KSU) operates from the Southwestern U.S. into Mexico through less congested interchange hubs. It has a strategic alliance with Canadian National Railway Company and Illinois Central Corporation to create a network connecting Canada, the US and Mexico. It is the smallest company of the seven covered, with 2001 revenue of $577 MM. Coal is its biggest source of traffic (26.2%), followed by Intermodal (16.2%) and Chemicals (11.7%).

Second-Quarter Financial and Operating Performance:

KSU experienced a revenue decline of 3.7%, but managed to increase operating profit per carload by 36.2% YOY in 2Q.

Outlook:

KSU has been plagued by a troublesome interest coverage ratio in the past, but it seems to be emerging from this pattern and achieving respectability. On July 25, CEO Michael Haverty said the company had completed implementation of a new computerized Management Control System that will provide cost savings and improve service. The Company is also in the process of implementing the Beltpack system for moving locomotives remotely in the railyard. (Company Releases).

We are optimistic about the cost-savings these implementations will contribute to its operating efficiency, but we nonetheless estimate that sales will remain flat. As a result, EPS is estimated at $0.50 (11% YOY increase).

Up the Line

Our neutral stance on the industry is driven by both solid and weak prospects in the stocks covered in this report.

Hesitance on BNI and CNI

We evaluate Burlington Northern and Canadian National with some caution. Both companies reported revenue and net income declines in Q2:02 and Canadian National also reported volume declines. While both companies have promising interest coverage and ROA, we remain pessimistic about their revenue outlook given poorer than average cost containment efforts and bottom line growth. We believe this caution is reflected in the P/E multiples of these two companies (both have P/E's well below our average of 17.0x). CSX appears to be moving in the right direction with growth in volume, revenue, and net income, but recent company guidance during a conference call revealed Q3:02 issues. The company has lowered its fiscal year-end 2002 numbers to reflect poorer than expected performance in coal traffic, which comprises a total of one-quarter of CSX's traffic.

Neutral on NSC and CP

We are neutral on Norfolk Southern and Canadian Pacific and look to year-end numbers to offer guidance. Both companies improved net income, but reported shaky volume and revenue Q2:02 performances.

Solid Performances from UNP and KSU

We have picked two companies that appear to lead the pack: Union Pacific and Kansas City Southern both improved Revenue and Net Income (after adjustments for one-time gains) and show solid cost containment numbers. Kansas City Southern has a P/E which is well above the industry average, but should be considered along with other facts: the railroad is a start-up in terms of the industry's definition of start-up. Further, future gains are expected from both of these companies as management had very favorable recent conference calls, citing transit time restructuring efforts and revenue growths.

The industry has fared well relative to the overall market and may fare even better with a continued focus on costs, margins, and improved technology. Further, traffic volumes are solid and there is the potential for a modest upside. On balance, the industry is close to its all-time high P/E ratio, which raises concerns about the sustainability and stability of these premiums. Federal tightening of fiscal policy could again place downward pressure on P/E. The results from these companies are mixed and our report reflects this underlying message. Overall, we rate the industry a hold and suggest paying careful attention to Q3 and year-end numbers.

Burlington Northern

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	9,054.0	9,195.0	9,207.0	9,208.0	2,163.0	2,207.0	9,023.8
Percentage Change		**1.56%**	**0.13%**	**0.01%**			**-2.00%**
Cost Of Goods Sold	3,832.0	3,823.0	3,753.0	3,934.0	988.0	2,148.0	
Gross Profit	**5,222.0**	**5,372.0**	**5,454.0**	**5,274.0**	**1,175.0**	**59.0**	
SG and A Expenses	2,232.0	2,270.0	2,451.0	2,610.0	577.0	(577.0)	
R and D Expenditures	-	-	-	-	-	-	
EBITDA	2,990.0	3,102.0	3,003.0	2,664.0			
Depreciation and Amortization	832.0	897.0	895.0	909.0	230.0	231.0	
EBIT	**2,158.0**	**2,205.0**	**2,108.0**	**1,755.0**	**368.0**	**405.0**	**1,714.5**
EBIT Margin	**23.83%**	**23.98%**	**22.90%**	**19.06%**			**19.00%**
Interest Expense	354.0	387.0	453.0	463.0	109.0	105.0	428.0
Non-Operating Income	45.0	1.0	(70.0)	(110.0)	16.0	10.0	(33.5)
Income Before Tax	1,849.0	1,819.0	1,585.0	1,182.0	275.0	310.0	1,253.0
Provision For Income Taxes	694.0	682.0	605.0	445.0	103.0	116.0	471.4
Implied Tax Rate	0.38	0.37	0.38	0.38	0.37	0.37	0.38
Income After Tax	1,155.0	1,137.0	980.0	737.0	172.0	194.0	781.6
Minority Interest	-	-	-	-	-	-	-
Net Income Before Extra Items	1,155.0	1,137.0	980.0	737.0	172.0	194.0	781.6
Extra Items Discontinued Operations	-	-	-	(6.0)	-	-	
Net Income	**1,155.0**	**1,137.0**	**980.0**	**731.0**	**172.0**	**194.0**	**781.6**
EPS	**2.45**	**2.46**	**2.38**	**2.08**			**2.03**
Common Shares Outstanding (MM)				385.78			
Balance Sheet							
Cash	25.0	22.0	11.0	26.0			
Marketable Securities	-	-	-	-			
Receivables	524.0	397.0	314.0	172.0			
Inventories	244.0	255.0	220.0	191.0			
Raw Materials	-	-	-	-			
Work In Progress	-	-	-	-			
Finished Goods	-	-	-	-			
Notes Receivable	-	-	-	-			
Other Current Assets	369.0	392.0	431.0	334.0			
Total Current Assets	**1,162.0**	**1,066.0**	**976.0**	**723.0**			
Property, Plant, and Equipment, Gross	20,662.0	21,681.0	22,369.0	23,110.0			
Accumulated Depreciation	-	-	-	-			
Property, Plant, and Equipment, Net	20,662.0	21,681.0	22,369.0	23,110.0			
Intangibles	-	-	-	-			
Investment Advances To Subsidiaries	-	-	-	-			
Deferred Charges	-	-	-	-			
Deposits And Other Assets	822.0	953.0	1,030.0	888.0			
Other Non-Current Assets	-	-	-	-			
Total Non-Current Assets	**21,484.0**	**22,634.0**	**23,399.0**	**23,998.0**			
Total Assets	**22,646.0**	**23,700.0**	**24,375.0**	**24,721.0**			
Notes Payable	-	-	-	-			
Accounts Payable	1,885.0	1,917.0	1,954.0	1,873.0			
Current Long Term Debt	268.0	158.0	232.0	288.0			
Current Portion Capital Leases	-	-	-	-			
Accrued Expenses	-	-	-	-			
Income Taxes	-	-	-	-			
Other Current Liabilities	-	-	-	-			
Total Current Liabilities	**2,153.0**	**2,075.0**	**2,186.0**	**2,161.0**			
Mortgages	-	-	-	-			
Deferred Charges To Income	5,662.0	6,097.0	6,422.0	6,731.0			
Convertible Debt	-	-	-	-			
Long Term Debt	5,188.0	5,655.0	6,614.0	6,363.0			
Non-Current Portion Of Capital Leases	-	-	-	-			
Minority Interest (Liabilities)	-	-	-	-			
Other Long Term Liabilities	1,859.0	1,701.0	1,673.0	1,617.0			
Total Non-Current Liabilities	**12,709.0**	**13,453.0**	**14,709.0**	**14,711.0**			
Total Liabilities	**14,862.0**	**15,528.0**	**16,895.0**	**16,872.0**			
Preferred Stock	-	-	-	-			
Common Stock, Net	5.0	5.0	5.0	5.0			
Capital Surplus	5,213.0	5,390.0	5,428.0	5,584.0			
Retained Earnings	2,811.0	3,726.0	4,505.0	5,048.0			
Treasury Stock	206.0	913.0	2,413.0	2,745.0			
Other Equity	(39.0)	(36.0)	(45.0)	(43.0)			
Total Shareholder Equity	**7,784.0**	**8,172.0**	**7,480.0**	**7,849.0**			
Total Liabilities Shareholders Equity	**22,646.0**	**23,700.0**	**24,375.0**	**24,721.0**			

Canadian National

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	4,078.0	5,236.0	5,428.0	5,652.0	1,509.0	1,551.0	5,623.7
Percentage Change		**28.40%**	**3.67%**	**4.13%**			**-0.50%**
Cost Of Goods Sold	1,726.0	1,989.0	2,086.0	1,485.0			
Gross Profit	**2,352.0**	**3,247.0**	**3,342.0**	**4,167.0**			
SG and A Expenses	1,028.0	1,290.0	1,169.0	1,698.0			
R and D Expenditures	-	-	-	-			
EBITDA	1,324.0	1,957.0	2,173.0	2,469.0			
Depreciation and Amortization	316.0	490.0	525.0	532.0			
EBIT	**1,008.0**	**1,467.0**	**1,648.0**	**1,937.0**	**406.0**	**490.0**	**1,743.4**
EBIT Margin	**24.72%**	**28.02%**	**30.36%**	**34.27%**			**31.00%**
Interest Expense	242.0	314.0	311.0	327.0	96.0	91.0	374.0
Non-Operating Income	(468.0)	55.0	136.0	(190.0)	38.0	23.0	(116.8)
Income Before Tax	298.0	1,208.0	1,473.0	1,420.0	348.0	422.0	1,252.6
Provision For Income Taxes	74.0	462.0	536.0	380.0	118.0	142.0	404.6
Implied Tax Rate	0.25	0.38	0.36	0.27	0.34	0.34	0.32
Income After Tax	224.0	746.0	937.0	1,040.0	230.0	280.0	848.1
Minority Interest	-	-	-	-	-	-	
Net Income Before Extra Items	224.0	746.0	937.0	1,040.0	230.0	280.0	848.1
Extra Items Discontinued Operations	42.0	5.0	-	-	-	-	
Net Income	**266.0**	**751.0**	**937.0**	**1,040.0**	**230.0**	**280.0**	**848.1**
EPS	**0.80**	**2.62**	**3.21**	**3.36**			**2.74**
Common Shares Outstanding (MM)				309.52			

Balance Sheet	FY 1998	FY 1999	FY 2000	FY 2001
Cash	263.0	305.0	15.0	53.0
Marketable Securities	-	-	-	-
Receivables	404.0	800.0	726.0	645.0
Inventories	132.0	115.0	110.0	133.0
Raw Materials	-	-	-	-
Work In Progress	-	-	-	-
Finished Goods	-	-	-	-
Notes Receivable	-	-	-	-
Other Current Assets	251.0	295.0	257.0	333.0
Total Current Assets	**1,050.0**	**1,515.0**	**1,108.0**	**1,164.0**
Property, Plant, and Equipment, Gross	5,442.0	14,620.0	15,638.0	19,145.0
Accumulated Depreciation	-	-	-	-
Property, Plant, and Equipment, Net	5,442.0	14,620.0	15,638.0	19,145.0
Intangibles	-	-	-	-
Investment Advances To Subsidiaries	3,802.0	-	-	-
Deferred Charges	280.0	-	-	-
Deposits And Other Assets	290.0	295.0	568.0	914.0
Other Non-Current Assets	-	-	-	-
Total Non-Current Assets	**9,814.0**	**14,915.0**	**16,206.0**	**20,059.0**
Total Assets	**10,864.0**	**16,430.0**	**17,314.0**	**21,223.0**
Notes Payable	-	-	-	-
Accounts Payable	1,174.0	1,373.0	1,389.0	1,374.0
Current Long Term Debt	134.0	271.0	434.0	163.0
Current Portion Capital Leases	-	-	-	-
Accrued Expenses	-	-	-	-
Income Taxes	-	-	-	-
Other Current Liabilities	84.0	120.0	82.0	132.0
Total Current Liabilities	**1,392.0**	**1,764.0**	**1,905.0**	**1,669.0**
Mortgages	-	-	-	-
Deferred Charges To Income	-	2,975.0	3,375.0	4,591.0
Convertible Debt	-	-	-	-
Long Term Debt	4,009.0	3,948.0	3,886.0	5,764.0
Non-Current Portion Of Capital Leases	-	-	-	-
Minority Interest (Liabilities)	-	-	-	-
Other Long Term Liabilities	1,172.0	1,287.0	1,205.0	1,345.0
Total Non-Current Liabilities	**5,181.0**	**8,210.0**	**8,466.0**	**11,700.0**
Total Liabilities	**6,573.0**	**9,974.0**	**10,371.0**	**13,369.0**
Preferred Stock	-	334.0	345.0	366.0
Common Stock, Net	2,873.0	4,597.0	4,349.0	4,442.0
Capital Surplus	190.0	-	-	-
Retained Earnings	1,221.0	1,531.0	2,098.0	2,988.0
Treasury Stock	-	-	-	-
Other Equity	7.0	(6.0)	151.0	58.0
Total Shareholder Equity	**4,291.0**	**6,456.0**	**6,943.0**	**7,854.0**
Total Liabilities Shareholders Equity	**10,864.0**	**16,430.0**	**17,314.0**	**21,223.0**

Canadian Pacific

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	3,516.5	3,496.4	3,655.1	3,698.6	875.4	922.5	3,661.6
Percentage Change		**-0.57%**	**4.54%**	**1.19%**			**-1.00%**
Cost Of Goods Sold	1,647.1	1,452.4	1,770.8	1,706.0			
Gross Profit	**1,869.4**	**2,044.0**	**1,884.3**	**1,992.6**			
SG and A Expenses	591.6	469.1	734.4	817.2			
R and D Expenditures	262.8	-	-	-			
EBITDA	1,015.0	1,574.9	1,149.9	1,175.4			
Depreciation and Amortization	279.0	292.5	304.7	334.4			
EBIT	**736.0**	**1,282.4**	**845.2**	**841.0**	**175.9**	**219.0**	**842.2**
EBIT Margin	**20.93%**	**36.68%**	**23.12%**	**22.74%**			**23.00%**
Interest Expense	118.5	136.6	167.0	209.6	64.3	61.8	252.2
Non-Operating Income	(18.4)	(1,046.9)	(23.1)	(59.9)	16.4	63.1	(33.8)
Income Before Tax	599.1	98.9	655.1	547.0	128.0	220.3	556.2
Provision For Income Taxes	236.7	32.0	122.8	136.6	41.2	51.6	158.7
Implied Tax Rate	0.40	0.32	0.19	0.25	0.32	0.23	0.29
Income After Tax	362.4	66.9	532.3	410.4	136.4	168.7	397.5
Minority Interest	-	-	-	-	-	-	
Net Income Before Extra Items	362.4	66.9	532.3	410.4	136.4	168.7	397.5
Extra Items Discontinued Operations	-	-	-	-	-	-	
Net Income	**362.4**	**66.9**	**532.3**	**410.4**	**136.4**	**168.7**	**397.5**
EPS	**1.55**	**1.22**	**2.24**	**1.57**			**1.52**
Common Shares Outstanding (MM)				158.4	261.40		

Balance Sheet	FY 1998	FY 1999	FY 2000	FY 2001
Cash	49.5	54.7	120.3	556.9
Marketable Securities	-	-	-	-
Receivables	458.7	503.8	495.3	464.1
Inventories	194.6	176.1	131.0	102.3
Raw Materials	-	-	-	-
Work In Progress	-	-	-	-
Finished Goods	-	-	-	-
Notes Receivable	-	-	-	-
Other Current Assets	50.4	58.8	82.8	92.2
Total Current Assets	**753.2**	**793.4**	**829.4**	**1,215.5**
Property, Plant, and Equipment, Gross	7,035.4	7,471.6	7,389.3	7,935.5
Accumulated Depreciation	-	-	-	-
Property, Plant, and Equipment, Net	7,035.4	7,471.6	7,389.3	7,935.5
Intangibles	-	-	-	-
Investment Advances To Subsidiaries	180.5	139.3	105.2	94.9
Deferred Charges	-	-	-	-
Deposits And Other Assets	395.0	360.3	484.3	607.1
Other Non-Current Assets	-	-	-	-
Total Non-Current Assets	**7,610.9**	**7,971.2**	**7,978.8**	**8,637.5**
Total Assets	**8,364.1**	**8,764.6**	**8,808.2**	**9,853.0**
Notes Payable	-	14.7	-	-
Accounts Payable	1,389.2	1,134.8	1,023.5	1,028.8
Current Long Term Debt	20.2	0.9	3.1	38.2
Current Portion Capital Leases	-	-	-	-
Accrued Expenses	-	-	-	-
Income Taxes	102.8	111.0	158.1	103.4
Other Current Liabilities	-	-	-	20.2
Total Current Liabilities	**1,512.2**	**1,261.4**	**1,184.7**	**1,190.6**
Mortgages	-	-	-	-
Deferred Charges To Income	1,913.1	2,189.9	1,734.4	1,815.9
Convertible Debt	-	-	-	-
Long Term Debt	1,489.2	1,646.0	2,276.3	3,709.0
Non-Current Portion Of Capital Leases	-	-	-	-
Minority Interest (Liabilities)	-	-	-	-
Other Long Term Liabilities	215.2	529.3	50.0 -	
Total Non-Current Liabilities	**3,617.5**	**4,365.2**	**4,060.7**	**5,524.9**
Total Liabilities	**5,129.7**	**5,626.6**	**5,245.4**	**6,715.5**
Preferred Stock	-	-	-	-
Common Stock, Net	1,812.5	1,812.5	1,812.5	1,114.1
Capital Surplus	283.7	297.9	299.4	291.1
Retained Earnings	1,042.9	959.8	1,366.6	1,606.8
Treasury Stock	-	-	-	-
Other Equity	95.3	67.8	84.3	125.5
Total Shareholder Equity	**3,234.4**	**3,138.0**	**3,562.8**	**3,137.5**
Total Liabilities Shareholders Equity	**8,364.1**	**8,764.6**	**8,808.2**	**9,853.0**

CSX Corp.

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	9,490.0	10,375.0	8,191.0	8,110.0	1,964.0	2,073.0	8,110.0
Percentage Change		**9.33%**	**-21.05%**	**-0.99%**			**0.00%**
Cost Of Goods Sold	-	-	-	-	1,452.0	406.0	
Gross Profit	**9,490.0**	**10,375.0**	**8,191.0**	**8,110.0**	**512.0**	**1,667.0**	
SG and A Expenses	8,359.0	9,802.0	7,386.0	7,153.0	148.0	1,191.0	
R and D Expenditures	-	-	-	-	-	-	
EBITDA	1,131.0	573.0	805.0	957.0	364.0	476.0	
Depreciation and Amortization	0.0	0.0	0.0	0.0	152.0	155.0	
EBIT	**1,131.0**	**573.0**	**805.0**	**957.0**	**212.0**	**325.0**	**932.7**
EBIT Margin	**11.92%**	**5.52%**	**9.83%**	**11.80%**			**11.50%**
Interest Expense	506.0	528.0	550.0	518.0	114.0	116.0	460.0
Non-Operating Income	119.0	59.0	22.0	9.0	17.0	14.0	52.3
Income Before Tax	744.0	104.0	277.0	448.0	107.0	209.0	524.9
Provision For Income Taxes	224.0	72.0	91.0	155.0	39.0	74.0	208.8
Implied Tax Rate	0.30	0.69	0.33	0.35	0.36	0.35	0.40
Income After Tax	520.0	32.0	186.0	293.0	68.0	135.0	316.1
Minority Interest	-	-	-	-	(8.0)	(10.0)	
Net Income Before Extra Items	520.0	32.0	186.0	293.0	68.0	135.0	316.1
Extra Items Discontinued Operations	17.0	(30.0)	379.0	-	(43.0)	-	
Net Income	**537.0**	**2.0**	**565.0**	**293.0**	**25.0**	**135.0**	**316.1**
EPS	**2.55**	**0.15**	**0.88**	**1.56**			**1.48**
Common Shares Outstanding (MM)				213.688			

Balance Sheet	FY 1998	FY 1999	FY 2000	FY 2001
Cash	533.0	974.0	686.0	618.0
Marketable Securities	-	-	-	-
Receivables	898.0	1,135.0	850.0	878.0
Inventories	225.0	220.0	194.0	206.0
Raw Materials	-	-	-	-
Work In Progress	-	-	-	-
Finished Goods	-	-	-	-
Notes Receivable	-	-	-	-
Other Current Assets	328.0	234.0	290.0	372.0
Total Current Assets	**1,984.0**	**2,563.0**	**2,020.0**	**2,074.0**
Property, Plant, and Equipment, Gross	18,678.0	17,526.0	17,863.0	18,151.0
Accumulated Depreciation	6,033.0	5,269.0	5,202.0	5,179.0
Property, Plant, and Equipment, Net	12,645.0	12,257.0	12,661.0	12,972.0
Intangibles	-	-	-	-
Investment Advances To Subsidiaries	4,798.0	4,663.0	4,668.0	4,655.0
Deferred Charges	-	-	-	-
Deposits And Other Assets	552.0	827.0	846.0	718.0
Other Non-Current Assets	448.0	410.0	353.0	382.0
Total Non-Current Assets	**18,443.0**	**18,157.0**	**18,528.0**	**18,727.0**
Total Assets	**20,427.0**	**20,720.0**	**20,548.0**	**20,801.0**
Notes Payable	187.0	574.0	749.0	225.0
Accounts Payable	1,216.0	1,197.0	1,030.0	966.0
Current Long Term Debt	100.0	349.0	192.0	1,044.0
Current Portion Capital Leases	-	-	-	-
Accrued Expenses	462.0	436.0	405.0	418.0
Income Taxes	-	224.0	372.0	101.0
Other Current Liabilities	635.0	693.0	503.0	549.0
Total Current Liabilities	**2,600.0**	**3,473.0**	**3,251.0**	**3,303.0**
Mortgages	-	-	-	-
Deferred Charges To Income	3,173.0	3,227.0	3,384.0	3,621.0
Convertible Debt	-	-	-	-
Long Term Debt	6,432.0	6,196.0	5,896.0	5,839.0
Non-Current Portion Of Capital Leases	-	-	-	-
Minority Interest (Liabilities)	-	-	-	-
Other Long Term Liabilities	2,342.0	2,068.0	2,000.0	1,918.0
Total Non-Current Liabilities	**11,947.0**	**11,491.0**	**11,280.0**	**11,378.0**
Total Liabilities	**14,547.0**	**14,964.0**	**14,531.0**	**14,681.0**
Preferred Stock	-	-	-	-
Common Stock, Net	217.0	218.0	213.0	214.0
Capital Surplus	1,489.0	1,525.0	1,467.0	1,492.0
Retained Earnings	4,294.0	4,034.0	4,337.0	4,459.0
Treasury Stock	-	-	-	-
Other Equity	(120.0)	(21.0)	-	(45.0)
Total Shareholder Equity	**5,880.0**	**5,756.0**	**6,017.0**	**6,120.0**
Total Liabilities Shareholders Equity	**20,427.0**	**20,720.0**	**20,548.0**	**20,801.0**

Kansas City Southern

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	613.5	601.4	572.2	577.3	142.5	137.9	577.3
Percentage Change		**-1.97%**	**-4.86%**	**0.89%**			**0.00%**
Cost Of Goods Sold	272.2	345.4	352.4	344.7	92.9	74.1	
Gross Profit	**341.3**	**256.0**	**219.8**	**232.6**	**49.6**	**63.8**	
SG and A Expenses	166.4	135.0	105.9	119.2	21.3	34.7	
R and D Expenditures	-	-	-	-	-	-	
EBITDA	174.9	121.0	113.9	113.4	28.3	29.1	
Depreciation and Amortization	56.7	56.9	56.1	58.0	14.9	14.6	
EBIT	**118.2**	**64.1**	**57.8**	**55.4**	**13.4**	**14.5**	**60.6**
EBIT Margin	**19.27%**	**10.66%**	**10.10%**	**9.60%**			**10.50%**
Interest Expense	59.6	57.4	65.8	52.8	11.3	10.5	43.6
Non-Operating Income	6.5	10.5	29.8	31.3	8.8	4.4	19.5
Income Before Tax	65.1	17.2	21.8	33.9	15.8	20.1	36.5
Provision For Income Taxes	27.1	7.0	(3.6)	2.8	4.1	2.9	7.0
Implied Tax Rate	0.42	0.41	(0.17)	0.08	0.26	0.14	0.19
Income After Tax	38.0	10.2	25.4	31.1	11.7	17.2	29.6
Minority Interest	-	-	-	-	-	-	
Net Income Before Extra Items	38.0	10.2	25.4	31.1	11.7	17.2	29.6
Extra Items Discontinued Operations	152.2	313.1	355.1	(0.4)	-	(2.7)	
Net Income	**190.2**	**323.3**	**380.5**	**30.7**	**11.7**	**14.5**	**29.6**
EPS	**3.48**	**0.18**	**0.44**	**0.45**			**0.50**
Common Shares Outstanding (MM)				59.2			

Balance Sheet				
Cash	144.1	11.9	21.5	24.7
Marketable Securities	32.2	-	-	-
Receivables	208.4	132.2	135.0	130.0
Inventories	47.0	40.5	34.0	27.9
Raw Materials	-	-	-	-
Work In Progress	-	-	-	-
Finished Goods	-	-	-	-
Notes Receivable	-	-	-	-
Other Current Assets	37.8	23.9	25.9	71.8
Total Current Assets	**469.5**	**208.5**	**216.4**	**254.4**
Property, Plant, and Equipment, Gross	1,266.7	1,277.4	1,327.8	1,327.4
Accumulated Depreciation	-	-	-	-
Property, Plant, and Equipment, Net	1,266.7	1,277.4	1,327.8	1,327.4
Intangibles	176.4	34.4	42.1	42.3
Investment Advances To Subsidiaries	707.1	337.1	358.2	386.8
Deferred Charges	-	-	-	-
Deposits And Other Assets	-	-	-	-
Other Non-Current Assets	-	814.6	-	-
Total Non-Current Assets	**2,150.2**	**2,463.5**	**1,728.1**	**1,756.5**
Total Assets	**2,619.7**	**2,672.0**	**1,944.5**	**2,010.9**
Notes Payable	-	-	-	-
Accounts Payable	125.8	74.8	52.9	50.4
Current Long Term Debt	10.7	10.9	36.2	46.7
Current Portion Capital Leases	-	-	-	-
Accrued Expenses	159.7	168.5	159.9	160.4
Income Taxes	-	-	-	-
Other Current Liabilities	-	-	-	-
Total Current Liabilities	**296.2**	**254.2**	**249.0**	**257.5**
Mortgages	-	-	-	-
Deferred Charges To Income	532.4	384.7	413.7	461.4
Convertible Debt	-	-	-	-
Long Term Debt	825.6	750.0	638.4	611.7
Non-Current Portion Of Capital Leases	-	-	-	-
Minority Interest (Liabilities)	34.3	-	-	-
Other Long Term Liabilities	-	-	-	-
Total Non-Current Liabilities	**1,392.3**	**1,134.7**	**1,052.1**	**1,073.1**
Total Liabilities	**1,654.2**	**1,388.9**	**1,301.1**	**1,330.6**
Preferred Stock	6.1	6.1	6.1	6.1
Common Stock, Net	1.1	1.1	0.6	0.6
Capital Surplus	-	-	-	-
Retained Earnings	849.1	1,167.0	636.7	676.5
Treasury Stock	-	-	-	-
Other Equity	74.9	108.9	-	(2.9)
Total Shareholder Equity	**931.2**	**1,283.1**	**643.4**	**680.3**
Total Liabilities Shareholders Equity	**2,619.7**	**2,672.0**	**1,944.5**	**2,010.9**

Norfolk Southern

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	4,221.0	5,242.0	6,159.0	6,170.0	1,498.0	1,593.0	6,170.0
Percentage Change		**24.19%**	**17.49%**	**0.18%**			**0.00%**
Cost Of Goods Sold	2,472.0	3,384.0	4,157.0	3,870.0	568.0	1,608.0	
Gross Profit	**1,749.0**	**1,858.0**	**2,002.0**	**2,300.0**	**930.0**	**(15.0)**	
SG and A Expenses	260.0	665.0	866.0	779.0	566.0	(466.0)	
R and D Expenditures	-	-	-	-	-	-	
EBITDA	1,489.0	1,193.0	1,136.0	1,521.0	364.0	451.0	
Depreciation and Amortization	437.0	475.0	503.0	514.0	127.0	129.0	
EBIT	**1,052.0**	**718.0**	**633.0**	**1,007.0**	**237.0**	**322.0**	**1,110.6**
EBIT Margin	**24.92%**	**13.70%**	**10.28%**	**16.32%**			**18.00%**
Interest Expense	516.0	531.0	551.0	553.0	134.0	130.0	528.0
Non-Operating Income	309.0	164.0	168.0	99.0	34.0	2.0	185.0
Income Before Tax	845.0	351.0	250.0	553.0	137.0	194.0	767.6
Provision For Income Taxes	215.0	112.0	78.0	191.0	51.0	75.0	254.6
Implied Tax Rate	0.25	0.32	0.31	0.35	0.37	0.39	0.33
Income After Tax	630.0	239.0	172.0	362.0	86.0	119.0	513.0
Minority Interest	-	-	-	-	-	-	
Net Income Before Extra Items	630.0	239.0	172.0	362.0	86.0	119.0	513.0
Extra Items Discontinued Operations	104.0	-	-	13.0	-	-	
Net Income	**734.0**	**239.0**	**172.0**	**375.0**	**86.0**	**119.0**	**513.0**
EPS	**1.66**	**0.63**	**0.45**	**0.91**			**1.33**
Common Shares Outstanding (MM)				385.8			

Balance Sheet	FY 1998	FY 1999	FY 2000	FY 2001
Cash	5.0	37.0	-	204.0
Marketable Securities	58.0	14.0	2.0	-
Receivables	519.0	857.0	411.0	475.0
Inventories	59.0	100.0	91.0	90.0
Raw Materials	-	-	-	-
Work In Progress	-	-	-	-
Finished Goods	-	-	-	-
Notes Receivable	-	-	-	-
Other Current Assets	272.0	363.0	345.0	278.0
Total Current Assets	**913.0**	**1,371.0**	**849.0**	**1,047.0**
Property, Plant, and Equipment, Gross	10,477.0	10,956.0	11,105.0	11,208.0
Accumulated Depreciation	-	-	-	-
Property, Plant, and Equipment, Net	10,477.0	10,956.0	11,105.0	11,208.0
Intangibles	-	-	-	-
Investment Advances To Subsidiaries	6,210.0	6,132.0	6,154.0	6,161.0
Deferred Charges	-	-	-	-
Deposits And Other Assets	580.0	791.0	868.0	1,002.0
Other Non-Current Assets	-	-	-	-
Total Non-Current Assets	**17,267.0**	**17,879.0**	**18,127.0**	**18,371.0**
Total Assets	**18,180.0**	**19,250.0**	**18,976.0**	**19,418.0**
Notes Payable	-	-	-	-
Accounts Payable	600.0	818.0	925.0	848.0
Current Long Term Debt	141.0	503.0	297.0	605.0
Current Portion Capital Leases	-	-	-	-
Accrued Expenses	-	-	-	-
Income Taxes	151.0	163.0	251.0	312.0
Other Current Liabilities	225.0	440.0	414.0	621.0
Total Current Liabilities	**1,117.0**	**1,924.0**	**1,887.0**	**2,386.0**
Mortgages	-	-	-	-
Deferred Charges To Income	2,545.0	2,687.0	2,745.0	2,781.0
Convertible Debt	-	-	-	-
Long Term Debt	7,483.0	7,556.0	7,339.0	7,027.0
Non-Current Portion Of Capital Leases	-	-	-	-
Minority Interest (Liabilities)	49.0	50.0	50.0	45.0
Other Long Term Liabilities	1,065.0	1,101.0	1,131.0	1,089.0
Total Non-Current Liabilities	**11,142.0**	**11,394.0**	**11,265.0**	**10,942.0**
Total Liabilities	**12,210.0**	**13,268.0**	**13,102.0**	**13,283.0**
Preferred Stock	-	-	-	-
Common Stock, Net	401.0	404.0	405.0	407.0
Capital Surplus	296.0	372.0	392.0	423.0
Retained Earnings	5,252.0	5,187.0	5,053.0	5,335.0
Treasury Stock	20.0	20.0	20.0	20.0
Other Equity	(8.0)	(11.0)	(6.0)	(55.0)
Total Shareholder Equity	**5,921.0**	**5,932.0**	**5,824.0**	**6,090.0**
Total Liabilities Shareholders Equity	**18,180.0**	**19,250.0**	**18,976.0**	**19,418.0**

Union Pacific

Income Statement	FY 1998	FY 1999	FY 2000	FY 2001	Q1:02	Q2:02	FY 2002E
Net Sales	10,514.0	11,237.0	11,878.0	11,973.0	2,967.0	3,154.0	12,212.5
Percentage Change		**6.88%**	**5.70%**	**0.80%**			**2.00%**
Cost Of Goods Sold	5,756.0	5,707.0	6,254.0	6,129.0	1,828.0	2,593.0	
Gross Profit	**4,758.0**	**5,530.0**	**5,624.0**	**5,844.0**			
SG and A Expenses	3,312.0	2,643.0	2,581.0	2,598.0	341.0	(341.0)	
R and D Expenditures	-	-	-	-	-	-	
EBITDA	1,446.0	2,887.0	3,043.0	3,246.0	798.0	902.0	
Depreciation and Amortization	1,070.0	1,083.0	1,140.0	1,174.0	299.0	300.0	
EBIT	**376.0**	**1,804.0**	**1,903.0**	**2,072.0**	**499.0**	**602.0**	**2,076.1**
EBIT Margin	**3.58%**	**16.05%**	**16.02%**	**17.31%**			**17.00%**
Interest Expense	714.0	733.0	723.0	701.0	163.0	159.0	644.0
Non-Operating Income	(358.0)	131.0	130.0	162.0	21.0	35.0	16.3
Income Before Tax	(696.0)	1,202.0	1,310.0	1,533.0	357.0	478.0	1,448.4
Provision For Income Taxes	(63.0)	419.0	468.0	567.0	135.0	174.0	460.7
Implied Tax Rate	0.09	0.35	0.36	0.37	0.38	0.36	0.32
Income After Tax	(633.0)	783.0	842.0	966.0	222.0	304.0	987.7
Minority Interest	-	-	-	-	-	-	
Net Income Before Extra Items	(633.0)	783.0	842.0	966.0	222.0	304.0	987.7
Extra Items Discontinued Operations	-	27.0	-	-	-	-	
Net Income	**(633.0)**	**810.0**	**842.0**	**966.0**	**222.0**	**304.0**	**987.7**
EPS	(2.57)	**3.17**	**3.42**	**3.77**			**3.95**
Common Shares Outstanding (MM)				250.29			
Balance Sheet							
Cash	176.0	175.0	105.0	113.0			
Marketable Securities	-	-	-	-			
Receivables	643.0	581.0	597.0	604.0			
Inventories	343.0	337.0	360.0	265.0			
Raw Materials	-	-	-	-			
Work In Progress	-	-	-	-			
Finished Goods	-	-	-	-			
Notes Receivable	-	-	-	-			
Other Current Assets	340.0	221.0	641.0	560.0			
Total Current Assets	**1,502.0**	**1,314.0**	**1,703.0**	**1,542.0**			
Property, Plant, and Equipment, Gross	33,145.0	34,370.0	35,458.0	36,436.0			
Accumulated Depreciation	6,206.0	6,851.0	7,262.0	7,644.0			
Property, Plant, and Equipment, Net	26,939.0	27,519.0	28,196.0	28,792.0			
Intangibles	-	-	-	-			
Investment Advances To Subsidiaries	691.0	753.0	740.0	786.0			
Deferred Charges	-	-	-	-			
Deposits And Other Assets	242.0	302.0	278.0	431.0			
Other Non-Current Assets	-	-	-	-			
Total Non-Current Assets	**27,872.0**	**28,574.0**	**29,214.0**	**30,009.0**			
Total Assets	**29,374.0**	**29,888.0**	**30,917.0**	**31,551.0**			
Notes Payable	-	-	-	-			
Accounts Payable	586.0	598.0	658.0	567.0			
Current Long Term Debt	181.0	214.0	207.0	194.0			
Current Portion Capital Leases	-	-	-	-			
Accrued Expenses	810.0	794.0	831.0	792.0			
Income Taxes	301.0	256.0	234.0	286.0			
Other Current Liabilities	1,054.0	1,023.0	1,032.0	853.0			
Total Current Liabilities	**2,932.0**	**2,885.0**	**2,962.0**	**2,692.0**			
Mortgages	-	-	-	-			
Deferred Charges To Income	6,308.0	6,715.0	7,561.0	7,882.0			
Convertible Debt	-	-	-	-			
Long Term Debt	8,511.0	8,426.0	8,144.0	7,886.0			
Non-Current Portion Of Capital Leases	-	-	-	-			
Minority Interest (Liabilities)	1,500.0	1,500.0	1,500.0	1,500.0			
Other Long Term Liabilities	2,730.0	2,361.0	2,088.0	2,016.0			
Total Non-Current Liabilities	**19,049.0**	**19,002.0**	**19,293.0**	**19,284.0**			
Total Liabilities	**20,481.0**	**20,387.0**	**20,755.0**	**20,476.0**			
Preferred Stock	-	-	-	-			
Common Stock, Net	7,393.0	8,001.0	8,662.0	9,575.0			
Capital Surplus	-	-	-	-			
Retained Earnings	-	-	-	-			
Treasury Stock	-	-	-	-			
Other Equity	-	-	-	-			
Total Shareholder Equity	**7,393.0**	**8,001.0**	**8,662.0**	**9,575.0**			
Total Liabilities Shareholders Equity	**29,374.0**	**29,888.0**	**30,917.0**	**31,551.0**			

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