BRITISH COLUMBIA RAILWAY COMPANY

THREE YEAR SERVICE PLAN

2003 - 2005

February 18, 2003

BRITISH COLUMBIA RAILWAY COMPANY

SERVICE PLAN

2003 - 2005

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COMMERCIAL SENSITIVITY AND CONFIDENTIALITY

The British Columbia Railway Company is a commercial Crown Corporation with all of its business activities operating in competition with the private sector in a deregulated environment.

The British Columbia Railway Company (BCRC) is vulnerable to the risks of disclosing or publishing any commercially sensitive information. The public availability of such information could seriously undermine BCRC's competitive position. For this reason, only consolidated results are currently published in BCRC Annual Reports.

As a result, this public Service Plan does not include any forward-looking information of a strategic nature, especially regarding competitive business initiatives. The release of such information could be detrimental to the company's commercial viability and, ultimately, harmful to the value of the enterprise to the Province.

Changes From 2002 - 2004 Service Plan

When the 2002 – 2004 Service Plan was tabled in the Legislature in February 2002, the Core Services Review process had just commenced for BCRC.

Although the Core Services Review process has not yet concluded for BCRC, a number of significant interim decisions were made on key issues. Since February 2002, BCRC has worked diligently toward its new corporate direction through the following key initiatives:

- Discontinuation of Intermodal ToFC (Trailer on Flatcar) services
- Discontinuation of uneconomic passenger train services
- Divestiture of its BCR Marine division (comprising the businesses of Vancouver Wharves, Canadian Stevedoring and Casco Terminals)
- Divestiture of non-rail subsidiary transportation businesses (Finlay Navigation)

The result of these changes will be the transformation of BCRC into a strictly industrial freight railway company with all business activity conducted through its principal operating subsidiary - BC Rail.

Consequently, the framework of BCRC's 2003 – 2005 Service Plan is substantially different from the previous two years. The scope of the company's strategic focus is narrower and this Service Plan deals exclusively with the three-year strategic direction for BC Rail as an industrial freight railway.

Even though the divestitures of BCR Marine and Finlay Navigation will not be completed until some time in the early part of 2003, these are regarded as "discontinued businesses" for planning and budgeting purposes, with the result that they are not included in this three-year Service Plan.

BRITISH COLUMBIA RAILWAY COMPANY

Overview of the Organization

The British Columbia Railway Company (BCRC) is comprised of two principal business units

- BC Rail, an industrial freight railway
- BCR Properties, managing the railway's real estate portfolio

Founded in 1912 as a private enterprise and acquired by the Province of British Columbia in 1918, BC Rail is the historic core business unit of the Crown corporation and continues to contribute 95% of BCRC's total annual revenue.

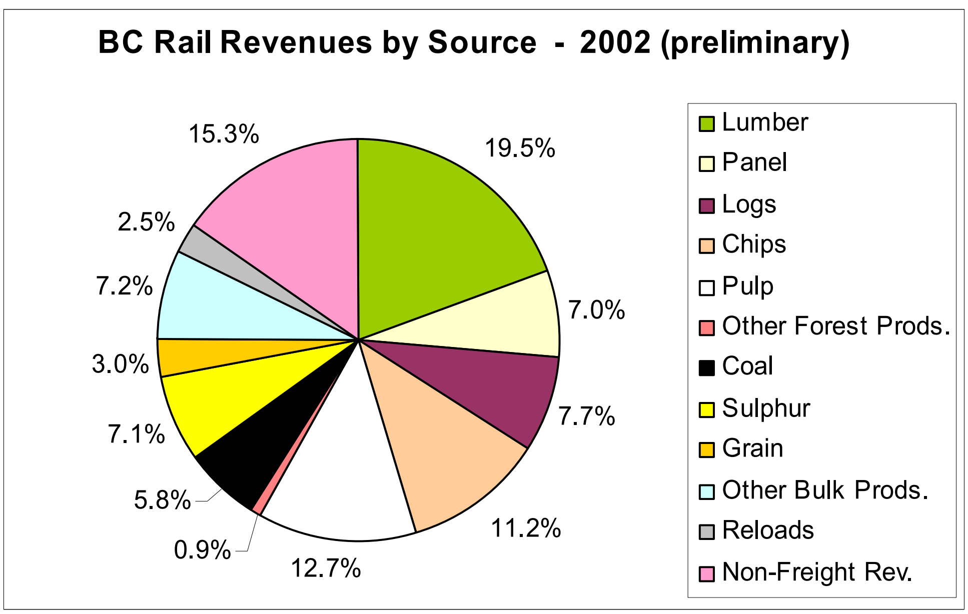
The original purpose and mandate for the Province's ownership of BC Rail was to open-up and develop frontier northern resource regions and to provide public passenger train services at a time when few transportation options were available to many interior communities. In 1993, the Province declared BC Rail to be a commercial Crown corporation, necessitating the railway to shift from its traditional role of "public utility" to one of providing commercial transportation services in getting B.C. products to markets.

BC Rail, Canada's third largest railway as measured by revenue and continuous track, operates exclusively within British Columbia and has inter-line connections to all rail-served points in North America. The BC Rail network consists of 2,315 route-kilometres and 740 kilometres of industrial, yard and track sidings throughout the Province.

The railway network consists of a 1,577 kilometre mainline from North Vancouver to Fort Nelson, plus branchlines to Mackenzie, Dawson Creek, Tumbler Ridge, Fort St. James and Takla.

In addition, BC Rail owns the 23-mile Port Subdivision line, connecting three major railways (CN, CP, BNSF) to the important port terminals at Roberts Bank. BC Rail does not operate any of its own trains over the Port Subdivision, but maintains the track and manages all train operations over the subdivision and into the port terminals for the user railways (CPR, CN and BNSF), for which BC Rail earns fees.

BC Rail plays an important role in the export economy of British Columbia as almost all of the railway's customers sell their commodities outside the Province. In 2002, BC Rail's revenues were earned on the basis of the following commodity mix.



This freight revenue mix illustrates BC Rail's heavy dependence on the forest products sector. In 2002, this sector accounted for 73% of the railway's freight traffic revenue (62% of total revenue). After spring 2003, this dependency will increase to approximately 78% of freight traffic revenue (65% of total revenue) when BC Rail's northeast coal traffic will cease due to closure of Bullmoose Mine. This heavy reliance on a single resource commodity sector - and one with its own sectoral challenges, vulnerable to cyclical markets and adversarial U.S. policies - is of significant concern to BC Rail's Board of Directors and management.

The majority of non-freight revenue is earned as Car Hire. This is revenue earned on BC Rail's railcar fleet while travelling off the railway's own network to destinations all over North America.

BCR Properties manages all of BCRC's real estate assets. The majority of these land holdings are those required for BC Rail operations (rights-of-way, yards, terminal facilities, etc.). BCR Properties also owns lands in the railway's important industrial parks, which are leased to major, long-term tenants and railway customers. In addition, the real estate business unit owns a smaller number of properties (lands and buildings) which it manages for income. This source of income has become increasingly vital to supporting the cash flow requirements of the railway overall. Even though BCRC is streamlining its strategic focus to being strictly a freight operating railway, it has been decided to retain the portfolio of income-producing properties.

As a commercial and competitive Crown corporation, BCRC does not place any demands on public taxpayer funds. BCRC has not received any direct operating subsidies or grants from the Province since March 31, 1993.

BCRC is governed by two principal pieces of enabling legislation. The *British Columbia Railway Act* establishes the corporation's structure, legislated responsibilities and accountabilities. This act also affirms the corporation's mandate to provide commercial freight rail services within the Province of British Columbia. The *British Columbia Railway Finance Act* establishes the borrowing and investment framework for BCRC.

VISION

To act as a valuable strategic advantage for our customers in moving their goods to market.

MISSION

To build a safe, reliable, cost effective, self-sustaining, freight railway company.

VALUES

- A safe and healthy work environment
- A customer-focused, market-driven approach to business
- A creative, resourceful and entrepreneurial spirit
- Continuous improvement and innovation
- Operate profitably and achieve business targets
- Treat everyone in an honest, fair and respectful manner
- Reward and recognize achievements of individuals and teams

Planning Context and Key Strategic Issues

BCRC is facing a number of key strategic challenges, resulting from both external issues in the business environment and from the internal re-structuring driven by the Core Services Review process. This section summarizes those issues and impacts on the organization.

1. Restructure and reduce BCRC's debt

   Due to Crown ownership, BCRC has not been able to source any new equity capital. All capital requirements (both essential sustaining capital needs and any growth or investment capital) must be financed out of retained earnings or, where retained earnings are insufficient, through debt.

   A large portion of BCRC's debt was incurred in 1983 through BC Rail's involvement in northeast coal developments. Unfortunately, the anticipated returns did not materialize as coal volumes and revenues fell far short of expectations. By the spring of 2003, all coal traffic from this development will cease. As a result, the value of all coal-related assets was written down by some $600 million in 1999, but the issue of the lingering debt attributed to northeast coal development has not yet been addressed. In addition, throughout most of the 1990s, BCRC's capital demands outstripped earnings, requiring most of the capital to be financed with debt through the Province. By year-end 2002, BCRC's debt-to-equity ratio increased to an estimated 1.76. This level is considerably higher than would be acceptable in a comparable publicly-traded company, but arises due to BCRC's inability to access new equity - all capital growth has been funded exclusively with debt. By comparison, the debt-to-equity ratios for CN and CP Rail at December 31, 2001, were 0.79 and 1.19 respectively.

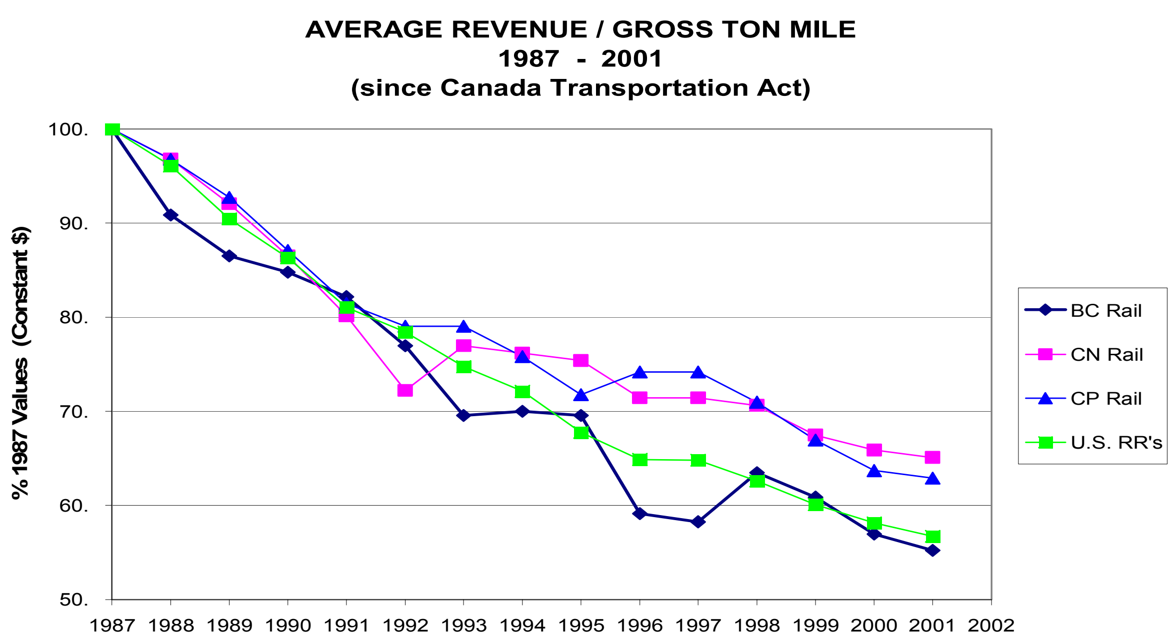
   As a result, the direction taken by BCRC's Board of Directors, working through the Core Services Review process, has been to substantially re-structure BCRC in a way to reduce the debt to more manageable levels and to improve cash flow so that BC Rail can be self-sustaining for future capital needs. This will be partly achieved through selling BCRC's businesses not related to the freight railway and discontinuing all services operating at a net loss or marginal contribution. Proceeds from the sale of businesses and assets will be applied against the debt. Following completion of the sale of BCR Marine, it is estimated that BCRC's debt-to-equity ratio could be reduced to 1.35.

The only non-rail activity to be retained is the railway's real estate business unit. Revenues earned by the real estate business unit have become increasingly important to BCRC in order to offset declining contributions earned from BC Rail. If not for the earnings from BCR Properties, BC Rail would not be able to self-fund its basic sustaining capital requirements. Therefore, BCRC's Board of Directors has adopted the strategy of retaining the income-producing, industrial/commercial real estate portfolio.

The principal challenge facing management is to re-structure BC Rail in a way that it can become economically viable on an independent, stand-alone basis. Given the many challenges and external pressures on the organization, cited in the issues below, there are substantial risks to achieving this transformation.

2. Continued pressure on revenue yields

As a result of complete de-regulation of the transportation industry (1980 in the U.S., 1987 in Canada), competitive pressures on freight traffic revenues have intensified. This is an industry-wide issue, resulting in a dramatic decline in revenue yields, measured on the basis of revenue per gross ton-mile[1].



[1] The movement of one ton over a distance of one mile. A measure of "work" performed by a railway.

In the case of BC Rail, revenue yield has declined by 45% (on a constant $ basis) over the past 15 years. The pressure on BC Rail's rates has been greater than that on larger, Class 1 railways[2] due to the regional scale of BC Rail's network and operations. Much of BC Rail's traffic (except bulk products) must compete head-to-head with the trucking industry for domestic "short-haul" moves within the Province. The larger Class 1 railways are typically engaged in "long-haul" movements. The natural efficiency and economic advantages of railway versus truck transportation only become significant at longer haul distances. Thus, much of BC Rail's domestic traffic is at constant risk of market-share loss to the trucking industry, which operates over a publicly-funded highway infrastructure.

3. <u>Consolidation of Class 1 rail carriers</u>

In 1990, there were 15 Class 1 railways in North America. By 2000, this number had been reduced to 7 as a result of a decade of mergers and acquisitions between the major industry players. In this same time period, CN Rail successfully made a transition from being a federal Crown corporation to being a publicly-traded company and North America's most efficient railway.

BC Rail has a high reliance on the participation of the Class 1 carriers in routing B.C. shippers' products to final destinations throughout North America. As the originator of valued traffic, one of BC Rail's strategic advantages is its ability to optimize routing options and competitive rate bidding between the various Class 1 carriers serving the different regions of the continent. The consequence of rail industry consolidation is that options are being reduced, particularly in accessing certain market regions. As a result, it has become more difficult for BC Rail to negotiate more favourable freight rates among the fewer competing interline carriers, putting pressure on BC Rail's share of the total freight rate it is able to charge for goods movement from origin to final destination.

4. <u>Loss of northeast coal traffic</u>

In 1997, coal traffic from the two mines near Tumbler Ridge accounted for 19% of BC Rail's freight revenue. Equally significant, northeast coal is BC Rail's only traffic commodity handled in highly efficient unit trains, resulting in relatively

[2] Class 1 railways (as defined under US law) are those with annual revenues > US$265 million.

attractive contribution margins despite some substantial freight rate concessions granted to keep the mines operating.

By spring 2003, the last of the northeast coal mines will cease operation and BC Rail will no longer enjoy any coal traffic, nor will it operate any efficient unit trains. Despite sincere efforts over the past seven years, the railway has been unsuccessful in securing replacement coal traffic for 2003 and beyond.

Faced with the loss of higher contribution coal traffic and competitive rate pressures on the remaining traffic (outlined in the two points above), BC Rail does not have the option of significantly raising freight rates to improve revenues. The railway's only option is to drastically reduce operating costs, particularly fixed costs, throughout the system. However, no amount of cost reduction at BC Rail could result in the ability to earn net revenue contributions on mixed freight traffic equivalent to that previously enjoyed from unit train traffic.

5. <u>No new freight traffic sources</u>

For a decade, BC Rail has been well aware of the threat resulting from the end of northeast coal traffic. It has actively pursued business development initiatives in efforts to encourage the development of new industries and sources of alternative freight traffic. However, to date, there are no firm commitments by any industry for new developments that would result in freight shipments.

There is some hope that one or two small-scale coal mines might be established in northeastern BC. There is also the prospect of a new OSB mill in Fort St. John within the next few years, although the proponents have not yet made a development commitment.

In addition, there are concerns that BC Rail could suffer shrinkage in its present traffic base as a result of facility consolidations and/or closures within the forest products industry.

6. <u>Increased dependence on forest products sector</u>

BC Rail already has a high dependency on the single resource commodity sector of forest products. Following the loss of coal, revenue earned from forest products traffic (lumber, pulp, chips, logs, panel products and paper) will increase to 78% of total freight traffic revenue. Management is very concerned over the railway's high dependence on one sector, and particularly a sector which is facing substantial challenges of its own. Markets for most forest products are highly cyclical in demand and commodity price.

In the past, BC Rail has found it extremely difficult to respond in a timely manner to the consequences of sharp swings in forest product commodity markets. It can take several months to acquire additional rail cars to meet increased shipper demand. At the same time, due to the length of terms normally required for leasing additional cars, the railway is hesitant to make such commitments unless it perceives the increase in shipper demand to be sustainable for a period of time commensurate with the lease term. The railway cannot afford to be left with surplus, idled railcars and continuing lease expenses when the shipper demand diminishes.

In contrast to BC Rail's concentration in a single commodity group, no more than 20% of CN's freight traffic revenue is earned from any single sector. Moreover, CN and other Class 1 railways participate in significant volumes of higher-value commodity traffic, such as autos, manufactured goods and containers, able to support higher unit revenues. The advantage is that, even though any commodity sector may experience cyclicality, the effects are dampened by broader, diversified sources of revenue traffic.

7. Difficulty in increasing market share

With no new traffic shippers on the horizon, one of BC Rail's only opportunities to increase revenue is through increasing its market share of traffic from existing shippers.

However, for much of this traffic, freight rates are already competitively established by the trucking industry. As a result, it is extremely challenging to increase market share with existing customers without discounting freight rates to levels that yield little or no margin. This challenge is made more acute by the fact that BC Rail competes in relatively short-haul movements with trucks, many of which are operated by low-cost, independent (non-union) drivers.

Even for longer haul interline shipments, the Class 1 railways contribute to this competitive pressure by taking advantage of the lower costs to truck traffic the relatively short distances from BC Rail shipper origins to reload facilities located on their own respective railways at Edmonton, Kamloops or the Lower Mainland.

8. Revenue eroding faster than cost cutting

BC Rail has been aggressively reducing costs since the mid-1990s. Between 1994 and 1999, annual operating costs were reduced by approximately $40 million. Unfortunately, the competitive compression in freight revenue yields matched or exceeded those cost reductions, with the result that the railway's operating income continued to shrink. The trend in revenue yield erosion continues.

As a result, BC Rail management is pursuing a very aggressive three-year program on cost reduction. In the railway industry, a key performance measure for the health of a railway is its Operating Ratio: the ratio of operating expenses to operating revenues. A lower Operating Ratio is more favourable than a high one. CN Rail has the lowest Operating Ratio in the industry, achieving a record 68.5% in 2001.

BC Rail's Operating Ratio has remained stubbornly high for many years, fluctuating in a range between the high eighties and low nineties. With a very successful fiscal year in 2002, the railway's Operating Ratio decreased dramatically to 79.8%. However, it has been estimated that, in order for BC Rail to remain viable and sustainable on a stand-alone basis, it must consistently achieve an Operating Ratio of 75% or lower.

9. Challenging operating environment

BC Rail's entire railway network operates within the challenging and rugged terrain of the Province of British Columbia. In fact, for the sake of benchmarking comparisons, it has not been possible to identify any other railway of a similar scale which operates with such a high proportion of its network in such extreme terrain. By contrast, the Class 1 railways operate with significant portions of their network across the Prairie provinces or the US west and mid-west. In addition, with most of its rail network in northern latitudes, BC Rail experiences climatic challenges, particularly in winter months.

Such challenging operating conditions require that BC Rail sustain a high-quality capital plant in order to achieve appropriate levels of safety and reliability. Consequently, BC Rail's physical plant is both capital and maintenance intensive, resulting in higher costs per track-mile-operated than others in the industry. Unfortunately, these higher costs per track-mile are more difficult to support with BC Rail's relatively low train traffic density and contribution margins. Despite the challenges of its physical operating environment, BC Rail has successfully reduced its annual capital expenditures while remaining vigilant to ensure safety standards are not compromised.

10. Cost Increases due to External Factors

At a time when BC Rail is most intensively focused on cost reduction, the railway is being adversely impacted by a number of external factors which are substantially forcing costs to increase.

Fuel costs have been relatively high throughout 2002 and, looking ahead into 2003, the trendline is indicating higher - not lower - costs for diesel fuel. Although the railway has historically applied a "fuel surcharge" to its freight rates during periods of extreme fuel price increases, this is not favourable to the shippers and only partly compensates for the actual cost increases incurred.

As with all industries, BC Rail has been adversely impacted by a sharp increase in insurance expense for 2003, as well as increased difficulty in obtaining insurance. Although this is not expected to signal a trend in annual increases in insurance costs, it is forecast that the price increases imposed for 2003 will remain in effect for several years to come.

On a related matter, the costs to provide health and other benefits for employees and retirees have increased substantially as governments strive to contain the costs of publicly-funded health care. This not only increases the annual payroll costs for active employees but has necessitated BC Rail to take an increased charge to fund its pension expense in order to meet future obligations. There is concern that increased costs for medical benefits may be a trend as the overall population ages.

BRITISH COLUMBIA RAILWAY COMPANY

Risks and Sensitivities in Strategic Outlook

Risk Factors:

1. BC Rail operates in challenging terrain and climates, with a high exposure to potential natural hazards. There is an ongoing risk of business interruption due to landslides, rockfall, washouts, avalanches and consequential derailments.

2. Due to BC Rail's extremely narrow revenue base, largely dependent on the forest products sector, the railway is directly exposed to challenges facing the forest products industry. Threats of further facility closures and/or consolidations exist. This uncertainty is heightened by continuation of the unresolved softwood lumber dispute with the U.S. and, in response, emerging new forestry policies in the Province of B.C.

3. The outlook for the Service Plan period assumes recovery of the U.S. economy in 2003. To the extent that recovery is weaker than expected, or delayed, this would likely impact global commodity market demand and prices and, consequently, volumes of commodities shipped via BC Rail.

Sensitivities:

1. BC Rail spends more than $23 million per year on diesel fuel. An increase of $1 per barrel in the price of crude oil translates into increased operating expenses of $750,000 for fuel. This sensitivity may be partially mitigated by BC Rail's fuel hedging program.

2. BC Rail's freight and car hire revenue is vulnerable to fluctuations in the Can$/US$ exchange rate. A one cent increase in this exchange rate can result in a $550,000 increase in revenues, but should be more-or-less offset by a corresponding increase in expenses, thus creating a natural hedge.

BRITISH COLUMBIA RAILWAY COMPANY

Goals, Objectives and Key Strategies

BC Rail's Service Plan is founded on four goals, representing the traditional four pillars of a balanced strategic plan:

1. Revenue and yield improvement
2. Productivity improvement and cost reduction
3. Customer service
4. Safe, healthy and productive work environment

Goal 1: Retain freight traffic revenues and pursue revenue growth opportunities that yield targeted margins over costs appropriate for the term and type of each freight traffic contract.

Objectives:

- Improve yield and net contribution from the industrial freight business
- Evaluate the contribution of new and existing traffic to determine whether it yields targeted margins
- Increase revenues earned from improved use or development of industrial and right-of-way property holdings
- Neutralize or minimize risk from fluctuations in foreign exchange rates

Key Strategies:

- Pursue new coal and OSB traffic from proposed new developments in northeastern B.C.
- Improve yield on selected traffic through more disciplined "corridor management"
- Develop and implement an updated costing system to analyse revenue yield margins on all potential new traffic, existing specific commodities and lanes of traffic
- Complete sales program of "surplus lands" (lands not required for railway operating purposes and which do not produce income)
- Continue increasing property leases to market rates
- Convert selected freight rate contracts to payments in US$ where shippers' commodities are sold in US$

Goal 2: Reduce operating expenses and eliminate lines of business that do not yield targeted margins over costs to improve Operating Income, increase free cash flow and retire debt.

Objectives:

- Reduce the Operating Ratio to 75%
- Rationalize BC Rail's rail system to improve Operating Income on the core rail network
- Divest and/or discontinue non-core transportation businesses and services
- Improve utilization and revenue yield on fleets of freight rail cars and motive power
- Improve operational productivity and infrastructure utilization
- Reduce overhead costs as a proportion of total operating expense to improve productivity

Key Strategies:

- Seek proposals for shortlining low-density branchline operations
- Salvage remaining track and facility assets off the Tumbler Subdivision after conclusion of Bullmoose coal traffic (if no new traffic commitments by spring 2003)
- Improve average "velocity" of on-line railcar fleet to achieve higher asset productivity
- Optimize size of railcar fleet to more efficiently support volumes of core freight traffic yielding targeted margins
- Consolidate and rationalize fleet maintenance and shop facilities to support scale of core freight business
- Working with locomotive engineers, develop improved fuel conservation procedures to increase fuel efficiency
- Replace legacy IT systems at risk of failure where full payback can be achieved within two years

Goal 3: Provide competitive, reliable and consistent services valued by freight shipping customers to achieve mutual business objectives and build loyalty.

Objectives:

- Protect rail freight traffic revenues in all retained lines of business by minimizing collateral impacts while implementing cost reduction initiatives
- Improve service reliability and consistency
- Integrate business systems and processes between customers and BC Rail to provide mutual value, build loyalty, improve efficiency and reduce processing costs
- Improve responsiveness to customer issues

Key Strategies:

- Refine and institutionalize the Service Design and Product Catalogue processes
- Provide consistent level of service on meeting type and quality commitments for supply of empty railcars
- Provide consistent level and timing of switching services to and from shipper and consignee facilities
- Where cost effective, increase volume and accuracy of electronically-transmitted inter-company transactional information and data exchanges
- Where cost effective, provide internet-based customer access to tailored data and information
- Establish an improved process for recording and highlighting customer issues, and for monitoring promptness of response

Goal 4. Create a safe, healthy and productive work environment.

Key Objectives:

- Continually improve occupational health and safety in the workplace
- Establish open two-way communications throughout the company to sustain employee knowledge and commitment to achievement of business initiatives
- Motivate all employees to implement and sustain organizational transformation

Key Strategies:

- Continue to drive personal commitment and accountability throughout the organization for ensuring that safe work practices and procedures are followed
- Introduce a new performance management and compensation plan consistent with those in similar businesses and industries
- Identify training and professional development needs of employees to assist the Company in human resource and succession planning

Performance Measures

Although several very specific measures are employed within BC Rail to measure and monitor progress on specific and detailed initiatives, operating divisions, revenue or cost elements, this higher-level set of measures (referred to as the "Corporate Dashboard") are the ones referenced by senior management in measuring and monitoring the company's overall progress towards its Service Plan objectives.

With the exception of the measures "Debt-to-Equity Ratio" and "Operating Ratio", which apply at the corporate level of BCRC (excluding discontinued operations), all of the other performance measures pertain only to the BC Rail operating subsidiary.

PERFORMANCE MEASURES	Actual 2001	Prelim. 2002*	Budget 2003	Targets	
				2004	2005
Operating Ratio (for BCRC)	92%	80%	81%	80%	79%
Net Operating Income ($ millions)	$26.7	$66.4	$58.1	$58.6	$63.0
Debt-to-Equity Ratio (at year-end)	1.54	1.76	1.29	1.13	1.03
Industrial Freight Revenue / Revenue-Ton-Mile (cents)	5.46	6.18	6.28	6.47	6.47
Revenue-Ton-Miles / Full-Time Employee	2,706	2,858	2,836	2,819	2,876
Litres of Diesel Fuel / thousand Gross-Ton-Miles	7.95	7.70	7.80	7.75	7.65
Lost-Time Accident Frequency	6.4	6.0	5.7	5.3	5.0
Lost-Time Accident Severity	199	186	172	160	151

*Preliminary, pre-audited, estimated results for year-end 2002.

See Appendix A for more detailed definitions of the constituent elements and calculations for each Performance Measure.

Previous efforts to measure Customer Satisfaction have not been satisfactory due to the highly subjective nature of the result. BC Rail is working to develop a more practical and meaningful measure for Customer Satisfaction, to be introduced and piloted in 2003.

For purposes of management incentive compensation plans at BCRC, threshold targets for performance bonuses have been set at levels which are considerably more aggressive than the fiscal forecast targets presented above. This is designed to encourage "stretch" in the achievement of management initiatives.

Performance Measure Benchmarks:

The key Performance Measures presented are ones which are commonly used across the North American railway industry. By adopting these "industry standards," BC Rail is able to monitor and gauge its progress against individual railway companies or the industry as a whole.

However, as discussed under the "Strategic Context," there are many aspects to BC Rail and its operating environment which are significantly unique and, therefore, do not enable direct comparison against specific performance results at other railways or the industry at large. For example, most of BC Rail's network has steep grades and sharp curves, which will naturally result in poorer fuel efficiency per ton-mile compared to railways with thousands of prairie miles. Relatively low traffic density affects productivity measures. The lack of unit train traffic (in 2003 and beyond) plus the railway's highly skewed dependence on freight traffic revenues from a single commodity sector affects revenue yields.

Since the direct comparison of numerical results for individual measures in any one year cannot be done meaningfully, BC Rail has accumulated performance measure results over a period of many years for the purposes of comparing trend-lines rather than absolute values. The objective is to ensure that BC Rail keeps pace with or betters the rate of industry change. In this way, BC Rail is able to compare itself against others in the industry (primarily CN, CP Rail and, collectively, the U.S. Class 1 railways). To date, BC Rail has not been able to find an appropriate "regional" railway of similar scale which publicly publishes its performance results.

The chart on page 8 is an example of this type of trend-line comparison.

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Alignment with Government's Strategic Plan

BCRC's Service Plan aligns with several key initiatives in the Government's Strategic Plan for 2002/03 to 2004/05 in the following specific areas.

GOVERNMENT'S STRATEGIC PLAN	BC RAIL'S SERVICE PLAN
Objective and/or Strategy	Comment
British Columbia will have a prosperous economy.	BC Rail recognizes that the vitality of the Province's economy depends on the ability of producers to be competitive in their chosen markets. The railway's Vision and Mission is focused on delivering efficient, cost-effective freight transportation services.
Reform the Province's Crown corporations so that they focus on public services, efficiency and effective service delivery.	Through the Core Services Review Process, BC Rail is transforming the company to be a more focused, efficient and cost-effective provider of rail freight transportation, fulfilling its role in the provincial economy at no cost to the taxpayer.
Ensure the development of socially responsible and safe industry practices.	Operating in a heavy industrial environment, BC Rail places a high priority on occupational health and safety issues. Two corporate safety measures are included on its "Corporate Dashboard" of priority performance measures.
Develop a made in British Columbia plan to address issues associated with greenhouse gases.	By seeking to gain market share from truck back to rail, BC Rail will be reducing the amount of greenhouse gas and particulate emissions. Transport industry studies have shown that rail transport is > 5 times more fuel efficient than trucks on the basis of ton-miles per litre.
Establish workable relationships with First Nation communities.	For many years, BC Rail has pursued a proactive role in dealing with 25 different First Nations along the railway system. BC Rail has concluded the signing of Protocol Agreements with eight of its neighbouring First Nations. It also operates a Rail Shuttle Service between D'Arcy and Lillooet in partnership with the Seton Lake Band.
Aggressively support the bid for the 2010 Olympic and Paralympic Winter Games.	BC Rail is actively represented on the Sea-to-Sky group under the 2010 Bid's Transportation Committee. BC Rail has committed itself to a key role in transporting thousands of people to and from event venues in the Whistler area.

BRITISH COLUMBIA RAILWAY COMPANY

Summary Financial Results

As a commercial Crown corporation, BCRC has been given the mandate of providing freight rail services in a competitive and commercial manner. The Shareholder has emphasized that the Province cannot afford to invest any further equity in the railway, nor is it able to forgive any debt, provide any grants or direct subsidies.

As a result, the Board of Directors has set a firm and necessary fiscal direction for BCRC, focused on improvement of BC Rail's earnings to ensure the railway will be fully able to service its debt and self-fund its sustaining capital requirements out of its own cash flow. At the same time, total debt must be reduced to an acceptable level.

Summary Consolidated BCRC Income Statement*
($ millions)

	Actual 2001	Prelim.# 2002	Budget 2003	Forecast 2004	Forecast 2005
Revenues	318.2	328.8	298.2	296.1	296.4
Expenses	291.5	262.4	240.1	237.5	233.4
Net Operating Income	26.7	66.4	58.1	58.6	63.0
Income Taxes	0.0	(15.9)	0.0	0.0	0.0
Interest Expense	29.1	30.0	29.0	28.6	28.4
Income (Loss) before Discontinued Operations and Special Charges	(2.4)	52.3	29.1	30.0	34.6
Results of Discontinued Operations	(4.5)	(135.7)	31.5	-	-
Special Charges	(100.0)	-	-	-	-
Net Income (Loss)	(106.9)	(83.4)	60.6	30.0	34.6

* Re-stated for 2001 and 2002 to segregate operations that will be discontinued in 2003 and beyond, enabling year-over-year comparison.

\# Preliminary, pre-audited, estimated results for year-end 2002.

Key Assumptions in Financial Forecasts:

- Occupational health and safety of the workforce remains a corporate priority.
- Proceeds of the BCR Marine sale will be applied to reduce debt and pay for restructuring costs.
- No interline railway service disruptions impacting interchange capacity.
- No labour disruptions or catastrophic events that would result in significant or sustained business interruption.
- Competing railways will not implement any new, aggressive reload strategies targeting BC Rail's originating shippers.
- CN, Canadian Pacific, BNSF and UP railways will continue to partner with BC Rail at existing revenue divisional requirements.
- Negotiations related to the Canada-US Softwood Lumber Agreement continue and producers will maintain their current strategy of high lumber production volumes throughout 2003.
- US housing starts will remain at a level higher than 1.5 million units per year.
- The Pine Beetle infestation does not adversely affect timber harvesting volumes in areas where BC Rail provides log transportation services.
- No additional negative impact from further rationalization or consolidation in the forest products industry.
- Coal traffic and unit train operations cease in spring 2003.
- No closures of any other shippers' existing plants or mills.
- No new sources of freight revenue traffic within the three-year plan period.
- Inflation-related cost increases will be neutralized by productivity gains.
- Fuel price volatility will be mitigated through fuel hedging and gains in consumption efficiency.
- The only passenger service operated by BC Rail (in partnership with the Seton Lake Indian Band) will be the local Rail Shuttle Service between D'Arcy and Lillooet.

Major Capital Project Information

Within the three-year period of this Service Plan, BC Rail has made no commitments for capital expenditures in excess of $50 million on any individual capital project.

However, there is the potential for one major capital project within the plan period. If a proposed new OSB plant is developed at Fort St. John, BC Rail will need to acquire a dedicated fleet of box cars to service this new traffic. A decision whether to purchase or lease the fleet will be based on a business case closer to the time. If it is decided to purchase the new fleet (instead of lease), the estimated capital cost would be $55 million. However, commitment of this expenditure will only occur when a construction start date for the OSB plant is established and a freight transportation contract is concluded.

APPENDIX A

Definitions of Key Performance Measures

Operating Ratio = Operating Expenses / Operating Revenues

- Operating Expenses includes all costs to operate the business (excluding extraordinary items) plus amortization.
- Operating Revenues includes all revenues earned from operations (excluding extraordinary items).
- Operating Ratio is the most frequently quoted "barometric" measure in the railway industry. It provides a broad sense of the railway's overall efficiency and health of its operations.
- Operating Ratio may be quoted as a percent (80%) or as a ratio (0.80). A lower figure is better than a higher one.

Net Operating Income = Total Operating Revenues – Total Operating Expenses

- Operating Revenues includes all revenues earned from operations (excluding extraordinary items).
- Operating Expenses includes all costs to operate the business (excluding extraordinary items) plus amortization.
- Net Operating Income is an indication of the earnings generated by business operations. Out of the cash flow from these earnings, the business must cover its costs for interest payments on debt, taxes, depreciation, dividends and fund its sustaining capital expenditure requirements.

Debt-to-Equity Ratio = Total Debt Outstanding / Total Shareholder's Equity

- Total Debt includes all Long-Term Debt, the current portion of Long-Term Debt, plus Short-Term borrowings at a particular date. In this Service Plan, the Debt-to-Equity Ratio is at December 31st.
- Total Shareholder's Equity is the book value of capital invested by the Shareholder (the Province of B.C.) in the enterprise, plus contributed surplus, plus retained earnings (or minus deficit).
- The Debt-to-Equity Ratio is a common indicator of how much a business is leveraged through debt rather than equity. Since debt is a riskier form of capitalization than equity, a high debt ratio indicates potential risk to the viability of a business, especially if its earnings and cash flow are under pressure, indicating potential difficulty in meeting future interest payment obligations on its debt.

Industrial Freight Revenue / Revenue-Ton-Mile

- Industrial Freight Revenue is all revenue earned through the transportation and handling of freight traffic, including switching revenue and off-line Car Hire earnings. It does not include revenue from other sources, such as real estate income.
- Revenue-Ton-Mile is the movement of one ton of shippers' product a track distance of one mile. Revenue-Ton-Mile (RTM) only measures "payload" tonnage which is earning the revenue and is a broad measure of "work" performed by a railway in revenue-earning train operations.
- This ratio is widely used as a general indicator of "revenue yield" for the freight services performed by the railway. It represents the average for all Revenues and all RTMs on the railway system in a specified period of time (monthly, quarterly, annually).
- For this Service Plan, the quoted figure is an annual average. Due to the very large number of RTMs generated, the resulting figure is quoted in cents per RTM.
- This ratio does *not* reflect "contribution earned." Bulk commodities typically yield a low ratio of Revenue per RTM but, if handled in efficient unit trains, can yield significantly higher net contributions than higher-valued commodities in mixed freight service.

Revenue-Ton-Miles / Full-Time Employee

- Revenue-Ton-Mile is the movement of one ton of shippers' product a track distance of one mile. Revenue-Ton-Mile (RTM) only measures "payload" tonnage which is earning the revenue and is a broad measure of "work" performed by a railway in revenue-earning train operations.
- Full-Time Employee represents the equivalent number of Full-Time Employees averaged over the period of time for which the RTMs are measured. An average is necessary due to the normal fluctuation in the workforce over seasonal periods.
- This ratio is widely used as a general indicator of "human resource productivity." To the extent that a railway is able to handle the same number of RTMs with fewer employees, the railway has a higher gross productivity and is more efficient. With the historical decline in "Revenue per RTM", a corresponding productivity increase in RTM per Full-Time Employee is necessary just to help keep earnings constant.

Litres of Diesel Fuel / thousand Gross-Ton-Miles

- Litres of Diesel Fuel measures the total volume of locomotive diesel fuel consumed over the period of time for which Gross-Ton-Miles is measured (typically one year).
- Gross-Ton-Mile (GTM) is the movement of one gross ton (payload plus tare weight) a distance of one track mile. This includes the weight of the railcars (whether loaded or empty) and locomotives. GTMs are the broadest measure of the "total work" performed by railway operations in conducting the business and reflects the fact that fuel is expended to move the locomotives and railcars around the railway system in addition to the revenue-earning freight tonnage.
- With fuel being the single largest expense item (after payroll), fuel efficiency is an important measure of productivity and efficiency.
- With increased concerns over both greenhouse gases and particulate emissions, this measure is useful for measuring progress in improving the railway's effect on air quality. It is also a useful measure for comparing the efficiency of railways against other diesel-consuming modes of transport, such a highway trucks and tractor-trailers.

Lost Time Accident Frequency = Number of Lost-Time Accidents per 200,000 person-hours worked

- Number of Lost-Time Accidents is the simple number of accidents or injuries resulting in an employee needing to take time away from work.
- 200,000 person-hours worked is the industry-standard benchmark for the calculation of this "Frequency" measurement.
- This is a broad measure of overall safety in the workplace and, because it is calculated as a ratio of hours worked, is not affected by fluctuations in size of the workforce.

Lost Time Accident Severity = Total Time Lost per 200,000 person-hours worked

- Total Time Lost measures the number of hours employees are away from work as a result of injury while continuing to be paid. This measure does not include employees deemed to be on Long-Term Disability.
- 200,000 person-hours worked is the industry-standard benchmark for the calculation of this "Frequency" measurement.
- This is a broad measure of accident severity based on the average amount of time injured employees are away from work. Because it is calculated as a ratio, is not affected by fluctuations in size of the workforce.
- It is important to measure both "Frequency" and "Severity" in tandem.