

Chicago, February 7, 1966

Mr. C. E. Crippen:

Re: Port Townsend Railroad

I believe that capitalization of earnings is the only logical approach to pricing this property. I suggest capitalizing at 10% or, in other words, that we think in terms of a price equal to ten times average annual earnings. And I suggest we think also in terms of after-tax earnings.

Because of the Port Townsend's present partnership form, income taxes are not reflected in any way in its financial statements. But they are very much in the picture because the partners must pay taxes on their drawings. Any other potential buyer will unquestionably be dealing in terms of the after-tax situation, and we can readily argue that the Milwaukee will soon be in a tax-paying status.

Proceeding then to the question of what are "average annual earnings", there can be no argument that the more recent (1960-1964) earnings experience should be used. These years produced average annual partnership net income (pre-tax) of \$24,600. There were sizeable "other" credits and debits to retained income in 1960, and it may be that these and other items would, upon full investigation, have to be adjusted into this average. However, assuming the net income figures as reported to be accurate, I believe the average should then be adjusted so as to reflect any significant changes which would be occasioned by merging the operation into ours. The only such adjustment of which I am aware from the data furnished would be the elimination of officers' compensation. The result, then, would be:

Average annual net income reported for the years 1960-1964	\$24,600
Add back compensation of officers	<u>19,000</u>
	\$43,600
Less Federal income taxes, at 48%	<u>20,900</u>
Adjusted annual earnings	<u>\$22,500</u>

Taking into consideration its current net worth of about \$180,000 and the evident downward trend in earnings by the Port Townsend, I think \$225,000 would be a fair price.

R. P. Kenton