SPECIAL REPORT TO STOCKHOLDERS

FOR THE PERIOD DECEMBER 1, 1945-AUGUST 31, 1950

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

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CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

General Offices—516 W. Jackson Boulevard, Chicago 6, Illinois
Fiscal Office—52 Wall Srreet, New York 5, New York

TO THE STOCKHOLDERS:

The Voting Trust Agreement, dated December 1, 1945, which was created in accordance with the Plan of Reorganization, will terminate on December 1, 1950, and we feel you will be interested in the following report on the affairs of your railroad for the period December 1, 1945 to August 31, 1950.

Your Board of Directors consists of financial, business and industrial men from important centers, such as Chicago, Milwaukee, Madison, Minneapolis, Sioux City, Omaha and Seattle, which points are the source of a large amount of traffic handled by the railroad.

The Directors have given very generously of their time in advising with the management of the company. We have inaugurated the practice of holding meetings of the Board of Directors in the more important cities served by the railroad. The Directors have also visited many cities, recognizing that the success of the railroad is in securing additional traffic.

In submitting this report we are attempting to give you an over-all review of the situation on the property on December 1, 1945, and the accomplishments during the period of operation subsequent to that date.

The following are the more important points, dealt with at some length in the subsequent pages of the report which you are urged to read in full:

- Your railroad is in a sound financial condition. The cash position is strong and liquid. A detailed statement of cash receipts and disbursements for the period is appended.
- At the time of consummation of the Plan of Reorganization there was a backlog of deferred maintenance, both in roadway and equipment, because of the shortage of labor and materials during the war years. Except for passenger cars, this deferred maintenance has been substantially overcome. In our opinion, the condition of the property and equipment is better than at any time in the past, and we believe that we are prepared to meet any emergency that may arise in the way of increased traffic.
- New and modern equipment has been acquired or has been ordered in this period at a cost of $111,970,708.
- The acquisition of Diesel-electric locomotives, one of the most prominent factors in reducing transportation costs, has been carried out as fast as finances permitted, facilities for maintenance could be constructed, and personnel trained in their maintenance.
- A recent study made by the Association of American Railroads indicates that our ownership of freight cars is in proper proportion to the requirements of the national pool.
- It has been demonstrated that The Milwaukee Road's high transportation ratio results principally from lack of volume of traffic and high terminal costs. Considerable mileage is branch line, with very light traffic density. The management fully recognizes the necessity of increased industrial expansion in our territory, in order

to provide a volume of traffic to keep transportation costs within reason, and it is constantly striving to attain this objective.

- First and General Mortgage Bonds and assumed Terre Haute Bonds, in the amount of $25,621,900, have been acquired and cancelled or are held in the Treasury. This has had the effect of reducing annual interest requirements by $1,138,899 which, of course, has been of considerable benefit to the stockholders.
- Equipment obligations increased $34,328,919, and the annual interest requirements thereon, $705,080.
- The matter of personnel is one that has been given careful consideration. During the period of the war and immediately following, there was a shortage of manpower, with the result that older men remained in key positions beyond the normal period of service. To correct this, a supplementary pension plan, providing for compulsory retirement, was put into effect.
- In the matter of Federal income taxes, all tax years from 1942 forward are still open. There were several large items in controversy. While final report of the Revenue Agent for the years involved has not been received, a number of controversial items have been disposed of satisfactorily, and a favorable adjustment is expected at a reasonably early date.
- On February 19, 1947 the railroads petitioned the Interstate Commerce Commission to fix a new basis of mail pay and sought an increase of not less than 45%. On December 23, 1947 the Commission entered an order authorizing a temporary increase of 25%, retroactive to February 19, 1947. Subsequently, other petitions for increases in mail pay were filed. On September 22, 1950 the railroads and the Post Office Department reached a compromise agreement on the retroactive feature of the increases sought, subject to approval of the Interstate Commerce Commission. This agreement provides for an increase, in addition to the temporary increase of 25% allowed earlier by the Interstate Commerce Commission, amounting to about 19%, for the period February 19, 1947 to December 31, 1950. While the exact amount of back mail pay to be received by your company has not been determined, it is expected to be about $4,000,000.
- In the light of the settlement of this part of the mail pay case and the anticipated satisfactory adjustment of income taxes with the Government, the Directors declared an additional dividend of $3.75 per share on the preferred stock for the years 1947, 1948 and 1949, so as to make up the difference between the amounts theretofore paid and the full $5.00 per share in respect of each of those years, and also a dividend of $2.00 per share on the common stock.

FREIGHT TRAFFIC DECLINES

Immediately following the reorganization, the entire railroad industry met with severe adversities. Freight traffic began to decline due to strikes in the automobile, steel, meat packing, electrical and maritime industries, the strike of railroad engineers and trainmen in May, 1946, and the two shut-downs in the coal mining industry. There was a nation-wide shortage of freight cars caused by the general return to a 5-day work week and the inability of the railroads to obtain sufficient new cars during and just after the war.

INCREASED LABOR COSTS

Railroad employes were granted a wage increase of 16c per hour, retroactive to January 1, 1946, and an additional 2½c per hour, effective May 22, 1946, making a total raise of 18½c per hour. Including payroll taxes, this amounted to about $19,500,000, a burden that, together with higher costs of materials and supplies, including fuel, caused our operating expenses to rise to a point far beyond what could be absorbed by the earning power of the railroad and leave anything for the owners of the property.

RATE RELIEF DELAYED

Because of the higher costs of labor and material, the Railroads filed a petition with the Interstate Commerce Commission for a 25% general increase in freight rates. The Interstate Commerce Commission, however, authorized only an interim increase, effective July 1, 1946, which for your railroad yielded about 4.7%. Further relief was not forthcoming until January 1, 1947, when the Commission cancelled its interim order and authorized a general increase which averaged 17.6% for the country as a whole. During the entire year 1946, when the railroad was operated at much higher costs, it received the benefits of only a small token raise in freight rates, illustrating that rate increase authorizations by the Interstate Commerce Commission do not come in time to offset advances in wages and price levels.

While the volume of freight traffic held up well in 1947 when the higher freight rates were in effect, another round of wage increases to non-operating and operating employes became effective September 1, 1947 and November 1, 1947 respectively. Since these amounted, in terms of dollars, to about the same as the added revenue from the higher freight rates granted at the beginning of the year, they virtually wiped out the gains resulting from the rate increases.

WAGES RISE AGAIN

During the years 1948 and 1949, wages rose again. The 40-hour week for non-operating employes became effective September 1, 1949. Further increases in freight rates followed, but they were never granted in time to compensate for the rise in payroll costs.

It is true that these conditions applied to the railroad industry as a whole. However, railroads such as yours, which operate in light traffic density areas where the margin between profit and loss is very narrow, need adequate relief promptly in the form of higher transportation charges to enable them to withstand the impact of increases in operating costs.

ADDITIONS AND BETTERMENTS FUND

In promulgating the Plan of Reorganization for the Company, the Interstate Commerce Commission gave lengthy and careful consideration to the need of funds for improvements and betterments of roadway property. Based upon the experience of an extended prior period, the Commission determined that the depreciation on roadway property, plus the service loss on non-depreciable property retired and not replaced, would not be sufficient to provide the necessary funds to cover improvements and betterments.

The provisions for the Additions and Betterments Fund, in accordance with the First and General Mortgages, are that payments into the fund with respect to any year will be partly mandatory and partly in the discretion of the management—the mandatory amount to be $2,500,000, and the optional amount to be such sum as the Board of Directors shall determine to set aside out of the available net income, provided that the total shall not exceed $5,000,000, or 4% of railway operating revenues, whichever is greater.

Events have proved that the funds made available from credits to the reserve for depreciation and amortization of roadway and structures and from salvage of roadway property retired will not be sufficient to provide for replacement of property retired and for additions to property at the current level of wage rates and material prices. With the mounting prices for construction and rehabilitation work, together with the possible expansion of facilities in order to effect economies it will be necessary to draw on the "Surplus" earnings of the company when the funds from these sources are insufficient.

GROSS CAPITAL EXPENDITURES

December 1, 1945 to August 31, 1950

PERIOD	ROAD	EQUIPMENT	TOTAL
December 1945	$ 1,100,047	$ 731,601	$ 1,831,648
Year 1946	9,377,830	9,698,638	19,076,468
1947	7,675,102	19,695,994	27,371,096
1948	8,373,706	29,538,973	37,912,679
1949	8,137,393	28,321,464	36,458,857
Jan. 1—Aug. 31, 1950	4,810,238	10,746,554	15,556,792
TOTAL	$39,474,316	$98,733,224	$138,207,540

SOURCE OF FUNDS FOR CAPITAL EXPENDITURES

Equipment obligations issued	$ 64,736,310
Depreciation, amortization and retirement charges	46,832,778
Salvage from road and equipment retired	10,160,687
Donations and grants	1,676,810
Appropriated from income	7,619,597
Allocated from unappropriated surplus	7,181,358
TOTAL	$138,207,540

YARDS AND TERMINAL PROBLEMS

During the past few years many studies have been made of our yards and terminals and considerable sums have been spent to improve and enlarge these facilities at

Chicago (Galewood and Bensenville), Milwaukee, St. Paul and Minneapolis. This year our yard at Savanna, Illinois, which is an important receiving and classification point, was enlarged and rearranged. All of these changes will result in improved service and reduced expenses. While it may appear that a large-scale revision of our yards and terminal facilities should be made, this would require a very large sum of money, and our studies have not indicated that the changes could be economically justified; therefore, your Directors have been reluctant to incur such an expenditure.

STUDY OF OPERATIONS

In our studies we found that your railroad, in order to be operated at a lower operating ratio, needs a heavier traffic density. There are 10,671 miles of railroad being operated, of which 4,062 miles are branch lines with very light traffic density. Our main lines can handle a larger volume of traffic, particularly our Lines West of Mobridge, South Dakota. Illustrative of the effect of a larger volume of traffic on our cost is a comparison of the months of May and August, 1950. For May the operating ratio was 83.4%, and the ratio of transportation costs to revenues, 41.5%; for August, when the traffic density was 31% higher than in May, the operating ratio was 70.3% and the transportation ratio, 35.6%.

ROADWAY AND STRUCTURES

While much has been written about the large expenditures made by railroads, including our own, for repairs to property during periods of bankruptcy, the fact is that as of December 1, 1945, there remained a large amount of deferred maintenance on your railroad which has now been substantially overcome. Had it not been for this deferred maintenance, or if there had been a provision in the Plan of Reorganization for a special reserve to cover it, our earnings in each of the years since the consummation of the Plan would have been substantially larger.

During the war period, when it was impossible to obtain sufficient manpower and steel, our track structure was somewhat neglected. Furthermore, because of the large volume of traffic moved at high speeds during the emergency, there was tremendous wear and tear on our track structure.

We have attempted to carry on a maintenance program related to the needs of the property and to place it on the standard necessary for the operation of faster and heavier trains. Furthermore, your Directors felt that their actions were in accordance with their responsibilities to the owners and patrons of your railroad to provide adequate safety and service on a par with our competitors.

Your railroad has been one of the leaders in the adoption and use of mechanical labor-saving devices for the maintenance of its track structure. Many new labor-saving machines have been installed for the laying of rail and fastenings and the distribution and application of ballast. In addition, considerable use has been made of off-track equipment, such as cranes and bulldozers. These machines have played an important part in reducing maintenance expenditures.

Due to the wisdom of consistently applying tie plates and treated ties in past years, our expenditures for tie renewals in the next few years will be reduced substantially. Considerable new, heavy rail has been laid, which will reduce maintenance expenses and increase safety. Requirements for new rail in the immediate future are not expected to be as large as in the past five years.

NEW EQUIPMENT

Since December 1, 1945, the following new equipment has been acquired or is on order for early delivery:

Equipment	Number	Cost
LOCOMOTIVES:		
Diesel-Electric:		
6000 HP	11	$ 6,653,619
4800 HP	6	2,976,000
4500 HP	29	14,492,584
4000 HP	7	2,578,168
3200 HP	2	666,704
2400 HP	1	198,982
2000 HP	1	199,471
2000 HP	1	211,562
1500 HP	26	3,476,691
1200 HP	24	2,376,398
1000 HP	51	5,107,246
Total Diesel-Electric Locomotives	159	38,937,425
Electric:		
3000 Volt	12	950,000
Total Locomotives	171	39,887,425
FREIGHT CARS:		
Box	5,372	20,526,365
Automobile	1,000	4,250,808
Hopper	1,540	6,349,753
Gondola	6,230	16,854,188
Flat	250	547,458
Log Flats, skeleton	500	725,289
Flat, depressed	4	32,841
Refrigerator	600	3,900,000
Caboose	165	1,052,045
Total Freight Cars	15,661	54,238,747
PASSENGER CARS:		
Coaches	72	5,409,831
Dining	12	1,087,897
Lunch-Lounge	8	653,771
Diner-Lounge	4	358,189
Cafe-Parlor	6	544,058
Parlor	8	629,827
Sleeping	40	4,453,773
Sleeping, used; acquired from Pullman	38	186,649
Coach-Sleeping	6	506,968
Baggage-Dormitory	8	507,823
Baggage	20	833,551
Mail and Express	23	1,098,549
Railway Postal	2	92,543
Parlor-Observation	4	354,251
Motor, Diesel-Electric	2	275,876
Total Passenger Cars	253	16,993,556
WORK AND FLOATING EQUIPMENT	13	850,980
GRAND TOTAL EQUIPMENT		$111,970,708

DIESELIZATION PROGRESSING

The Diesel-electric locomotive is one of the most prominent factors in reducing transportation costs, and your company has been installing this type of motive power as fast as finances permitted, facilities for their maintenance could be constructed, and repair forces trained in the maintenance of this new type of motive power.

During December, 1945, the month in which the Plan of Reorganization was consummated, your railroad, excepting in the electrified zones, was operated principally with steam locomotives, and at that time 82% of our freight service, 91% of our passenger service, and 65% of our yard service was performed by steam locomotives.

When the Diesel-electric locomotives now on order, delivery of which is expected to be completed early next year, are placed in service, 30% of our freight service, 15% of our passenger service and 30% of our yard service will be performed by steam locomotives. Our studies have not indicated that complete elimination of steam locomotives on your railroad can be economically justified.

ROLLING STOCK

During the war period, due to the huge volume of freight traffic moved, together with the large movement of troops and civilians, locomotives and cars could not be given adequate repairs, because of the scarcity of manpower and materials and because the equipment could not be withdrawn from service. Consequently, at the end of the war there was a large amount of deferred maintenance of rolling stock.

As soon as manpower and materials became available, we started to rehabilitate our locomotives and freight and passenger cars, and continued to do so through the period under review. This deferred maintenance has had the effect of increasing our repair costs above what might be considered normal. We still have some deferred maintenance in the case of our passenger cars. However, with the new equipment that has been acquired and placed in service during the past five years, our rolling stock is in much better condition than it was just prior to World War II.

During the period covered by this report 14,731 units of freight cars were acquired at a cost of about $48,100,000.

A recent study made by the Association of American Railroads, in connection with the allocation of additional units of freight cars that should be acquired by Class I railroads to make up an estimated shortage of 120,000 units, indicates that your company need not further add to its ownership at this time.

TRAFFIC SOLICITATION

The solicitation of traffic can only be successful if the service is as good or better than that of a competitor, and good service can only be furnished with a well-maintained railroad and sufficient equipment to handle the volume of traffic obtained. These factors are having our constant attention.

During the period under review the Traffic Department has been reorganized to strengthen it and enable it to meet competition and the demands upon it for the securing of additional traffic. Staff meetings are held at frequent intervals for the purpose of exchanging ideas, acquainting the solicitation forces with conditions as they exist in territories other than their own, and obtaining suggestions for the improvement of service, all in the interest of intensifying traffic solicitation.

INDUSTRIAL DEVELOPMENT

To meet the demand for industrial sites during and since the post-war period, your company has maintained an Industrial Development Department under the supervision of an Industrial Commissioner, with offices at Chicago and Seattle.

The primary function of this department is to assist industries seeking locations served by railroad facilities.

Experienced industrial engineers, who are thoroughly familiar with all phases of transportation problems, are available for consultation with industries.

The Industrial Development Department, in cooperation with traffic and operating officers, provides an organization which can solicit and advise industries as to available sites, raw materials and marketing areas. This department is in a position to report on the characteristics of the populations, educational facilities, general economic conditions, banking facilities, zoning ordinances, building codes, tax rates, water supply, and the labor pool.

During the past several years the Industrial Development Department has assisted many new industries in selecting industrial sites which are now served by your railroad. A few of these are the American Can Company, Continental Can Company, General Motors Corporation (Allison-Bedford Foundry Division), International Harvester, Kroger, Consolidated Grocers Company, National Tea Company, Superior Separator Company, Archer-Daniels-Midland Company, and Deere & Company. In addition, many industries now served by your railroad have expanded their facilities. There is need of further expansion of industry along the lines of your railroad, in order to produce a greater density of traffic, particularly on Lines West of the Missouri River. This is having our constant attention.

ELIMINATION OF PASSENGER TRAIN MILES AND ABANDONMENT OF BRANCH LINES

With passenger train revenues down almost 50% from what they were in the year 1945, a determined effort has been made to eliminate unprofitable passenger train service. During the year 1949 we discontinued on an annual basis, 605,799 miles of steam, motor car, mixed train, and bus service. In the first eight months of 1950, an additional 394,641 miles were eliminated. The total mileage eliminated in this 20-month period was 1,000,440, and the reduction in out-of-pocket expenses is estimated at $1,249,000 annually. Applications are pending before the Railroad Commissions of several States, or studies are now being made, in connection with the elimination of ten additional passenger trains or buses, aggregating about 834,000 miles annually.

Despite our best efforts, we are experiencing difficulty and delay in obtaining authority from the State Railroad Commissions to discontinue unprofitable trains.

Since 1945 two branch lines have been abandoned: DeKalb to Aurora, Illinois, 47.46 miles in length, including 22.50 miles of trackage rights over the Elgin, Joliet & Eastern Railway, and Reno to Caledonia, Minnesota, 13.66 miles in length. Studies of the earnings of many other lines have been conducted in the past five years.

The earnings of over forty branch lines of low freight density are being watched for possibilities of abandonment, and whenever losses are continuous, because of declining revenues or increased expenses, petitions for authority to aband on will be filed with the proper authorities.

LABOR COSTS MOUNTING

In addition to the wage increases that have been granted to railroad employes since the beginning of World War II (wages have more than doubled) labor has made substantial gains in working conditions, which have cost the railroad industry huge sums of money.

Among the more important gains of labor was the granting of vacations, beginning in 1941, to certain classes of employes, which have been supplemented and expanded so that at the present time almost all employes are receiving 2-week vacations with pay. For the year 1950 this will cost your railroad about $3,800,000.

On September 1, 1949, the 40-hour week went into effect for non-operating employes. A program was outlined so as to avoid, as much as possible, penalty payments for work performed in excess of 40 hours per week. The large freight stations and transfer platforms are closed for handling less-carload freight on Saturday, and many smaller stations are closed on that day. Work on maintenance of way and equipment is restricted to five days a week, and General Offices are closed on Saturday. In spite of this curtailment, the change from 48 hours to 40 hours a week is costing your railroad a substantial sum of money.

RETIREMENT PLAN FOR OLDER EMPLOYES

During the period of World War II, and the period immediately following, there was a shortage of manpower with the result that older men remained in key positions beyond the normal period of productive efficiency. This situation was particularly true on your railroad.

Prior to the consummation of the Plan of Reorganization, the District Court authorized a plan of retirement allowances, effective July 1, 1943, for officers and employes whose duties are executive, supervisory or professional in character. This Pension Plan made no provision for compulsory retirement.

Your Directors, after careful study, found that in the interest of efficient operation, executives and supervisors, upon reaching an advanced age should relinquish their positions to younger and more energetic personnel, and amended the plan to provide for compulsory retirement. During the period December 1, 1945 to August 31, 1950, there were 401 persons retired under the pension plan.

In filling vacancies caused by retirement it has been the policy to appoint younger, experienced men from the ranks—assistants trained in their particular fields—who have earned advancement by hard work and loyalty to the company.

FEDERAL INCOME TAX CONTINGENCIES

In 1942, during examination of our Federal income tax returns for the years 1939 and 1940, the Commissioner of Internal Revenue raised, and referred to his Chief Counsel, the question of whether or not your company was entitled to deduct from gross income the full amount of accrued interest in arriving at its taxable income for those years. The question of its right so to do was suggested on the ground that there was no reasonable expectancy that it would pay the accrued interest in full. The question was thoroughly considered by the Income Tax Unit and by the Chief Counsel's office in 1942 and 1943, and in General Counsel's Memorandum 23,600, dated February 16, 1943, the Chief Counsel ruled that the interest on the old bonds of the company outstanding at the time was deductible.

Later, after the Plan of Reorganization for the Company had been promulgated by the Interstate Commerce Commission and reviewed by the Supreme Court of the United States, the Commissioner of Internal Revenue again referred the interest deduction question to his Chief Counsel for further consideration and directed particular attention to the question of whether the right to deduct the interest on the old bonds continued for the period between the effective date of the Plan and its consummation. The opinion previously given was reaffirmed in General Counsel's Memorandum 23,926, dated October 6, 1943, and the view was expressed that the right to make such deductions continued until the date of consummation of the Plan.

TAX RULING ISSUED

Income Tax Unit Ruling 3635 was issued in 1944, giving effect to the opinions expressed by the Chief Counsel. This ruling was applied in determining the Federal income tax for the years 1939, 1940 and 1941, which years are now closed. It was likewise applied in returns for the years 1942, 1943, 1944 and 1945. Interest on the old bonds for the years 1942 to 1944, inclusive, and for the first 11 months of 1945, up to the date of consummation of the Plan of Reorganization, was deducted, and thereafter interest on the new bonds was deducted beginning with December 1, 1945. The returns for the year 1942 were examined and covered by a Revenue Agent's report, dated October 31, 1945, in which Income Tax Unit Ruling 3635 was applied. Tax liability for that year was agreed upon by conference, subject to further adjustment for certain deductible items, the amounts of which were not then determinable. This ruling has likewise been applied in cases of several other reorganized railroads.

Notwithstanding all that had happened before, the Revenue Agent assigned in 1946 to examine our income tax returns for the year 1943 and later years, again brought up the same old question of the right to accrue and deduct interest on the old bonds. The Internal Revenue Agent in charge in Chicago was requested to refer the matter to the Commissioner's office in Washington and he has been instructed that Income Tax Unit Ruling 3635 was in force and applicable.

TAX REFUND CLAIMS

The company has filed certain claims for refund of Federal income taxes. These claims arise, first, from overpayments due to unused excess profits credit carrybacks to the years 1943 and 1945, and second, from overpayments of income tax due to repayment to the Government of certain transportation charges assessed at commercial rates and reported as taxable income but later reduced because of the application of lower rates established by land grant or equalization agreements, or reclassification of traffic, thereby reducing taxable income.

While the final report of the Revenue Agent for the years 1943 to 1947, inclusive, has not been received, a number of controversial items have been disposed of satisfactorily, and a favorable adjustment of our claims is expected at a reasonably early date.

MILWAUKEE LAND COMPANY

The Milwaukee Land Company, a wholly-owned subsidiary of your company, now engaged in liquidating its land and timber holdings, will have on hand at the end of this year approximately $4,500,000 realized from sales of property.

The Land Company owes your railroad $2,652,000, evidenced by a promissory note pledged under the First Mortgage and, in addition, interest amounting to $5,909,180, all of which, according to present indications, it will be able to pay prior to final liquidation.

One of the questions in connection with our income tax returns has been whether the amounts paid to the railroad as interest shall be subject to tax in the year of payment or in the year of accrual. At the present time it appears that the Revenue Agent will concede that income shall be taxed on an accrual basis, and if the matter is so decided finally, we will be in a position to draw down approximately $4,500,000, of which $2,652,000 will be applied in retirement of the note held by the Railroad Company and pledged under the First Mortgage; the remainder to be used for additions and betterments to road and equipment.

REDUCTION OF MORTGAGE BONDS

In the period December 1, 1945 to August 31, 1950 mortage bonds in the amount of $25,621,900 were acquired and cancelled or are held in the Treasury. This reduced the annual interest requirements in the amount of $1,138.899.

INCREASE IN EQUIPMENT OBLIGATIONS

In the same period equipment obligations were increased in the amount of $34,328,919. This increased annual interest requirements in the amount of $705,080. The equipment obligations are principally in the form of Equipment Trust Certificates which mature serially and are paid from the reserve for equipment depreciation.

CASH POSITION

Shareholders will be glad to know that your Directors have been careful to maintain a strong cash position. This is necessary because with present high wage, material and fuel costs, as well as high taxes, a great deal more money is required as a working fund than was needed a few years ago. Equally important is the maintenance of a reserve to meet emergencies such as fixed interest charges for a period of not less than two years.

Experience shows that the 1928 reorganization was consummated without providing sufficient liquid assets for the company to weather the depression of the '30s, because in 1935 its cash became depleted and it was not in a position to meet its obligations resulting in the institution of bankruptcy proceedings on June 29 of that year.

The reorganization which was consummated on December 1, 1945, provided the company with more liquid assets. The wisdom of this has been amply shown by the experience of the last five years. During this period railroads generally had difficulty borrowing funds for needed improvements, other than new equipment. In our case we were able to overcome this difficulty in part by drawing upon our cash for some of these improvements.

DIVIDENDS

Your Board of Directors, at its meeting on October 10, declared an additional dividend on the Series A Preferred Stock, amounting to $1.00 per share in respect of each of the years 1947 and 1948, and $1.75 per share for the year 1949, making a total of $3.75, payable November 20, 1950 to holders of Voting Trust Certificates of record at the close of business November 1, 1950.

The Directors, at a Special Meeting of the Board held on November 20, 1950, declared a dividend of $2.00 per share on the common stock, payable December 9, 1950 to holders of Voting Trust Certificates of record at the close of business December 1, 1950.

CONCLUSION

Your Directors feel that they have conscientiously and energetically administered the affairs of your company in such a way as to place it in the best possible position to meet the service needs of the future, to pay off our obligations, and to earn money for the stockholders.

Including the retroactive mail pay, if approved by the Interstate Commerce Commission, the net income of the company available for dividends and other corporate purposes for the year 1950 is estimated at $14,500,000. After the accounts for the year have been completed and a determination of available net income has been made, your Directors will give attention to the matter of payment of dividends out of the earnings for the year 1950.

The present indications are that the volume of freight traffic will be relatively high during the next several years. With a management that is experienced and aggressive and a property which is in good condition, and assuming rate changes commensurate with increases in labor costs, the prospects of increased net income are very favorable.

Income and earned surplus statements and condensed summary of cash receipts and disbursements for the period December 1, 1945 to August 31, 1950, and balance sheet as of August 31, 1950, follow.

LEO T. CROWLEY,
Chairman of the Board.

November 21, 1950.

J. P. KILEY,
President.

STATEMENT OF INCOME FOR THE PERIOD FROM DECEMBER 1, 1945, TO AUGUST 31, 1950, INCLUSIVE

Railway Operating Revenues:	
Freight	$ 885,895,948.20
Passenger	106,089,340.11
Mail	25,239,358.37
Express	19,079,455.81
Switching	24,009,410.93
All other	39,672,762.98
Total	1,099,986,276.40
Railway Operating Expenses:	
Maintenance of way and structures	174,844,632.53
Maintenance of equipment	198,708,993.44
Traffic	22,300,451.70
Transportation	473,394,415.42
Miscellaneous	15,311,269.70
General	35,102,149.67
Total	919,661,912.46
Net Revenue from Railway Operations	180,324,363.94
Taxes and Rents:	
Federal income taxes	6,433,187.36
Other taxes	77,975,812.64
Equipment rents—net charge	18,112,324.03
Joint facility rents—net charge	11,507,565.19
Total	114,028,889.22
Net Railway Operating Income	66,295,474.72
Other Income, Less Deductions	7,653,530.05
Income Available for Fixed Charges	73,949,004.77
Fixed Charges:	
Rent for leased roads and equipment	1,940,390.84
Interest on funded debt—fixed	16,000,971.41
Interest on unfunded debt	102,550.09
Amortization of discount on funded debt	217,953.57
Total	18,261,865.91
Income after Fixed Charges	55,687,138.86
Contingent Charges:	
Interest on general mortgage income bonds	20,868,790.45
Interest on modified Terre Haute bonds	534,815.00
Rent for leased road and equipment (contingent interest on Chicago, Terre Haute and Southeastern Railway Company bonds)	986,796.00
Total	22,390,401.45
Net Income	$ 33,296,737.41

Disposition of Net Income

Appropriated for additions and betterments fund	$ 7,619,596.66
Appropriated for sinking funds	3,218,868.44
Transferred to unappropriated surplus	22,458,272.31
Total	$ 33,296,737.41

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY
GENERAL BALANCE SHEET AS OF AUGUST 31, 1950

ASSETS	AMOUNT
INVESTMENTS:	
Road and equipment property:	
Road	$603,609,514.86
Equipment	274,527,730.01
General expenditures	40,608,316.97
Improvements on leased property	632,259.00
TOTAL	919,377,820.84
LESS:	
Acquisition adjustment	*166,159,529.36*
Donations and grants	*1,116,434.41*
INVESTMENT IN TRANSPORTATION PROPERTY	752,101,857.07
Accrued depreciation—road property	*72,970,438.14*
Accrued depreciation—equipment	*125,345,184.23*
Accrued amortization of defense projects—road property	*2,248,688.02*
Accured amortization of defense projects—equipment	*20,633,599.16*
INVESTMENT IN TRANSPORTATION PROPERTY LESS RECORDED DEPRECIATION AND AMORTIZATION	530,903,947.52
Capital, sinking, and other reserve funds	4,616,221.14
Miscellaneous physical property (less accrued depreciation—$2,033,417.34)	6,599,610.94
Investments in affiliated companies:	
Stocks (less reserve for adjustment of investment—$64,458.94)	4,894,917.36
Bonds, unsecured notes and investment advances	9,696,108.15
Other investments:	
Stocks	7,785.00
Bonds, ($12,960,000.00 United States Treasury 2% Bonds, due September 15, 1952-50)—at cost, less amortized premium	12,981,666.07
Other secured obligation and advance	690,500.00
TOTAL INVESTMENTS	570,390,756.18
CURRENT ASSETS:	
Cash	24,460,636.77
Temporary cash investments (United States Government obligations)—at cost	13,132,000.00
Special deposits (cash and United States Government obligations reserved for payment of specific current liabilities)	3,582,339.05
Net balance receivable from agents and conductors	4,363,649.77
Miscellaneous accounts receivable	5,888,058.81
Material and supplies inventories—at cost	23,194,819.52
Interest and dividends receivable	574,006.69
Accrued accounts receivable	5,231,882.83
Claims for refund of federal taxes on income	8,582,278.20
Other current assets	356,527.11
TOTAL CURRENT ASSETS	89,366,198.75
DEFERRED ASSETS:	
Working fund advances	604,448.44
Other deferred assets	1,599,044.68
TOTAL DEFERRED ASSETS	2,203,493.12
UNADJUSTED DEBITS:	
Prepayments	289,802.52
Discount on funded debt	707,492.59
Other unadjusted debits	1,335,910.93
TOTAL UNADJUSTED DEBITS	2,333,206.04
	$664,293,654.09

Italics denote deductions.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY
GENERAL BALANCE SHEET AS OF AUGUST 31, 1950

LIABILITIES	AMOUNT
CAPITAL STOCK:	
Common stock—no par value (stated value—$100.00 per share):	
Authorized (including 514,221 shares reserved for conversion of General Mortgage Bonds, Series B)—2,637,450 shares	
Issued and outstanding—2,123,214 shares	$212,321,400.00
Preferred stock—par value $100.00 per share (5% participating):	
Authorized—1,150,000 shares	
Issued and outstanding—1,121,740 shares	112,174,000.00
TOTAL CAPITAL STOCK	324,495,400.00
LONG-TERM DEBT (AFTER DEDUCTING BONDS HELD BY THE COMPANY):	
Chicago, Milwaukee, St. Paul and Pacific Railroad Company:	
First Mortgage 4% Bonds, Series A, due January 1, 1994	56,969,800.00
General Mortgage 4½% Income Bonds, Series A, due January 1, 2019	50,682,400.00
General Mortgage 4½% Convertible Income Bonds, Series B, due January 1, 2044	35,408,300.00
The Bedford Belt Railway Company First Mortgage Bonds, due January 1, 1994	235,000.00
The Southern Indiana Railway Company First Mortgage Bonds, due January 1, 1994	7,279,000.00
Chicago, Terre Haute and Southeastern Railway Company:	
First and Refunding Mortgage Bonds, due January 1, 1994	8,056,000.00
Income Mortgage Bonds, due January 1, 1994	5,814,800.00
Equipment obligations	57,850,247.01
TOTAL LONG-TERM DEBT	222,295,547.01
CURRENT LIABILITIES:	
Traffic and car-service balances—net payable	4,016,387.49
Audited accounts and wages payable	18,398,750.33
Miscellaneous accounts payable	3,636,920.80
Interest matured unpaid	424,848.47
Dividends matured unpaid	404,486.25
Unmatured interest accrued	3,585,080.52
Accrued accounts payable	3,584,164.65
Taxes accrued (including for federal taxes on income—$5,125,278.98)	12,455,188.92
Other current liabilities	3,268,784.41
TOTAL CURRENT LIABILITIES	49,774,611.84
DEFERRED LIABILITIES	783,886.62
UNADJUSTED CREDITS:	
Premium on funded debt	2,021.66
Accrued depreciation on leased property	246,813.95
Equalization reserve	324,000.00
Reserve for loss and damage and freight overcharge claims	2,494,879.68
Other unadjusted credits	2,479,844.55
TOTAL UNADJUSTED CREDITS	5,547,559.84
EARNED SURPLUS (SINCE JANUARY 1, 1944):	
Appropriated surplus	19,128,101.10
Unappropriated surplus	42,268,547.68
TOTAL EARNED SURPLUS	61,396,648.78
	$664,293,654.09

EARNED SURPLUS FOR THE PERIOD FROM DECEMBER 1, 1945, TO AUGUST 31, 1950, INCLUSIVE

Balance at December 1, 1945	$45,163,865.58
ADDITIONS:	
Net income for the period	33,296,737.41
Discount on purchase of bonds issued or assumed by the Company:	
On First Mortgage Bonds acquired	8,195.00
On General Mortgage Bonds acquired	9,212,481.91
On Chicago, Terre Haute and Southeastern Railway Company Bonds acquired	147,476.77
Profits, less losses, derived from sales or retirements of land and nonoperating properties	513,254.81
Miscellaneous credits, less charges	10,634.43
	88,352,645.91
DEDUCTIONS:	
Dividends paid on Preferred Stock	26,641,325.00
Premium on $30,500,000 U. S. Treasury 1½% Notes, matured September 15, 1947, exchanged for like amount of 1% notes, due October 1, 1948	228,750.00
Premium on First Mortgage Bonds acquired for the treasury or for retirement	66,742.13
Premium on General Mortgage Bonds acquired for the treasury or for retirement	19,180.00
	26,955,997.13
BALANCE AT AUGUST 31, 1950	$61,396,648.78
The status of earned surplus at August 31, 1950, was as follows:	
APPROPRIATED:	
For additions and betterments	$18,820,728.18
For sinking fund—First Mortgage Bonds	126,210.26
For sinking fund—General Mortgage Bonds	181,162.66
TOTAL APPROPRIATED SURPLUS	19,128,101.10
UNAPPROPRIATED	42,268,547.68
TOTAL	$61,396,648.78

AVAILABLE NET INCOME AND APPLICATION THEREOF FOR THE PERIOD FROM DECEMBER 1, 1945, TO AUGUST 31, 1950, INCLUSIVE

Income available for fixed charges	$73,949,004.77
FIXED CHARGES:	
Rent for leased roads and equipment	1,940,390.84
Interest on funded debt:	
On First Mortgage 4% Bonds, Series A	11,096,846.58
On modified Terre Haute Bonds	992,574.98
On equipment obligations	3,911,549.85
Interest on unfunded debt	102,550.09
Amortization of discount on funded debt	217,953.57
TOTAL FIXED CHARGES	18,261,865.91
INCOME AFTER FIXED CHARGES	55,687,138.86
ADD: Charges to operating expenses representing the service value of non-depreciable roadway property retired and not replaced	1,597,097.37
AVAILABLE NET INCOME	57,284,236.23
APPLICATION OF AVAILABLE NET INCOME:	
Appropriated for sinking fund for retirement of First Mortgage 4% Bonds, Series A	818,880.49
Contingent interest on General Mortgage 4½% Income Bonds, Series A	11,534,918.97
Contingent interest on modified Terre Haute bonds (obligations of Chicago, Terre Haute and Southeastern Railway Company, The Bedford Belt Railway Company, and The Southern Indiana Railway Company) assumed by Chicago, Milwaukee, St. Paul and Pacific Railroad Company	1,521,611.00
Appropriated for additions and betterments fund (optional amount)	7,619,596.66
Contingent interest on General Mortgage 4½% Convertible Income Bonds, Series B	9,333,871.48
Appropriated for sinking fund for retirement of General Mortgage 4½% Income Bonds, Series A and Series B	2,399,987.95
	33,228,866.55
REMAINING AVAILABLE NET INCOME	24,055,369.68
DEDUCT: Charges to operating expenses representing the service value of non-depreciable roadway property retired and not replaced	1,597,097.37
REMAINDER TRANSFERRED TO EARNED SURPLUS—UNAPPROPRIATED	$22,458,272.31

CONDENSED SUMMARY OF CASH RECEIPTS AND DISBURSEMENTS FOR THE PERIOD FROM DECEMBER 1, 1945, TO AUGUST 31, 1950, INCLUSIVE

Cash and temporary cash investments at December 1, 1945			$ 98,895,868
SOURCE OF FUNDS:			
Net revenue from railway operations:			
Revenues:			
From hauling freight	$885,895,948		
From carrying passengers	106,089,340		
From hauling mail and express	44,318,814		
From switching cars	24,009,411		
From all other services	39,672,763	$1,099,986,276	
Expenses:			
Repairs to buildings, bridges, tracks and other fixed properties	152,522,455		
Repairs to cars and locomotives	155,569,223		
Cost of transporting freight and passengers	473,394,416		
Other operating expenses (exclusive of depreciation, amortization and retirement charges)	72,713,871	854,199,965	
Net from railway operations			245,786,311
Rentals from others for use of system properties and equipment			8,269,836
Income from investments and other miscellaneous income			4,085,645
Salvage recovered from property retired (through sale or dismantling)			11,826,199
Proceeds from issuance of equipment obligations			64,885,546
Receipts account bills versus U.S. Government for transportation paid, in excess of bills issued			7,747,950
Total funds to be accounted for			441,497,355
EXPENDITURES OF FUNDS:			
Taxes paid:			
To U.S. Government for income taxes		16,128,311	
To U.S. Government for old age retirement and unemployment insurance		37,563,124	
To U.S. Government for all other taxes		384,325	
To all other governmental bodies		37,113,601	91,189,361
Rentals for use of other companies' properties and equipment			35,500,563
Miscellaneous expenses other than for operations			353,530
Cash deposited with The First National Bank of Chicago as Exchange Agent for payment of interest on First Mortgage Bonds for petiod from January 1, 1944 to June 30, 1945 and on General Mortgage Series A and B bonds for the year 1944			7,939,306
Intetest on:			
First mortgage 4% bonds, Series A		11,708,999	
General mortgage 4½% income bonds, Series A		12,376,282	
General mortgage 4½% convertible income bonds, Series B		10,405,249	
Chicago, Terre Haute and Southeastern Railway Company bonds, assumed		1,215,528	
Equipment obligations		3,647,742	
Overcharge claims and other minor accounts		102,550	39,456,350
Sinking funds:			
For First mortgage bonds, Series A		978,806	
For General mortgage income bonds, Series A and B		3,260,361	4,239,167
Purchase of mortgage bonds other than through operation of sinking funds:			
First mortgage 4% bonds, Series A		1,597,336	
General mortgage 4½% income bonds, Series A		1,457,636	
General mortgage 4½% convertible income bonds, Series B		8,504,964	
Chicago, Terre Haute and Southeastern Ry. Co. bonds		392,871	11,952,807
Payment of equipment obligations maturing during the period			31,038,831
Capital expenditures:			
Additions and betterments to road (exclusive of donated property)		37,797,506	
New equipment and improvements to existing equipment		98,733,224	136,530,730
Increase in inventory of material and supplies			3,422,591
U.S. Government securities deposited in and remaining in Reserve and Retirement Fund for payment of equipment obligations as they mature			3,968,000
Dividends on Series A Preferred Stock			26,641,325
All other items (principally increase in net payables)			*Cr. 1,309,509*
Total expenditures of funds			390,923,052
Cash and temporary cash investments at August 31, 1950 (including $12,960,000 United States Treasury 2% Bonds, due September 15, 1952-50, at cost, less amortized premium, carried in balance sheet under Investments)			$ 50,574,303