1975 ANNUAL REPORT

Chicago Milwaukee Corporation

PROFILE: Chicago Milwaukee Corporation

Chicago Milwaukee works . . . to move people and freight . . . to put food on the tables in restaurants and institutions of all types . . . to pave highways, develop land, grow trees.

These are the principal companies which together constitute Chicago Milwaukee Corporation:

In transportation . . . *The Milwaukee Road:* More than 10,000 miles of railroad in the Midwest extending to the Pacific North Coast; a diversified freight hauler; operator of some of Amtrak's intercity trains; commuter carrier at Chicago for 30,000 riders daily. *The Milwaukee Motor Transportation Company:* Trucking adjunct to the railroad; operator of intermodal terminals; over-the-road transporter. *Washington, Idaho & Montana Railway Company:* Common carrier in Idaho and Washington, principally of lumber and grain.

In food service . . . *Aslesen Company:* Distributor of food, supplies and equipment to restaurants, institutions and others in the upper Midwest who do volume feeding; contract designer of kitchens and restaurants. *Vulcan-Hart Corporation:* manufacturer of commercial and institutional cooking, food preparation and storage equipment. *Hanson Porcelain Company, Inc.:* specialist in applying porcelain enameling.

In land and timber . . . *Milwaukee Land Company:* Owner of timberlands in Washington, Idaho and Montana; tree-grower and reforester; timber producer whose trees are harvested under contract; developer of industrial properties.

In highway construction . . . *Hi-Way Paving, Inc.:* Concrete paving subcontractor in Ohio and adjoining states.

Financial Highlights

Chicago Milwaukee Corporation and Subsidiaries

	1975	1974
Operating revenues	**$450,576,000**	$466,174,000
Operating expenses and costs	**470,468,000**	453,306,000
Operating income (loss)	**(19,892,000)**	12,868,000
Other income	**6,315,000**	11,690,000
Interest expense	**10,550,000**	10,806,000
Earnings (loss) before income taxes	**(24,127,000)**	13,752,000
Net earnings (loss)	**(19,595,000)**	11,274,000
Earnings (loss) per share of common stock	**(8.97)**	3.62
Cash and temporary cash investments	**17,785,000**	21,278,000
Working capital	**8,521,000**	22,918,000

CORPORATE HEADQUARTERS

Chicago Milwaukee Corporation
516 West Jackson Boulevard
Chicago, Illinois 60606

STOCK EXCHANGE

Common and Preferred Stocks of Chicago Milwaukee Corporation are traded on the New York Stock Exchange.

STOCK TRANSFER AGENTS AND REGISTRARS

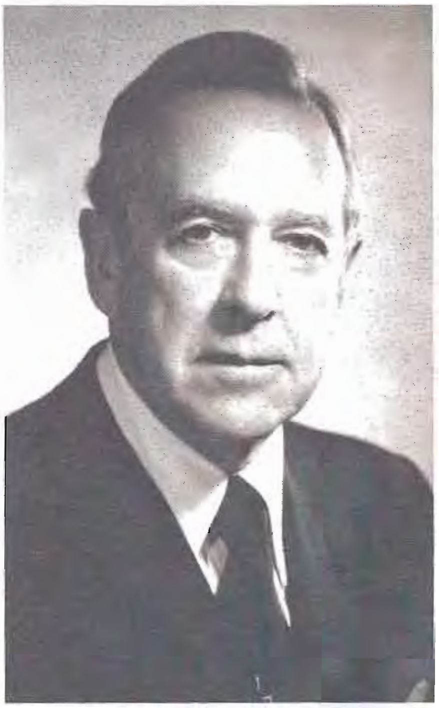
The Chase Manhattan Bank,
New York, N.Y. 10015

The First National Bank
of Chicago,
Chicago, Illinois 60670

FORM 10-K

Stockholders of Chicago Milwaukee Corporation may receive without charge a copy of the Corporation's 1975 Annual Report to the Securities and Exchange Commission, Form 10-K, by writing to Mr. James T. Taussig, Secretary, Chicago Milwaukee Corporation, 516 West Jackson Boulevard, Chicago, Illinois 60606. This offer is extended to persons who, as of the record date of March 25, 1976, for the 1976 Annual Meeting, are beneficial owners of securities entitled to vote at the meeting.

To the stockholders:



We report a manifestly unsatisfactory year for Chicago Milwaukee Corporation in 1975. We report also that 1976 is going better.

Chicago Milwaukee incurred in 1975 a consolidated net loss equivalent to $8.97 per common share. In 1974, the company produced consolidated net earnings equivalent to $3.62 per common share.

More than anything else, the difference represents the impact of the deep economic recession on the Milwaukee Road, Chicago Milwaukee's railroad subsidiary. The resiliency of the railroad was severely tested in 1975.

Chicago Milwaukee's nonrailroad subsidiaries as a group rolled with the blow of the recession better than did the railroad. The ability of the food service operations to withstand the recession's impact, coupled with the growth trend of away-from-home and volume feeding, suggests that our continuing interest in the food service industry is well placed. Chicago Milwaukee intends to expand in this area, as well as in others, when attractive opportunities present themselves.

As the recession eased, which it did noticeably as the year progressed, the railroad and Chicago Milwaukee responded. Each succeeding quarter of 1975 was better than its predecessor. The company returned a profit in the fourth quarter, on a consolidated basis, of $1.90 per common share. It should be noted that historically the railroad's earning power has been concentrated in the third and fourth quarters.

While it was uncomfortable, our economic posture during 1975 was by no means unique. Other members of each area of business activity in which Chicago Milwaukee participates felt the same economic pressures — particularly the nation's railroads. For the first time in history, the industry had a deficit in net railway operating income at midyear; earnings for the year as a whole were the worst since the depression of the 1930's.

Nonetheless, there were some bright spots in the economic gloom. During the year the Milwaukee Road was able to arrange financing for nearly $30 million in equipment. As this report discusses, the railroad saw the last major segment of its historic passenger-service deficit substantially eliminated through a three-year agreement with the Chicago-area Regional Transportation Authority. Industry-wide legislative efforts culminated, in early 1976, in national legislation which offers a number of opportunities for financial aid to the railroad in the future. This legislation is discussed in some detail later in this report. One of the food-service subsidiaries began a major expansion of its distribution center. Elsewhere in the food-service area, manufacturing subsidiaries saw, in the latter part of the year, improvement in orders and a brightening sales outlook.

Chicago Milwaukee met all its current fixed obligations in 1975. The Milwaukee Road paid its fixed interest on bonds and on equipment debt. While the railroad accrued contingent interest in 1975 as it must under the provisions of certain mortgages, its lack of earnings means that it will not be required to pay in 1976 any contingent interest or sinking fund obligations.

Obviously, there can be no dividends on Chicago Milwaukee's stock at this time. Dividends must come from the earnings of the company's subsidiaries. The Milwaukee Road must clear its contingent interest obligations before it can pay dividends to Chicago Milwaukee. The cash flows of nonrailroad subsidiaries are committed largely to the debt incurred in financing their acquisitions.

You will find, beginning on page 26, the financial statements of the Milwaukee Road for 1975 and 1974. We include them so that the nature of the financial circumstances in which our railroad subsidiary finds itself is clear.

The Milwaukee Road is working to place itself within a stronger, sounder railroad system. There are simply too many railroads competing for what business the western United States has to offer railroads, clearly too much duplication of rail service and rail facilities.

The time has come — is long past, in fact — that a comprehensive restructuring of the railroad industry in the West be undertaken. I believe that with the plan which we first advanced at the Annual Meeting last May we helped begin the slow process of creating an atmosphere amenable to the necessary — and, to be sure, profound — changes in national public, and in railroad-industry, thinking.

As you shall read in this report, the Congress and the Administration now hold the view that restructuring is essential. Clearly, the Railroad Revitalization and Regulatory Reform Act sets a new national policy in this regard in addition to providing the aforementioned funding opportunities and launching ConRail in the Northeast. Federal regulatory authorities have begun laying the groundwork for implementing the new national policy. Not in recent times has so significant a piece of railroad legislation been enacted — with a timing that could not have been more opportune.

In a related vein, the Milwaukee Road continues its activities designed to seek its inclusion within Burlington Northern or another carrier. And until such an event occurs, the Milwaukee Road will be operated as efficiently, as productively, and as competitively as is possible.

Litigation over the question of the determination of income available for contingent interest continues. You will find a summary of the various lawsuits and their status in note 12 of the Notes to Consolidated Financial Statements. The current status of the investigation of the company by the staff of the Securities and Exchange Commission is discussed under "Legislation and Regulation."

To date in 1976, the year is progressing more satisfactorily than did 1975 to date. The general economy continues to improve. We believe 1976 will not present the economic pressures that 1975 did. In your behalf we look forward to a better year.

Respectfully,

Chairman of the Board

March 26, 1976

TRANSPORTATION

Chicago Milwaukee's transportation operations are conducted — cooperatively, in many instances — by railroad and motor-carrier subsidiaries. Briefly, here are the highlights of the activities during 1975 in the transportation area.

The Milwaukee Road

With the diminished demand for freight service brought about by the recession, and therefore with reduced funds available to it, Chicago Milwaukee's railroad subsidiary necessarily placed itself in the position of maintaining the best service it could with the limited funds.

To the degree that it could consistent with safety, efficiency and service, it postponed planned improvements until a better year. Projects and activities which would both increase efficiency and reduce operating expenses received priority.

The Milwaukee constantly analyzes its administrative and operating procedures for cost-effectiveness and results. Several departments were partially or wholly restructured during the year with greater internal effectiveness in mind. The field sales force of the Traffic Department was reorganized, as was the Corporate Communications Department. The number of operating divisions was reduced by one in the first phase of a comprehensive reorganization of the Operating Department which continues into 1976.

Coal traffic, while a relatively small part of the Milwaukee Road's total business, grew substantially in 1975. This unit coal train brings North Dakota lignite to a South Dakota power generating station.

There were several notable marketing achievements for the company during 1975.

In import traffic, a new schedule of rates significantly increased the volume of freight which moves in containers inland from ports on the Pacific North Coast.

Unit-train movements of coal continue to increase. A new service delivers coal to a power plant in eastern South Dakota from a mine in western North Dakota.

The year saw the return to the Milwaukee of volume mail traffic under a contract with the U. S. Post Office. Once a prime commodity on certain of the railroad's passenger trains, the mail is now moved out of concentration points "piggyback" in freight trains.

In grain, the Milwaukee reinaugurated its seasonal "mini-unit" trains for certain portions of the grain trade. Grain market conditions were such that the trains were needed for only a few weeks, however. The railroad expects to operate its "MUT's" again in 1976.

Physical improvements were confined to those which were essential and to those which consumed few operating-expense dollars. Additions and betterments to property totaled $13.8 million in 1975 compared with $14.2 million in 1974.

Notable among the fixed-facility projects in 1975 is the new locomotive maintenance facility at St. Paul, Minnesota, construction on which was begun during the year. The shop represents the transfer of a principal maintenance base to a more natural point of concentration of locomotives, and thus will increase the over-all efficiency of the locomotive maintenance process. The shop is expected to become fully operational in 1976.

During 1975 the Milwaukee Road acquired, through lease, 32 new 1,500-horsepower diesel-electric locomotives of a type which makes them most useful in yard and switching assignments but does not preclude their being used in road assignments. The acquisition represents a new phase in the company's motive-power upgrading program, it having leased a sizable fleet of new road locomotives in recent years. The 32 new switchers, along with 32 more ordered in 1975 for 1976 delivery, will replace approximately 100 less efficient locomotives.

In 1975 the Milwaukee placed in service, through lease, 683 freight cars of six types and, through purchase, 100 tri-level automobile-transporting cars and two special cabooses. Additionally, 105 existing cars were rebuilt and returned to service. Planned major rebuild work on additional cars and on certain existing locomotives was postponed.

The company was successful in obtaining during 1975 the permission of the Interstate Commerce Commission to eliminate 63 miles of branch-line track no longer necessary to provide service to the company's customers.

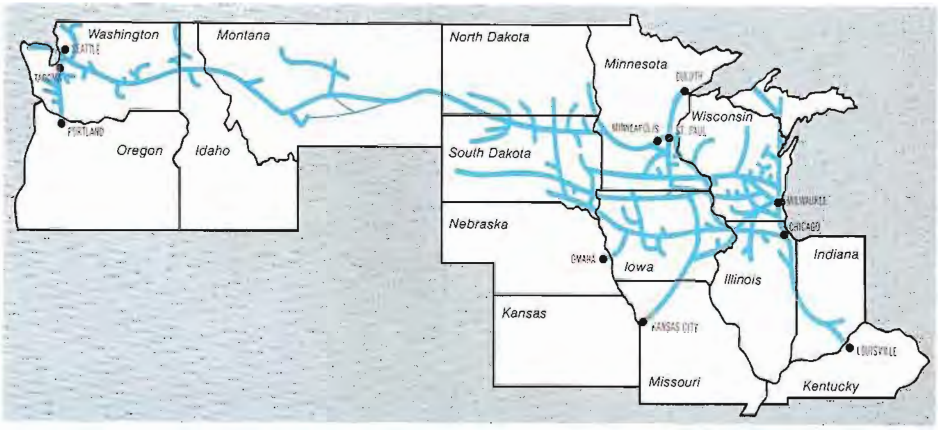
Labor difficulties were minimal during 1975. There were no strikes. As did the railroad industry generally, the Milwaukee became a party to new wage and benefit agreements covering most employees which are expected to increase labor costs substantially over the next few years. Average employment in 1975 was 9.3 per cent below what it was in 1974.

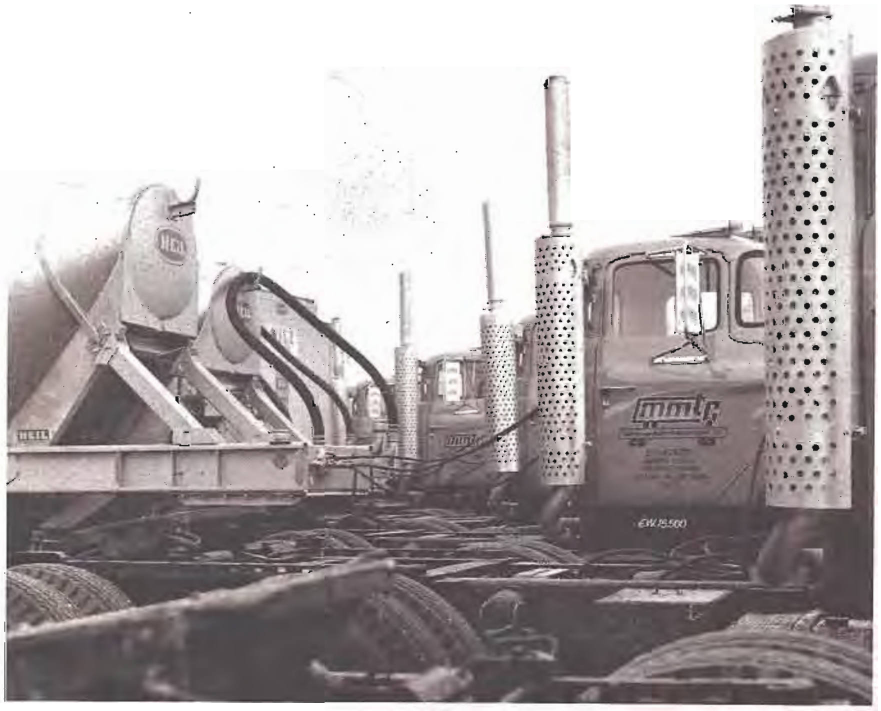
Milwaukee Motor Transportation

The Milwaukee Road's motor-carrier subsidiary turned in an excellent performance in 1975.

The company opened a new intermodal terminal capable of handling both "piggyback" trailers and containers on chassis at Perry, Iowa, principally to provide a point from which to serve Des Moines in conjunction with the new U. S. Mail contract.

Late in 1974 the company applied to the Interstate Commerce Commission for the right to substitute truck





The Milwaukee Road (map) and its trucking subsidiary, The Milwaukee Motor Transportation Company, together serve the Midwest, the northern tier of western states, and the Pacific North Coast. In the photo are bulk cement trucks purchased by Milwaukee Motor in 1975.

service for rail service between points on the Milwaukee Road in Montana, Idaho, Washington and Oregon. Hearings were held during 1975; and early in 1976 the authority was received. Now, MMTC trucks may handle rail freight traffic in substituted service, at rail rates and on rail billing, over most of the railroad's service territory subject to certain restrictions.

During 1975 Milwaukee Motor purchased 19 new diesel tractors and five new bulk tank trailers for cement. It purchased two new mobile "Piggy Packers" with which to load highway trailers on railroad flat cars. One was placed at Chicago, the second at Seattle to assist with the railroad's increased export-import traffic.

FOOD SERVICE

Chicago Milwaukee's food-service operations are centered around two major companies: Aslesen Company of Minneapolis, and Vulcan-Hart Corporation of Baltimore. Aslesen is a distributor of food and institutional food-service products, Vulcan-Hart a manufacturer of commercial and institutional cooking, food-preparation and food-storage equipment.

Aslesen Company

Aslesen continues to expand in all areas of its business: restaurants, hospitals, schools and other institutions; colleges; industrial in-plant feeding; hotels and motels; and catering organizations.

Aslesen's operations involve five separate departments: food and frozen food; supplies; kitchen contract design; decor and furniture; and bakery equipment and used equipment. In 1975 the company expanded the housekeeping part of its supply department to enable it to expand its sales of cleaning supplies and equipment to organizations which do volume feeding.

At Aslesen, all the necessities of volume food service are available within a "single-stop shopping" concept, a marketing style which Aslesen originated and which is now the objective of much of the industry. Aslesen stocks approximately 11,000 items — 3,600 dry grocery, 800 frozen food, 6,000 supply — for its 12,000 customers.

Aslesen's main distribution center in Minneapolis is being expanded. Storage capacity is being increased by approximately 200 per cent for frozen foods in line with the volume feeding industry's trend toward greater use of frozen products, and by approximately 25 per cent for stocks of items used in the company's growing hotel- and motel-supply business. Begun in 1975, the expansion will be completed in 1976. Aslesen's sales force was increased in 1975.

Contract design departments implemented installations for a number of major volume feeding requirements, including the Metropolitan Medical Center in Minneapolis and the new

Showroom at Aslesen Company's Minneapolis distribution center offers buyers the opportunity to see actual table settings.

Vulcan-Hart food-service equipment is designed for restaurants, fast-food operations and institutions of all types. These ranges are in a church kitchen.

central lunch kitchen for the City of Minneapolis.

Vulcan-Hart Corporation

Vulcan-Hart is Chicago Milwaukee's principal food-service equipment manufacturing subsidiary. From several plants it produces a complete line of gas, electric and steam cooking equipment, dishwashers, mixers, fast-food counter equipment, beverage coolers, reach-in and walk-in coolers and freezers, and self-leveling dishware dispensers.

Pressures of the recession caused Vulcan-Hart to get off to a slow start in 1975, with the factories working principally to reduce backlog. Optimism within the food-service industry appeared to return at about the time of a major restaurant industry trade show in May; by August actual orders had begun to surpass their level of a year earlier. By November, backlog was restored to approximately its level of November, 1974.

Special quality-control programs instituted in 21 production departments reduced defects in manufactured items to an all-time low, with zero-defect rates achieved on some production lines.

In one plant, two of the four assembly tracks devoted to the manufacture of electrical appliances were redesigned during the year, reducing the labor requirement by a third and, simultaneously, increasing production capacity by 40 per cent.

Upon the successful testing of stove and other castings from outside suppliers, a decision was made to close Vulcan-Hart's own foundry, an old and relatively inefficient operation.

LAND AND TIMBER

Milwaukee Land Company is a wholly owned subsidiary of the Milwaukee Road.

Milwaukee Land's timber division lets contracts to lumber producers who remove marketable trees from its property. Timber-cutting activities were adversely affected during 1975 by the reduced level of housing starts.

Approximately 1,300 acres of previously cut-over timberland was replanted during the year by hand or aerial methods. There were nominal sales and purchases of timberland during 1975.

The industrial division of Milwaukee Land Company continues to inventory industrial property and, as appropriate, to sell it for industrial purposes. With the falloff in industrial development due to the recession, only nominal acreages of industrial property were bought and sold in 1975.

In December, 1975, Milwaukee Land Company became associated with a proposed new petroleum pipeline venture designed to assure a supply of crude oil to refineries in the northern tier of states should supplies of Canadian crude be shut off as is presently expected. The pipeline developers have incorporated as Northern Tier Pipeline Company. They are planning a line from the Puget Sound area to a connection with an existing pipeline in Minnesota, possibly using railroad rights of way as portions of the route to reduce land-acquisition costs and environmentally based objections.

Northern Tier's initial activity is in research and development. Portions of the right of way of the Milwaukee Road are under study as to their feasibility as portions of the pipeline route.

HIGHWAY CONSTRUCTION

The 1975 construction season was highly successful for Hi-Way Paving, Inc., one of the nation's larger concrete paving subcontractors. During the year Hi-Way paved approximately 42 miles of Interstate highway in Ohio and West Virginia. Operations and profitability benefited from better scheduling and a lessening of the impact of inflation.

During 1975 Hi-Way was awarded new contracts for approximately 66 miles of highway. Stated in terms of square yards of pavement, Hi-Way's backlog at the close of 1975 was greater than its backlog at the close of 1974 by 38 per cent.

The mechanized equipment of a logging contractor stacks timber cut from Milwaukee Land Company property in Washington state. Milwaukee Land conducts a continuing reforestation program.

Legislation and Regulation

Several events of importance have occurred since our last report in the general area of law and regulation, and in the relationships between the company and public agencies.

Securities and Exchange Commission

As reported in the interim report to stockholders for the six months ended June 30, 1975, Chicago Milwaukee, the Milwaukee Road and their subsidiaries have, since June, 1975, been the subject of a private investigation by the staff of the Securities and Exchange Commission with respect to compliance with the disclosure requirements of the federal securities laws. The company has been advised by its attorneys that the SEC staff is presently of the view that it will recommend to the Commission that a civil enforcement action be instituted.

National rail legislation

Responding to the need to fund ConRail, the semiprivate railroad company which will succeed the bankrupt rail companies in the Northeast, and also to the critical economic condition which during 1975 affected the industry as a whole, federal legislators framed, and in February, 1976, President Ford signed, the Railroad Revitalization and Regulatory Reform Act of 1976.

The new law contains much which the railroad industry has been urging for many years. Generally, its provisions include $6.5 billion in grants, loans and loan guarantees for ConRail, for Amtrak passenger services, and for a variety of uses by the railroads generally. The law modernizes federal regulation of railroads, allowing them greater flexibility in adjusting freight rates and directing the Interstate Commerce Commission to expedite its rate-review procedures.

The law prohibits states from taxing railroad properties at discriminatory rates. It provides certain subsidies for branch lines which the railroads are required to operate.

Significantly, the new law sets in motion, through the Secretary of Transportation, a planning process designed to determine how the nation's railroad industry might be restructured to improve its over-all efficiency. It also provides new procedures for expediting rail merger proceedings before the ICC.

A project team of senior Milwaukee Road personnel has been formed to determine the maximum extent to which the company can benefit from the new law. Of particular interest are the portions dealing with industry restructuring because of their relationship to the company's own long-range objectives.

Inclusion and acquisitions

The Milwaukee Road's efforts before the Interstate Commerce Commission to seek inclusion within Burlington Northern Inc. or some other railroad with greater inherent financial strength than its own continued during 1975.

In March, the company filed with the ICC an amendment to its 1973 petition for inclusion which sought additional protective conditions from Burlington Northern without abandoning the Milwaukee's earlier desire to have the entire company included within Burlington Northern. Hearings on the inclusion are expected in 1976.

The ICC approved in early 1975 the Milwaukee's application to acquire and operate the Port Townsend Railroad, a 12-mile line between Discovery Junction and Port Townsend, Washington. The line provides a link between the Milwaukee's own Port Angeles branch and the remainder of the system.

Together with the Chicago & North Western Transportation Company and Soo Line Railroad Company, the Milwaukee Road has proposed that the three lines acquire and operate portions of the Green Bay & Western Railroad, a 250-mile line across central Wisconsin. The offer, which was extended to the GB&W in early March, 1976, is an alternative to one made by Burlington Northern. Burlington Northern's operation of the GB&W is unacceptable to the Milwaukee, North Western and Soo in that it would allow BN to invade Wisconsin territory which it has not heretofore served. Hearings on the Milwaukee-C&NW-Soo proposal are expected in 1976.

Commuter services

With an agreement in December, 1975, with the Chicago-area Regional Transportation Authority over the purchase by the RTA of commuter services to be supplied by the railroad, the Milwaukee Road began taking the last few steps in the process of removing itself from the passenger-service business except as a supplier of services to others.

The purchase-of-service contract was signed in March, 1976, upon the finalization of details. The Milwaukee Road is the first of the commuter railroads of Chicago to enter into the contractual arrangement contemplated by the law which established the RTA in 1973.

Under the contract, the Milwaukee will receive at least $4,650,000 per year from the RTA to cover costs of commuter operations in excess of revenues collected from the service. The amount may be higher depending on the railroad's performance. The contract is effective as of July 1, 1975.

During 1975 the Milwaukee began the process of discontinuing its commuter service to two stations in Wisconsin, a service not within the jurisdiction of the RTA.

Aid programs of the State of Illinois and the several Mass Transit Districts with which the Milwaukee Road is associated resulted in significant improvements to commuter station facilities in 1975 with the promise of greater improvements in future years.

Financial Review and Analysis

The 1974-75 business recession, by most accounts the most severe since World War II, made 1975 a difficult year for Chicago Milwaukee Corporation. Revenues declined. Expenses and costs continued to climb because of higher prices and wage rates. The operating income level of about $13 million in each of the two preceding years was reduced in 1975 to a negative $19.9 million. The net loss was $19.6 million.

The trough of the recession seems clearly to have been reached in the first two quarters of 1975. Substantial recovery, particularly in the company's transportation segment, occurred in the second half of the year. Net earnings in the fourth quarter of 1975 were $5.3 million, as compared to fourth-quarter net earnings of $1.3 million in 1974 and $2.7 million in 1973.

For over-all perspective, reference may be made to the Five Year Consolidated Summary of Operations on page 14. For revenue and pretax earnings results by principal business segments, reference may be made to the lines-of-business table on page 11. The latter table shows that the heaviest of the 1975 financial damage occurred in the freight transportation segment.

The following table traces the rail volume decline, and the subsequent recovery, in terms of the Milwaukee Road's revenue ton-miles. For comparison, the Commerce Department's index of four coincident indicators is also shown. The table begins with the fourth quarter of 1973, the acknowledged peak preceding the recession. Revenue ton-miles, which are expressed as percentages of the 1967 level for comparison against the coincident indicators in which 1967 equals 100, moved substantially in parallel with the general economy.

Calendar Quarter	Coincident Indicators	Revenue Ton-Miles
1973		
IV	176.7	118.9
1974		
I	172.8	115.2
II	172.0	115.0
III	171.8	108.5
IV	162.7	110.5
1975		
I	149.9	92.4
II	148.3	97.7
III	154.0	106.4
IV	158.5	115.9

The full financial impact of the recession on the Milwaukee Road can be assessed from its unconsolidated financial statements, which appear on pages 26, 27 and 28 as supplementary information.

Revenues

The dominant factor affecting 1975 freight transportation revenues was the volume decline, which was offset to an important extent by a series of three general rate increases effective in the year plus the carryover effect of increases that took effect in 1974. The over-all effect of the higher rates on 1975 revenue is estimated at $39 million. The combined adverse effect of the volume decline and changes in the traffic mix is placed at $56.7 million.

Volume was down in all major commodity groups except coal, beverages and malt, automobile parts and forwarder traffic. Total carloadings dropped 10.9 per cent from 1974; excluding coal, which accounted for 11.7 per cent of 1975 carloads but only 5.8 per cent of revenues, the decline was 17.6 per cent. Revenue ton-miles showed a decline of 8.2 per cent over-all and 16.4 per cent for all commodities other than coal. Volume was generally well below break-even levels during the period from November, 1974, to August, 1975.

Passenger transportation revenues were up $3.4 million principally because government assistance to the railroad's commuter service increased $2.1 million and also because commuter ridership increased.

Land and timber revenues were down mainly because there were minimal timberland sales in 1975 whereas there were $3.5 million in timberland sales in 1974.

Food service revenues were higher principally because Vulcan-Hart Corporation is included in the figures for all of 1975 and for only 10 months of 1974. Vulcan-Hart was purchased on Feb. 28, 1974. The units engaged in the manufacture of commercial and institutional cooking, food preparation and storage equipment experienced generally lower demand and volume in 1975; the related reduction in sales of these units was only partially recovered through price increases. Food service units engaged in the distribution of wholesale food showed meaningful gains in physical sales volume; however, the over-all gain in dollar sales of these units was only 6 per cent because of lower food prices.

Operating expenses and costs

Expenses and costs were higher than in 1974 by $13.7 million in the transportation segment, $600,000 in land and timber, and $3.1 million in food service. In land and timber the increase came from certain industrial land sales which, though profitable, involved comparatively high costs. In food service, the increase was attributable to increased wholesale food volume, inflationary factors in the manufacturing units, and inclusion of Vulcan-Hart for the full 12 months of 1975.

The $13.7 million increase in transportation expenses masks certain major factors that were totally or largely offsetting, as the following paragraph explains. Other major items were (1) a $4.7 million increase in long-term lease payments on rolling stock; (2) a $6.8 million increase in payments to other carriers for the use of freight cars; (3) a $1.9 million increase in lading-damage expense; and (4) a $900,000 increase in roadway retirement charges.

The quantity of transportation labor expended, measured in total service hours, was down from 1974 by 10.3 per cent, including decreases of 9.5 per cent in train and engine labor and 15.9 per cent in maintenance. Including related reductions in payroll taxes, the resulting labor-cost savings were almost exactly offset by the $16.7 million effect of general wage-rate increases. Transportation materials other than fuel cost $760,000 less in 1975 than in 1974 due to decreased usage of $7.8 million, less price increases of $7.1 million. Transportation fuel cost approximately $1.5 million more, with price increases of $2.5 million offsetting $1 million in decreased usage.

Operating income and other income

At the operating income level, transportation dropped to a negative $26.5 million from a positive $1.6 million in 1974 and $3.4 million in 1973.

High and Low Sales Price of $5 Prior Preferred and Common Stock by Calendar Quarters on the New York Stock Exchange

		$5 Prior Preferred		Common	
	Calendar Quarter	High	Low	High	Low
1974	First quarter	18¼	13¾	11⅞	8¼
	Second quarter	15¾	11⅜	9⅝	6⅝
	Third quarter	15¼	9⅜	8¾	5
	Fourth quarter	13¾	9	8⅛	5⅛
1975	First quarter	15	10	11¼	5⅜
	Second quarter	12¾	10⅛	7¾	6
	Third quarter	12⅞	9	7⅜	4¾
	Fourth quarter	10½	7¾	4⅞	4

Land and timber contributed $3.4 million compared to $7.6 million in 1974 and $9.2 million in 1973. Businesses acquired in the diversification program which began in 1973 contributed operating income of $3.2 million in 1975, $3.6 million in 1974 and $400,000 in 1973.

The major elements of other income are shown for 1975 and 1974 in the Consolidated Statements of Earnings and Retained Earnings. Principal factors causing the $5.4 million decrease in 1975 were fewer sales of transportation property not required for transportation purposes, lower interest earnings because of declining rates and lower temporary cash balances, and a shift in equity in undistributed earnings of affiliates from $1 million in 1974 to a loss of $300,000 in 1975. Comparing 1974 other income against 1973, all of these three factors operated in the opposite direction. Nonoperating rents were a steady $2.2 million in all three years.

Miscellaneous other income includes the interest of the Milwaukee Road's minority stockholders in its consolidated results. This item had the effect of increasing other income by approximately $900,000 in 1975 and decreasing it $400,000 and $500,000 in 1974 and 1973 respectively.

Other income was reduced $1.4 million in 1975 by the Milwaukee Road's $1.2 million writeoff of accounts receivable from the bankrupt Chicago, Rock Island & Pacific Railroad, and a $200,000 charge by Vulcan-Hart related to a decision to discontinue its foundry operations. In 1974, other income was reduced $800,000 by a Milwaukee Road writeoff related to the bankruptcy of REA Express.

Interest expense and taxes

Although contingent interest will not be payable in 1976 because of the absence of railroad earnings in 1975, approximately $2.8 million accrued and was booked pursuant to the interest accumulation provisions of the Milwaukee Road mortgages, causing contingent and total interest expense to be about the same as it was in 1974, which saw a $3.5 million increase because contingent interest was not accruable in 1973 on the Milwaukee Road's Series B General Mortgage bonds and because of charges on new borrowings to finance business acquisitions.

An analysis of deferred federal income taxes is included in the Notes to Consolidated Financial Statements.

Working capital — liquidity

On a consolidated basis, the company's operations generated less than $1 million of working capital during 1975, compared to $34.4 million in 1974. The Consolidated Statements of Changes in Financial Position show that other fund sources were also less productive in 1975. Railroad salvage

Financial Results by Lines of Business

	(amounts in thousands)				
	1975	1974	1973	1972	1971
REVENUES					
Transportation					
Freight	**$373,950**	$391,681	$355,258	$312,328	$293,894
Passenger	**14,058**	10,623	7,361	6,910	7,675
Land and timber	**4,834**	8,680	10,320	7,960	5,786
Food service (commercial food service equipment and wholesale food)	**52,051**	49,340	4,371	—	—
Other	**5,683**	5,850	3,919	—	—
	$450,576	$466,174	$381,229	$327,198	$307,355
EARNINGS (LOSS) BEFORE FEDERAL INCOME TAXES AND EXTRAORDINARY ITEMS					
Transportation					
Freight	**$ (31,085)**	$ 3,813	$ 5,138	$ (4,978)	$ 3,001
Passenger	**(75)**	(1,616)	(1,979)	(2,009)	(5,303)
Land and timber	**4,690**	9,814	11,212	8,155	5,362
Food service (commercial food service equipment and wholesale food)	**835**	1,423	243	—	—
Minority interest	**883**	(405)	(470)	(35)	(87)
Other, including unallocated corporate expenses	**625**	723	(91)	(289)	41
	$ (24,127)	$ 13,752	$ 14,053	$ 844	$ 3,014

operations, for example, benefited more in 1974 than in 1975 from sales of copper and other scrap salvaged from the railroad's discontinued electrification system.

Larger borrowings during 1974 were mainly for property additions and business acquisitions and therefore benefited working capital in that year only to the extent that net current assets were involved in the acquisitions.

Working capital declined $14.4 million in 1975, contrasted to an increase of $13.3 million in 1974. Cash position fared better, declining $3.5 million with the help of a $7.7 million reduction in receivables and inventories.

Whereas the Milwaukee Road normally has a sizeable cash flow from operations, its operations consumed $10.7 million of working capital in 1975. To cope with this drain the railroad borrowed $12 million from its subsidiary Milwaukee Land Company during the months of March through July. These loans and advances were repaid at year-end from the proceeds of a $12.3 million cash dividend paid by the Land Company. In 1975 Milwaukee Land Company had pretax earnings of $4.7 million and at year-end its cash and working capital positions were $6.8 million and $6.1 million respectively.

In 1974 the Interstate Commerce Commission approved a nationwide general freight rate increase with the proviso that its proceeds be set aside to be applied to deferred maintenance and deferred capital expenditures. In 1975 the Milwaukee Road received approval from the ICC to utilize the proceeds for general operating and corporate purposes, subject to certain conditions as described in note 13 of the Notes to Consolidated Financial Statements.

Other steps taken by the railroad to improve working capital were the negotiation of a stretchout of principal payments on its note payable to a bank; the stretchout of back-pay disbursements; and a materials control program which contributed importantly to a $3.5 million inventory reduction during 1975. Current position was also helped by a transfer of $3.2 million from special funds to unrestricted cash pursuant to an ICC order permitting certain "incentive" freight-car-hire earnings to be applied toward long-term rental payments covering box cars added to the company's fleet.

The railroad studied but did not pursue the possibility of a loan from the United States Railway Association for working capital and other purposes under provisions of the Regional Rail Reorganization Act of 1973.

Current projections based upon funds generated internally by the railroad and assuming no contingent interest payments indicate a modest improvement in the railroad's cash position during 1976.

Financing in 1975

The Milwaukee Road was able to obtain outside lease-financing for new rolling stock having an aggregate invoice cost of approximately $29.7 million, of which approximately $6.1 million was financed by builders and the remaining $23.6 million by privately placed long-term leveraged leases. Effective interest costs included in such leases rose to a weighted average of 9.0 per cent in 1975 from 7.5 per cent in 1974.

Analysis of prior years

Both operating revenues and operating expenses and costs were significantly higher in 1974 compared with 1973. An increase in other income was offset by a similar increase in interest expense.

The 1974 revenue increase of $84.9 million was concentrated in freight transportation ($36.4 million) and food service ($45 million). The increase in food service reflects revenues added by business acquisitions in late 1973 and early 1974.

The 10 per cent increase in freight transportation revenues in 1974 was attributable to higher rates. Freight volume dropped 4 per cent, mainly in the latter part of the year. The rate increase effect on revenues is estimated at $48 million, which includes approximately $16.2 million from upward adjustments granted by the ICC in respect of specific cost increases in diesel fuel and payroll taxes.

A $3.3 million increase in passenger revenues was partially offset by a $1.6 million decline in land and timber revenues. This decline reflected in part the continuing depression in housing construction. Passenger revenues were helped by growing commuter patronage and by state and local government operating grants, which totaled $1.7 million in 1974 and $400,000 in 1973.

Of the $85.1 million increase in operating expenses and costs in 1974 over 1973, approximately $42 million is the result of business acquisitions. Transportation operating expenses and costs increased $41.6 million or 12 per cent, including these estimated inflationary effects: fuel, $13.7 million; other material and supplies, $5.5 million; wages, $8.2 million; and payroll taxes, $7.8 million. Rail rolling stock rents, including payments under long-term leases, increased $5.6 million. As noted, certain of these items were offset in part by special revenue rate adjustments. Depreciation and retirement charges were lower by $700,000.

Transportation maintenance expenses increased $5.8 million in 1974. In addition to the material and wage inflationary effects previously mentioned, the increase reflects a greater quantity of labor expended on track upgrading projects.

The improvement in operating results during 1973, as compared with 1972, was attributable principally to the achievement in 1973 of a relatively satisfactory level of transportation volume and to a modest move by the ICC to correct the shortfall in freight-revenue rate increases versus cost escalations. According to railroad industry indices, average wage and material prices rose more than 50 per cent during the period 1970 through 1973. Land and timber operations in 1973 also made an important contribution to the upturn. The impact of other lines of business on over-all results was minimal.

Freight transportation volume increased 12 per cent in 1973 over 1972; revenues were up 14 per cent. Rate increases, occurring late in the year, provided an estimated $9.2 million in added revenues. Roughly half of the $42.6 million increase in operating expenses and costs came from higher wage and payroll tax rates. Material prices were not as significant a factor except in the case of diesel fuel following the energy crisis triggered by the foreign oil embargo. Total fuel costs rose $3.4 million. Rail rolling stock rentals increased $8 million, or 32 per cent.

The 1972 extraordinary item was a special rail property retirement charge amounting to $1,920,000 before deducting the applicable deferred income tax benefit of $924,000 and minority interest.

The 1971 extraordinary item represents one-time costs and losses incurred as a result of the takeover by Amtrak of intercity rail passenger service on May 1, 1971. The costs and losses consisted principally of an "entry fee" of $5.9 million, severance and protective payments to employees, charges for the termination of joint terminal arrangements and losses on passenger rolling stock.

Remaining intercity passenger runs over the Milwaukee Road are performed by the railroad for Amtrak under contract. The contract reimburses the railroad only for avoidable costs. It provides no compensation for the use of the railroad's right of way and tracks nor for any return on the railroad's investment in such properties. In the accompanying information stated by lines of business, contract reimbursements are netted against operating expenses and costs. Any excess of full cost over avoidable cost of performing intercity passenger service is reflected at the earnings level in "freight transportation."

Railroad Freight Traffic by Commodity Groups

Commodity Groupings	Per Cent of Freight Revenues 1975	1974	1973	1972	1971
Farm products	14.0%	15.9%	16.1%	13.3%	12.4%
Food and food products	13.6	13.2	13.2	14.0	15.2
Lumber products	13.3	12.8	15.2	15.7	16.1
Transport equipment	11.4	10.2	10.1	9.8	9.1
Pulp paper products	8.6	9.2	8.9	9.5	9.6
Chemicals	6.0	6.0	5.3	5.4	5.8
Coal	5.8	3.1	2.9	3.1	3.6
Primary metal products	4.7	5.4	5.3	5.3	5.4
Waste and scrap metal	2.9	3.2	2.5	2.3	2.0
Stone, clay and glass products	2.9	3.0	2.8	2.9	3.2
All other	16.8	18.0	17.7	18.7	17.6
	100.0%	100.0%	100.0%	100.0%	100.0%

Five-Year Consolidated Summary of Operations

(amounts in thousands)

	1975	1974	1973	1972	1971
Operating revenues	**$450,576**	$466,174	$381,229	$327,198	$307,355
Operating expenses and costs	**470,468**	453,306	368,232	325,602	298,921
Operating income (loss)	**(19,892)**	12,868	12,997	1,596	8,434
Other income	**6,315**	11,690	8,402	5,624	4,110
Total income (loss)	**(13,577)**	24,558	21,399	7,220	12,544
Interest expense	**10,550**	10,806	7,346	6,376	9,530
Earnings (loss) before income taxes and extraordinary items	**(24,127)**	13,752	14,053	844	3,014
Deferred federal income taxes (benefit)	**(4,532)**	2,478	2,654	285	918
Earnings (loss) before extraordinary items	**(19,595)**	11,274	11,399	559	2,096
Extraordinary items — after deducting deferred federal income tax benefit ($924,000 in 1972, $7,944,000 in 1971) and minority interest ($40,000 in 1972, $650,000 in 1971)	**—**	—	—	(956)	(15,602)
Net earnings (loss)	**$ (19,595)**	$ 11,274	$ 11,399	$ (397)	$ (13,506)
Per share earnings (loss) applicable to common stock					
Before extraordinary items	**$ (8.97)**	$ 3.62	$ 3.67	$ (.75)	$ (.12)
Extraordinary items	**—**	—	—	(.39)	(6.36)
Net earnings (loss)	**$ (8.97)**	$ 3.62	$ 3.67	$ (1.14)	$ (6.48)

Consolidated Statements of Earnings and Retained Earnings

Years Ended December 31, 1975 and 1974

	1975	1974
	(amounts in thousands except per-share data)	
OPERATING REVENUES		
Transportation	**$388,008**	$402,304
Non-transportation	**62,568**	63,870
	450,576	466,174
OPERATING EXPENSES AND COSTS		
Transportation		
Maintenance of way and structures	**59,136**	61,012
Maintenance of equipment	**56,328**	55,299
Transportation	**174,823**	171,148
Traffic and general	**35,618**	34,026
Taxes other than federal income taxes	**37,950**	39,101
Equipment and joint facility rents, net	**50,606**	40,201
	414,461	400,787
Non-transportation		
Cost of sales	**45,090**	42,378
Operating expenses	**10,917**	10,141
	470,468	453,306
Operating income (loss)	**(19,892)**	12,868
OTHER INCOME		
Gain on sales of transportation property	**2,210**	4,647
Interest	**1,564**	4,062
Rents	**2,280**	2,228
Miscellaneous	**261**	753
	6,315	11,690
Total income (loss)	**(13,577)**	24,558
FIXED INTEREST	**7,776**	8,029
CONTINGENT INTEREST (note 12)	**2,774**	2,777
	10,550	10,806
Earnings (loss) before income taxes	**(24,127)**	13,752
DEFERRED FEDERAL INCOME TAXES (BENEFIT) (note 6)	**(4,532)**	2,478
Net earnings (loss)	**$(19,595)**	$ 11,274
RETAINED EARNINGS, beginning of year	**$ 54,166**	$ 42,892
RETAINED EARNINGS, end of year	**$ 34,571**	$ 54,166
PER SHARE EARNINGS (LOSS)		
Applicable to Common Stock	**$ (8.97)**	$ 3.62

See accompanying supplementary information and Notes to Consolidated Financial Statements

Consolidated Balance Sheets

December 31, 1975 and 1974

	1975	1974
	(amounts in thousands)	
ASSETS		
Current Assets		
Cash and temporary cash investments	**$ 17,785**	$ 21,278
Accounts receivable	**43,087**	45,549
Inventories (note 3)	**38,888**	44,116
Other current assets	**5,512**	5,408
Total current assets	**105,272**	116,351
Special Funds (notes 4 and 13)	**5,782**	16,031
Investments		
Affiliated companies	**24,263**	24,441
Other companies	**466**	858
Total investments	**24,729**	25,299
Properties (notes 1, 5 and 10)		
Transportation properties		
Road	**638,672**	633,940
Equipment	**293,778**	297,132
	932,450	931,072
Less allowances for depreciation and amortization	**303,238**	297,200
	629,212	633,872
Other property, less accumulated depreciation	**30,276**	29,563
Total properties	**659,488**	663,435
Other Assets and Deferred Charges	**12,007**	12,264
Total assets	**$807,278**	$833,380

See accompanying supplementary information and Notes to Consolidated Financial Statements

	1975	1974
	(amounts in thousands)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	**$ 2,240**	$ 2,890
Accounts payable	**48,834**	48,784
Payroll and vacation pay	**21,929**	18,302
Accrued taxes	**10,342**	10,269
Other current liabilities	**2,604**	2,579
Current maturities of long-term debt	**10,802**	10,609
Total current liabilities	**96,751**	93,433
Long-Term Debt (note 5)	**229,490**	236,208
Deferred Federal Income Taxes (note 6)	**32,820**	37,352
Reserves and Other Liabilities	**25,813**	23,504
Total liabilities	**384,874**	390,497
Minority Interest	**18,815**	19,699
Shareholders' Equity (notes 5, 7, 8 and 9)		
Capital stock		
$5 Prior Preferred Stock — without par value (stated value $100 per share), nonparticipating, noncumulative. Authorized 518,652 shares, issued and outstanding 477,946	**47,795**	47,795
Common Stock — $1.00 par value per share. Authorized 15,000,000 shares, issued and outstanding 2,451,708	**2,452**	2,452
	50,247	50,247
Capital in excess of par value	**318,771**	318,771
Retained earnings	**34,571**	54,166
Total shareholders' equity	**403,589**	423,184
Contingencies (notes 12 and 13)		
Total liabilities and shareholders' equity	**$807,278**	$833,380

See accompanying supplementary information and Notes to Consolidated Financial Statements

Consolidated Statements of Changes in Financial Position

Years Ended December 31, 1975 and 1974

	1975	1974
	(amounts in thousands)	
SOURCE OF FUNDS		
From operations:		
Net earnings (loss)	$ (19,595)	$ 11,274
Add items not requiring outlay of working capital in the current period:		
Depreciation and retirement charges	18,880	17,622
Deferred federal income taxes	(4,532)	2,478
Accrual for contingent bond interest	2,776	—
Other	3,229	3,053
Working capital provided from operations	758	34,427
Salvage	6,147	12,418
Borrowing, including $13,800,000 in 1974 for business acquisitions	4,353	28,530
Release of funds on deposit with mortgage trustee	9,460	8,279
Release of funds segregated in compliance with Interstate Commerce Commission orders	9,103	360
Miscellaneous sources, net	120	924
	$ 29,941	$ 84,938
APPLICATION OF FUNDS		
Property additions and betterments	$ 22,103	$ 34,954
Debt retirement	11,958	12,395
Investment in rail terminal and other companies	(194)	1,233
Deposit of property sale proceeds with mortgage trustee	3,959	8,218
Segregation of funds in compliance with Interstate Commerce Commission orders	4,451	3,210
Reclassification of estimated liabilities for claims and accumulated contingent interest ($1,556,370 in 1974) to current liabilities	1,629	2,554
Business acquisitions (note 2):		
Noncurrent assets acquired, at fair value, including property, plant and equipment of $8,095,000	—	8,415
Excess of purchase price over net assets acquired (1973 acquisitions)	432	632
Increase (decrease) in working capital	(14,397)	13,327
	$ 29,941	$ 84,938
ANALYSIS OF CHANGES IN WORKING CAPITAL		
Increase (decrease) in current assets:		
Cash and temporary cash investments	$ (3,493)	$ (12,347)
Accounts receivable	(2,462)	11,964
Inventories	(5,228)	23,048
Other current assets	104	1,460
	(11,079)	24,125
Increase (decrease) in current liabilities:		
Notes payable to banks	(650)	(1,200)
Accounts payable	50	8,568
Payroll and vacation pay	3,627	1,456
Accrued taxes	73	1,454
Other current liabilities	25	165
Current maturities of long-term debt	193	355
	3,318	10,798
Increase (decrease) in working capital	$ (14,397)	$ 13,327

See accompanying supplementary information and Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

1. Significant Accounting Policies

Consolidation — The consolidated financial statements include the accounts of Chicago Milwaukee Corporation and all of its majority owned subsidiaries. All significant intercompany items have been eliminated in consolidation.

Investment in the Corporation's railroad subsidiary, Chicago, Milwaukee, St. Paul and Pacific Railroad Company ("Railroad"), is carried at equity in underlying net assets. At December 31, 1975 the carrying amount of investments in other subsidiaries exceeded underlying net assets by $176,000 included in the consolidated balance sheet as other assets and deferred charges ($2,717,000), properties ($581,000) and long-term debt reduction ($180,000), less undistributed earnings since acquisition of $3,302,000 included in retained earnings.

Revenue Recognition — Freight transportation revenues are recognized upon completion of service except as to interline shipments originating on-line, for which revenues are recorded when service begins. Passenger (commuter) fares are accounted for on a cash basis, and other transportation revenues are recognized generally at the time service is performed. Revenues from long-term construction contracts are recognized under the percentage-of-completion method. Revenues from timber harvested by licensees under long-term contracts are recognized in the period in which cutting and harvesting is performed.

Investments — Investments in affiliates (companies in which 20% but not more than 50% of the voting stock is held) are accounted for by the equity method. Investments in non-affiliates are reflected principally at cost, less allowances to reflect the estimated amount of any permanent impairment in value.

Transportation Properties — The investment in railroad properties is stated at original cost or estimated original cost, as determined by the Interstate Commerce Commission in 1917 and 1918, with subsequent additions and betterments at cost.

The Corporation follows the policy of providing for depreciation of equipment and certain road properties by charging against earnings amounts sufficient to amortize the cost of such properties on a straight-line basis over their anticipated useful lives.

In conformity with Interstate Commerce Commission accounting rules, ratable depreciation provisions are not made in the case of certain roadway properties, principally grading and track, amounting to approximately $365 million. Instead, these properties are accounted for by an alternative generally accepted accounting principle whereby replacement costs are recorded as operating expenses and only additions and betterments are capitalized. Gains or losses on sales and retirements of these nondepreciable properties are reflected in current operations. Normal gains or losses on sales and retirement of depreciable railroad properties are reflected as adjustments of accumulated depreciation. All dismantling and removal costs are treated as current operating expenses as incurred.

Net gains or losses resulting from sale-and-lease-back transactions are amortized over the term of the respective leases as an adjustment of the rental cost.

Inventories — Inventories are stated at the lower of cost or market. Cost is determined generally by the first-in, first-out method.

Earnings (Loss) Per Share — Earnings (loss) per share of common stock are based upon the average number of outstanding shares of common stock and common stock equivalents, and are computed after giving recognition to preferred dividend requirements.

Federal Income Taxes — The Corporation follows the practice of providing for income taxes based upon income reported for financial statement purposes rather than amounts payable under current tax laws. Net tax benefits resulting from timing differences are deferred to future periods when the differences may reverse.

Stock Options — Proceeds from the sale of stock under the Corporation's long-range incentive program are credited to Common Stock at par value and the excess of the option price over par value is credited to capital in excess of par value. No charges are made against operations in respect of stock options.

Business Acquisitions — The Corporation amortizes the excess of purchase price over fair value of the acquired net assets on a straight-line basis over the estimated benefit period not to exceed 40 years.

2. Business Acquisitions

On February 28, 1974, the Corporation acquired the net assets of Vulcan-Hart Corporation and Hanson Porcelain Company, Inc. The two companies manufacture and sell equipment for the institutional food service market and porcelain enameling. The acquisitions were accounted for by the purchase method of accounting and accordingly results of operations of the two companies are included in the consolidated financial statements from the acquisition date. The total cash purchase price of $18,070,000 was financed in part by bank borrowings. The excess of fair value of the acquired net assets over the purchase price was distributed to non-current assets.

3. Inventories

Year-end inventories consist of (a) material and supplies to be consumed or used in transportation operations, maintenance or construction: 1975 — $26,603,000, 1974 — $30,135,000; and (b) merchandise held for sale and manufactured products including raw materials and parts therefor: 1975 — $12,285,000, 1974 — $13,981,000.

4. Special Funds

Special funds consist principally of cash and temporary cash investments restricted under debt instrument provisions or by Interstate Commerce Commission order requiring the funds to be invested in transportation property additions and betterments. (See also note 13.)

5. Long-Term Debt

Long-term debt, exclusive of installments due within one year, is summarized as follows:

	Interest		Principal Amount	
	Fixed	Contingent	Dec. 31, 1975	Dec. 31, 1974
Chicago, Milwaukee, St. Paul and Pacific Railroad Company first mortgage bonds, Series A, 1994 (d)	4%	—	$ 48,735,300	$ 48,735,300
Chicago, Milwaukee, St. Paul and Pacific Railroad Company general mortgage income bonds, Series A, 2019	—	4½% (a)	24,684,700	24,684,700
Chicago, Milwaukee, St. Paul and Pacific Railroad Company general mortgage convertible income bonds, Series B, 2044 (e)	—	4½% (a)	31,127,400	31,127,400
The Bedford Belt Railway Company first mortgage bonds, 1994 (f)	2¾%	1½% (b)	178,000	178,000
The Southern Indiana Railway Company first mortgage bonds, 1994	2¾%	1½% (b)	5,514,000	5,639,000
Chicago, Terre Haute and Southeastern Railway Company first and refunding mortgage bonds, 1994 (g)	2¾%	1½% (b)	7,170,000	7,170,000
Chicago, Terre Haute and Southeastern Railway Company income mortgage bonds, 1994	2¾%	1½% (b)	4,738,800	4,738,800
Chicago, Milwaukee, St. Paul and Pacific Railroad Company income debentures, Series A, 2055	—	5% (c)	55,604,000	55,634,000
Equipment obligations	4 to 12¼%	—	30,694,078	34,587,919
Other (h)	6% to prime plus 1%	—	21,043,762	23,712,684
Total			$229,490,040	$236,207,803

(a) Cumulative to a maximum of 13½%.

(b) Cumulative to a maximum of 4½%.

(c) Noncumulative.

(d) Chicago, Milwaukee, St. Paul and Pacific Railroad Company first mortgage Series B bonds in the principal amount of $3,150,000 have been authenticated and pledged, along with a mortgage note receivable in the principal amount of $512,507 as collateral to note payable to bank.

(e) Convertible into Railroad common stock on the basis of one share of common stock for each $100 principal amount of bonds.

(f) Bonds held by Railroad include $100,000 principal amount pledged under Chicago, Terre Haute and Southeastern Railway Company first and refunding mortgage.

(g) Bonds held by Railroad include $1,515,000 principal amount pledged under Chicago, Milwaukee, St. Paul and Pacific Railroad Company first mortgage.

(h) The Corporation is guarantor of certain loans of its subsidiaries, both as to the outstanding principal amount ($15,967,000) of the indebtedness and as to certain aspects of the financial condition of such subsidiaries. Under a December 1975 amendment to one such loan the Corporation has agreed with the lender (a) that to the extent it pays cash dividends on its capital stock it will make equal capital contributions to the subsidiary up to a maximum of $2,000,000, and (b) that until such maximum amount of capital contributions is reached, it will in general make no investments other than business acquisitions involving only the issuance of capital stock or the issuance of debt secured only by the investment acquired. This indebtedness is collateralized by substantially all of the subsidiary's assets, other than cash, totaling approximately $18,400,000.

Substantially all of the properties and the investments in common stock of certain non-transportation subsidiaries are pledged under the mortgages and/or debt obligations. Investments in affiliated companies include $6,970,585 pledged as collateral to mortgage bonds.

Maturities of long-term debt, exclusive of contingent sinking fund requirements, during each of the years 1976-1980 inclusive are approximately $10,802,000, $8,737,000, $8,066,000, $5,586,000 and $5,312,000.

6. Federal Income Taxes

Federal income tax liabilities have been settled through the year 1967. Based in part upon unaudited returns and estimated 1975 tax data, the Corporation had available at December 31, 1975, consolidated tax operating loss carryforwards of approximately $32,800,000, of which $4,500,000 will expire in 1976 and $28,300,000 in 1982.

The available investment credit carryforward for tax purposes as of December 31, 1975, amounted to approximately $14,165,000, which will expire as follows: 1976 — $2,900,000, 1977 — $2,861,000, 1978 — $1,928,000, 1979 — $2,262,000, 1980 — $1,560,000, 1981 — $1,836,000, 1982 — $818,000. For financial reporting purposes approximately $14,165,000 of investment credit carryforwards were available to reduce future income tax provisions.

The deferred Federal income tax expense (benefit) reported in the accompanying consolidated statements of earnings represents the recognition given to the tax effect of timing differences, as between tax reporting and financial statement reporting, attributable principally to depreciation expense. The following table reconciles the United States Federal income tax rate of 48% to the effective rates:

	1975 Tax Benefit % of Pretax Loss	1974 Tax Expense % of Pretax Income
Federal corporate income tax rate	48.0	48.0
Increases (decreases) resulting from:		
Investment tax credit	—	(18.0)
Capital gains at 30% rate	—	(10.7)
Income taxable as dividend income	(0.3)	(3.5)
Excess of accounting basis over tax basis of inventories purchased in business acquisitions	—	2.5
Benefit of book loss carryback at less than 48%	(30.5)	—
Miscellaneous items	1.6	(0.3)
Effective rate	18.8	18.0

Although the Corporation utilizes a 30% Federal income tax rate for tax provision purposes with respect to capital gains, the 30% rate will not be used in the Corporation's tax return due to the utilization of the tax operating loss carryforward.

Other income taxes consisting of various state income taxes are minor in both 1975 and 1974 and are included in operating expenses and costs.

7. Leased Assets and Lease Commitments

Total rental expense included in operating expenses and costs amounted to $26,476,000 in 1975 and $21,585,000 in 1974. Of these amounts $22,663,000 in 1975 and $18,381,000 in 1974 represent rentals on non-capitalized financing leases. For purposes of this note, a distinction has been made between "financing" lease arrangements and other lease arrangements. A "financing" lease is one which, during the noncancelable lease period, either (a) covers 75 per cent or more of the economic life of the property or (b) has terms which assure the lessor a full recovery of the fair market value of the property at the inception of the lease, plus a reasonable return on his investment.

The foregoing rental expense figures are exclusive of net car-hire expenses incurred by Railroad on a per diem and/or mileage basis for the use of railroad rolling stock in interchange service with other railroads. Such expenses amounted to $27,448,000 in 1975 and $20,314,000 in 1974. Also excluded are railroad joint-facility "rents" of $4,885,000 in 1975 and $4,255,000 in 1974 representing essentially operating expenses shared with other joint owners or joint users.

The following table summarizes minimum rental commitments under all noncancelable leases as of December 31, 1975 (amounts in thousands):

				Totals	
Year or Period	Railroad Rolling Stock	Other Equipment	Real Property	Financing Leases	Other Leases
1976	$ 24,341	$1,313	$ 429	$ 23,494	$2,589
1977	23,549	1,189	387	22,690	2,435
1978	22,389	411	369	21,946	1,223
1979	21,703	159	349	21,737	474
1980	21,252	125	323	21,377	323
1981-1985	92,189	443	1,331	92,632	1,331
1986-1990	39,145	40	304	39,185	304
Totals	$244,568	$3,680	$3,492	$243,061	$8,679

With relatively minor exceptions the leases represented in the foregoing table do not contain renewal or purchase options other than options at termination of many of the rolling stock leases to renew or purchase the equipment on the basis of its then fair market value. The leases typically require the lessee to pay taxes, maintenance and other operating expenses applicable to the leased property. Leases represented in the foregoing table by rental commitments of $62,265,000 require the lessor to pay for maintenance, and some of these in turn include provisions for price-level escalation of lease payments attributable to maintenance.

The present value of minimum rental commitments under non-capitalized financing leases at December 31, 1975 and 1974 is summarized by the following table, which also indicates the level of interest rates implicit in the leases and used for purposes of discounting net lease payments to present value:

	Present Value		Interest Rates Used in Present Value Computations: Weighted Average		Range	
	1975	1974	1975	1974	1975	1974
	(amounts in thousands)					
Railroad rolling stock	$158,727	$142,138	7.72%	7.15%	4.54% to 11.46%	4.54% to 10.41%
Other equipment ...	1,375	1,681	7.64%	7.73%	4.05% to 12.34%	4.05% to 12.34%
	$160,102	$143,819				

Assuming all the above financing leases were capitalized, the related property rights were amortized on a straight-line basis over the lease term, and the interest costs were accrued on the basis of the outstanding present value lease commitment, the net loss for 1975 would have been increased and net earnings for 1974 would have been reduced by $3,786,000 and $1,837,000, respectively. Amortization included in the foregoing computation of earnings impact is $14,019,000 and $11,885,000 in 1975 and 1974, respectively, and interest cost included in the computation is $12,169,000 and $8,701,000 in 1975 and 1974, respectively.

8. Stock Options and Incentives

On May 9, 1972, the stockholders approved a Long-Range Incentive Program, which became effective August 1, 1972, and consists of an Incentive Stock Compensation Plan and a Stock Option Plan. Under the Incentive Stock Compensation Plan selected employees may be awarded incentive stock compensation units which qualify them to receive cash and/or shares of the Corporation's Common Stock upon termination of employment. The amounts which accrue to grantees under the incentive plan are based upon dividends paid by the Corporation on its Common Stock and the increase in market value of the Common Stock subsequent to the time the units were awarded.

Under the Stock Option Plan key officers of the Corporation and its subsidiaries may be awarded qualified and non-qualified options to purchase an aggregate of 150,000 shares of the Corporation's Common Stock at prices not less than 100% of fair market value at the date of grant. Options were granted in 1972 for the purchase of 27,500 shares at $9.75 a share; in 1973 for the purchase of 22,500 shares at $9.00 a share, 500 shares at $6.50 a share and 500 shares at $10.00 a share; in 1974, for the purchase of 500 shares at $8.63 a share; and, in 1975 for the purchase of 500 shares at $8.37 a share. At December 31, 1975, options totaling 35,333 shares were outstanding and exercisable, 16,667 shares were outstanding but not exercisable and 98,000 shares were available for option.

In connection with certain business acquisitions the Corporation issued warrants entitling the purchasers of the warrants to purchase 60,000 shares of the Corporation's Common Stock at $8.00 a share and 50,000 shares at $10.00 a share. Consideration of $220,000 for the warrants was accounted for as an addition to capital in excess of par value. At December 31, 1975, these warrants were outstanding and exercisable as to the 50,000 shares, and outstanding but not exercisable as to the 60,000 shares.

9. Dividends

No dividends have been declared on the capital stock of the Corporation since its inception in 1971. Under its debt indentures Railroad may pay dividends on its capital stock from Available Net Income, as defined, only to the extent there is Available Net Income remaining after specified requirements. The major requirements having priority under the indentures as of December 31, 1975 and 1974, are current contingent interest of approximately $5,577,000, accumulated contingent interest of approximately $5,442,000 in 1975 and $2,646,000 in 1974 and Available Net Income deficit carryforwards of approximately $40,305,000 in 1975 and $28,884,000 in 1974. The propriety of carrying forward Available Net Income deficits is in litigation, as explained in note 12. See also note 5.

10. Reclassifications

In the 1975 Consolidated Balance Sheet accumulated depreciation of improvements on leased property in the amount of $1,594,000 is reported under "Properties." This allowance account was previously reported under the caption "Reserves and Other Liabilities." The consolidated balance sheet for 1974 has been reclassified to make it comparable in this respect to 1975.

11. Pensions and Profit Sharing

The Corporation's subsidiaries maintain several pension plans providing for benefits upon retirement to qualified employees.

Executive and supervisory employees of Railroad and its subsidiaries were covered by unfunded non-contributory plans prior to January 1, 1976. Pension expense under these plans amounted to $1,505,000 in 1975 and $1,469,000 in 1974. The actuarially computed value of vested benefits was approximately $18,032,626 as of June 1, 1975. Changes to conform with the Employee Retirement Income Security Act (ERISA) of 1974 and modifications in the benefit provisions of the plans were implemented by Railroad and its subsidiaries on January 1, 1976. Contributions being charged to income in 1976 under the new trusteed non-contributory plans are approximately 40% greater than 1975 pension expenses primarily because of changes required to conform to ERISA, the impact of amendments to the Railroad Retirement Act, and modifications to the benefit provisions. The accounting practice followed is to accrue the cost of current benefit payments to beneficiaries under the plans but not less than the actuarially computed normal cost plus 40-year amortization of prior service cost.

The non-rail subsidiaries maintain funded pension and profit-sharing plans covering substantially all full-time employees. Total costs of such plans charged against earnings for the years ended December 31, 1975 and 1974, were $283,332 and $230,060, respectively. The accounting policy is to fund pension costs accrued. Changes to comply with ERISA are not expected to be significant.

12. Contingent Interest and Litigation

Contingent interest charges relate to Railroad obligations on which the accrual of interest is dependent upon the level of Railroad earnings ("Available Net Income") as defined by the applicable debt instruments.

Based upon the principal amount of contingent interest obligations outstanding at the end of 1975, the annual amounts of such contingent interest items are: Series A General Mortgage bonds, $1,132,000; Terre Haute bonds, $264,000; Series B General Mortgage bonds, $1,401,000; 5% Income Debentures, $2,780,000. If Available Net Income is not sufficient, contingent interest on the General Mortgage and Terre Haute bonds is nevertheless accruable up to a maximum of three years' interest, and such accumulations become payable when subsequent Railroad Available Net Income permits. There is no interest accumulation feature in the case of the 5% Income Debentures.

Contingent interest expense for both 1975 and 1974 consists of interest on Railroad's Series A and Series B General Mortgage bonds and the contingent portion of the interest on the Terre Haute bonds. In 1974 there was Available Net Income sufficient to cover such interest but not for interest on the 5% Income Debentures.

As to 1975, Railroad's Board of Directors determined on February 16, 1976, that Available Net Income was a negative amount and accordingly that there will be no payment of contingent interest and no deposits to sinking funds in 1976 with respect to 1975. However, contingent interest was accrued in 1975 on the General Mortgage and Terre Haute bonds pursuant to the accumulation provisions of those mortgages. As of December 31, 1975, there was a one-year contingent interest accumulation on the Series A General Mortgage and Terre Haute bonds and a 13% accumulation on the Series B General Mortgage bonds.

In September, 1974, the Interstate Commerce Commission ordered railroads to follow, "for financial statement purposes only," the so-called equity method of accounting for investments in any company of which 20% or more of the outstanding voting stock is owned. The order became effective January 1, 1974. In general, under the equity method an investor company includes in its earnings its share of any undistributed earnings or losses of investee companies.

After the issuance of the Commission's order, the Trustees of the General Mortgage and of the Debenture Indenture of Railroad took the position that Railroad should include in the computation of Available Net Income commencing January 1, 1974, its proportionate share of the undistributed earnings of those companies coming within the scope of the Commission's order and should include in the computation of Available Net Income for 1974 its proportionate share of the accumulated undistributed earnings of such companies for prior years.

In December, 1974, outside counsel for Railroad advised that in its opinion, under the terms of the applicable Indentures, the Available Net Income determinations should continue to be made, as in prior years, on the basis of the separate income of Railroad exclusive of Railroad's equity in undistributed earnings or losses of subsidiaries and other affiliated companies. Railroad has computed Available Net Income in this manner for 1975 and 1974.

The Trustee of the Debenture Indenture has also raised the question of the propriety of carrying forward negative Available Net Income under the terms of the 5% Income Debenture Indenture. As of December 31, 1975, in the opinion of management, there was an accumulated deficit in Available Net Income of $40,304,535 which must be offset by subsequent earnings before interest is payable on the Debentures. The Trustee under this Indenture has taken the position that the carryforward of such a deficit from one year to the next is not authorized except in a limited set of circumstances. Outside counsel has advised Railroad, however, that such carryforward is authorized by the terms of the Indenture.

As reported in the 1974 Annual Report to Stockholders, Railroad, in order to clarify these matters, has brought an action in the Circuit Court of Cook County, Illinois, naming the Trustees under the applicable indentures as defendants, seeking a judicial determination of these issues. The Court has ruled that deficits in Available Net Income under the Debenture Indenture for the years 1969-1974 should not be carried forward to offset earnings in subsequent years except in a limited set of circumstances. An appeal from this ruling has been taken to the Appellate Court of Illinois. The Trustees have recently filed motions for summary judgment on the equity accounting issue, and briefs on the motions are presently scheduled to be filed through July, 1976.

On June 23, 1975, a holder of the 5% Income Debentures filed a class action suit in the United States District Court at Chicago, raising issues included in the action pending in the Circuit Court of Cook County, Illinois, mentioned above.

If it is finally determined that Railroad's share of the 1974 earnings of its subsidiaries and affiliates owned 20% or more must be included in Available Net Income, the $2,646,000 (8½%) interest accumulation on the Series B General Mortgage bonds as of December 31, 1974, would be payable out of 1974 income, and a $543,000 deposit into the sinking fund for the retirement of General Mortgage bonds would be required. In the event of such an outcome, neither of these payments would affect reported earnings of Railroad or of the Corporation.

If it is finally determined, in addition to the determination described in the preceding paragraph, that either (a) 1974 Available Net Income must include the accumulated equity in undistributed earnings and losses of affiliates from their acquisition dates up to 1974, or (b) Available Net Income deficits should not be carried forward and do not accumulate, 1974 interest of $2,782,000 on the 5% Income Debentures and a $300,000 deposit into the sinking fund for the retirement of 5% Income Debentures would also be payable. In such event, the after-tax charge of $2,285,000 for interest on the Debentures would be reported as a charge against 1974 earnings in the year of the determination.

If it is finally determined that Available Net Income does not include any undistributed earnings and losses of affiliates, but that Available Net Income deficits should not be carried forward and do not accumulate, there would be no effect on interest payments or sinking fund deposits in respect of 1975 or 1974. Such a determination would increase the possibility of Debenture interest and sinking fund payments in respect of 1976 and subsequent years.

Also reported last year was a class action by a holder of Railroad Series B General Mortgage bonds which included as defendants certain officers and directors of Railroad. The suit seeks a redetermination of Available Net Income for the years 1969 through 1974, and the payment of any additional contingent interest which the Court might find to be due on the Series B bonds. A motion by Railroad for referral of the proceedings to the Interstate Commerce Commission for an opinion on the accounting issues was denied by the Court, and an appeal from this ruling has been taken to the United States Court of Appeals for the Seventh Circuit. Plaintiff has filed a motion for summary judgment under one of the counts in the amended complaint, claiming that certain of Railroad's subsidiaries, including Milwaukee Land Company, are "Railroad Subsidiaries" under the Mortgage, and, accordingly, their earnings are required to be consolidated with the earnings of Railroad in computing Available Net Income. Briefs on the motion are due to be filed during the next several months.

A redetermination of Available Net Income could result in additional payments for such years under Railroad mortgages in the amount of approximately $6,851,000 as additional contingent interest and approximately $1,435,000 as additional sinking fund payments. Of the foregoing amount of $6,851,000, $2,646,000 has been accrued in prior years under the three-year accumulation feature described elsewhere in this note and is included as a liability in the accompanying Consolidated Balance Sheet as of December 31, 1975. This same obligation of $2,646,000 is also referred to earlier in this note 12 in connection with other litigation.

Regardless of the outcome of the foregoing litigation, no interest payments or sinking fund deposits under the General Mortgage or Debenture Indenture would be required in respect of the year 1975. A determination adverse to Railroad's positions would, however, increase the possibility of interest and sinking fund payments in 1976 and subsequent years.

13. Contingencies

Railroad is liable, jointly with other railroads, as guarantor of obligations of affiliated companies amounting to $56,445,600 at December 31, 1975. Also, Railroad is contingently liable as guarantor along with other railroads for its proportion (2.44%), and its proportionate share of any contingent obligations not met by other railroad participants of obligations of Trailer Train Company aggregating $12,653,474. Certain lease agreements include guaranty by a subsidiary of the Corporation of approximately $55,100,000 invested indirectly in the leased property by loan participants.

Railroad carries a service interruption insurance policy under which it may be obligated to pay additional premiums up to a maximum of $9,826,020 for certain work stoppages.

Under a 1974 Interstate Commerce Commission order granting a general freight rate increase, railroads have been required to segregate a specified portion of the revenues generated by the increase and to expend such funds only on deferred maintenance or delayed capital improvements. Because of its financial condition during 1975 and to avoid curtailment of transportation service, Railroad sought and obtained from the Commission permission to use for general operating purposes funds which would otherwise be subject to segregation and restriction under the Commission's order. Through December 31, 1975, the funds so released amounted to $7,912,000. The permission was granted subject to certain conditions, including requirements that funds released be considered a borrowing to be "repaid" to the Special Funds account when Railroad's financial condition warrants, that monthly financial reports of Railroad be furnished to the Commission, and that Railroad be prohibited from transferring any assets to its parent company or to any affiliated company without Commission approval until all borrowed funds are repaid. The authority of the Commission to restrict the use of carrier revenues has been challenged in the courts by another railroad; a Federal appeals court ruled in April 1975 that the Commission lacks statutory authority to order a railroad how to spend its revenue. This decision is under appeal to the United States Supreme Court.

Railroad, together with other railroads and companies, has been named a defendant by REA Express, Inc. in suits seeking monetary damages and nullification of certain amounts heretofore treated as indebtedness to the railroads. In one of the two suits, the court has granted the railroads' motion for summary judgment and dismissed the complaint. No ruling has yet been made in the remaining suit. Counsel believes that, under the present state of the law and on the basis of facts now known, Railroad has substantial defenses to all claims made therein.

As reported in the interim report to stockholders for the six months ended June 30, 1975, the Corporation, Railroad and their subsidiaries have, since June 1975, been the subject of a private investigation by the staff of the Securities and Exchange Commission with respect to compliance with the disclosure requirements of the Federal securities laws. The Corporation has been advised by its attorneys that the SEC staff is presently of the view that it will recommend to the Commission that a civil enforcement action be instituted.

14. Supplementary Information

Included in this report under "Financial Review and Analysis" is a discussion of Chicago, Milwaukee, St. Paul and Pacific Railroad Company. Also included at pages 26, 27 and 28 are separate financial statements of the Railroad Company. Both the discussion and the financial statements should be read in conjunction with the Corporation's consolidated financial statements and notes thereto.

The Railroad financial statements have been prepared in accordance with Interstate Commerce Commission rules. In keeping with such rules transportation properties are stated net of other elements of investment, which arose in connection with reorganization of Railroad as of January 1, 1944. The account was credited as of that date with an amount sufficient to reduce properties and other assets to the aggregate of the capitalization and other liabilities established by the Court. Starting in 1962, Railroad has followed the practice of writing off to other income an equitable portion of the account assignable to nondepreciable pre-reorganization properties retired. Miscellaneous other income includes amortization of other elements of investment amounting to $1,022,000 in 1975 and $1,158,000 in 1974. At December 31, 1975, the unamortized balance of other elements of investment amounted to $105,297,000. In the accompanying consolidated financial statements of the Corporation and its subsidiaries the account has been treated as capital in excess of par value and the amortization entries have been eliminated.

Accountants' Report

The Board of Directors
Chicago Milwaukee Corporation:

We have examined the consolidated balance sheets of Chicago Milwaukee Corporation and subsidiaries as of December 31, 1975 and 1974, and the related consolidated statements of earnings and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As explained in note 12, the Circuit Court of Cook County has ruled that interest on certain income debentures should be computed in a manner different from that consistently used in prior years. This ruling has been appealed, but if it is not reversed and equity accounting is applied in the 1974 computation of available net income, the result will be an additional charge to 1974 operations for interest expense which will reduce 1974 net earnings approximately $2,285,000 ($.93 per share); however, there will be no effect on 1975 operations.

In our opinion, subject to the effect, if any, that resolution of the above matter will have on 1974 operations, the aforementioned consolidated financial statements present fairly the financial position of Chicago Milwaukee Corporation and subsidiaries at December 31, 1975 and 1974, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Chicago, Illinois
March 26, 1976

PEAT, MARWICK, MITCHELL & CO.

Statements of Earnings and Retained Earnings

Years Ended December 31, 1975 and 1974

	1975	1974
	(amounts in thousands)	
OPERATING REVENUES:		
Freight	**$367,034**	$384,053
Passenger	**14,058**	10,623
	381,092	394,676
OPERATING EXPENSES AND COSTS (including depreciation and retirement charges of $16,790,096 in 1975 and $16,026,380 in 1974):		
Transportation	**171,459**	167,226
Maintenance of way and structures	**58,976**	60,841
Maintenance of equipment	**54,840**	53,824
Traffic	**10,230**	10,260
Payroll and other taxes	**37,359**	38,482
Equipment and joint facility rents, net	**55,007**	42,855
General and other	**23,047**	21,427
	410,918	394,915
Net operating income (loss)	**(29,826)**	(239)
OTHER INCOME:		
Gain on sales of transportation properties, net	**2,210**	4,647
Interest	**943**	2,342
Rents	**2,136**	2,123
Miscellaneous, net	**619**	528
	5,908	9,640
	(23,918)	9,401
FIXED INTEREST	**5,343**	5,735
	(29,261)	3,666
CONTINGENT INTEREST ON LONG-TERM DEBT	**2,796**	2,798
	(32,057)	868
EQUITY IN EARNINGS OF AFFILIATES	**6,608**	12,301
Earnings (loss) before income taxes	**(25,449)**	13,169
DEFERRED FEDERAL INCOME TAXES (BENEFIT)	**(4,382)**	1,767
Net earnings (loss)	**(21,067)**	11,402
RETAINED EARNINGS, BEGINNING OF YEAR	**66,497**	55,095
RETAINED EARNINGS, END OF YEAR	**$ 45,430**	$ 66,497

Balance Sheets

December 31, 1975 and 1974

	1975	1974
	(amounts in thousands)	
Assets		
Current Assets:		
Cash and temporary cash investments	**$ 7,875**	$ 4,832
Accounts receivable	**35,739**	35,066
Material and supplies, at cost	**26,375**	29,906
Other current assets	**4,982**	4,784
Total current assets	**74,971**	74,588
Special Funds	**5,782**	16,031
Investments:		
Equity in undistributed pretax earnings of affiliates since acquisition	**51,721**	57,413
Other investments	**23,707**	23,941
Total investments	**75,428**	81,354
Properties, less accumulated depreciation:		
Transportation properties	**508,142**	516,049
Other property	**3,473**	3,509
Total properties	**511,615**	519,558
Other Assets and Deferred Charges	**6,773**	7,281
Total assets	**$674,569**	$698,812
Liabilities and Shareholders' Equity		
Current Liabilities:		
Note payable to bank	**$ 2,090**	$ 2,590
Accounts payable	**53,973**	50,884
Payroll and vacation pay	**21,209**	17,517
Accrued taxes	**9,725**	9,497
Other current liabilities	**1,815**	2,036
Current maturities of long-term debt	**6,261**	7,341
Total current liabilities	**95,073**	89,865
Long-Term Debt	**206,348**	213,215
Deferred Federal Income Taxes	**32,342**	36,724
Reserves and Other Liabilities	**25,522**	22,657
Total liabilities	**359,285**	362,461
Shareholders' Equity:		
Capital stock:		
Common Stock	**217,989**	217,989
Preferred Stock	**51,865**	51,865
Retained earnings	**45,430**	66,497
Total shareholders' equity	**315,284**	336,351
Total liabilities and shareholders' equity	**$674,569**	$698,812

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Statements of Changes in Financial Position

Years Ended December 31, 1975 and 1974

	1975	1974
	(amounts in thousands)	
SOURCE OF FUNDS:		
From operations:		
Earnings (loss) before equity in earnings of affiliates and deferred federal income taxes	**$ (32,057)**	$ 868
Add items not requiring an outlay of working capital in the current period:		
Depreciation and retirement charges	**16,866**	16,102
Accrual for contingent bond interest	**2,796**	—
Other, net	**1,711**	1,862
Working capital provided from (used by) operations	**(10,684)**	18,832
Loans and advances from Milwaukee Land Company	**12,000**	—
Dividend from Milwaukee Land Company	**12,300**	—
Drawdown of funds on deposit with mortgage trustee	**9,460**	8,279
Release of funds segregated in compliance with Interstate Commerce Commission orders	**9,103**	360
Salvage	**5,791**	12,221
Miscellaneous, net	**389**	(775)
	$ 38,359	$ 38,917
APPLICATION OF FUNDS:		
Principal payments on equipment debt	**$ 6,712**	$ 7,748
Repayment of loans and advances from Milwaukee Land Company	**12,000**	—
Other debt retirement	**907**	1,067
Property additions and betterments	**13,760**	14,226
Segregation of funds in compliance with Interstate Commerce Commission orders	**4,451**	3,210
Deposit of property sale proceeds with mortgage trustee	**3,959**	8,218
Reclassification of estimated liabilities for claims and accumulated contingent bond interest ($1,556,370 in 1974) to current liabilities	**1,629**	2,554
Investments in terminals and other companies	**(234)**	1,233
Increase (decrease) in working capital	**(4,825)**	661
	$ 38,359	$ 38,917
ANALYSIS OF CHANGES IN WORKING CAPITAL:		
Increase (decrease) in current assets:		
Cash and temporary cash investments	**$ 3,043**	$ (11,688)
Accounts receivable	**673**	6,082
Material and supplies	**(3,531)**	11,672
Other current assets	**198**	124
	383	6,190
Increase (decrease) in current liabilities:		
Note payable to bank	**(500)**	(500)
Accounts payable	**3,089**	4,633
Payroll and vacation pay	**3,692**	1,023
Accrued taxes	**228**	1,107
Other current liabilities	**(221)**	409
Current maturities of long-term debt	**(1,080)**	(1,143)
	5,208	5,529
Increase (decrease) in working capital	**$ (4,825)**	$ 661

Directors

TILDEN CUMMINGS*
Former President,
Continental Illinois National Bank & Trust Company of Chicago *(banking)*,
Chicago, Illinois

JERRY FINKELSTEIN
Chairman of the Board,
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(engineers and manufacturers of heat transfer and pressure vessels),
Publisher, New York Law Journal and Publisher, Civil Service Leader,
New York, New York

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(petroleum products),
Chicago, Illinois

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President,
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Maun, Hazel, Green, Hayes, Simon & Aretz *(lawyers)*,
St. Paul, Minnesota

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Chairman of the Board, President and Chief Executive Officer of the Company, Chairman of the Board and Chief Executive Officer, Chicago, Milwaukee, St. Paul & Pacific Railroad Company *(transportation)*,
Chicago, Illinois

WORTHINGTON L. SMITH
President
Chicago, Milwaukee, St. Paul & Pacific Railroad Company
(transportation), Chicago, Illinois

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Chicago, Illinois

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Allis Chalmers Corporation
(machinery), Milwaukee, Wisconsin

EMORY WILLIAMS
Chairman of the Board and Chief Executive Officer,
Sears Bank & Trust Company
(banking), Chicago, Illinois

ARTHUR M. WIRTZ*
Chairman,
Wirtz Corporation *(real estate and diversified activities)*,
Chicago, Illinois

**Members of the Executive Committee. Mr. Wirtz is Chairman of the Committee*

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Assistant to Chairman of the Board

RAYMOND K. MERRILL
Vice President

P. LAURIN COWLING
Vice President,
Executive Department;
Group Vice President,
Food Service

RICHARD F. KRATOCHWILL
Treasurer

JAMES T. TAUSSIG
Secretary

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