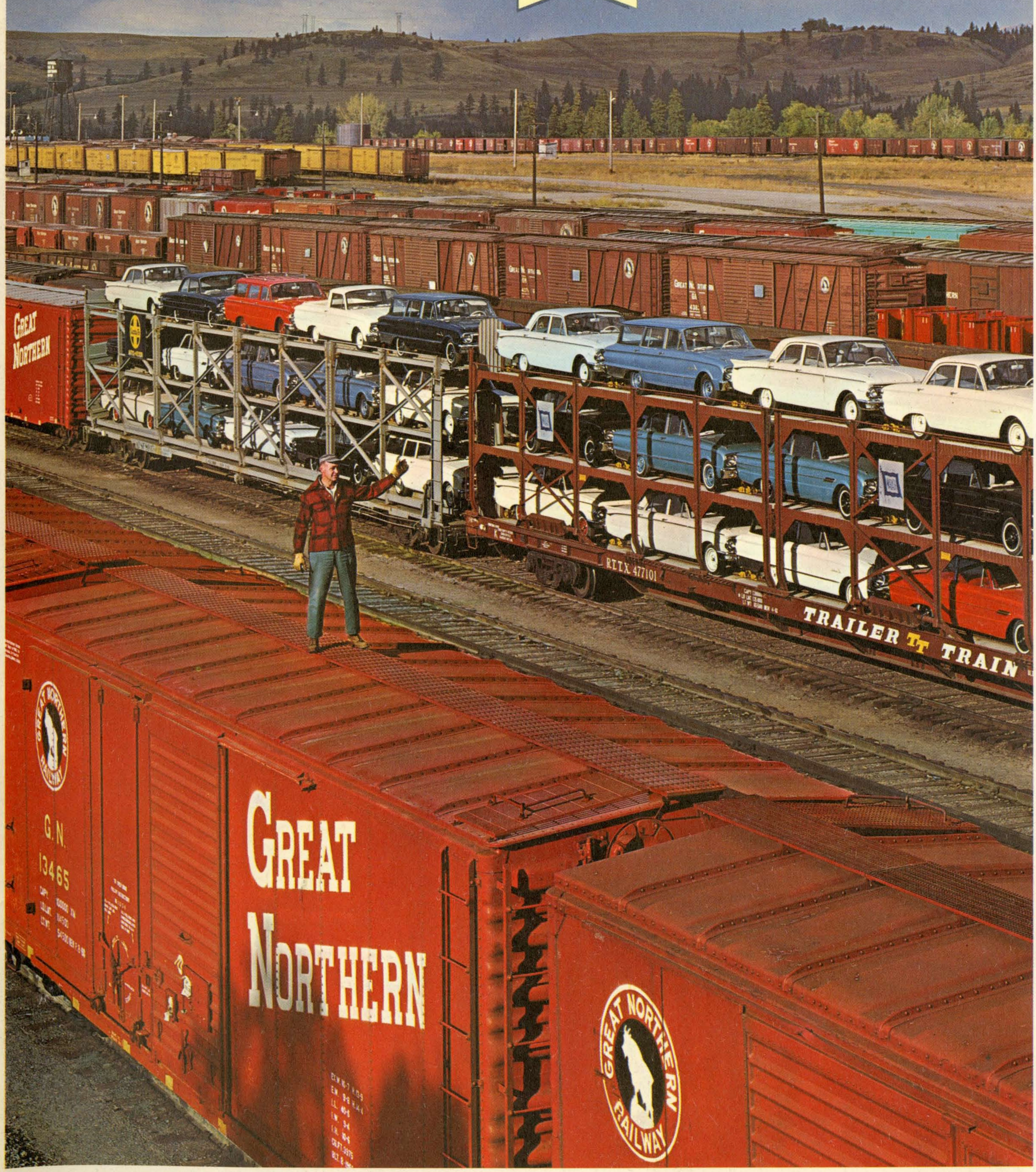
GREAT NORTHERN RAILWAY 73rd ANNUAL REPORT

GREAT NORTHERN RAILWAY

1961



GREAT NORTHERN RAILWAY COMPANY

GENERAL OFFICES: GREAT NORTHERN RAILWAY BUILDING, ST. PAUL, MINNESOTA

SEVENTY-THIRD ANNUAL REPORT FOR THE YEAR ENDING DECEMBER 31, 1961

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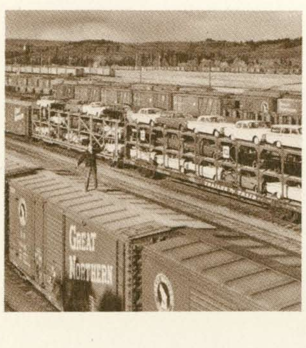


A "bright spot" in Great Northern's 1961 traffic picture, as illustrated in our colorful cover photo, was the rapidly rising volume of new automobiles riding the rails on multi-level rack cars. The scene is at Hillyard Yard, in Spokane, Washington. Tri-level racks, shown here, carry 12 standard or 15 compact autos. More than 3,000 multi-level carloads moved on Great Northern freight trains during the year.

HIGHLIGHTS OF 1961

Financial Data	1961	1960
Net Income	$ 18,632,420	$ 20,723,214
Per Share	$3.07	$3.41
Dividends Paid	$ 18,236,342	$ 18,293,929
Per Share	$3.00	$3.00
Shareholders	41,794	41,435
Operating Revenues	$232,951,918	$246,024,650
Operating Expenses	185,066,905	194,051,856
Federal Income Taxes	5,775,000	5,850,807
Available for Fixed Charges	$ 26,785,037	$ 29,210,121
Fixed Charges	$ 8,152,617	$ 8,486,907
Times Fixed Charges Earned	3.29	3.44
Return on Property Investment	2.40%	2.64%
Cash and Temporary Investments—Dec. 31	$ 41,811,873	$ 40,421,150
Working Capital—Dec. 31	38,736,729	41,940,632
Long-Term Debt—Dec. 31	$242,399,130	$246,032,725
Operating and Wage Statistics		
Miles of Road Operated	8,277	8,292
Revenue Net Ton Miles (millions)	15,100	15,839
Revenue Passenger Miles (millions)	432	409
Ratios to Revenues:		
Net Income	8.0%	8.4%
Transportation Expenses	37.7%	36.8%
Maintenance Expenses	34.0%	34.5%
All Operating Expenses	79.4%	78.9%
Employes	18,619	19,863
Wages Paid	$117,288,605	$123,952,689
Employment Costs (Payroll plus Benefits, Payroll Taxes, etc.)	$131,630,657	$137,604,338

To Great Northern Shareholders:

This 1961 Annual Report brings you the story of our Company's 99th year of service, dating from June 28, 1862 when the pioneer locomotive William Crooks steamed over the first 10 miles of rail linking St. Paul and Minneapolis.

In the still youthful territory served by Great Northern, 1961 was a year of continuing growth, which though tempered by the lingering effects of recession augured well for the railway's future. Results of our operation, however, were disappointing. Although dividends were continued at $3.00 per share, net income was down from $3.41 to $3.07 per share.

Lower earnings resulted principally from a $13 million drop in operating revenues. Three adverse factors—the lag in recovery from the recent recession, the poor grain crop in our territory and the competitive price squeeze from unregulated carriers—were largely responsible for this drop.

Although wage rates and some material costs increased, operating expenses were held to a minimum without deferring maintenance or impairing service. The property is in fine physical condition.

Our cash position at the end of 1961 remained about the same as on December 31, 1960. Working capital was reduced by about $3.2 million, as noted on page 20.

It is with regret that the resignation of Mr. James F. Oates, Jr. from the Board of Directors is reported. Finding that his duties as Board Chairman of The Equitable Life Assurance Society did not permit him to give Great Northern affairs the time and attention he felt they deserved, Mr. Oates chose to end his 13 years of distinguished service to the Company. Mr. John E. Adams, Jr. was elected to take his place on the Board.

A problem of growing perplexity to railroads is the inability to price our services to adequately compensate for soaring costs. The condition is aggravated by the number of unregulated carriers—many operating illegally—in the transportation field. General rate increases have become self-defeating in the face of inequitable competition, and no longer can be looked to as an aid in meeting rising costs. Consequently, there have been no substantial general increases since 1958. On the other hand we must continue to reduce individual rates to meet specific competitive situations.

As a result, Great Northern's average revenue per ton mile has declined steadily since 1958. While our 1961 level of traffic was only slightly lower than that of three years ago, we suffered a $19 million reduction in freight revenues during the period because of cheaper rates.

To meet this situation we have reduced expenses as rapidly as possible, investing heavily in cost-saving devices. This program will be continued. The problem, however, remains a serious one, having reached the point where one major railroad has been forced into bankruptcy and several smaller but important lines have gone out of business.

Soundly conceived mergers are one of the promising avenues leading to cost reduction. The importance of Great Northern's proposed merger, the subject of a special progress report on page 4, has become increasingly compelling since studies first began.

As our Company enters its 100th year of operation, we look to the future with optimism. We expect that the territory served will grow and prosper, with the economic condition of the northwestern states further enhanced by the development of natural resources. For the year ahead, however, we share the cautious optimism of business generally. Although moisture conditions have materially improved since the drouth of 1961 and the outlook for general commodities is better than a year ago, we continue to face the cost-price problem.

Our accomplishments in 1961 are the measure of the competence and devotion to duty of nearly 19,000 employes. To these Great Northern men and women I wish to express the thanks and appreciation of the Board of Directors.

March 15, 1962

John M. Budd
PRESIDENT

FINANCIAL REVIEW...1961

The year 1961 began in a period of recession which had been in progress since the last half of 1960. While there were signs of recovery on the national level early in the Spring, the effects were not felt in Great Northern territory until Summer. Although the year produced continuing evidence of growth in the Northwest, it was not until the fourth quarter that our operating revenues reached the level of the previous year. A further adverse influence on traffic volume was the drouth which struck the grain growing area of western North Dakota and Montana.

In view of the low level of traffic and revenues it was necessary to exercise careful control of expenses. This was done without impairing good service to customers.

NET INCOME

Net income of $18.6 million equal to $3.07 per share was earned in 1961, compared with $20.7 million or $3.41 per share in 1960.

The reported net income of Great Northern does not include its share of the undistributed net income of Chicago, Burlington & Quincy Railroad Company (48.6% owned), Spokane, Portland and Seattle Railway Company (50% owned), Western Fruit Express Company (100% owned), Glacier Park Company (100% owned) and Great Northern Pipe Line Company (100% owned). During 1961 this equity amounted to $1.1 million or 19c per share of Great Northern stock.

Annual dividends at the rate of $3.00 per share were continued in 1961.

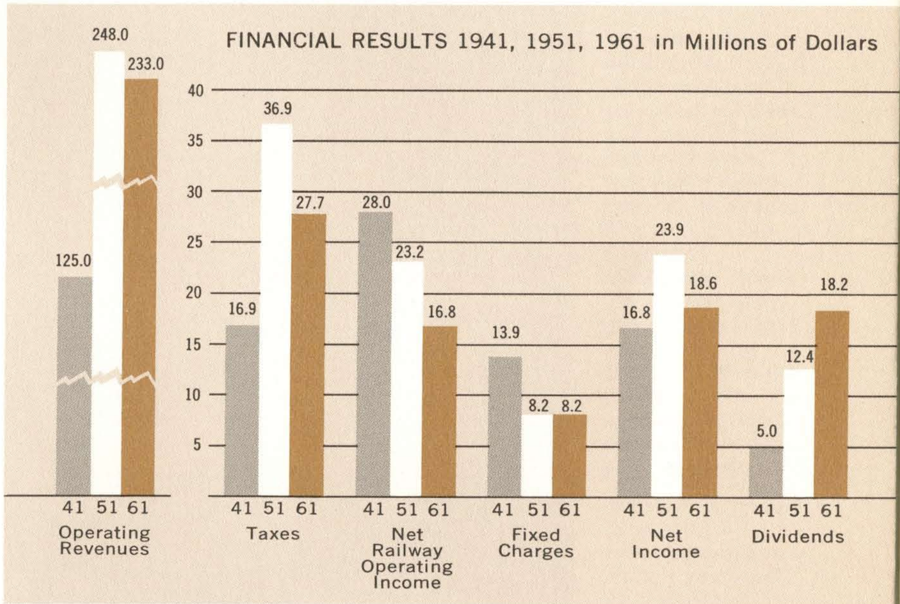
Operating revenues for 1961 of $233.0 million were $13.1 million less than in 1960. With continued increases in wage rates it was possible to reduce operating expenses only $9.0 million below the level of the year before. Although taxes paid by the company far exceeded net income, there was a reduction of $1.0 million in taxes from 1960.

Fixed charges were earned 3.29 times, slightly less than in the preceding year. The charges were 3.9% lower because of reduction in debt. As in every recent year Great Northern's fixed charges have been more than covered by the amount received as "Other Income," consisting of dividends and interest from investments.

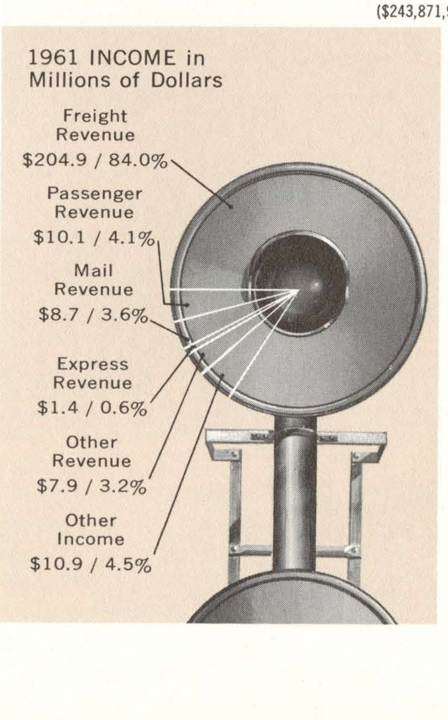
FINANCIAL POSITION AT END OF YEAR

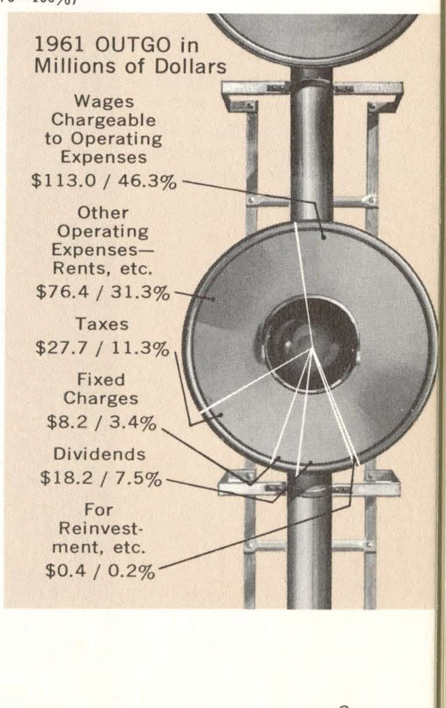
Cash, including temporary investments, was $41.8 million compared with $40.4 million at the end of 1960.

Current assets were $83.1 million and current liabilities amounted to $44.4 million. Net working capital, the excess of current assets over current liabilities, totaled $38.7 million compared with $41.9 million at the end of 1960. Figures for 1960 have been restated on a basis comparable to that of 1961 by transfer of $8,366,300 from reserves and other liabilities to current liabilities. In conformance with a change in accounting procedure authorized by the Interstate Commerce Commission, accrued vacation pay and certain other liabilities which in previous years had been included in reserves and other liabilities have been included in current liabilities in 1961.



($243,871,975=100%)





REPORT ON UNIFICATION

Tangible progress was made during the year in unifying into a single system the Great Northern, the Northern Pacific, the Chicago, Burlington & Quincy, the Spokane, Portland and Seattle, and Pacific Coast railways. The studies which began in 1956 and the agreement on merger terms reached in July, 1960 led to filing an application on February 17, 1961 with the Interstate Commerce Commission, asking for authority to proceed.

An important intermediate step, taken on January 13, 1961, was the filing in Dover, Delaware of articles of incorporation for the Great Northern Pacific & Burlington Lines, Inc., the corporate name chosen for the proposed unified transportation system.

Subsequently, late in April and early in May, stockholders of all of the merging lines voted in favor of the merger. In the case of Great Northern's shareholders an overwhelming majority of 4,929,931 shares, equivalent to 81% of the company's outstanding shares, voted in favor of the merger plan, compared with only 10,941 shares opposed.

The Interstate Commerce Commission assigned Examiner Robert H. Murphy to the case, and hearings were held in St. Paul October 10-13, 1961 when the affirmative case of the applicants was presented by 21 witnesses. At a further hearing December 5-19, a part of these witnesses were cross-examined by intervenors in the case; the remaining witnesses were questioned early in 1962. Additionally, the testimony of 40 public witnesses representing organizations and shippers who support the merger was presented. We feel that testimony introduced to date establishes that this merger would be consistent with the public interest.

ICC Examiner Robert H. Murphy talks with Northern Pacific President Robert S. Macfarlane (center) and Great Northern President John M. Budd (right) during a recess period at the December, 1961 merger hearing in Minneapolis.

Beginning in March, 1962, further hearings will be conducted at 16 locations in the area served by the merging lines. Testimony of additional supporters will be introduced and intervenors will be given an opportunity to present their cases. It is hoped that all evidence will be in the record by the end of June, 1962. Final decision of the Commission, however, is not expected before the middle of 1963.

Opposition to the merger is confined almost entirely to that of labor unions, or that inspired by labor unions, because of concern over reduced employment. Some railroads are asking that conditions be imposed for their protection against possible loss of traffic. Significantly, almost without exception, shippers—the customers of the railroads—endorse the merger proposal.

Following the merger it is anticipated that up to five years will be required to complete integration of the properties. During that time, 6% of the employes of the merging companies normally would leave the service annually, creating almost as many jobs in one year as will be eliminated during the five-year period when the properties are being put together. All employes who are worse off because of the merger are well protected by an agreement between the railroads and the labor unions; additionally, the Commission is required by law to protect employes who may be adversely affected. But the best prospect of enduring job stabilization —contrasted to the steadily declining employment of recent years—is in the strengthened ability of the new company to compete with other forms of transportation.

The physical advantages of unification include use of the best trackage and terminals of Burlington, Great Northern and Northern Pacific to provide new routes superior to those now in use. Concentration of traffic on the best lines will lead to construction of modernization projects which the separate lines could not justify alone. The benefits to shippers include faster handling of their freight, more dependable service and an improved supply of cars.

Projected principal freight route of the new consolidated railroad will benefit from this impressive three-mile relocation of GN's main line through the Cascade Mountains. Nearly $1\frac{1}{4}$ million cubic yards of earth and rock are being moved. Reduced curvature will speed train operations and cut maintenance costs.

REPORT ON OPERATIONS

Programs of track and equipment maintenance in 1961 were planned on a somewhat lower basis than in 1960. When it became apparent in early Spring that revenue would run well below estimates, programs were cut back substantially, but with regard for continuing essential maintenance work. Track and equipment are in good condition without deferred maintenance.

In the final quarter of the year the recovery in traffic volume and the reduced level of expenses produced more favorable operating results. The ratio of maintenance expenses to revenues was slightly lower than in 1959-1960, offsetting to some extent a rise in the transportation ratio. The over-all operating ratio was slightly higher than in 1960.

OPERATING REVENUES

The principal sources of operating revenues were:

	Operating Revenues (Millions)		Per Cent Change
Source of Revenue	*1961*	*1960*	
Freight	$204.9	$218.5	6.2-D
Passenger	10.1	9.4	7.4-I
Mail	8.7	8.4	3.6-I
Express	1.4	1.5	6.7-D
All other operating	7.9	8.2	3.7-D
Total	$233.0	$246.0	5.3-D

Freight Revenue

Since freight revenue produces 88% of Great Northern's total operating revenue, the trend of general business is of great importance. There is substantial diversity as may be seen by the following table:

Commodity	1961 Revenues (Millions)	1960 Revenues (Millions)	Per Cent Change
Grain and grain products	$50.0	$56.8	12.0-D
Lumber and wood products	37.1	37.9	2.1-D
Iron ore, including dock charges	18.3	23.2	21.1-D
Paper	13.2	13.1	0.8-I
Crude petroleum, petroleum products and asphalt	9.0	10.1	10.9-D
Forwarder traffic and less-than-carload traffic	10.4	10.2	2.0-I
Aluminum ore and products	6.5	6.4	1.6-I
Iron and steel products	5.4	5.5	1.8-D
Fresh apples	3.1	3.5	11.4-D
Passenger automobiles	3.2	1.8	77.8-I

As will be noted in the table, the decreases in grain and iron ore far overshadowed all other changes. To a large extent this was due to special factors which are not expected to recur in 1962.

The January 1, 1961 estimate of grain in storage on farms and in country elevators in Great Northern territory was 260 million bushels. This grain from previous crops moved to market in a normal pattern during the first half of the year. However, the crop harvested in 1961, other than that west of the Rocky Mountains, was extremely disappointing.

In North Dakota and Montana, moisture was short from the beginning of the growing season, and the shortage was relieved by only a few scattered showers during the summer. For most of the area the crop was very poor, and the over-all system average was about 60% of normal. While there was a short seasonal movement at the time of the harvest, grain traffic during the remainder of the year was light, even though some of the stored stocks of grain from previous crops moved at that time. The availability of ample storage room and the government loan program tended to slow the shipments to market.

At the end of 1961 about 208 million bushels of grain were in storage awaiting movement. Prospects for the 1962 crop are reasonably satisfactory. Areas of depleted soil moisture recovered some of their deficiency through early Fall rains, and snowfall has been moderate to heavy.

Iron ore movement was disappointingly low. When the shipping season opened in April, stockpiles of ore at furnaces which use Lake Superior iron ore were exceptionally large and the steel industry as a whole was operating at a relatively low rate. Accordingly, iron ore shipments got off to a slow start. Toward the latter part of the

Completely finished homes, pre-fabricated in Indiana and bound for Anchorage, Alaska, are shown here on a Great Northern freight train as it emerges from the famed eight-mile Cascade Tunnel in Washington State.

season as the stockpiles were worked down to more normal levels and the steel operating rate improved, the tempo of iron ore shipping increased. The handicap of the early months could not be easily overcome, however, and total tonnage shipped from Allouez Dock at the head of Lake Superior was only 14.6 million tons. In considering the importance of iron ore to Great Northern, it should be kept in mind that while it constituted 38% of tonnage, it contributes only 7% to total operating revenues because of the low rate level and short haul.

In contrast to the generally disappointing freight revenue from most commodities, rapidly growing automobile traffic gave dramatic evidence of what can be accomplished in recovering traffic which originally moved by rail but had been largely diverted to other forms of transportation.

Freight Rates

During 1961 the general level of freight rates was not increased in spite of higher costs. Pressure of competition from other forms of transportation precluded such a change and some rate reductions were required to meet unregulated highway competition. Other adjustments were made to assist producers in our territory in reaching distant markets.

One of the most important decreases in rates was made on grain and grain products from Montana to North Pacific Coast terminals and to California. Corresponding adjustments were made eastbound.

Reduced rates on lumber, based on more heavily loaded cars, were put into effect to assist the marketing of that commodity. While these reductions help shippers retain their markets, they bring no additional business to the rails. Lower revenues have increased the urgency for greater freedom in cutting our own costs. The proposed unification would be a long step in this direction by affording greater efficiency. Rate adjustments without cost reductions can lead only to disaster.

Passenger Revenue

In contrast to decreased freight business, 1961 marked a reversal of the long continued downward trend in passenger revenue. The summer season business was better than for several years and the improvement continued as the year progressed. Some special movements did particularly well. Expanded housing facilities and the addition of a new chairlift at The Big Mountain Ski Resort at Whitefish, Montana helped boost rail arrivals there 138%. This ski traffic is particularly desirable as it is long distance, off-season travel which can be handled with little extra expense.

Heavy passenger business during the Christmas holiday season pressed all available coaches into service, including six modern streamlined coaches purchased from another railway and refurbished to Great Northern standards.

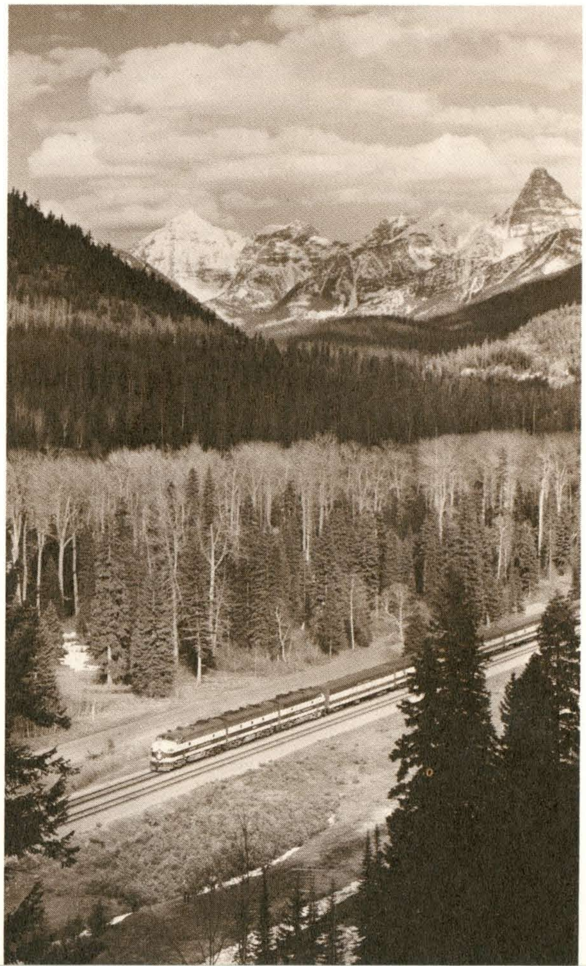
In an effort to make train travel attractive, high standards of service are being maintained and charges kept to a minimum. Coach class tickets are honored in sleeping cars on the Western Star except during the heavy summer travel season. Quality and reasonable pricing of dining car service is being stressed.

While there has been improvement in recent years, the net return from passenger business is still unsatisfactory. It is hoped that in 1962 steps may be taken by Congress to repeal the 10% excise tax on passenger fares, as recommended by the Interstate Commerce Commission in 1958 after a thorough study of passenger problems. Great Northern was able to reduce costs this past year by taking off three pairs of secondary trains no longer being used by the public. A saving of 346,000 train miles on a full-year basis or 7% of total miles run in 1960 was accomplished.

Mail and Express Revenues

Mail revenue for 1961 was $8.7 million, an increase of $226,000 from 1960. The volume of mail handled on the long haul transcontinental trains has been increasing moderately. Great Northern has for many years carried most of the Twin Cities-Spokane-Seattle mails. A new postal terminal on Great Northern trackage at Spokane operated for its first full year, facilitating the handling of transcontinental mails at this point.

Since 1959 operations of the Railway Express Agency have been reorganized and great strides



The Empire Builder, pictured here near Glacier National Park, contributed to the 1961 improvement in passenger revenues. Great Northern's top train scored an increase of more than 15,000 revenue passengers, as compared with 1960.

A modern Swedish motorship, the Johnson Line's ROSARIO, takes on cargo at Great Northern's Pier 88 in Seattle. Many products from GN territory flow through this bustling world port.

made in revitalizing its service. The net amount received by Great Northern after the Agency paid its own expenses was $1.4 million, compared with $1.5 million in 1960. However, there was a striking improvement in the last half of 1961, reversing the unfavorable trend of recent years.

OPERATING EXPENSES

Railway operating expenses in 1961 amounted to $185.1 million, down $9.0 million or 4.6% from 1960. This was not as great as the 5.3% decrease in revenues, and the operating ratio—the proportion of operating revenue taken by operating expenses—increased from 78.9% in 1960 to 79.4% in 1961.

Transportation expenses which include the cost of operating trains, yards and stations were $87.8 million in 1961, lower by $2.8 million than in 1960 but not proportionally lower than revenues. Since much of the decrease in revenue was due to less grain traffic which originates on branch lines with fixed service, it was particularly difficult to hold expenses in line.

Maintenance of Way expenses were $36.4 million in 1961, compared with $39.5 million in 1960. Although the work programmed was less extensive than in 1960, much of the $3.1 million reduction was accomplished by further use of labor-saving machinery which has revolutionized track maintenance in recent years. It is now possible to carry out substantial work programs without large seasonal gangs once required. Fewer skilled men now operate and maintain machines which have largely replaced unskilled manual laborers.

Maintenance of Equipment expenses were also reduced as traffic volume declined. Costs of $42.7 million in 1961 were $2.7 million lower than the $45.4 million spent in 1960. Great Northern freight cars in need of heavy repairs at the end of 1961 are 1.9% of the total owned compared with the national average of 7.5%. Likewise, only a nominal number of locomotive units are being held for repairs. The expected increase in freight traffic volume in 1962 can be handled without any substantial increase in equipment repairs.

The over-all ratio of maintenance expenses to operating revenues improved from 34.5% in 1960 to 34.0% in 1961. The transportation ratio increased on the other hand to 37.7% in 1961 from 36.8% in 1960.

In spite of the necessity for giving good competitive service regardless of traffic declines and for providing relatively fixed service on many light traffic lines, many of the indices of operating efficiency improved in 1961.

Gross ton miles per train hour which measures both the loading and speed of freight trains exceeded all records at 68,670. The increase in 1961 was 6% above the 64,808 of 1960 which was itself a record. Freight trains were run faster than ever before and the average stood at 21.8 miles per hour in 1961. In the past ten years average freight train speeds on Great Northern have increased 31%.

Rentals of Equipment

With fewer cars required to handle the decreased traffic of 1961, net rentals paid for equipment were $1.4 million less than in 1960. Except for a shortage of wide door cars for lumber loading in the Pacific Northwest—a situation shared by all lines serving that territory—our supply of cars was sufficient throughout the year.

Great Northern has adequate ownership of freight cars designed and maintained to meet the needs of its customers. In common with most railways, however, we depend on private car lines for our supply of refrigerator, tank, piggyback and auto rack cars. Payments for such equipment are on a mileage basis.

Railroad-owned cars are interchanged freely between carriers, and rental paid to the owner on a daily rate. Because of substantial loading at Great Northern stations for off-line points, and of the failure of other roads to return cars when made empty, Great Northern has less per diem cars on its lines than it owns and collects more in rental than it pays to others for such equipment. Total rentals for freight cars as shown in our accounts represent the difference between payments on the mileage basis for private line cars and collections on the daily basis for company-owned cars.

There is a deficiency of car ownership in the railroad industry, and because of the slow return of empties Great Northern has suffered chronic periodic shortages of certain types of cars. The

Interstate Commerce Commission has recommended legislation to encourage greater ownership by those roads which do not own enough cars. While Great Northern has joined other lines in support of this legislation, on the basis that the industry itself is unable to solve the problem of chronic car shortages, many roads have opposed this further control of railways by government. Congress has not acted on the recommendation.

Net receipts of $366,000 were obtained for use of other items of equipment such as locomotives and passenger cars.

Taxes

Taxes paid by Great Northern fall in three general classes. First are income taxes paid to the Federal Government. Property taxes are paid to most of the States for general upkeep of State and local governments, including especially the school systems. Finally there are payroll taxes, presently amounting to 8.1% of wages. These go to the Federal Government to support half of pension payments to retired employes and all of the generous unemployment and sickness benefits paid to railroad employes from a special fund administered by the Railroad Retirement Board.

Taxes accrued in 1961 were $27.7 million, a reduction of $1.0 million from 1960. Federal income taxes were slightly lower because of less net income. Payroll taxes were lower because of the reduced payroll. Property taxes were approximately the same as in 1960.

One of the heaviest burdens on the railroads in meeting the competition of other forms of transportation is the unequal effect of property taxes. A railroad, since it owns the track and roadway on which it operates, is obviously subject to taxes on property. In many instances Great Northern's tax contribution will exceed half of a county's total governmental costs. In a number of states the assessment methods used cause a greater burden of taxation to fall on the railroads than on other taxpayers.

Waterways, highways and airways, all owned by governmental agencies, are not subject to property taxes. Barge lines, without any thought of payment as a user, operate on inland waterways improved for use by the Federal Government at a cost of millions of dollars. Although truck lines pay license fees and fuel taxes, the payments go only to the maintenance and operation of the highways, leaving nothing as a contribution to schools and the expenses of general government. It is significant that the percentage of gross revenue which most other forms of transportation pay in taxes is far below that of railroads on a comparable basis.

Wage Rates

The wage contract which became effective November 1, 1959 provided for an increase of approximately 5½c per hour on March 1, 1961. The nonoperating employes elected to take this increase in the form of improved insurance coverage. The monthly premium of $21.82 covering medical, hospital and life insurance benefits is paid by Great Northern. On November 1, 1961 this contract became open for modifications, and while negotiation is in progress the outcome will not be known for some time. Meanwhile the wage rates of the current contract continue in effect.

The average wage per hour worked in 1961 was $2.88 compared with $2.80 per hour in 1960. Including fringe benefits such as pensions, unemployment and health insurance amounting to 60c per hour, the total cost to the railway for each man-hour worked was $3.59. This compared with $3.45 per hour in 1960. For every dollar of operating revenue earned by Great Northern in 1961, wage payments—excluding fringe benefits—took 50c.

Carload shipments of apples and soft fruit from the famous Wenatchee-Okanogan Valley district totaled 9,438 for the 1960-61 crop year. Pictured here is a loading scene at the big new Wenatchee Wenoka Growers Association warehouse.

IMPROVEMENTS IN FACILITIES

Heat-treated rail, flash-welded into 78-foot lengths, is laid by GN forces on curve near Carlton, Minnesota. Now standard for main line curves of 4° or more, this rail is highly resistant to wear, reducing maintenance costs.

The budget for 1961 capital expenditures was prepared in line with long-range plans for improvement of facilities. It was assumed that while business might be slow in the early months of the year, agricultural crops would be normal and the general economy would reach higher levels than in 1960. However, when it became apparent that drouth would cut sharply into grain revenue it was decided to defer the completion of some improvements. These items are being carried over into 1962.

Additions and betterments in 1961 totaled $20.6 million, which included $7.8 million for roadway and structures and $12.8 million for equipment. This compares with a total of $24.6 million in 1960 and the five-year (1957-1961) average of $24.2 million. Planning for 1962 is on a reduced basis, carrying out work held over from 1961 and concentrating on items which will improve service and will be of most value after consolidation. The program for 1962 contemplates a total expenditure of $5.9 million for new projects and a carryover of $2.1 million from 1961.

EQUIPMENT PROGRAM

Great Northern's 1961 equipment program included construction of 500 box cars at the railway's shops at St. Cloud, Minnesota. In addition 50 box cars and 20 airslide covered hopper cars were acquired from outside car builders.

In recent years the advent of labor-saving mechanical loading equipment such as fork-lift trucks and of incentive rates which reward shippers for heavier loading of cars has increased the demand for 50-foot box cars with wide door openings. All 500 of the cars built in company shops are of this length and are equipped with plug doors. These versatile cars have two doors on each side—one a conventional sliding door useful when the cars are being loaded with bulk commodities such as wheat; the adjacent "plug" door fits tightly into the side of the car but can be opened to provide a wide opening convenient for mechanical loading of lumber, plywood and many other commodities.

A number of specialized items of equipment were acquired. The 50 purchased box cars have cushion underframes and special loading devices which protect particularly fragile freight. The 20 airslide covered hopper cars have special equipment which permits easy unloading of bulk commodities such as flour and sugar. These types of specialized equipment enable the railway to lower the overall cost of distribution incurred by shippers and thereby making rail service more attractive.

Great Northern's subsidiary Western Fruit Express Company acquired 100 new refrigerator cars in which temperatures can be mechanically maintained at any point between zero and 70 degrees.

These cars are particularly suitable for transportation of frozen foods.

For the expanding needs of piggyback service, 46 additional trailers were acquired including a number of mechanically equipped refrigerated trailers purchased by Western Fruit Express for handling perishables. Twenty flat cars were equipped for high-speed piggyback service by installing improved trailer hitches and roller bearings. In addition, Great Northern continued its participation as a member of Trailer Train Company in a rapidly growing nationwide pool of flat cars in piggyback and automobile rack service.

During the year 18 older 1350 HP diesel freight units were given heavy repairs and upgraded to heavy duty 2000 HP general purpose units. These units not only have greater power but have included all of the design improvements which have been developed since their original construction fifteen to twenty years ago when dieselization was in its early stages.

The equipment program for 1962 includes capital expenditures of $3.6 million, principally $625,000 for 50 covered hopper cars and $1.5 million for other specialized freight equipment. In addition 550 box cars will be completely overhauled in company shops to provide the equivalent of new cars.

FIXED PROPERTY IMPROVEMENTS

The most important single improvement to the fixed property in 1961 was further extension of centralized traffic control on the main line in North Dakota and Montana. A 50 mile segment between Surrey and Aylmer, North Dakota and 59 miles between Pacific Junction near Havre and Chester, Montana were included. This is the area where freight traffic will increase substantially as a result of unification. Great Northern now has 874 miles of line where signals and switches are remotely controlled by electronic means.

Also of outstanding importance was the beginning of construction of a major line change on the west slope of the Cascade Mountains east of Seattle. This work will be carried out in phases over a period of several years. A series of very sharp curves will be straightened so that train speeds can be increased and track maintenance costs reduced.

In addition, Great Northern built a 6-mile branch line jointly with the Canadian National Railway in the Vancouver, B.C. area to develop a new industrial area along the lower Fraser River.

Ordinary programs of track maintenance such as replacement of rail, tie renewals, installation of crushed rock ballast, replacement of timber bridges with more permanent structures, stabilization of roadbed, and application of chemicals for weed control were carried out in 1961.

Although the improvement program was somewhat less extensive than in 1960, new 115 pound rail was laid on 33 miles of main line of which 20 miles was continuously welded, making a total of 287 miles of welded track on Great Northern. The economies and better riding qualities of welding have been demonstrated so conclusively that except on sharp curves practically all new rail will be welded in the future. On secondary main lines and branches 82 miles of secondhand rail of various weights was laid to replace light and worn rail.

Cleaning of freight cars became speedier and more efficient with the completion in 1961 of Great Northern's new mechanized car-cleaning facility at Grand Forks, North Dakota.

New crushed rock ballast was laid on 88 miles of line in connection with major overhauls of track structure. In addition smaller amounts of ballast were used on many miles of track which required only smoothing with the mechanical tamping equipment obtained in recent years. In total, 239,000 cubic yards of rock ballast were placed on main lines, plus 216,000 yards of secondary ballast on branch lines and in yards.

The 1962 capital expenditure program for roadway and structures provides for work estimated to cost $2.2 million. It will include the usual items of track improvement and contemplates laying of 54 miles of new rail on main lines, 102 miles of secondhand rail on branch lines and placing of 516,000 cubic yards of ballast.

SERVICE IMPROVEMENTS AND TRAFFIC DEVELOPMENT

GAINS MADE IN PIGGYBACK, MULTI-LEVEL AUTO TRAFFIC

Trailers on flat cars and new automobiles riding two and three high on multi-level racks have brought an impressive "new look" to the modern freight train. But more significant has been the role of this specialized equipment in enabling the railroads to offer service and economies which are attracting substantial traffic previously moving over the highways.

Although Great Northern began handling auto transport trailers on flat cars in mid-1959, the big upsurge in new automobile traffic was coincident with the introduction of bi-level and tri-level racks. Great Northern acquired its first equipment of this type in late 1960, and that same year joined the Trailer Train Company, providing access to a large pool of piggyback flat cars. The impact was notably evident in 1961, when we moved 3,074 multi-level carloads, carrying as many as 15 compact autos on each car (see cover photo). All makes of passenger automobiles manufactured in the U. S., as well as imports, were handled on this equipment.

Comparative revenues demonstrate the importance of this recaptured traffic. Great Northern's movement of new passenger cars and trucks in 1961 brought revenues totaling $3,402,479—as against $1,167,694 in 1958.

Piggyback (including some automobiles on transport trailers but excluding multi-level loads) continued to score gains in 1961. Trailers loaded and received from connecting lines totaled 19,787—10.5% more than in 1960—while tonnage increased by 29%. Although still representing a small percentage of total freight revenues, piggyback has shown an impressive rate of growth and potential.

Among unusual movements in 1961, illustrating the growing diversity of piggyback, were 10 trailerloads of office furniture, fixtures and equipment, transferred from Western Life Insurance Company at Helena, Montana to the St. Paul-Western Insurance Companies at St. Paul; 66 trailerloads of granite from Rockville, Minnesota, for construction of a chapel in Illinois; and five trailerloads of trees from Illinois for the Seattle World's Fair.

A number of additional TOFC (trailer-on-flat-car) services were established during 1961, equipment ownership was expanded and continued steps were taken to meet motor carrier competition by establishing competitive rates for this service.

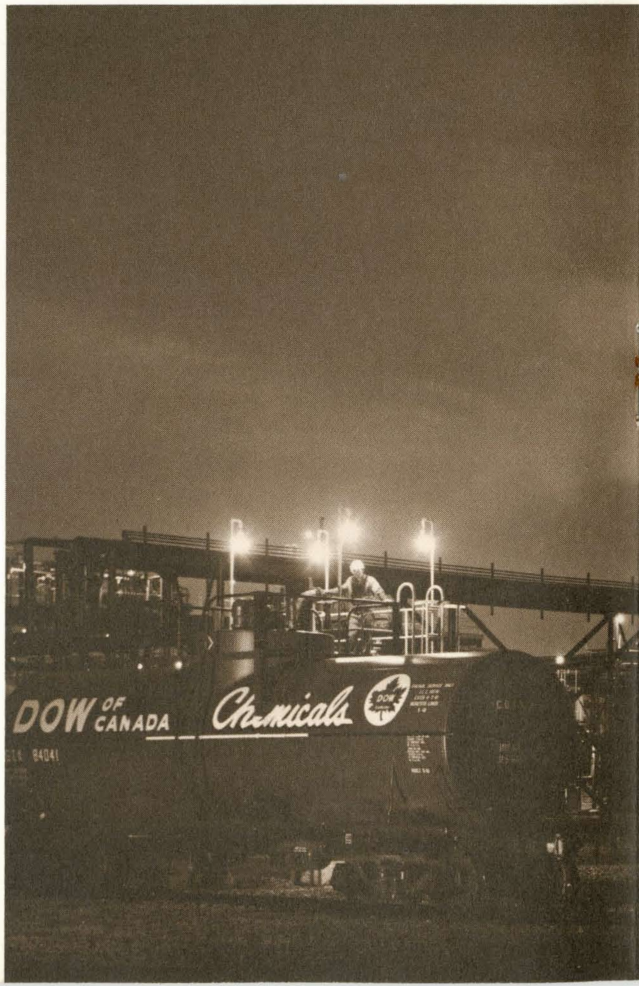
INDUSTRIAL EXPANSION

Location of 151 new industries on Great Northern trackage during 1961 was at the same level as in the previous year. Of this number, approximately 75% are in the warehousing and distribution category, with the remainder classified as manufacturing and processing. Substantial additions to many existing installations also were made or planned during the year.

Among significant industrial developments across Great Northern's territory are the following:

Construction of potato warehouses continued at a high level, with storage capacity in the Red River Valley increased by over 1,500,000 bushels. Seven new warehouses were built at Great Northern points in Minnesota and North Dakota.

At Grand Rapids, Minnesota, the Blandin Paper Company began a $15,000,000 expansion program to increase productive facilities, while at Fridley, Minnesota, the Downing Box Company completed a $2,000,000 corrugated container plant.



Two new natural gasoline plants, both local to Great Northern and vital to industrial expansion in North Dakota, were begun and nearly completed in 1961. The $4,800,000 facility of the TXL Oil Corporation and Oilchem Corporation is near Lignite, while Hunt Oil Company has located its $2,000,000 plant east of McGregor. Both will produce propane, butane and dry gas, with sulphur also coming from the Lignite plant. North Dakota's first facility of this type, built by Signal Oil and Gas Company at Tioga in 1954, recently was expanded.

Of high interest in Montana are preliminary plans of the Permanente Cement Company to construct a $10,000,000 cement plant on the Great Northern near Helena. Annual capacity will be 1,400,000 barrels, with initial production going to Yellowtail Dam in southeastern Montana.

Substantial progress was made during the year on construction of the huge plywood plant being built at Libby, Montana by the J. Neils Lumber Company, a division of St. Regis Paper Company. Production is scheduled to begin in 1962, with a planned annual capacity of 60 million square feet.

At Valley, Washington, on Great Northern's branch line running north from Spokane, the Lane Mountain Silica Company—controlled by Northwestern Glass Company of Seattle and Del Monte Properties of San Francisco—dedicated its new 100,000-tons-per-year silica sand plant.

The growing industrial expansion of Western Canada continues to stimulate a high degree of activity in the strategic seaport region of Vancouver and New Westminster, British Columbia. An important milestone in the development of the Tilbury Island industrial area, situated on deep water in the Fraser River, was reached in mid-September when commercial production began at Dow Chemical of Canada's new $3,000,000 phenol plant.

A six-mile branch line, built jointly last year by Great Northern and Canadian National, serves the Dow facility and has opened an entire new area to industrial development.

Another multi-million dollar phenol plant is being constructed by the Dow Chemical Company at Kalama, Washington, while at Tacoma the St. Regis Paper Company last year completed a $30,000,000 expansion of its pulp mill.

New military installations along Great Northern continue to enlarge the railway's role in national defense. Particularly significant is the development of the Minuteman Missile complex in two states, with expenditures expected to exceed $128,000,000. Construction of launching sites in Montana got underway in 1961, with Great Northern providing both rail and truck transportation of materials to the contractors. GN also serves the projected launching sites area in North Dakota, where activity is scheduled to begin in 1962.

Phenol, a chemical used in the manufacture of adhesives for plywood, is produced at this new Dow Chemical of Canada plant near Vancouver, British Columbia. It is the first operation within the recently-developed Tilbury Island industrial area.

POWER AND IRRIGATION PROJECTS

More than a million and a half new kilowatts of electric energy surged into the Pacific Northwest's Bonneville power grid in 1961 with the completion of two giant hydro-electric projects on the Columbia River.

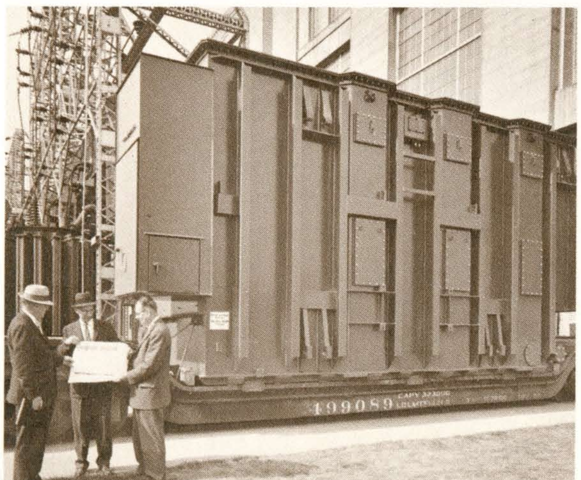
First to go into operation was Priest Rapids Dam, below Wenatchee, Washington, with 10 generators producing 788,500 kilowatts. Rocky Reach Dam, a short distance above Wenatchee, now has seven generators installed and operating, and will be dedicated July 21, 1962. Its capacity is rated at 775,000 kilowatts.

Wanapum Dam, newest project on the Columbia, stood at a little better than 70% complete at year's end, with the first generator scheduled to go on the line in September, 1963. Announced capacity of Wanapum, located above Priest Rapids, is 831,250 kilowatts. Although the Grant County Public Utility District, builder of the dam, already has favorable commitments for this power, it has reserved as much as 20% for prior commitment if an industry can be located in the immediate territory.

Future expansion of hydro-electric power on the Columbia and its tributaries, to attract new industry as the demand is indicated, is dependent in substantial degree on the still-awaited ratification by the Canadian Parliament of a 1960 International Joint Commission agreement on utilization of Columbia River waters, ratified by the U. S. Senate in 1961.

Immediately pending is the future of Libby Dam, on the Kootenai River in northwestern Montana. Libby, with an estimated capacity of 486,000 kilowatts and provision for future installations, would additionally provide water storage to increase the output of downriver dams on the Columbia. Its construction would necessitate extensive relocation of Great Northern's main line, and several alternate routes have been surveyed and are under consideration by the railway and the U. S. Army Corps of Engineers.

This giant 140-ton transformer, capable of handling enough electricity for a city of 250,000, moved via the GN and Pacific Coast railroads to the Puget Sound Power & Light Company at Renton, Washington.



Feasibility studies and Congressional hearings on the Garrison Diversion Unit of the Missouri River Basin Project continued in 1961, but no funds for construction have yet been allocated. It is hoped that appropriations will be made for a start in 1963. Meanwhile, the drought which hit the western two-thirds of North Dakota during the summer of 1961 fully demonstrated the need for supplemental water supplies in this area. Completion of this important irrigation and municipal water supply project will affect more than half a million irrigable acres and a number of communities served by Great Northern.

RESEARCH AND DEVELOPMENT

Two separate but related research projects sponsored by Great Northern and supervised by its Mineral Research and Development Department moved ahead encouragingly during 1961.

At the University of North Dakota, a simple and economical process for gasifying lignite was successfully developed, and application has been made for patent. The gasifier was fully demonstrated during the year in conjunction with a second GN-sponsored project at the University of Minnesota, where research is being conducted in the beneficiation of non-magnetic taconite, a low grade iron ore.

Recognizing the potential of the lignite gasification process, not only for taconite beneficiation but for a variety of industrial uses, the railway has initiated a second three-year project at the University of North Dakota. Increased utilization of that state's vast lignite reserves, estimated at 350 billion tons, would be immensely beneficial to both North Dakota and Great Northern.

Several semi-pilot plant runs were made at the University of Minnesota Mines Experiment Station as a part of the project to develop a process for the economical recovery of a high grade ore concentrate from low grade non-magnetic taconite. This type of taconite is plentiful in GN territory on the western Mesabi Range, and on its successful use depends the long-range future of the western Mesabi and of the railway as a major carrier of iron ore.

Tests at the U. of M. successfully demonstrated that the developed process is one method of providing a product which is of a quality now being demanded by the iron and steel industry; it is comparable to either foreign ores or to other taconite concentrates. In line with keeping the iron mining industry fully informed on our research activity, demonstration runs were made for their technical representatives.

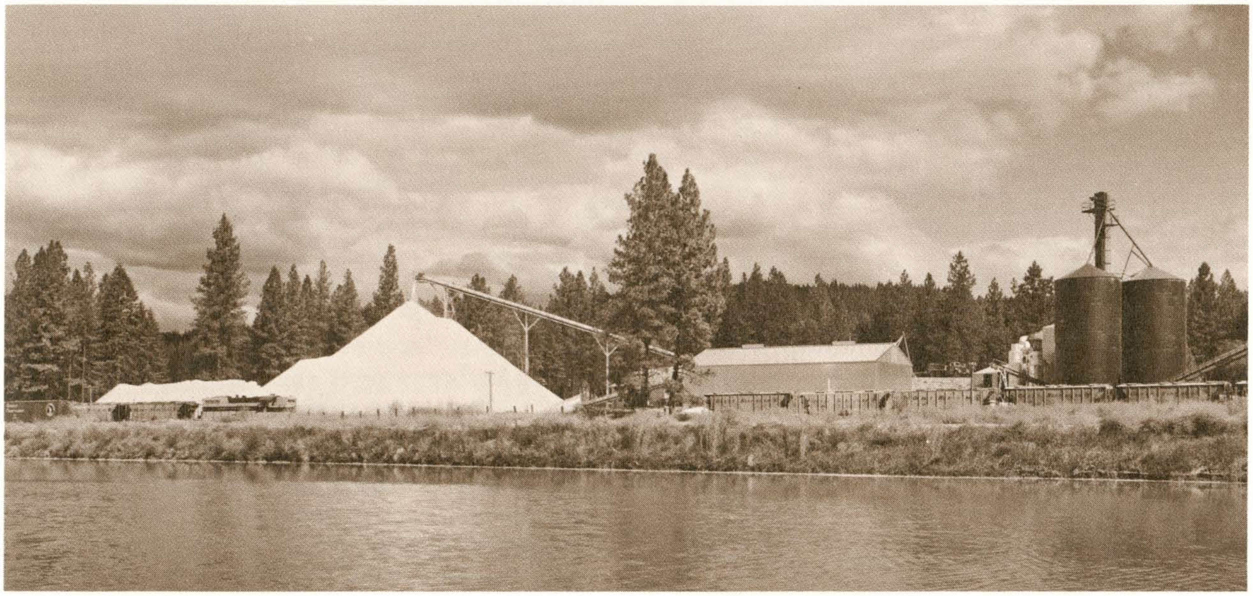
The M. A. Hanna Company's semi-taconite

pilot plant on Great Northern trackage at Cooley, Minnesota began operations in 1961, and production was resumed at a similar facility completed the previous year at Trout Lake by the Oliver Iron Mining Division of U. S. Steel. However, it is too early for conclusions about either of these pilot plants, and the future of commercial production still hinges on the establishment of a favorable tax climate in Minnesota.

Jones & Laughlin Steel Corporation has developed another recovery process for low grade ore, and at mid-season began operation of a new concentrator near Calumet on the Mesabi Range. An 8-million-ton stockpile of ore rejected as unsuitable for the company's main Hill Annex concentrator, nearby, is being worked. Production of processed ore at the new plant in the 1961 season was 150,000 tons.

In northwestern Montana, a five-year mineral resources survey jointly sponsored by Great Northern and Pacific Power and Light Company reached its fourth year. The third annual report on the project contained much new, accurate and interesting information, encouraging prospecting and mineral development in this area.

Mapping of the geology and mineral deposits in Great Northern territory was continued in 1961, with coverage extended to approximately 3,500 square miles adjacent to the Bend-Chemult portion of the railway's Klamath Division in Oregon.



Glass sand of very high quality is produced at this new plant on Great Northern trackage north of Spokane. It is of particular industrial significance as the first operation of its kind in the Northwest.

FINANCIAL AND CORPORATE

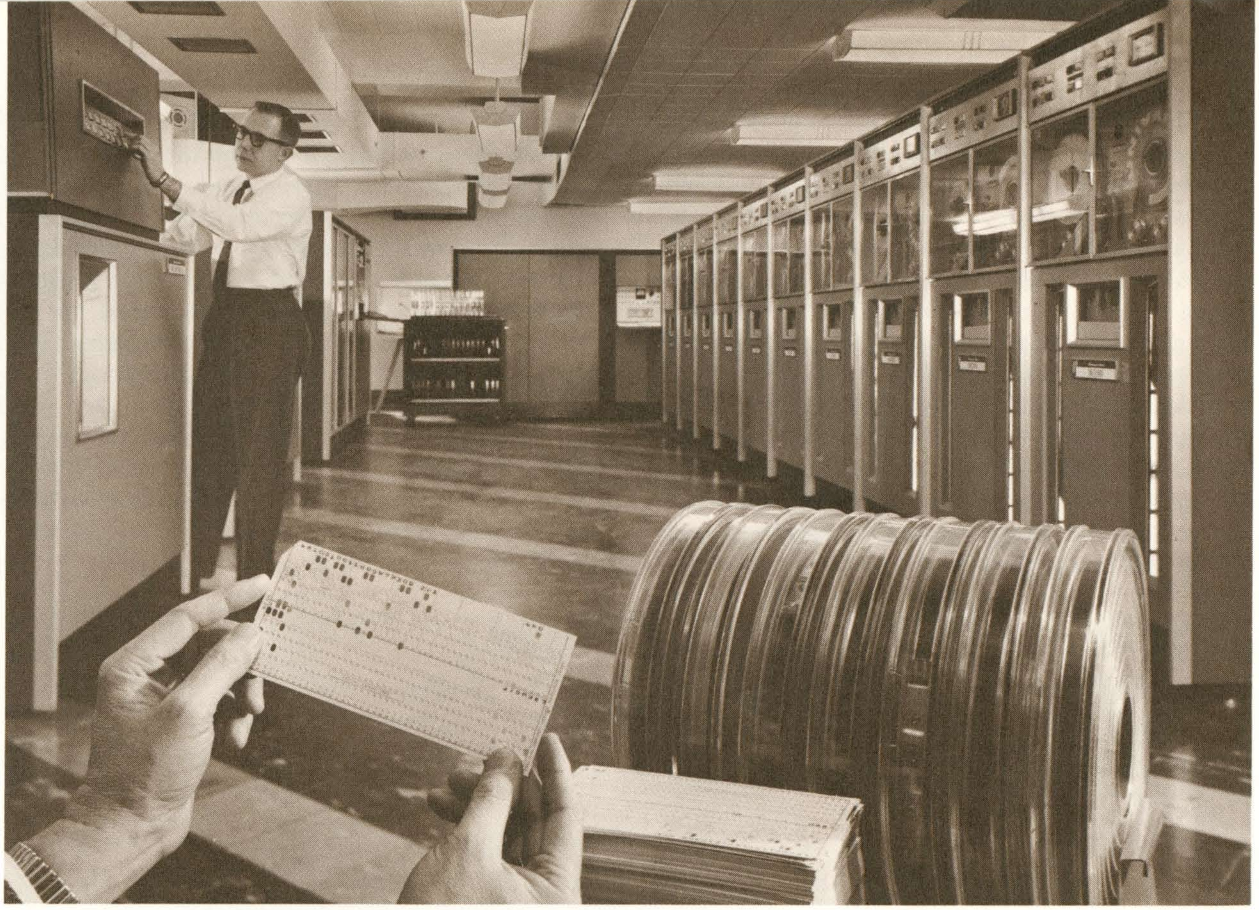
CAPITAL STOCK

On the last record date in November, Great Northern was owned by 41,794 stockholders. There were 6,075,269 shares outstanding in the hands of the public at the end of 1961. There was some further widening of public ownership as the number of shareholders increased and, in addition, arrangements for acquisition of stock by payroll deduction through the Monthly Investment Plan added to the growing number of employes who own a share in their company.

During the year preliminary steps were taken to mechanize preparation of dividend checks and maintenance of stockholder records on Great Northern's new solid-state computer. It is anticipated that beginning about the middle of 1962 dividend checks will be prepared by the computer more quickly and economically than has been possible in the past.

FUNDED DEBT

At the end of 1961 funded debt was $242.4 million compared with $246.0 million at the end of 1960, a decrease of $3.6 million. The reduction was primarily due to sale of fewer equipment obligations during the year than principal payments on existing issues. Of the total debt $8.9 million of equipment obligations are due in 1962. Mortgage bonds in the hands of the public remained the same, as the payment of $16.7 million Series "R" bonds at maturity on January 1, 1961 was included in 1960 reports. The amount of funded debt outstanding is now at the lowest level since 1947.



Capacity and versatility of the electronic data processing center at Great Northern's St. Paul headquarters was increased substantially in 1961 with installation of the advanced new Univac solid state computer shown here.

As of December 31	General Mortgage Bonds (Millions)	Equipment Obligations (Millions)	Total Funded Debt (Millions)
1961	$178.7	$63.7	$242.4
1960	178.7	67.3	246.0
1959	195.3	66.7	262.1
1958	200.4	69.9	270.7
1957	200.5	65.3	266.4

One issue of equipment trust certificates, amounting to $5,100,000, was sold during February at an interest cost of 4.03% to maturity. The retirement of $8.9 million of certificates which matured during the year reduced the total equipment debt outstanding to the lowest level in a number of years.

In 1961 depreciation charges which are included in maintenance expenses provided more than sufficient cash to make the annual principal payments on existing equipment trusts and to make the 20% down payment on new equipment acquired during the year.

	1961	
Depreciation Charges		$15,172,800
Cash Down Payments on New Equipment (20% of cost)	$1,476,029	
Principal Payments on Equipment Trusts	8,723,318	
Total Payments		10,199,347
Excess of Depreciation over Payments		$ 4,973,453

EFFECT OF TAX LAWS ON NET INCOME

Federal income tax laws permit rapid amortization of investment in certain facilities declared essential for national defense in the period during and after the Korean War. In addition the Federal tax laws permit accelerated depreciation of facilities acquired after January 1, 1954. However, the Interstate Commerce Commission requires that depreciation be recorded in our income account on a straight-line basis, with the result that book depreciation is lower than tax depreciation in the earlier years of the facilities and higher in later years.

Amortization and depreciation for tax purposes in 1961 was $4.3 million in excess of that shown in the income account. This resulted in postponement of income taxes and increase in reported net income of $2.2 million as indicated in the following table:

	Defense Facilities being Amortized	Facilities with Accelerated Depreciation
Amortization or depreciation estimated for tax return—1961	$3,550,000	$7,175,000
Normal straight-line depreciation as reported—1961	2,570,000	3,900,000
Excess—1961	980,000	3,275,000
Increase in net income—1961	500,000	1,700,000

Benefits from the excess of tax amortization of defense facilities over book depreciation reached a high point in 1956 and will affect net income unfavorably in 1963 and for a number of years thereafter to the extent of about 22c per share annually. However, the tax benefit from accelerated depreciation of new facilities will continue to increase for several years. It is anticipated, therefore, that the net effect of tax amortization and accelerated depreciation on reported income will be favorable for some years, although to a lesser extent than in the past, as shown in the following table:

	Effect of Amortization of Defense Facilities on Net Income	*Effect of Accelerated Depreciation on Net Income*	*Combined Effect on Net Income*
Year	*Increase Per Share*	*Increase Per Share*	*Increase Per Share*
1956	$0.66	$0.07	$0.73
1957	0.59	0.11	0.70
1958	0.49	0.15	0.64
1959	0.36	0.19	0.55
1960	0.22	0.24	0.46
1961 (est.)	0.08	0.28	0.36
1962 (est.)	0.08-*Decr.*	0.32	0.24

EXPANSION OF COMPUTER OPERATIONS

The complex and extremely numerous transactions characteristic of a railroad's paper work lend themselves to use of the various computers developed in recent years for data processing. Great Northern owns its large Univac I, now being operated on a round-the-clock basis.

During the year a Univac solid state computer was installed to complement the Univac I. This machine is being assigned several new tasks, including the processing of stockholder records. The timing of dividend paying after declaration can be expedited and substantial economy in processing is anticipated.

Clerical work involving customer and station accounting is being consolidated in central offices. Four of these offices have been established. They expedite the accounting work and at two of the larger central offices small computers have been installed to further mechanize clerical work with resultant economies.

In the field of inventory control of Materials and Supplies an intensive drive has been in progress for several years to reduce the stocks of material kept in stock. The advantages of reducing investment, handling costs, deterioration and potential obsolescence have been fully recognized and a notable reduction from $34 million at the end of 1957 to $22 million at the end of 1961 has been achieved. A substantial factor in the reduction already obtained and anticipated further changes in the future is a system of maintaining a perpetual inventory and management control through use of electronic data processing on the Univac computer.

AFFILIATES AND SUBSIDIARIES

In 1961 Great Northern received $6.2 million in dividends from the Chicago, Burlington & Quincy Railroad Company, the same as in 1960. Of the Burlington's outstanding stock, all but 2.8% is owned in equal amounts by Great Northern and Northern Pacific. The Burlington enjoyed good crops and with somewhat earlier recovery of manufactured traffic its net income improved to $14.4 million from $12.5 million in 1960.

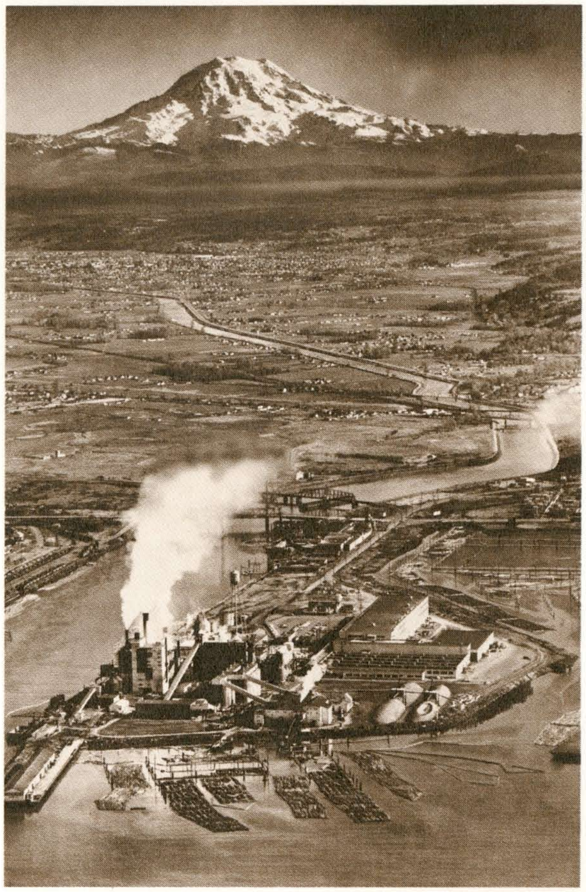
The Spokane, Portland and Seattle Railway Company, owned 50% each by Great Northern and Northern Pacific, suffered in the early part of the year from continued reduced movement of forest products on which it is heavily dependent. A small deficit of $89,000 was incurred in 1961 compared with net income of $700,000 in 1960. Great Northern and Northern Pacific own all of the outstanding mortgage bonds of the SP&S and each parent company received $1.1 million in bond interest during the year. The mortgage bond issue matured March 1, 1961 and with the approval of the Interstate Commerce Commission was extended for ten years to March 1, 1971.

The Western Fruit Express Company, a wholly-owned Great Northern subsidiary which owns and operates refrigerator cars, had a successful year. During the period since World War II, the company rebuilt or replaced a large part of its fleet. Much of this work was financed with loans from Great Northern. With final repayment of these loans in 1960, the company was in a position to pay a dividend in 1961, the first in many years. Net income of $507,000 was less than the $1.2 million earned in 1960. This difference was due largely to accrual of considerably larger Federal income taxes in 1961 than in the preceding year.

During 1961 Western Fruit Express acquired 100 new cars with automatically controlled mechanical refrigeration. For 1962 delivery 35 new insulated box cars are on order and a number of refrigerated trailers for piggyback service will be acquired.

Glacier Park Company, wholly-owned subsidiary of Great Northern which carries on a number of miscellaneous activities related to the railway, had a successful year in 1961. It is no longer operating the hotels in Glacier Park which were sold at the end of 1960.

Great Northern Pipe Line Company ended its first full year of operating a 50-mile crude oil feeder pipe line from the Newburg and Glenburn fields of North Dakota to tank car loading facilities at Minot. The pipe line moved 2,310,000 barrels of crude oil in 1961. This oil formerly was loaded at a number of places on several branch lines. Concentration at a single loading point on the main line effected considerable savings in rail operating costs. The Pipe Line Company paid Great



Magnificent Mount Rainier, towering 14,410 feet above tide-water on Puget Sound, adds a dramatic touch to this aerial photo of St. Regis Paper Company's newly-expanded kraft pulp and paper mill at Tacoma, Washington.

Northern $64,000 in interest on the money advanced for construction and repaid $100,000 on its note during the year.

LEGISLATION

A Minnesota law which has required railroads to maintain full agency service at many small stations in the State was relaxed by a 1961 enactment. Under the amended law, Great Northern is finding it practicable to close some unnecessary agencies and to combine or dualize others under the control of a single agent without depriving the public of any essential services.

Aside from this step forward in Minnesota, 1961 produced no legislation of importance, beneficial or otherwise, to Great Northern in its own area or to the railroad industry in general.

Last August President Kennedy assigned to Secretary of Commerce Hodges the responsibility for developing recommendations for legislation concerning transportation to be submitted to the present session of Congress. The railroad industry, through the Association of American Railroads, has presented its views to Secretary Hodges. Included are endorsement of the urgently needed bills now pending which would establish realistic policies governing depreciation of railroad plant and equipment, impose adequate charges for the use of publicly provided facilities and modify the law which now permits agricultural commodities to be transported by motor vehicles without regulation. As this is written Secretary Hodges' recommendations have not been released to the public and President Kennedy's message to Congress has not yet been sent. It is hoped that the President's message may serve to open the way toward a constructive solution of some of the critical problems of the transportation industry.

LITIGATION

Reference was made in the 1960 Annual Report to the Spokane Gateway case, the Divisions cases, the Grain case and the Western Pacific control case.

The Spokane Gateway case, initiated by the Milwaukee Railroad before the Interstate Commerce Commission in an attempt to obtain a larger share of traffic to and from the Spokane, Portland and Seattle Railway, is now terminated favorably to Great Northern by decision of the United States Supreme Court.

The Divisions case, which involves the proportions of through freight revenues as between eastern and western railroads on transcontinental traffic, is now pending for decision before the Interstate Commerce Commission on exceptions taken to the proposed report of the hearing officers. In the companion case involving a dispute about divisions between eastern roads and midwestern roads (including Great Northern as to some traffic) the hearing officers of the Commission recommended a proposed report which, if finally adopted by the Commission and made final, would increase the divisions of the eastern lines and reduce those of the midwestern lines, with adverse effect on the revenues of Great Northern. Exceptions have been taken to the proposed report of the hearing officers. The case has been orally argued and is now pending for decision by the Commission.

In the Grain case brought by southeastern interests for changes in the grain rate structure, the hearing officer of the Interstate Commerce Commission has made a recommended report which is regarded as unsatisfactory by Great Northern. Exceptions have been taken and this case will come before the Commission for decision.

The record has been closed in the case involving competitive applications of the Southern Pacific Company and the Santa Fe Railroad to the Interstate Commerce Commission to acquire control of the Western Pacific Railroad, in which Great Northern intervened in support of the Santa Fe to protect the future of the Bieber route. In the course of extensive hearings Great Northern appeared and produced witnesses in support of its intervention. The case now awaits the issuance of a proposed report by the hearing officer.

The most important matter of litigation active in 1961 was, of course, the proposed unification, which is covered separately in this report.

PERSONNEL

Since wages constitute over 60% of all operating expenses, the productivity of the labor force is a matter of greatest concern to Great Northern's management.

To some extent the development and increasing use of labor-saving equipment in operations and maintenance work has helped offset the effect of a continuing rise in wage rates, resulting from settlements which have more or less conformed to national patterns. The investment of millions of dollars in better facilities and equipment has increased the efficiency of operation substantially, contributing to a slight upturn in productivity since 1958. However, over a period of years there has been a disturbing downward trend in employe productivity as measured in traffic units per dollar of wages paid.

Great Northern, like most railroads, has been seriously affected by this squeeze on profit, since prices cannot be increased in the face of competition from other carriers, both private and for-hire, using government-subsidized facilities.

WORK RULES STUDY

The Presidential Railroad Commission was established in November 1960 to investigate and report on restrictive and obsolete working rules of operating employes. The Commission completed the fact-finding phase of its work in late 1961, and on February 28, 1962 presented to President Kennedy its report and recommendations. Comprising the 15-member Commission were five members nominated by the carriers, five representing employe groups and five neutral public members chosen by the President and including the chairman, Judge Samuel Rifkind of New York.

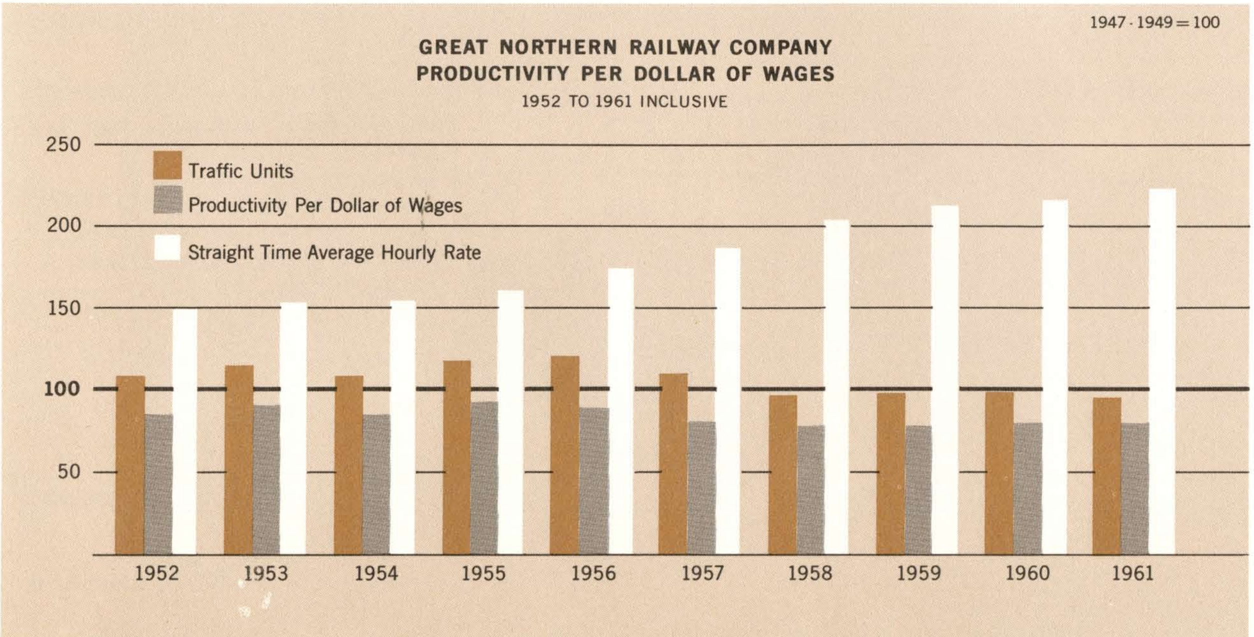
The 576-page report was accepted—with strong reservations—by carrier members of the Commission. All union members dissented.

Principal recommendations of the Commission's report are: 1. Gradual elimination of firemen from diesel locomotives in freight and yard service (firemen would continue on passenger engines); 2. Retirement of all operating employes at 70, with age lowered to 65 in five years; 3. Modernization of the pay basis to combine time and distance, with more overtime pay and fringe benefits; 4. Unrestricted right of carriers to utilize technological advances in operations, but with railways required to give severance pay, two years' job retraining and preferential rehiring status to workers displaced by technological changes; 5. Revision of work schedules to equalize working hours of employes performing similar work; 6. Revision of crew change requirements at divisional terminals to conform with modern high-speed operation.

The Commission estimated the net effect of various pay change recommendations would mean a 2% wage increase for operating employes as a group. Effect of the complete proposals on Great Northern operations and costs cannot be determined for some time.

LABOR CONTRACTS

Current labor contracts under which employes are working permit changes on November 1, 1961. Non-operating employes have asked for a substantial change in working rules to require six months' notice before forces can be reduced or positions abolished. This elimination of flexibility and a 25c per hour increase in wage rates, currently under negotiation, would greatly increase labor costs.



GREAT NORTHERN RAILWAY COMPANY

CHANGES IN WORKING CAPITAL

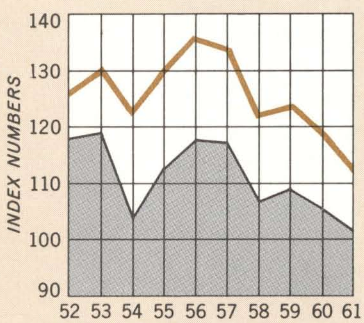
January 1 to December 31, 1961

BALANCE AT BEGINNING OF YEAR		$41,940,632*
SOURCES OF WORKING CAPITAL:		
Net income	$18,632,420	
Retained income credits	124,910	
	$18,757,330	
Depreciation and other non-cash income items	15,076,211	
Sale of property, investments and other assets	5,735,754	
Proceeds from equipment financing	5,078,828	
Other—net	47,718	44,695,841
		$86,636,473
APPLICATIONS OF WORKING CAPITAL:		
Additions and betterments to property and equipment	$20,929,808	
Reduction of debt	8,733,594	
Dividends paid on capital stock	18,236,342	47,899,744
BALANCE AT END OF YEAR		$38,736,729
NET DECREASE IN WORKING CAPITAL		$ 3,203,903

**Adjusted in accordance with Note 4 on Page 24.*

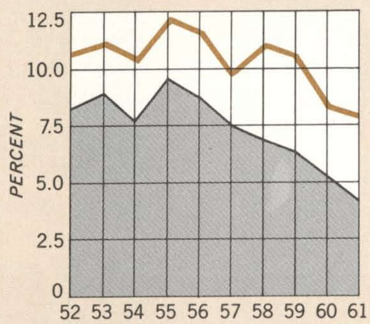
1961 Class I Railroad statistics are preliminary figures.

OPERATING REVENUES



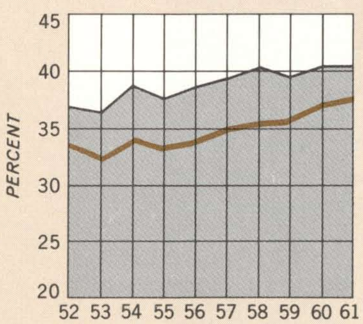
The expanding economy of the Northwest has resulted in greater traffic growth for Great Northern than for the railroad industry as a whole.

% NET INCOME TO OPERATING REVENUE



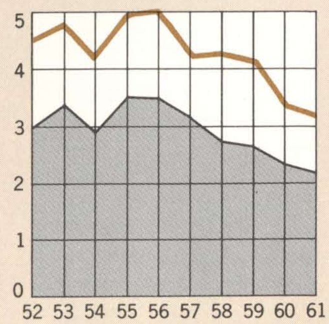
In spite of continued rise in costs, Great Northern's modern facilities, favorable location and "Other Income" resulted in a more favorable percentage of revenue to net income.

TRANSPORTATION EXPENSE RATIO



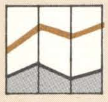
Great Northern's modern facilities and favorably located lines have permitted holding the ratio of transportation expenses to revenues well below the industry average.

TIMES FIXED CHARGES EARNED



Although fixed charge coverage was less than in recent years, Great Northern maintained its usual advantage above that of the railroad industry. There was a further reduction in long term debt.

GREAT NORTHERN RAILWAY
ALL U.S. CLASS I RAILROADS



A supplementary report containing additional operating and financial statistics may be obtained upon request to the Secretary of the Company at St. Paul 1, Minnesota.

GREAT NORTHERN RAILWAY COMPANY

STATEMENT OF INCOME

Year ended December 31, 1961 with comparative figures for 1960

	1961	1960
Operating Revenues:		
Freight	$204,862,561	$218,533,299
Passenger, mail and express	20,175,746	19,296,526
Other	7,913,611	8,194,825
Total operating revenues	232,951,918	246,024,650
Operating Expenses:		
Transportation	87,751,336	90,568,907
Maintenance of way and structures	36,406,979	39,453,944
Maintenance of equipment	42,736,255	45,378,180
Traffic, general and other	18,172,335	18,650,825
Total operating expenses	185,066,905	194,051,856
Net Revenue From Railway Operations	47,885,013	51,972,794
Taxes and Rents:		
Federal income tax (note 1(a)) less adjustment of prior years' provisions of $700,000 in 1961 and $1,100,000 in 1960	5,775,000	5,850,807
Payroll taxes	9,465,644	10,155,100
Property taxes	8,373,657	8,263,563
Other taxes	4,082,315	4,432,046
Equipment and joint facility rents—net	3,425,996	4,835,830
Total taxes and rents	31,122,612	33,537,346
Net Railway Operating Income	16,762,401	18,435,448
Other Income:		
Dividends	6,822,316	6,313,714
Interest	2,252,189	3,177,810
Rent and miscellaneous income—net	945,353	1,278,823
Total other income	10,019,858	10,770,347
	26,782,259	29,205,795
Interest on Long-Term Debt, Including Amortization of Discount	8,149,839	8,482,581
Net Income	$ 18,632,420	$ 20,723,214

STATEMENT OF RETAINED INCOME

	1961	1960
Retained Income at Beginning of Year	$369,992,061	$368,817,153
Add Net Income for Year	18,632,420	20,723,214
	388,624,481	389,540,367
Deduct:		
Dividends—$3.00 a share in each year	18,236,342	18,293,929
Miscellaneous charges and related income taxes (note 1(b) and (c)):		
Loss on obsolete property retirements	600,386	2,019,391
Past service pension fund costs	281,857	593,895
Provision for unfunded past service pension costs	14,256,906	—
Related income taxes (credit)	(7,820,358)	(1,358,909)
	7,318,791	1,254,377
	25,555,133	19,548,306
Retained Income at End of Year	$363,069,348	$369,992,061

See accompanying notes to financial statements.

ASSETS	1961	1960
CURRENT ASSETS:		
Cash and temporary cash investments	$ 45,251,581	$ 60,375,993
Accounts receivable	15,621,158	16,745,229
Material and supplies, at cost	21,728,286	24,069,862
Other current assets	506,962	571,762
Total current assets	83,107,987	101,762,846
CAPITAL AND OTHER SPECIAL FUNDS	2,480,263	2,736,775
INVESTMENTS, AT OR BELOW COST:		
Affiliated companies (note 3)	170,485,880	175,456,083
Other companies	5,312,831	995,740
Reserve for adjustment of securities	(6,318,353)	(6,318,353)
Total investments	169,480,358	170,133,470
PROPERTIES (note 2):		
Road and roadway structures, etc.	558,010,578	553,286,414
Equipment	329,831,064	323,737,184
Acquisition adjustment and donations and grants	(11,384,357)	(11,079,585)
Total transportation property	876,457,285	865,944,013
Allowance for depreciation and amortization	(222,095,665)	(213,415,734)
Net transportation property	654,361,620	652,528,279
Non-operating property	12,813,384	12,772,518
Net properties	667,175,004	665,300,797
OTHER ASSETS AND DEFERRED CHARGES (note 1(c))	15,860,975	10,091,311
TOTAL ASSETS	$938,104,587	$950,025,199

See accompanying notes to financial statements.

SHEET December 31, 1961 with comparative figures for 1960

LIABILITIES AND SHAREHOLDERS' EQUITY	1961	1960
CURRENT LIABILITIES (note 4):		
Accounts payable	$ 13,535,492	$ 11,784,695
Accrued payroll and vacation pay	9,702,256	9,976,271
Accrued taxes	15,595,317	13,904,711
Other current liabilities	5,538,193	24,156,537
Total current liabilities (excluding debt due within one year)	44,371,258	59,822,214
DEBT DUE WITHIN ONE YEAR	8,619,594	8,279,594
LONG-TERM DEBT:		
General mortgage gold bonds:		
DUE 1973, RATE 5%, AMOUNT $14,154,900		
DUE 1976, RATE 4½%, AMOUNT 14,508,000		
DUE 1982, RATE 2¾%, AMOUNT 40,000,000		
DUE 1990, RATE 3⅛%, AMOUNT 37,500,000		
DUE 2000, RATE 3⅛%, AMOUNT 37,500,000		
DUE 2010, RATE 2⅝%, AMOUNT 35,000,000	178,662,900	178,662,900
Equipment and other obligations, 2% to 5%	55,116,636	59,090,231
Total long-term debt	233,779,536	237,753,131
PROVISION FOR UNFUNDED PAST SERVICE PENSION COSTS (note 1(c))	14,256,906	—
RESERVES AND OTHER LIABILITIES (note 4)	4,156,019	4,069,215
Total liabilities	305,183,313	309,924,154
SHAREHOLDERS' EQUITY:		
Common stock without par value. Authorized 7,500,000 shares; issued 6,208,957 shares at stated value	274,028,150	274,028,150
Less treasury stock 133,647 shares (129,254 shares in 1960) (note 5).	6,035,494	5,841,711
Common stock outstanding—6,075,310 shares (6,079,703 shares in 1960)	267,992,656	268,186,439
Capital surplus (note 5)	1,859,270	1,922,545
Retained income (note 1), including $1,125,000 in each year appropriated for sinking funds	363,069,348	369,992,061
Total shareholders' equity	632,921,274	640,101,045
CONTINGENT LIABILITIES (note 6)		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$938,104,587	$950,025,199

NOTES TO FINANCIAL STATEMENTS

1. The accompanying financial statements have been prepared in conformity with generally accepted accounting principles with the following exceptions which are due to the requirement that the Company maintain its accounts in accordance with the rules and regulations prescribed or authorized by the Interstate Commerce Commission:

(a) Provision has not been made for deferred income taxes applicable to the net excess of accelerated depreciation and amortization over recorded depreciation deducted from income in determining estimated Federal income tax liability. This reduced the 1961 Federal income tax provision and increased net income for the year by approximately $2,200,000 ($2,800,000 in 1960). The corresponding aggregate reduction in Federal income taxes for prior years at December 31, 1961 applicable to the net excess of amortization and accelerated depreciation over recorded depreciation amounted to $33,500,000.

(b) Losses on certain obsolete property retirements, less related income taxes, amounting to $340,186 ($969,307 in 1960) have been deducted from retained income, rather than charged against income for the year, pursuant to a permissive order of the Interstate Commerce Commission.

(c) Pension fund contributions relating to past service benefits, less related income taxes, amounting to $135,291 ($285,070 in 1960) have been deducted from retained income, rather than charged against income for the year.

Retained income was reduced in 1961 by an additional $6,843,315 representing provision for the balance of unfunded past service pension costs of $14,256,906, as shown in the accompanying balance sheet, less estimated future Federal income tax benefits amounting to $7,413,591 included in deferred charges at December 31, 1961. As a consequence, income in future years will be relieved of annual contributions for past service pension costs less related Federal income tax benefits.

2. The road and equipment property is stated at original cost plus additions and betterments, less retirements and depreciation. Consistent with the practice generally followed by Class I railroads, the Company has not provided for depreciation prior to 1943 of road property held at that date.

3. Investments in affiliated companies include $109,504,385 pledged under general gold bond mortgages and $20,000,000 restricted as to disposition under escrow agreement. Of the investments in affiliated companies $10,632,734 represents the cost of stock held in wholly-owned subsidiary companies. The Company's equity in the net assets of such unconsolidated subsidiaries at December 31, 1961 (as shown by their unaudited financial statements) amounts to $23,745,124. The Company's equity in net income of unconsolidated subsidiaries amounted to $1,267,279 in 1961 ($349,730 in 1960) of which $570,000 was received during 1961 ($40,000 in 1960) as dividend income.

4. Accrued vacation pay and certain other liabilities which in previous years had been included in reserves and other liabilities in accordance with accounting authorized by the Interstate Commerce Commission, have been included in current liabilities in 1961. Figures for 1960 have been restated on a comparable basis by transfer of $8,366,300 from reserves and other liabilities to current liabilities.

5. Treasury stock includes 109,625 shares at December 31, 1961 reserved for officer and key employe options at prices ranging from $24 to $58 a share. During the year ended December 31, 1961, the Company acquired 13,300 shares and reissued 8,907 shares of treasury stock.

Capital surplus has been reduced by the excess of cost over stated value of stock repurchased ($5,148) and by the excess of stated value over proceeds of stock issued upon exercise of stock options ($58,801). Other increases in capital surplus ($674) relate to retirements of donated properties.

6. The Company was liable as guarantor of certain obligations of affiliated companies amounting to approximately $14,100,000 at December 31, 1961. Also, the Company is contingently liable as guarantor along with other railroads for its proportion (approximately 2.7%), and in addition its proportionate share of any contingent obligations not met by other railroad participants, of the obligations of Trailer Train Company aggregating approximately $84,700,000.

PEAT, MARWICK, MITCHELL & CO.
Certified Public Accountants
FIRST NATIONAL BANK BUILDING, ST. PAUL 1, MINNESOTA

ACCOUNTANTS' REPORT

The Board of Directors, Great Northern Railway Company:

We have examined the balance sheet of Great Northern Railway Company as of December 31, 1961, and the related statements of income and retained income for the year then ended. Our examination was 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.

The Company is required to maintain its accounts in accordance with the rules and regulations of the Interstate Commerce Commission, which differ in some respects from generally accepted accounting principles. Such differences are explained in note 1 to the financial statements.

In our opinion, except for the matters referred to in the preceding paragraph, the accompanying balance sheet and statements of income and retained income present fairly the financial position of Great Northern Railway Company at December 31, 1961 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

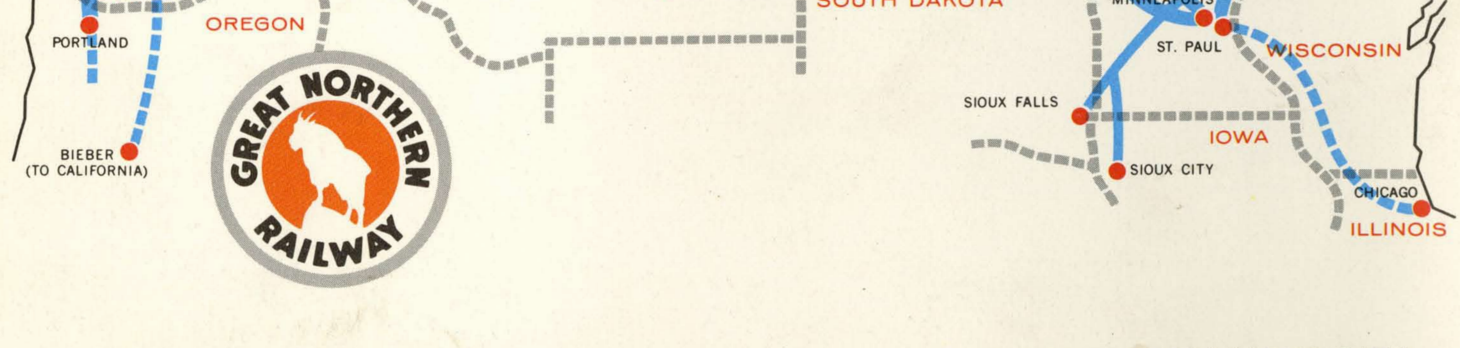
St. Paul, Minnesota, February 9, 1962

Peat, Marwick, Mitchell Co.

That soaring steel structure pictured above is an electrifying sight to travelers on Great Northern's Empire Builder. To the expected 10 million visitors who will throng to Seattle, Washington in 1962, the fantastic, 600-foot-high Space Needle, with a revolving restaurant at its top, symbolizes Century 21—the Space Age World's Fair.

At the base of the Space Needle, on a 74-acre site overlooking Puget Sound, an $80 million exposition opens April 21, to run through October 21. Here, in dazzling exhibits, are unfolded the "five worlds of tomorrow"—The World of Science, The World of Century 21, The World of Commerce and Industry, The World of Art and The World of Entertainment.

Great Northern Railway, which for more than 70 years has served and grown with this principal city of the Pacific Northwest, proudly salutes Seattle and its citizens, whose enterprise and imagination have produced a great World's Fair.



GREAT NORTHERN RAILWAY, SAINT PAUL, MINNESOTA