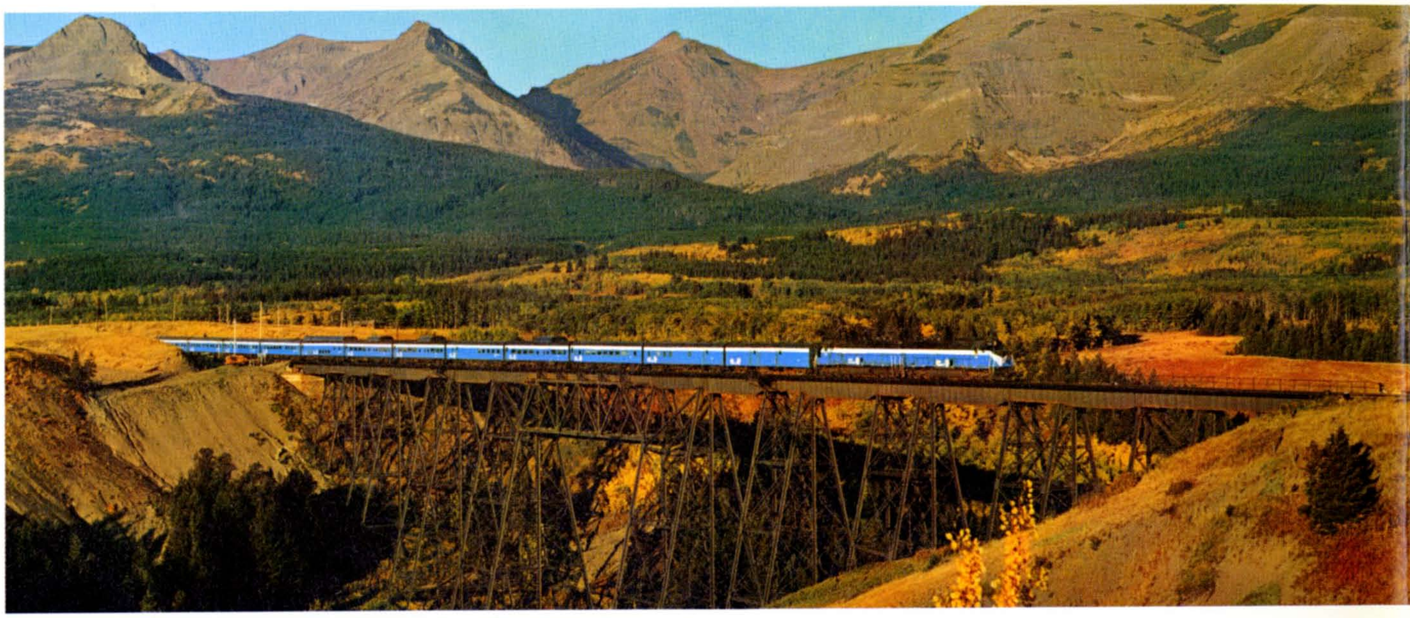
GREAT NORTHERN RAILWAY 1967 ANNUAL REPORT

GREAT NORTHERN RAILWAY COMPANY ANNUAL REPORT FOR THE YEAR ENDED DECEMBER 31, 1967



1967 was a year of purposeful change at Great Northern, and with it came a "new look." In the crisp redesigning of our familiar trademark a symbolically trimmer and more agile mountain goat appeared. We adopted a bright new color, too — Big Sky Blue. Appropriately, our cover scene is from the heart of "Big Sky Country" at Shelby, Montana, where jumbo covered hopper cars are pictured being loaded with wheat.

HIGHLIGHTS	1967	1966	INCREASE (DECREASE)
Consolidated Operations			
Net Income	$ 19,921,993	$ 37,604,594	($17,682,601)
Per Share of Great Northern Stock	$3.24	$6.11	($2.87)
Operating Revenues	$268,362,803	$289,683,805	($21,321,002)
Operating Expenses	219,895,700	214,304,939	5,590,761
Federal Income Taxes	2,420,672	12,875,672	(10,455,000)
Available for Fixed Charges	30,243,493	47,424,214	(17,180,721)
Fixed Charges	10,299,738	9,796,751	502,987
Great Northern Railway Company Operations			
FINANCIAL DATA			
Net Income	$ 19,323,461	$ 36,547,109	($17,223,648)
Per Share	$3.14	$5.94	($2.80)
Dividends Paid	$ 18,463,162	$ 18,447,494	$15,668
Per Share	$3.00	$3.00	—
Shareholders	42,647	44,519	(1,872)
Operating Revenues	$260,243,329	$281,777,075	($21,533,746)
Operating Expenses	212,853,294	207,856,575	4,996,719
Federal Income Taxes	1,885,483	12,723,000	(10,837,517)
Available for Fixed Charges	28,492,490	45,427,618	(16,935,128)
Fixed Charges	$ 9,169,029	$ 8,880,509	$ 288,520
Times Fixed Charges Earned	3.11	5.12	(2.01)
Return on Property Investment	2.08%	4.47%	(2.39%)
Cash and Temporary Investments December 31	$ 57,770,952	$ 78,283,969	($20,513,017)
Working Capital — December 31	46,519,248	64,779,839	(18,260,591)
Funded Debt — December 31	$262,575,295	$250,318,524	$12,256,771
OPERATING AND WAGE STATISTICS			
Miles of road operated	8,282	8,274	8
Revenue Net Ton Miles (millions)	17,948	19,342	(1,394)
Revenue Passenger Miles (millions)	398	436	(38)
Ratios to Revenues			
Net Income	7.4%	13.0%	(5.6%)
Transportation Expenses	39.6%	36.4%	3.2%
Maintenance Expenses	32.7%	29.5%	3.2%
All Operating Expenses	81.8%	73.8%	8.0%
Employees	16,517	16,797	(280)
Wages Paid	$130,151,559	$125,888,148	$ 4,263,411
Employment Costs:			
(Payroll plus benefits, payroll taxes, etc.)	$150,530,461	$145,110,553	$ 5,419,908

The annual meeting of Shareholders will be held at St. Paul on May 9, 1968.

To Our Shareholders:

For a year which brought commendable growth and progress in many areas of our corporate life, 1967 was singularly lagging in financial rewards. The record is all the more disappointing when compared with 1966, one of the best years in Great Northern history.

Operating revenues were down $21.5 million, or 7.6%. Expenses, on the other hand, increased by $5 million, or 2.4%. The result was a drop in net income from $36.5 million in 1966 to $19.3 million in 1967.

The boom anticipated in late 1966 and early 1967 simply did not materialize in Great Northern territory, excepting in the Everett-Seattle-Tacoma area.

Grain, lumber and iron ore paced the general decline in traffic volume. Strikes by grain handlers in the St. Paul - Minneapolis and Duluth-Superior areas, plus work stoppages in the copper and automobile industries, took a toll of our revenues.

The grain harvest was excellent in both quantity and quality, but large crops in other countries helped produce a world market surplus. Lumber suffered from a decline in housing starts, attributed to tight money and high interest rates. Iron ore reflected reduced demands for steel and delayed production from new taconite facilities.

A further decline in the passenger train situation came with a Post Office Department announcement that cars used for sorting mail were being removed from most Great Northern trains, and that remaining post office cars and almost all storage mail would be eliminated from passenger trains during 1968. Passenger patronage also dropped from the 1966 level, and a reexamination of our entire passenger train operation is underway, prompted by these developments.

On the expense side, a vigorous program of cost reduction was outweighed by the increase in labor and materials costs. Minimum train service requirements preclude cutting transportation expenses on a direct ratio with reduced tonnage.

Two additional factors which pared 1967 net income were substantially increased payroll taxes and high rates of interest on borrowed money.

Happily, the year had many bright spots, including Interstate Commerce Commission approval of our merger with the Northern Pacific, Chicago, Burlington & Quincy and Spokane, Portland and Seattle railways. Shareholders of the GN, NP and Burlington will have voted (March 14) on the merger, as conditioned by the ICC, before this report is off the press.

We hope that the Commission will have taken action, too, disposing of several requests for reconsideration, as discussed more fully on a following page. Meanwhile, our enthusiasm for the merger grows, and we are eager to exploit its vast potential for superior service and enhanced earning power.

Last year's report told of a program which would capitalize on opportunities to improve the long-term strength of the railway. There was encouraging progress on this program during 1967.

A major reorganization of Great Northern's Traffic Department, now known as Marketing, crystalized a new philosophical approach to securing business, with its focus on the total distribution requirements of our principal customers, present and potential. Specialized knowledge of these needs will be applied to creating rail services economically attractive to the customer and profitable to the railway.

Industrial development, as a responsibility of the Marketing Department, is being given greater emphasis in the new program. In this connection, a jet aircraft delivered early in 1968 will be a useful tool, and will contribute to the effectiveness of other departments in this increasingly fast-paced business.

Improvements in service are essential to Great Northern's customer-oriented planning. A first stage is computerized checking and control of terminal performance. Installations were made at several important yards in 1967, and the remainder will be completed this year. Better control of cars, faster movement of traffic through terminals and generally more efficient operation already have been noted.

Quality of our transportation service will be measured more objectively so that trouble spots can be eradicated. Important strides already have been made in improving the quality and efficiency of locomotive and freight car repairs, and of accounting and other clerical work.

Capital expenditures in 1967 totaled $48.5 million, an amount previously exceeded only by the $50.3 million spent in 1966. Investment in new equipment was $38.2 million, with $10.3 million allocated to fixed property improvements.

The 1968 outlook at Great Northern is complicated by many puzzling uncertainties on both the national and international scene. It is pleasing that traffic levels in the early part of 1968 are slightly higher than a year ago. Great Northern, of course, is particularly dependent upon products of the fields, forests and mines as principal revenue sources, and in this perspective there are some encouraging signs.

Grain in storage along the railroad is at a high level, with much more of it under the loan program than was true a year ago. It seems reasonable to assume the movement of a substantial tonnage in 1968. Also, a predicted increase in home building should improve our lumber picture.

Production of steel, which determines the movement of iron ore, is uncertain. Consumers of steel are stockpiling in anticipation of a strike in this industry, and heavy shipments are expected prior to the first of August, with a sharp decline in the latter part of the year. The movement of iron ore will vary to a lesser extent, however, and should reflect the anticipated needs of the steel industry not only in 1968 but through the first half of 1969.

The level of business activity during the year will of course influence revenues from the transport of manufactured goods. The prospects of a continued boom in the Everett-Seattle-Tacoma area are good and should bolster the tonnage of general commodities handled. Everything considered, 1968 should be a year of reasonable progress for Great Northern and other railroads in the region.

In concluding this letter, I would like to pay high tribute to Great Northern's officers and employees, who have responded with vigor and imagination to the difficult but exciting challenge of preparing for the future.

March 8, 1968

PRESIDENT

FINANCIAL

GN earnings reflected unstable economic trend in 1967, as net income dipped to $19.9 million or $3.24 per share. Income of $14.3 million from investments more than covered fixed charges of $10.3 million.

The trend of the economy in 1967 brought frustration for most forecasters, who had anticipated that business levels would be at least stable in the early part of the year, followed by a boom. The actual movement of most commodities was disappointing from the beginning, reaching a low point in the second quarter and then gradually recovering. At no point did Great Northern reach the excellent level of net income of 1966.

Shipments of Great Northern's three principal commodities — grain, lumber and iron ore — were down well into the year. While lumber made a good recovery about mid-year, movement of grain remained well below that of 1966 in spite of an excellent harvest. The fact that 62% of the entire decline in freight revenue occurred in grain indicates the importance of this commodity in the revenue picture. Fortunately, the grain that did not move in 1967 is still largely in storage and should bolster income in 1968.

Net Income

Consolidated net income of Great Northern and its majority-owned subsidiaries was $19.9 million or $3.24 per share in 1967, down from $37.6 million or $6.11 per share in 1966.

Net income of Great Northern Railway alone was $19.3 million, equal to $3.14 per share, compared with $36.5 million or $5.94 per share in 1966.

The annual dividend of $3.00 per share was continued with payments of 75¢ per share in each quarter.

Operating revenues of $260.2 million in 1967 were $21.5 million less than in 1966. Many expenses, particularly wage costs, increased sharply during the year. The entire economy is passing through a period of inflation in which rising costs are outpacing improvements in labor productivity.

The 7.6% decline in revenue brought a strenuous effort to control expenses, particularly in view of the 6% increase in wage rates negotiated for the industry on a national basis. These settlements became effective during the year, with some made retroactive to January 1, 1967 or earlier. By keeping a tight rein on costs, the increase in operating expenses was held to 2.4%.

Although income taxes decreased because of lower earnings, property taxes remained about the same. There was an increase of nearly 11% in payroll taxes to pay greater benefits to employees under various Federal programs such as Medicare, retirement and unemployment insurance.

Fixed charges were earned 3.31 times before income taxes and 3.11 times after taxes. The strength of Great Northern's financial position is shown by the stability in income from investments, primarily dividends and interest. This source of income declined only modestly from $14.4 million in 1966 to $13.9 million in 1967, more than covering fixed charges of $9.2 million during the latter year.

The financial position discussed in the preceding paragraphs relates to the railway alone. In the consolidated statements shown in the statistical material at the end of this report, majority-owned subsidiaries are included.

Net income as consolidated is increased by 10¢ per share to $3.24 per share. These additional earnings come from the undistributed share of the earnings of Western Fruit Express Company and Glacier Park Company, both of which are 100% owned, and certain other small companies in which a majority of the stock is owned.

These consolidated earnings do not include Great Northern's share of the undistributed net income of two major affiliated railroads and a pipe line company in which less than a majority interest is owned. These companies are Chicago, Burlington & Quincy Railroad Company (48.6% owned), Spokane, Portland and Seattle Railway Company (50% owned) and Portal Pipe Line Company (43.75% owned). During 1967 Great Northern's share of the earnings of these companies not included in the consolidated accounts amounted to $908,000, or 15¢ per share of Great Northern stock.

Financial Position at End of Year

At the end of 1967, cash and temporary investments which can easily be converted into cash amounted to $57.8 million, a decrease of $20.5 million during the year due to investment of funds in the property.

Current assets were $103.8 million and current liabilities were $57.3 million. The level of working capital is satisfactory, and after deducting debt due in 1968 the net working capital position is $37.7 million.

Funded debt, consisting mostly of bonds and equipment trust certificates outstanding in the hands of the public, amounted to $262.6 million. This was an increase of $12.3 million, since the debt incurred for new equipment exceeded maturities of equipment trusts during the year.

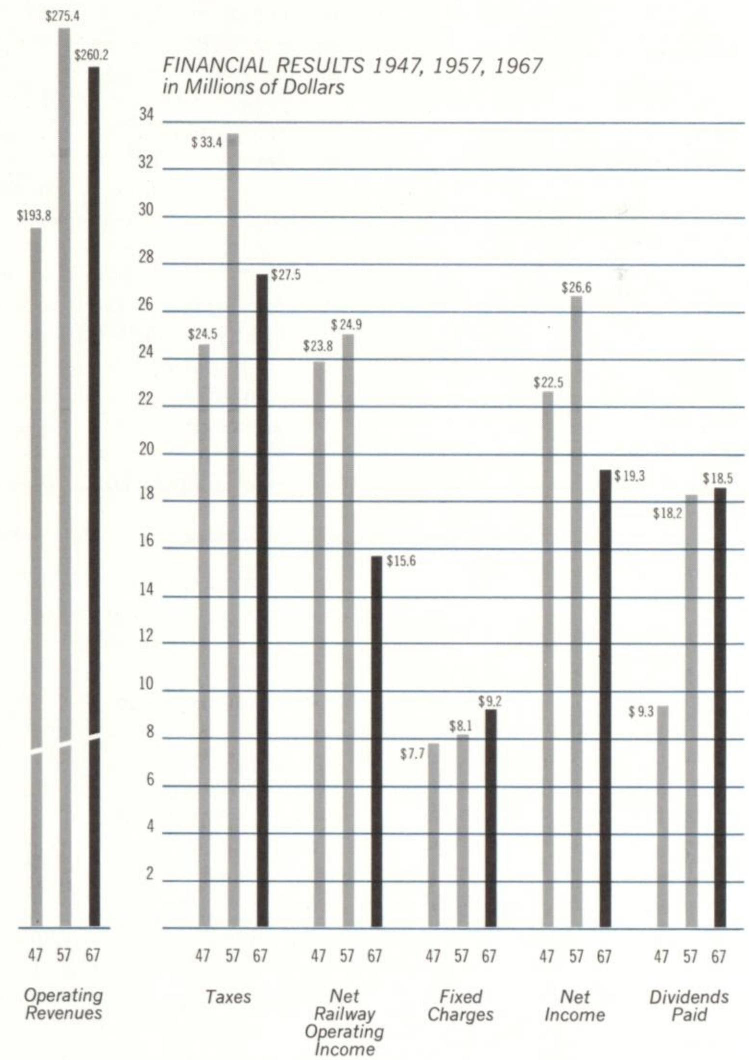
Report on Unification

The 1966 Annual Report reviewed several historic developments in the long effort to unify Great Northern, Northern Pacific, Burlington and Spokane, Portland and Seattle into a single railway system. Disapproval of the proposal by the Interstate Commerce Commission on a 6 to 5 vote in April that year was followed in July with the filing of a petition for reconsideration. Agreements providing protective conditions subsequently were reached with the Milwaukee Road and the Chicago and North Western Railway, which then supported the merger.

In January 1967 the Commission granted reconsideration and set a hearing for March 6. The record was reopened on a limited basis to bring it up to date by reflecting changes in savings as a result of the protective conditions for the Milwaukee and C&NW. Most, although not all, of the opposition to the merger which had been manifested at earlier hearings had disappeared, and the record was closed with oral argument by counsel in June.

The Interstate Commerce Commission issued an order on December 15, 1967 which approved the merger by an 8 to 2 majority and set January 20, 1968 as the earliest date on which the merger could become effective. A few days prior to that date petitions were filed with the Commission by The Denver & Rio Grande Western Railway and the committee representing a small group of Northern Pacific Railway stockholders. These request that the merger be postponed and restudied. In addition, three railroads have asked for changes in certain of the conditions. An early decision by the Commission is hoped for.

The latest savings estimates indicate an annual increase in net before taxes of at least $39.7 million. In addition, unification will bring important improvements in the quality of service which can be obtained in no other way. Necessarily, this report is written before the special meetings of stockholders of the applicant lines which are scheduled for March 14, 1968. Full information concerning the merger has been furnished in proxy statements sent to the stockholders.



1967 INCOME in Millions of Dollars

Freight Revenue	$232.9	85.0%
Passenger Revenue	$ 9.6	3.5%
Mail Revenue	$ 9.4	3.4%
Express Revenue	$ 1.3	0.5%
Other Revenue	$ 7.0	2.5%
Other Income	$ 13.9	5.1%

1967 OUTGO in Millions of Dollars

Wages chargeable to Operating Expenses	$125.8	45.9%
Other Operating Expenses—Rents, etc.	$ 92.4	33.7%
Taxes	$ 27.5	10.0%
Fixed Charges	$ 9.2	3.4%
Dividends	$ 18.5	6.7%
For Reinvestment, etc.	$ .7	0.3%

$274,145,209=100%

OPERATIONS

Operating revenues of $260.2 million were down 7.6% from record level of 1966. Loadings of most commodities slackened, but expenses jumped 2.4% with higher price tags on wages and materials. Mail loss hits passenger trains.

Final phase of Index line change in Cascade Mountains included two new bridges spanning Skykomish River. Completion of the seven-year, $8 million improvement project shortened GN's main line 7,420 feet and reduced curvature 864 degrees.

Operating Revenue

By almost any measure, 1967 was a disappointing year — particularly following Great Northern's record-breaking 1966. Total operating revenues of $260.2 million in 1967 compared with $281.8 million the year before.

Decreases were noted in most categories, with the major reduction in freight, which consistently produces nearly 90% of all operating revenues. Most railroads in the United States experienced similar painful results of a decelerated economy.

Sources of operating revenues were:

Operating Revenues (millions)

	1967	% change over 1966	1966	1965
Freight	$232.9	7.5-D	$251.8	$236.9
Passenger	9.6	11.0-D	10.7	10.1
Mail	9.4	0.7-I	9.4	9.1
Express	1.3	14.7-D	1.5	1.4
All other operating revenues	7.0	16.3-D	8.4	8.1
Total	$260.2	7.6-D	$281.8	$265.6

Freight Revenue

Revenue from freight traffic declined in nearly every important category in 1967. Volume in net ton miles also was down, but relative only to the two boom years of 1965 and 1966. The bulk of the reduction occurred in three major commodities which are the backbone of Great Northern's traffic: grain, lumber and iron ore.

Grain revenue was down $11.7 million from 1966 due principally to lower market prices and a slackening of the heavy export movement of the year before. The 1967 crop was an excellent one, with good yields and an increase in acreage planted. However, holding of grain on farms was encouraged by the tremendous storage capacity available and by the "soft" market which made storage under the government loan program attractive.

As a result, 275 million bushels of grain were in storage and awaiting movement at the beginning of 1968. This compared with 245 million bushels at the beginning of 1967, or an increase in storage of 12.2%.

Consistent with the downward trend in the use of natural iron ore, Great Northern experienced a drop of about 35% in volume handled. Although we moved 2.1 million tons of taconite pellets for the first time in 1967, total iron ore shipments were still off 21% from 1966.

The decrease was greater than anticipated, and was attributed in part to larger inventories of iron ore at the steel mills, and the lower operating rate of the steel industry as compared to 1966.

A significant volume of iron ore moved all-rail in train loads from the Mesabi Range to a steel mill in Illinois. This market for Minnesota ore is made possible by the economy inherent in large volume train movement. Plans are being made to develop additional all-rail movements of both natural ores and taconite pellets.

Lumber shipments for the year were down 6.7%. Depressed revenues for the first half of 1967 were countered somewhat by an upswing of activity in this commodity in the second half. A slight increase in lumber revenue is anticipated for 1968.

Industrial strikes also took their toll of Great Northern revenue during the year. The shut-down of the copper industry brought a $3 million reduction of revenues, while the strike in the auto industry produced a 5% decline in the movement of automobiles and trucks.

A general freight rate increase of about 3% was granted in August by the Interstate Commerce Commission. This was the first general increase since 1960. In this same period wages escalated 27%, indicating that rail freight transportation is a real bargain in today's economy.

Passenger Train Revenue

Passenger traffic shared in the general decline from 1966 levels. Revenues of $9.6 million were down 11%. This ended a four-year trend of modest improvement, stimulated notably by major strikes in other segments of the transportation industry during 1966.

The rail passenger deficit is a problem of general knowledge and national concern, and Great Northern's deficit is very real, regardless of how costs are allocated. On a direct expense basis it was approximately $7 million

Commodity	*1967 Revenues (Millions)*	*1966 Revenues (Millions)*	*Percent Change 1967*
Grain and grain products	$58.4	$69.6	(16.1)
Lumber and products	37.6	39.8	(5.5)
Iron ore including dock charges	14.9	18.2	(18.1)
Smelter products (copper, aluminum, lead and zinc)	11.8	11.1	6.3
Wood pulp, paper and products	11.7	12.5	(6.4)
Motor vehicles	7.2	7.2	—
Crude petroleum and products	5.8	6.1	(4.9)
Alumina	5.7	6.5	(12.3)
Coal and coke	5.6	5.4	3.7
Iron and steel manufactured articles	5.5	5.5	—
Apples	4.4	4.5	(2.2)

Huge "canopy" cars, largest in regular rail service, look like toys inside the new plant near Everett, Washington where Boeing is assembling its 747 jumbo jet. Component parts for the plane move by rail from other plants across the nation. Final leg of the journey is up a steep spur from Puget Sound, with the caboose running ahead of the Diesel on a 5.6% grade.

in 1967, or about $1.9 million more than in 1966.

We have on one hand a low volume of traffic during all but a few months of the year. On the other a high level of expense continues, inexorably, the year around. This includes provision of facilities such as stations and ticket offices, as well as expenses for depreciation and repair of equipment. Adding further to the dilemma is the extremely high ratio of labor costs characteristic of the service, making the profitable operation of this segment of our business impossible.

Nonetheless, every effort has been made to provide an attractive service to the extent that patronage warrants it. During the year five new coaches were rebuilt from former sleeper-observation cars. In St. Paul a new central reservation bureau was equipped with the latest facilities for nation-wide communications with railway ticket offices and travel agencies.

Mail and express revenue was about the same as in 1966, although it is expected that revenue from mail will decline significantly in 1968 with the withdrawal of railway postal service late in 1967 and the anticipated shift of storage mail to freight service.

The loss of RPO business will cost Great Northern about $1.3 million annually.

Operation of one pair of trains between St. Paul and Fargo, North Dakota ended February 15, 1968, with approval of the Interstate Commerce Commission. The railway had applied for their discontinuance in the fall of 1967.

Operating Expense

Despite reduced employment and a paring of maintenance work scheduled for 1967, operating expenses increased from $207.9 million to $212.9 million for the year.

Transportation expense was only slightly higher than in 1966, but with lower revenue the transportation ratio increased from 36.4% that year to 39.6% in 1967. The average length of haul, at 407 miles, was the highest in Great Northern history. Average freight train speed also increased 4%.

Expenses for the maintenance of way and properties totaled $39.8 million, up $1.8 million from 1966. The increase was due principally to higher wage rates and material prices.

Maintenance of equipment expenses in 1967 were about the same as the previous year, rising only $103,000.

Changes in Operation

More effective operating organization was achieved for the railway in 1967 with a realignment of operating divisions on July 1. The number was reduced from eight to seven with the elimination of the Klamath Division, in central Oregon and northern California, and the inclusion of its lines in the Cascade Division. This brings all service between California points and the Pacific Northwest under the jurisdiction of one superintendent, headquartered at Seattle.

The increase in freight claims, both in number and dollar value, brought an acceleration of loss and damage prevention activity, with a new program launched under the direction of the reorganized Security-Freight Claim Prevention Department as an extension of their property protection responsibilities.

Another new program, aimed at a more effective control of cars in terminals, was instituted in 1967, with a pilot installation at Spokane.

Called Terminal Performance Control (TPC), the system is based on a perpetual inventory of all cars in the terminal, with time standards established for each type of move which a car might make within that terminal.

The new control system at Spokane produced a dramatic reduction in the time required to move a car through the terminal. It was extended to Minneapolis in September and will be installed in all other major terminals in 1968. It is expected that when completed the system will yield an overall 10% increase in the utilization of freight cars on our line.

Automated loading of Great Northern's 200-car pellet train at the Butler Taconite plant takes less than 3½ hours, or 40 seconds per car, with the train moving .4 mph.

End of the line for the taconite pellets, prior to their loading in a Great Lakes ore carrier, is Great Northern's dock No. 1 at Superior. The pellets are moved to the dock on a conveyor belt system designed to handle 3,000 tons per hour.

TACONITE

Late in 1892 the first trainload of iron ore from Minnesota's Mesabi Range rolled slowly toward Lake Superior. Ten wooden cars of 25-ton capacity carried the rust-red mineral to a dock near Superior, Wisconsin, where it was transferred to a whaleback barge destined for Cleveland.

This was the inauspicious beginning of the giant Minnesota iron ore industry. The railroad was a predecessor line of the Great Northern. The dock was a forerunner of the largest iron ore docks in the world, built and operated by Great Northern.

On March 27, 1967 another ore train made a landmark journey down from the Mesabi, ushering in a bright new era for both the railroad and the range it serves. Its 196 specially-constructed cars comprised Great Northern's first unit train. Its cargo: 13,000 tons of iron-rich pellets, produced from a flint-like rock called "taconite," once believed worthless.

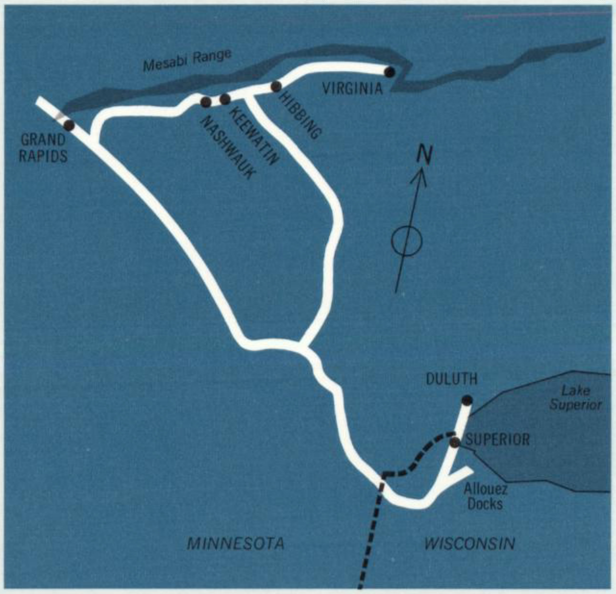
The train had been loaded, automatically while in motion, at the ultra-modern $56 million Butler Taconite plant, recently opened near Nashwauk, Minnesota.

At Superior, Wisconsin, terminus of the taconite train's speedy run, was another new facility—a giant pellet-handling and stockpiling complex built by Great Northern near its Allouez Docks. Connecting the unloading area with one of the docks, which had been remodeled to receive the pellets, was a 2-mile-long conveyor system.

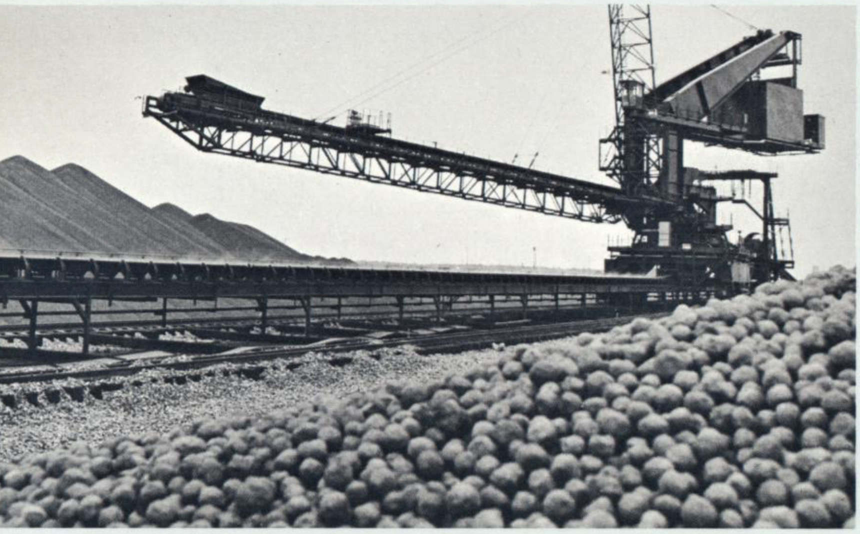
On a rainy April 14, 1967 the Hanna Company's *Joseph H. Thompson* nudged up to the dock to take on the first load of Mesabi taconite pellets, bound for Huron, Ohio.

A few months later, in August, the unit train began serving the new $70 million National Steel plant at Keewatin, where production for National Steel Corporation is projected at 2.4 million tons annually. The Hanna Mining Company operates both this and the nearby Butler plant, with a production of two million tons of pellets annually, primarily for Inland Steel Corporation and Wheeling Steel Corporation.

By the close of 1967, Great Northern had hauled 2,074,360 tons of pellets, and it is anticipated that the volume will increase over the next few years as new plants, now being planned, come into operation. With the volume of natural ore decreasing, the taconite development has been a vitalizing influence on the Mesabi Range.



Dominating GN's pellet-handling facility at Superior is this traveling 85-foot-high stacker with 160-foot boom, which straddles the conveyor belt between unit train unloading station and ore dock. During winter the marble-sized pellets, distorted in the photo, are stockpiled here.



This mechanical monster is a bucket wheel reclaimer, which bites ravenously into a stockpile of pellets at the rate of 1,500 tons per hour, returning them to the conveyor belt to the ore dock.

Meanwhile, the once-seasonal ore operation has become year-around, with the flow of pellets being stockpiled at Superior as they arrive by the unit trainload during the winter months. Great Northern's present stockpile area has a capacity of 2.2 million tons, but its potential capacity is 5.5 million tons.

The taconite train, nominally consisting of 200 cars and carrying 15,000 tons of pellets, makes the 230-mile round trip in approximately 13 to 14 hours, including loading time.

During the Great Lakes shipping season, the taconite pellets are unloaded automatically at the Superior facility and moved directly to the ore dock over the conveyor belt system. Automatically weighed enroute, they are deposited in holding pockets on the dock at an average rate of 3,000 tons per hour.

In the winter months, the pellets are diverted from the conveyor belt and placed in stockpiles by a giant 85-foot traveling stacker with a 160-foot boom. With the arrival of spring and opening of shipping lanes, the pellets are retrieved and placed again on the conveyor belt by a huge bucket wheel reclaimer. There they resume their journey to the dock and eventually to the blast furnaces, where the operators prize their ideal structure, uniformity and high iron content.

And so it was that Great Northern and the iron mining companies of the Mesabi entered the taconite era in 1967.

IMPROVEMENTS

Roadway and equipment expenditures in 1967 were near record high at $48.5 million, with significant additions to GN's freight car fleet. New taconite pellet facility at Superior and Index line change were major projects.

Nearly 10,000 carloads of new automobiles and trucks rode GN rails in 1967, producing more than $6.3 million in revenues. To handle the growing volume, 93 new bi-level and tri-level racks like these were bought.

Great Northern spent $48.5 million for new equipment and fixed property improvements in 1967. This was $1.8 million less than our record capital expenditures of $50.3 million in the more prosperous year of 1966. The allocation for roadway improvements in 1967 was $10.3 million, with $38.2 million invested in new freight equipment. The planned capital program was cut back somewhat as the decline in revenue became evident.

Equipment

Twenty-eight new diesel-electrics were added to Great Northern's locomotive fleet in 1967, replacing older, first generation units. Eight of these were 3600 HP combination freight and passenger locomotives, 10 were 3600 HP freight units and 10 were 1500 HP switchers, the first new units of this type ordered since 1957.

The switch engines were ordered after suspension of the investment credit had been lifted, and replace old switch engines of obsolete design and high maintenance cost. They are of the latest design, giving excellent visibility to the engineer and making them well suited to one-man operation in the cab.

Added to the freight car fleet were 1,622 high-capacity units, including 800 jumbo covered hoppers of which 600 are designed primarily for grain loading. Nearly 20% of the grain now transported on Great Northern moves in these efficient cars, whose reduced costs of loading and unloading are attractive to shipper and consignee. The loss of grain in transit has been sharply cut.

Two hundred of the covered hoppers were acquired for more dense commodities such as cement and fertilizers. The growing shipment of packaged lumber on open cars prompted the purchase of 100 new bulkhead flats. Also delivered during the year were 300 box cars and 200 gondolas, all of 77-ton capacity.

Another purchase was 12 special flat cars for the transport of components of the Boeing 747 jet aircraft from widely-scattered sub-contractors to a giant new assembly plant on our line near Everett, Washington.

Finally, 10 modern, all-steel cabooses were acquired to replace older cabooses due for retirement. And Western Fruit Express, a wholly-owned GN subsidiary, added 200 refrigerator cars to its fleet.

In addition to the new car program, our St. Cloud, Minnesota shops rebuilt 668 older box cars, which were fully modernized with roller bearings and 10-foot-wide doors to meet customer demand for this type of equipment.

Fixed Property Improvements

The $10.3 million expenditure for roadway improvements in 1967 was $4.4 million less than the previous year but only about a million dollars under the five-year average.

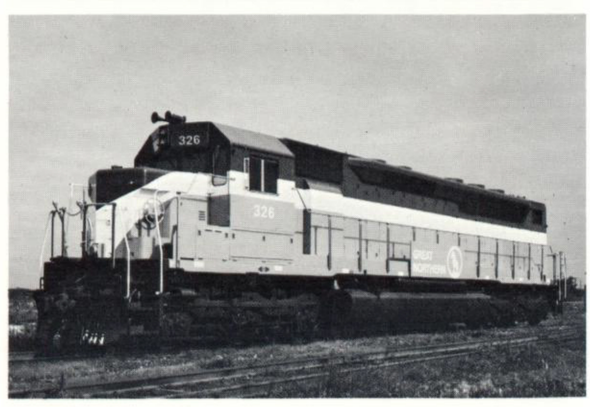
Of the continuing programs, 57.4 miles of track were laid with new rail, 368,100 cubic yards of crushed rock ballast placed and 355,000 ties renewed. Second hand relaying of branch lines was reduced, but 27.5 miles of light traffic branch lines were relaid.

Great Northern's mammoth new taconite pellet-handling facility at Superior, Wisconsin was completed early in 1967. And at the other end of the railroad, on the west slope of the Cascade Mountains, the final phase of a major line-straightening project begun in 1961 was near completion as the year closed. This latest segment of im-

Boring of GN's 7-mile Flathead Tunnel in northwestern Montana progressed rapidly in 1967, with laser beams being utilized to align drilling through Elk Mountain. Pictured here is crew placing concrete for tube extension at east entrance. Lining of tunnel will follow "holing through" expected in June, 1968.

An additional 800 covered hoppers were added to GN's freight fleet, bringing the total to 2,799 at year's end. The 100-ton jumbos seen here will haul cement for Montana's Libby Dam.

New power for Great Northern's locomotive fleet in 1967 included 1500 HP switchers and 3600 HP road engines like those pictured below. A total of 28 units were placed in freight, passenger and yard service, with 18 more ordered for 1968.



proved line is between Halford and Gold Bar, Washington, and will contribute measurably to greater dependability of service and lower track maintenance in this ruggedly scenic area.

Work progressed on yard modernization projects at Seattle and Vancouver, British Columbia during the year. Also at Seattle new trailer-on-flat-car (TOFC) loading and unloading facilities were constructed.

Centralized traffic control (CTC) installations on the 1967 program included 9.9 miles between Mukilteo and Edmonds, Washington, and two segments totaling 56.2 miles between Blackfoot and Conkelley in the Montana Rockies. Completion of the Montana project in early 1968 brings the system total to 1,285 miles.

Five miles of new automatic block signals were installed on freight tracks between St. Paul and Minneapolis and revisions made to the automatic block signal system between Nolan and New Rockford, North Dakota. The block signal revision is part of a continuing program which, when completed, will allow higher permissible speeds for freight trains while increasing the safety of our operation.

Grading was completed for four siding extensions on the Spokane Division between Whitefish, Montana and Spokane, Washington. These extensions are part of an upgrading program prior to installation of CTC planned for that territory in 1968.

Also during the year, modern highway crossing protection was installed at 18 crossings at various points on the system.

Program for 1968

The major portion of the capital expenditure program for 1968 again will be devoted to new rolling stock, although a larger proportion of the total will be assigned to necessary roadway improvements. Equipment expenditures are planned at $26 million, while $13 million will be spent on roadway and fixed facility improvements.

Planned acquisition of 18 high-horsepower road locomotives is part of a continuing program aimed at maintaining a fleet of modern high-capacity units in terms of both power and utilization.

The 800 new freight-carrying cars on the 1968 program include 150 box cars, 400 gondolas and open top hoppers, 150 bulkhead flat cars and 100 wood chip cars. For company service, 20 new cabooses and 30 air dump cars for maintenance of way work will be purchased.

Western Fruit Express, our refrigerator car subsidiary, is planning for 1968 the conversion of 200 standard refrigerator cars to bulk potato cars. This type of equipment, eliminating the expensive sacking of potatoes, has gained wide acceptance by producers and processors, and it is expected that bulk potato cars will carry approximately 35% of the Red River Valley crop. Western Fruit Express currently owns 497 of these cars, equipped with a built-in conveyor which permits automated loading and unloading.

Roadway programs for 1968 will include relaying of 42 miles of main line with new rail and 50 miles of branch line with second hand rail. Additionally, 390,000 cubic yards of ballast will be replaced and about 300,000 ties renewed.

Centralized traffic control will be installed between Troy, Montana and Sandpoint, Idaho, a distance of 65.7 miles. At Seattle the modernization of Interbay yard will continue. At Havre, Montana the diesel locomotive servicing facility will be expanded and modernized to increase the efficiency with which motive power is repaired and to reduce the time that a locomotive is out of productive service for maintenance and servicing.

In the marketing chapter of this report mention is made of a large deposit of bentonite clay being developed southwest of Glasgow, Montana. To reach the site, where a processing plant will be built, Great Northern during 1968 will construct an 18-mile spur from our main line at Glasgow.

Minneapolis is the locale of another improvement project in which new car and locomotive repair facilities will be built. Extensive improvements also are being made at the railway's general office building in St. Paul, where new automatic elevators are being installed and a new auditorium being built for joint use by Great Northern and Northern Pacific.

"Holing through" of 7-mile Flathead Tunnel in northwestern Montana is expected in late spring of 1968. The tunnel is part of a 59-mile relocation of our main line necessitated by the building of Libby Dam on the Kootenai River. Construction is by the U.S. Army Corps of Engineers.

MARKETING

Commitment to marketing concept brought major changes in organization and philosophy in 1967. New industries located on GN lines during year totaled 109, with aluminum production setting new records. Office opened in Tokyo.

Montana vermiculite, destined for England, is loaded by the Canadian Star at the Port of Seattle. The 1,800-ton export shipment of the mineral, hauled by the GN from Libby, was a "first" for the Port's new small-lot bulk handling facility.

In its portent for the future, one of the most significant developments on Great Northern during 1967 was the establishment of a Marketing Department. The phasing out of the traditional Traffic Department on July 1 marked a fundamental change in management philosophy, implemented by major changes in organization.

The commitment to a total marketing approach to our business, following more than a year of research and planning, is aimed squarely at producing improved net earnings by broadening Great Northern's revenue base. The move should enhance substantially our contribution to a healthy, viable transportation company under merger.

Advanced management practices have given the producers of goods and materials a new understanding of their total distribution process, and transportation services increasingly are evaluated within this framework.

To remain competitive it is essential that we apply at least the same degree of sophistication to probing our customers' needs and fulfilling them in ways which will be more profitable to them and to ourselves. This is the aim of Great Northern's aggressive, customer-oriented program. Research, market study, service innovation, operational changes, equipment acquisition and planning and pricing policies all will be focused imaginatively on a common target.

A major share of responsibility for implementing this marketing concept rests with the Marketing Planning Department. Twelve market managers, supported by a marketing services group, will be accountable for the revenues from specifically assigned shippers, usually in the same or closely allied commodity groups. They are charged with developing and coordinating profitable new programs based on their knowledge of the total distribution requirements of their assigned accounts.

At the close of the year, 10 of the 12 market managers and a director of marketing services had been appointed. Five of them were attracted to Great Northern from responsible positions in other industries.

While several projects already have

been initiated, it probably will be two to three years before the full impact of the marketing approach is evident.

Industrial Expansion

Another phase of marketing reorganization brought the establishment of a new Industrial Development Department which also embraces mineral research and development activities. Agricultural development, formerly linked with industrial, has been given separate status under marketing planning.

Competition for new industry is intense, and Great Northern will operate from a strengthened position with the new department. Expanded professional staffing, and a more concentrated authority for coordinating GN's industrial development effort will help assure for our area a fair share of future economic expansion.

New industries on Great Northern trackage in 1967 totaled 109, bringing the five-year tally to 545. We also participated in locating an additional 11 new industries on the jointly-operated line between Seattle and Portland, while GN's wholly-owned Pacific Coast Railroad welcomed two new warehouse operations.

The importance of agriculture in the economy of our territory is again evident in the numerical dominance of fertilizer plants, warehouses, and storage facilities in the 1967 listing, but the growth of heavy industry continues to make news.

Aluminum production in the Pacific Northwest again set new records. A substantial share of the increase occurred on Great Northern lines, with current construction providing for even greater capacity in the future.

The fourth and fifth pot lines being added to Anaconda Aluminum Company's giant reduction facility in the Montana Rockies near Columbia Falls will be completed in June and November of 1968, increasing capacity there from 100,000 to 175,000 tons annually. Also under construction is an aluminum rod mill.

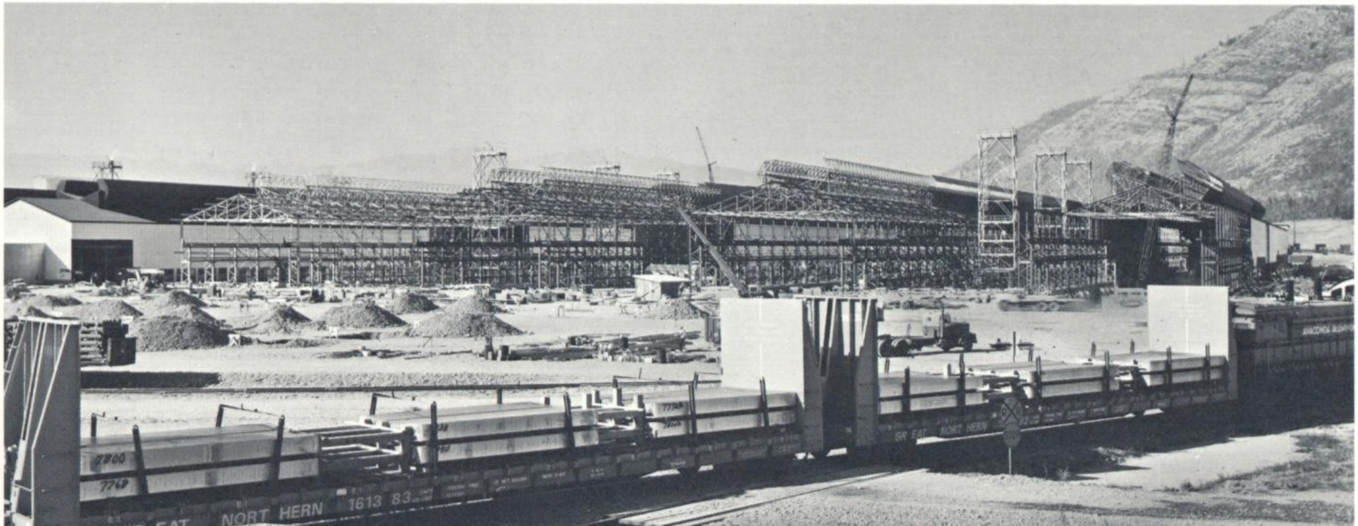
Intalco, located on Puget Sound and served by a GN spur out of Ferndale, Washington, has scheduled completion of its third pot line in 1968. An annual capacity of 228,000 tons will make it one of the largest aluminum producing facilities in the world.

Kaiser Aluminum Company currently is constructing an additional pot line and a new rod mill at their Tacoma plant, where annual production will be increased to 80,000 tons.

Alcoa, near Wenatchee, Washington, and Reynolds, at Longview, Washington, also added substantially to their production with completion of new facilities in 1967.

Industrial development efforts in

GN bulkhead flat cars loaded with giant aluminum ingots roll from the Anaconda plant at Columbia Falls, Montana. The imposing steel skeleton, when completed, will house two new potlines scheduled to begin production in 1968.



Opening GN's new office in Japan were, left to right: Vice Presidents Scanlan and Robson; Tokyo Manager Hideo Takaoka; President Budd; and Roy Inui, Seattle manager of Transpacific Export Corporation. Photo was made later in St. Paul.

which Great Northern participated brought handsome results in North Dakota in 1967 with the announcement by Holly Sugar Company of Colorado that they would construct a $20 million sugar beet refinery between Harwood and Argusville. The plant, to be served by GN, is expected to be in operation for the 1970 harvest.

Southwest of Glasgow, Montana, a major new discovery of bentonite — the clay widely used as a binder in making taconite pellets — brought the announcement of another new industry. Ashland Chemical Company, a Division of Ashland Oil & Refining Company, will develop the 16,000-acre deposit, constructing a processing plant with a planned production of 300,000 tons per year. The railway's mineral research and development staff played an important role in creating this new traffic.

A partial listing of other representative industrial expansion along Great Northern would include:

Wood chippers and rail loading facilities completed by Ksanka Lumber Company at Fortine and by Superior Buildings Company at Columbia Falls, both in Montana; a veneer plant and chipper and a plywood mill, both opened for production by Boise Cascade Corporation at Kettle Falls, Washington.

Also construction of a multi-million dollar cheese manufacturing plant at Melrose, Minnesota, where Kraft Foods expects to be in full operation by mid-March of 1968; completion by General Mills of a $750,000 addition to their storage and distribution facilities at Great Falls, Montana.

Near Everett, Washington the plant in which the Boeing Company will assemble its 490-passenger 747, the world's largest commercial airliner, was more than 90% completed at year's end. Great Northern handled 1,566 carloads of construction material during the year. Shipment of parts and sub-assemblies for the airplane will begin to arrive by rail early in 1968.

A new $350,000 car-barge slip was completed in the spring of 1967 at Great Northern's Burrard Inlet Dock in Vancouver, British Columbia. During the balance of the year the railway handled nearly two thousand carloads of newsprint and wood pulp through the facility. Formerly this traffic arrived in barges from which the paper and pulp had to be transferred to box cars.

Foreign Trade

Great Northern's new marketing concept took on an international flavor in November, when the railway announced the opening of an office in Tokyo.

Establishment of "on the ground" representation in Japan was prompted by the rapid growth of the export-import business with that country and the potential for increased container shipments. It anticipates a greater role for Great Northern not only in providing specialized marketing services to Japanese manufacturers and shippers, but in developing reciprocal west-east trade.

Great Northern is uniquely favored for this role in that it serves both the Canadian and U.S. Pacific Northwest ports closest to Japan, linking them with major markets in the heartland of America.

PERSONNEL

Program to reduce administrative costs effective, but labor productivity down with costly wage settlements. Merger agreements reached with rail unions. Personnel training programs stepped up.

It's back to night school for this group of foremen in the Twin Cities area, first to participate in a Personnel Department-sponsored course in principles of leadership and supervisory management. A broader 1968 program is planned.

Great Northern's work force declined to the lowest level in years, with the employee count standing at 16,179 at the close of 1967. This was a decrease of 413 from the previous year. It is noteworthy that although the average number of employees was down 2%, total wages paid to the lesser number increased 3%. The rising cost of labor makes imperative investment in improved equipment and labor-saving facilities.

The need to reduce administrative costs so that the largest possible work force can be concentrated on producing and selling transportation has led to extensive studies in the Accounting Department and in the clerical work of all departments. Substantial savings from simplification of work and elimination of unnecessary procedures have been achieved. Some of these are dependent upon computer applications which are now being implemented. It is anticipated that the results of the administrative cost reduction program will become increasingly apparent in 1968.

The rise in total compensation resulted in a decline in labor productivity, as shown in the table on this page.

TREND OF LABOR COSTS AND PRODUCTIVITY

Year	Average Wages Per Hour Worked *	Average Fringe Benefits Per Hour Worked	Total Labor Cost Per Hour Worked	Productivity (Traffic Units Per Dollar of Labor Costs)**
1940	$ .79	$ .05	$ .84	247
1950	1.71	.17	1.88	147
1960	2.88	.56	3.44	119
1965	3.37	.81	4.18	135
1966	3.45	.89	4.34	136
1967	3.67	.97	4.64	122

*Excludes pay for vacation, sick leave and holidays.
**Traffic units are net ton miles plus passenger miles.

Fringe benefits include: retirement and pensions; unemployment insurance; health, welfare and group insurance premiums; vacation, sick leave and holidays; and meals and lodging. The cost of these benefits to Great Northern in 1940 was $2,696,719. Twenty-eight years later, in 1967, the cost had swollen to $31,408,048.

During this same period the average wages per hour worked increased 365%, while the average fringe benefits per hour worked increased 1840%. In terms of total compensation per hour worked there was an increase of 452% since 1940.

Expansion of the activities of the Personnel Department occurred during the year, with special attention being given to training and developing the manpower resources of the railroad. A number of recent college graduates were started in training and they were joined by some outstanding men from the ranks of present employees.

During 1967, instruction of employees in safe performance of their work continued. Although there has been concern that train accidents in the railroad industry as a whole have increased in recent years, on Great Northern the rate was down in 1967. The seriousness of those accidents which did occur was materially less, with a $1.2 million decline in their cost compared to 1966.

Labor Relations

In the field of labor relations, 1967 was an especially active one. At the beginning of the year the operating unions had requests on file from various dates in 1966, while agreements with the non-operating unions permitted negotiation of wage changes no earlier than January 1, 1967. Agreements were reached late in 1966 with two operating unions, the Locomotive Firemen and the Trainmen, providing for increases of 5% retroactive to August 12, 1966. Another settlement, with the Clerks, was for a 5% increase effective January 1, 1967.

Subsequently, during 1967, agreements were concluded with almost all of the remaining union organizations on various bases averaging 5% to 6%. However, the wage dispute with five shop craft organizations could not be settled voluntarily in accordance with this pattern in spite of Government mediation and Congressional action delaying a strike.

Finally, a brief strike occurred July 16-17 on Great Northern and most other railroads. Congress enacted legislation calling for a Special Board whose findings became binding. The Board ordered increases of 6% effective January 1, 1967, plus a further increase of 5% effective July 1, 1968. Mechanics received an additional 20¢ per hour. These increases will remain in effect until December 31, 1968.

Agreements will expire on various dates during 1968 in almost all of the crafts, so another busy year in labor relations can be expected. Exceptions are the shop crafts, as noted above, and the clerks, with whom a new agreement was signed in December 1967. Rates of pay for the clerks will increase 6% in 1968 and 5% in 1969.

Since announcement of the merger approval by the Interstate Commerce Commission, labor relations officers have worked hard with the labor organizations to reach agreements implementing the changes which must come with consolidation. Accord now has been reached with all of the major unions.

These important agreements provide maximum protection for employees in meeting the personal problems of change. At the same time they give the new company the flexibility required to integrate the properties into a strong, efficient system equal to today's competitive demands.

CORPORATE

GN's 42,647 owners were widely spread in 1967. Funded debt increased moderately. Depreciation charges were more than enough for annual principal payments on debts and 20% down payment on new equipment.

Electronic computers are making a major contribution to the revolution in railroad science, and GN has been an industry leader in this field. Our latest "hardware" is this IBM 360.

Great Northern is owned by a widespread group of stockholders, numbering 42,647 on the last record date in 1967. They are found in every state, in most Canadian provinces and abroad. A great many others are indirect owners through their interest in the nearly 100 institutions, such as mutual funds, insurance companies and pension funds, which own Great Northern shares.

Funded Debt

During 1967 funded debt outstanding in the hands of the public increased moderately. No change in mortgage bonds occurred. However, sales of three new issues of equipment trust certificates totaling $18,735,000, to finance new equipment, exceeded maturities of already outstanding issues.

As of Dec. 31	General Mortgage Bonds	Equipment Obligations	Miscellaneous Obligations	Total Funded Debt
		(Millions)		
1962	$178.7	$56.2	$—	$234.9
1963	178.7	59.1	—	237.8
1964	178.7	58.9	—	237.6
1965	178.7	69.5	—	248.2
1966	178.7	71.6	—	250.3
1967	178.7	82.3	1.6	262.6

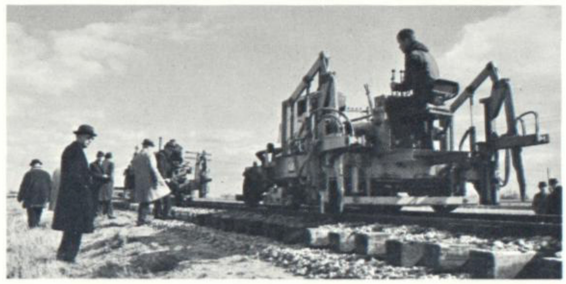
Lease obligations for rolling stock are relatively minor, and excluding payments to a wholly-owned subsidiary amounted to $1.7 million in 1967. Because requirements are changing and improved models become available at frequent intervals, relatively little of our extensive computer equipment is owned, but instead is rented or leased.

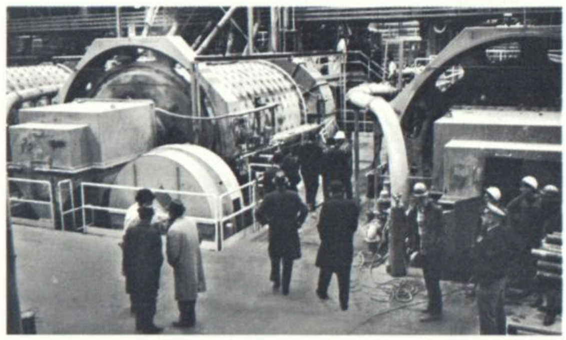
Depreciation charges, which are included in maintenance accounts as an expense but do not require payment of actual cash, amounted to $18.0 million. This is more than enough to make the annual principal payments on debts due in 1968 amounting to $8.8 million and to make the 20% down payment on new equipment to be financed by trusts during the year.

For many years the Interstate Commerce Commission has consistently ruled that depreciation be on a straight line basis, and Great Northern accounts reflect this method of reporting.

In making returns for Federal income taxes, however, Great Northern varies from straight line accrual of depreciation in the following ways:

1. To encourage investment in facilities essential to the war effort, Federal tax laws for a number of years during and shortly after the Korean War per-





Stewardship responsibility of Great Northern directors requires a first-hand knowledge of the railway and its customers. Directors are pictured here on a 1967 inspection trip which included stops at a North Dakota track job and a Butte, Montana copper concentrator.

Year	Change in Net Income Due to Amortization of Defense Facilities (Millions)	Change in Net Income Due to Amortization of Defense Facilities Per Share	Increase in Net Income Due to Accelerated Depreciation and Guideline Lives (Millions)	Increase in Net Income Due to Accelerated Depreciation and Guideline Lives Per Share	Total Increase in Net Income (Millions)	Total Increase in Net Income Per Share
1962	$0.5-D	$0.08-D	$6.5-I	$1.07-I	$6.0-I	$0.99-I
1963	1.3-D	0.22-D	7.1-I	1.17-I	5.8-I	0.95-I
1964	1.3-D	0.21-D	6.9-I	1.12-I	5.6-I	0.91-I
1965	1.2-D	0.20-D	6.8-I	1.11-I	5.6-I	0.91-I
1966	1.1-D	0.18-D	4.4-I	0.71-I	3.3-I	0.53-I
1967 (Est.)	1.1-D	0.18-D	4.3-I	0.70-I	3.2-I	0.52-I
1968 (Est.)	1.1-D	0.18-D	4.1-I	0.67-I	3.0-I	0.49-I

mitted amortization of investments over a five-year period. The tax benefits of this law expired in 1962, and net income currently is reduced as depreciation is still charged on the company's books with no offsetting income tax benefits.

2. Federal tax laws permit property acquired after January 1, 1954 to be depreciated on an accelerated basis for tax purposes.

3. In addition, the Treasury in 1962 published new guide lines which permit use of shorter lives in calculating depreciation for tax purposes than authorized by the Commission.

The net effect in 1967 of the depreciation adjustments, with consequent reduction of income taxes, is net income \$3.2 million, or 52¢ per share, greater than would have been reported had the tax benefits not been taken.

These tax benefits may result in payment of higher taxes in the future, the timing and extent of which cannot be determined. There has been some difference of opinion as to the appropriate accounting. The Interstate Commerce Commission has ruled that net income should be determined on the basis of tax expense actually incurred in the current year, regardless of the fact that a benefit from depreciation for tax purposes greater than book depreciation may be temporary.

We continue to use the accelerated depreciation methods when beneficial, and the shorter guideline lives for tax purposes. The effect of this tax accounting is to reduce current income taxes and to increase net income as shown, for Great Northern Railway Company only, in the table on the preceding page.

Another important tax benefit is the credit of 7% of the cost of new equipment which is allowed against income taxes subject to certain limitations. The purpose of this credit is to encourage the acquisition of new equipment by American industry, and it is particularly helpful to Great Northern.

However, in October 1966 the investment credit was suspended as part of a program to dampen overexpansion in the economy. The effect of the suspension on railroad expenditures was greater than had been anticipated, and in mid-1967 the credit was reinstated. In 1966 the tax benefit on a consolidated basis was \$4,485,000, but no benefit was available in 1967. However, the unused credit totaling \$5,700,000 on a consolidated basis at the end of 1967 is being carried forward for use in later years.

GREAT NORTHERN RAILWAY COMPANY

CONSOLIDATED FINANCIAL STATEMENTS

The consolidated statements on the following pages indicate the balance sheet accounts as of December 31, 1967, and results of operations for the year then ended (with comparative figures for 1966) of the Great Northern Railway Company and its majority-owned subsidiary companies. These are:

Western Fruit Express
Principal business: ownership of refrigerated boxcars and trailers.

Pacific Coast R.R. Co.
Principal business: line of railway Seattle, Washington, to Renton, Washington.

Minneapolis, Anoka, & Cuyuna Range R.R. Co. (since Sept. 1, 1967, only)
Principal business: line of railway Minneapolis, Minnesota, to Fridley, Minnesota.

Delta Alaska Terminal, Ltd. (60% owned)
Principal business: tranship terminal at Vancouver, B. C.

Superior Transfer Company
Principal business: pick up and delivery service at Duluth, Minnesota; Superior, Wisconsin; and Seattle, Washington.

Glacier Park Company
Principal business: ownership of timber and industrial development lands, tie treating facilities, and freight cars.

For comparative purposes, condensed statements for Great Northern's two large jointly-owned affiliates — the Chicago, Burlington & Quincy Railroad Company (and subsidiaries), and the Spokane, Portland and Seattle Railway System — are shown on pages 27 and 28, with condensed statements for Great Northern only for 1966-67 on page 25.

A supplementary report containing additional operating and financial statistics may be obtained upon request to the Secretary of the Company at St. Paul, Minnesota 55101.

GREAT NORTHERN RAILWAY COMPANY AND
MAJORITY-OWNED SUBSIDIARIES

STATEMENT OF CONSOLIDATED INCOME

	Year Ended December 31, 1967, With Comparative Figures for 1966 1967	1966
OPERATING REVENUES:		
Freight	**$239,284,630**	$258,194,424
Passenger, mail and express	**20,272,675**	21,603,977
Other	**8,805,498**	9,885,404
Total operating revenues	**268,362,803**	289,683,805
OPERATING EXPENSES:		
Transportation	**104,744,577**	103,681,624
Maintenance of way and structures	**38,050,603**	36,639,425
Maintenance of equipment	**50,393,400**	50,076,399
Traffic, general and other	**26,707,120**	23,907,491
Total operating expenses	**219,895,700**	214,304,939
NET REVENUE FROM RAILWAY OPERATIONS	**48,467,103**	75,378,866
TAXES AND RENTS:		
Federal income tax (note 2)	**2,420,672**	12,875,672
Payroll taxes	**13,676,444**	12,310,255
Property and other taxes	**12,822,960**	13,086,538
Equipment and joint facility rents — net	**1,961,900**	1,931,648
Total taxes and rents	**30,881,976**	40,204,113
NET RAILWAY OPERATING INCOME	**17,585,127**	35,174,753
OTHER INCOME (DEDUCTIONS):		
Dividends	**6,761,065**	6,743,453
Interest	**4,591,656**	4,926,602
Rent and miscellaneous income — net	**1,305,645**	579,406
Interest on long-term debt, including amortization of discount	**(10,299,738)**	(9,796,751)
Minority interest	**(21,762)**	(22,869)
Total other income — net	**2,336,866**	2,429,841
NET INCOME	**$ 19,921,993**	$ 37,604,594
PER SHARE (including 54¢ in 1967, 59¢ in 1966, attributable to acceleration of depreciation deductions for income tax purposes) (note 2)	**$ 3.24**	$ 6.11

STATEMENT OF CONSOLIDATED RETAINED INCOME

	1967	1966
RETAINED INCOME AT BEGINNING OF YEAR		
As previously reported (company only)		$414,104,682
Adjustment of prior year provision for past service pension cost (note 4) (less taxes)		864,000
Other adjustments (less taxes)		942,309
		415,910,991
Applicable to subsidiaries consolidated		15,064,780
As restated	**$450,123,807**	430,975,771
NET INCOME FOR YEAR	**19,921,993**	37,604,594
CASH DIVIDENDS ON COMMON STOCK $3.00 per share in each year	**(18,465,663)**	(18,456,558)
RETAINED INCOME AT END OF YEAR (note 2)	**$451,580,137**	$450,123,807

See accompanying Notes to Financial Statements

Great Northern Railway Company and
Majority-Owned Subsidiaries

BALANCE SHEET

December 31, 1967, with
Comparative Figures for 1966

ASSETS	1967	1966
CURRENT ASSETS:		
Cash and temporary cash investments	**$ 59,402,138**	$ 82,282,509
Accounts receivable	**24,607,054**	22,610,068
Materials and supplies, at cost	**23,793,447**	21,608,122
Other current assets	**682,156**	633,193
Total current assets	**108,484,795**	127,133,892
CAPITAL AND OTHER SPECIAL FUNDS	**2,305,606**	2,638,202
INVESTMENTS, AT OR BELOW COST:		
Common stock of major jointly-owned affiliates (Great Northern's equity in the increase in retained income of these affiliates since dates of acquisition is $271,481,000) ($271,032,000 in 1966)	**129,245,456**	129,245,456
Other investments	**30,918,084**	29,241,149
Total investments	**160,163,540**	158,486,605
PROPERTIES:		
Road and roadway structures, etc.	**589,354,125**	580,870,722
Equipment	**503,929,623**	474,037,034
Total transportation property	**1,093,283,748**	1,054,907,756
Allowance for depreciation and amortization	**310,007,308**	301,954,237
Net transportation property	**783,276,440**	752,953,519
Non-operating property	**20,743,100**	18,838,216
Net properties	**804,019,540**	771,791,735
OTHER ASSETS AND DEFERRED CHARGES	**13,185,137**	13,934,543
Total assets	**$1,088,158,618**	$1,073,984,977

See accompanying Notes to Financial Statements

LIABILITIES AND SHAREHOLDERS' EQUITY	1967	1966
CURRENT LIABILITIES:		
Accounts payable	**$ 21,067,327**	$ 19,279,696
Accrued payroll and vacation pay	**12,233,185**	11,823,119
Accrued taxes	**16,950,398**	21,049,099
Dividends payable	**4,617,203**	4,614,702
Other current liabilities	**4,036,546**	2,253,922
Total current liabilities (excluding debt due within one year)	**58,904,659**	59,020,538
DEBT DUE WITHIN ONE YEAR	**15,828,221**	9,520,579
LONG-TERM DEBT:		
General mortgage bonds:		

Due	Rate	Amount
1973	5%	$14,154,900
1976	4 1/2%	14,508,000
1982	2 3/4%	40,000,000
1990	3 1/8%	37,500,000
2000	3 1/8%	37,500,000
2010	2 5/8%	35,000,000

	1967	1966
General mortgage bonds total	**178,662,900**	178,662,900
Equipment and other obligations	**93,873,591**	84,140,327
Total long-term debt	**272,536,491**	262,803,227
PROVISION FOR UNFUNDED PAST SERVICE PENSION COSTS (note 5)	**9,500,000**	9,500,000
RESERVES AND OTHER LIABILITIES	**6,964,202**	10,284,335
Total liabilities	**363,733,573**	351,128,679
MINORITY INTEREST	**196,434**	208,005
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 — 53,295 shares (56,305 shares in 1966) (note 3)	**2,491,028**	2,623,805
Common stock outstanding — 6,155,662 shares (6,152,652 shares in 1966)	**271,537,122**	271,404,345
Capital surplus (note 3)	**1,111,352**	1,120,141
Retained income (note 2), including $1,125,000 in each year appropriated for sinking funds	**451,580,137**	450,123,807
Total shareholders' equity	**724,228,611**	722,648,293
CONTINGENT LIABILITIES (note 4)		
Total liabilities and shareholders' equity	**$1,088,158,618**	$1,073,984.977

Great Northern Railway Company
and Majority-Owned Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1967

1. Principles of Consolidation and Other Matters:

The accompanying consolidated financial statements include the accounts of the Great Northern Railway Company and all majority-owned subsidiaries. Investments in major jointly-owned affiliates (the C. B. & Q. Railroad Co. — 48.59% owned, and the S. P. & S. Railway — 50% owned) are carried at cost.

Investments in stocks of the C. B. & Q. Railroad Co. and of three companies included in other investments in the accompanying balance sheet, at an aggregate carrying value of $109,504,385, have been pledged under the general mortgage bonds. The investment in the S. P. & S. Railway Co., with a carrying value of $20,000,000, is restricted as to disposition under an agreement with the joint owner.

The Interstate Commerce Commission on December 15, 1967 approved a plan of merger including the Great Northern; Northern Pacific; Chicago, Burlington & Quincy, and one minor railroad. (See page 5 for information on the current status of the merger.) Under terms of a merger agreement entered into in 1961, the common stock of the company would be exchanged for stock of a new company, which would operate the merged roads, on the basis of one share of common stock and one-half share of $10 par value 5½% preferred stock of the new company for each common share of the Company now outstanding. The merger agreement provides, among other things, that dividend rates cannot be increased during the period prior to the aforementioned stock exchange without the mutual consent of the parties to the agreement.

2. Federal Income Taxes:

In the accompanying financial statements, federal income taxes have been reduced and net income correspondingly increased by approximately $3,300,000 ($3,600,000 in 1966) through acceleration of depreciation deductions for income tax purposes. The corresponding aggregate reduction in Federal income taxes for the current and prior years included in retained income at December 31, 1967, amount to $71,100,000.

Federal income taxes in the statement of income for 1966 were reduced $4,485,000 through application of a tax investment credit. No investment tax credit was available in 1967. Federal income taxes were reduced $678,000 ($649,000 in 1966) as a result of adjustment of prior years' provisions for income taxes.

3. Capital Stock:

Treasury stock includes 25,441 shares at December 31, 1967 (28,451 shares in 1966) reserved for officer and key employee options at prices ranging from $35 to $58 a share. During the year ended December 31, 1967, the Company reissued 3,010 shares of treasury stock upon exercise of stock options.

Capital surplus has been reduced by the excess of stated value over proceeds of stock issued upon exercise of stock options, $8,789.

4. Contingent Liabilities:

At December 31, 1967 the Company was liable as guarantor of certain obligations of affiliated companies amounting to approximately $9,874,000. Also, the Company is contingently liable as guarantor along with other railroads for its proportion (approximately 2.4%), 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 $73,000,000.

The Company and another company with which it shares majority ownership of the stock of Portal Pipe Line Company are parties to a throughput agreement with the pipe line company. Under this agreement these proprietors have an equal, but several, obligation to provide shipments of petroleum through the pipe line which, with other traffic generated by the pipe line, will be sufficient to enable the pipe line company to satisfy all of its expenses, liabilities and debt obligations or, if sufficient funds are not so provided, to advance sufficient funds to enable the pipe line company to meet such obligations. In calculating the proportion of any deficiency which each of the two proprietors must advance, each is credited with petroleum provided by it for shipment through the pipe line; hence the Company's share, which is not presently determinable, of any such cash advances may be greater or less than its proportionate interest in the pipe line company. The total outstanding debt of Portal Pipe Line Company at December 31, 1967 amounted to $10,822,000 and is payable in quarterly installments of $187,875 through June 30, 1982.

5. Pension Plan:

The Company has a noncontributory pension plan which provides pension and supplemental retirement benefits to substantially all regular salaried employees. The total pension expense of the Company and its subsidiaries for the year was approximately $1,120,000 ($1,210,000 in 1966), including cash payments of $110,000 in each year mainly for the benefit of employees who were retired prior to adoption or amendment of the funded pension plan. The Company's policy is to fund pension cost accrued. The pension fund together with the balance sheet provision for past service pension costs exceeded the actuarially computed value of vested benefits under the plan as of January 1, 1967.

The provision for unfunded past service pension costs in the accompanying balance sheet, $9,500,000, represents the balance of a prior year provision for pension requirements not being funded through normal cost contributions. Such balance sheet provision was reduced by $1,800,000 in 1967 to give recognition to the increased proportion of total retirement benefits which will now be payable under the Railroad Retirement Act. The balance sheet at December 31, 1966 has been restated to reflect retroactive adjustment of $1,800,000 in the provision for unfunded past service pension costs, less related deferred income taxes of $936,000, and the net amount, $864,000, has been added to the balance of retained income at the beginning of the year.

ACCOUNTANTS' REPORT

The Board of Directors
Great Northern Railway Company:

We have examined the consolidated balance sheet of Great Northern Railway Company and majority-owned subsidiaries as of December 31, 1967, 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.

In our opinion, except that no provision has been made for deferred income taxes as referred to in note 2, such financial statements present fairly the financial position of Great Northern Railway Company and majority-owned subsidiaries at December 31, 1967 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The accompanying condensed financial statements of Great Northern Railway Company (Company only) for the year ended December 31, 1967 have been subjected to the same auditing procedures and, in our opinion, except to the extent provision has not been made for the deferral of income taxes, are stated fairly when considered in conjunction with the consolidated financial statements and notes thereto.

St. Paul, Minnesota
February 16, 1968

Peat, Marwick, Mitchell & Co.

Great Northern Railway Company

FINANCIAL REVIEW

(Thousands of Dollars)

CONDENSED STATEMENT OF INCOME

CONDENSED STATEMENT OF INCOME	1967	1966
Operating revenues	$ 260,243	$ 281,777
Operating expenses	212,853	207,856
Revenues over expenses	47,390	73,921
Taxes	27,452	37,352
Equipment and joint facility rents — net	4,346	4,281
Operating income	15,592	32,288
Other income	12,896	13,138
Interest on long-term debt, including amortization of discount (deduct)	(9,165)	(8,879)
Net income	$ 19,323	$ 36,547

STATEMENT OF RETAINED INCOME

Retained income at beginning of year as restated	$ 434,002	$ 415,911
Net income for year	19,323	36,547
Dividends	(18,466)	(18,456)
Retained income at end of year	$ 434,859	$ 434,002

CONDENSED BALANCE SHEET

Assets:		
Current assets and other special funds	$ 106,125	$ 125,076
Investments	174,444	171,873
Property investment — net	753,249	724,804
Other	10,751	13,569
Total assets	$1,044,569	$1,035,322
Liabilities and shareholders' equity:		
Current liabilities	$ 57,305	$ 57,662
Long-term debt due within one year	8,843	7,662
Long-term debt due after one year	253,732	242,657
Reserves and other liabilities	17,182	20,815
Total liabilities	337,062	328,796
Common stock	271,537	271,404
Capital surplus	1,111	1,120
Retained income	434,859	434,002
Total shareholders' equity	707,507	706,526
Total liabilities and shareholders' equity	$1,044,569	$1,035,322

GREAT NORTHERN RAILWAY COMPANY

ADJUSTED NET INCOME

for the Years 1967 and 1966

	1967	1966
Net income of Great Northern Railway Company and majority-owned subsidiaries (page 21)	**$19,921,993**	$ 37,604,594
Add (Deduct)		
Equity of Great Northern Railway Company in consolidated net income of:		
C.B.&Q. and subsidiaries (page 27)	**6,119,116**	12,187,537
S.P.&S. and subsidiaries (page 28)	**555,710**	1,834,708
Dividends received from C.B.&Q. and included in net income of Great Northern Railway Company	**(6,226,343)**	(6,226,343)
Consolidated net income on Interstate Commerce Commission accounting basis	**$20,370,476**	$ 45,400,496
Deduct provision for deferred income taxes attributable to use of accelerated depreciation and guideline lives	**4,257,980**	5,960,614
Net income on generally accepted accounting basis including equity in consolidated net income of C.B.&Q. and S.P.&S.*	**$16,112,496**	$ 39,439,882
Per Share	**$ 2.62**	$ 6.41

*Net income shown above exceeds amounts previously reported in financial statements included in a Proxy Statement furnished to shareholders by $1,103,610 in 1967 and $1,898,813 in 1966, representing net income of consolidated subsidiaries of the Great Northern Railway Company and net income (loss) of consolidated subsidiaries of C.B.&Q. and S.P.&S., and adjustments of deferred income taxes.

GREAT NORTHERN RAILWAY COMPANY
AND MAJORITY-OWNED SUBSIDIARIES

CHANGE IN WORKING CAPITAL

January 1 to December 31, 1967

BALANCE AT BEGINNING OF YEAR		$ 68,113,354
SOURCES OF WORKING CAPITAL:		
Net income	$19,921,993	
Depreciation and other non-cash income items	24,849,252	
Total provided from operations	$44,771,245	
Sale of property, investments, and other assets	3,349,473	
Sale of common stock (stock option)	123,988	
Proceeds from equipment financing	25,270,000	73,514,706
APPLICATIONS OF WORKING CAPITAL:		$141,628,060
Additions and betterments to property and equipment	$58,063,121	
Reduction in long-term debt	9,229,094	
Dividends on common stock	18,465,663	
Settlement of Transcontinental Divisions case	3,193,579	
Increase in other investments	2,525,357	
Other — net	571,110	92,047,924
BALANCE AT END OF YEAR		$ 49,580,136
NET DECREASE IN WORKING CAPITAL		$ 18,533,218

Chicago, Burlington & Quincy Railroad Company and Subsidiaries
(48.59% of C. B. & Q. common stock owned by Great Northern Railway Company)

CONDENSED FINANCIAL STATEMENTS

December 31, 1967 and the year then ended (with comparative figures for 1966)
(Thousands of Dollars)

CONDENSED STATEMENT OF INCOME	1967	1966
Operating revenues	$ 327,740	$ 347,011
Operating expenses	268,579	273,298
Revenues over expenses	59,161	73,713
Taxes	28,434	30,208
Equipment and joint facility rents — net	12,604	12,601
Operating income	18,123	30,904
Other income	6,768	5,445
Fixed charges (deduct)	(11,991)	(10,743)
Minority interest	307	524
Net income (see notes below)	$ 12,593	$ 25,082

STATEMENT OF RETAINED INCOME	1967	1966
Retained income at beginning of year	$ 479,996	$ 460,727
Misc. credits less related income taxes	—	7,000
Net income for year	12,593	25,082
Dividends (deduct)	(12,813)	(12,813)
Retained income at end of year	$ 479,776	$ 479,996

CONDENSED BALANCE SHEET	1967	1966
Assets:		
Current assets	$ 83,287	$ 90,239
Investments	30,615	38,859
Property investment — net	897,921	882,437
Other	21,960	23,277
Total assets	$1,033,783	$1,034,812
Liabilities and shareholders' equity:		
Current liabilities	$ 57,229	$ 67,146
Long-term debt due within one year	19,868	18,092
Long-term debt due after one year	282,954	275,785
Reserves and other liabilities	8,660	8,414
Total liabilities	368,711	369,437
Minority interest	14,457	14,540
Common stock	170,839	170,839
Retained income	479,776	479,996
Total shareholders' equity	650,615	650,835
Total liabilities and shareholders' equity	$1,033,783	$1,034,812

Great Northern's equity in the net income of the C. B. & Q. and subsidiaries is $6,119,116 in 1967 ($12,187,537 in 1966) of which $6,226,343 was received in dividends in both years and included in Great Northern income accounts for these years.

The above statements are presented on the Interstate Commerce Commission accounting basis.

Spokane, Portland and Seattle Railway System
(50% of stock and 50% of bonds of S. P. & S. owned by Great Northern Railway Company)

CONDENSED FINANCIAL STATEMENTS

December 31, 1967 and the year then ended (with comparative figures for 1966)
(Thousands of Dollars)

CONDENSED STATEMENT OF INCOME	1967	1966
Operating revenues	$ 38,739	$ 40,491
Operating expenses	29,774	29,078
Revenues over expenses	8,965	11,413
Taxes	4,558	4,410
Equipment and joint facility rents — net	2,567	2,279
Operating income	1,840	4,724
Other income	676	974
Fixed charges (deduct)	(1,895)	(2,029)
Extraordinary and prior period items — net	490	—
Net income (see notes below)	$ 1,111	$ 3,669

STATEMENT OF RETAINED INCOME	1967	1966
Retained income at beginning of year	$ 33,629	$ 29,960
Net income for year	1,111	3,669
Retained income at end of year	$ 34,740	$ 33,629

CONDENSED BALANCE SHEET	1967	1966
Assets:		
Current assets	$ 18,342	$ 16,687
Investments	1,478	680
Property investment — net	124,603	124,546
Total assets	$ 144,423	$ 141,913
Liabilities and shareholders' equity:		
Current liabilities	$ 12,653	$ 12,108
Long-term debt due within one year	1,158	794
Long-term debt due after one year	46,156	45,747
Reserves and other liabilities	416	335
Total liabilities	60,383	58,984
Common stock	40,000	40,000
Capital surplus	9,300	9,300
Retained income	34,740	33,629
Total shareholders' equity	84,040	82,929
Total liabilities and shareholders' equity	$ 144,423	$ 141,913

Great Northern's equity in the net income of the S. P. & S. and subsidiaries is $555,710 in 1967 ($1,834,708 in 1966).

The above accounts are presented on the Interstate Commerce Commission Accounting basis.

DIRECTORS

ROYAL D. ALWORTH, JR.
President, Oneida Realty Company, Duluth

JOHN M. BUDD
President, Great Northern Railway Company, St. Paul

JOHN S. DALRYMPLE, JR.
Manager, Dalrymple Farms, Casselton, North Dakota

THOMAS L. DANIELS
Director Emeritus, Archer Daniels Midland Company, Minneapolis

F. PEAVEY HEFFELFINGER
Chairman of the Executive Committee, Peavey Company, Minneapolis

RONALD M. HUBBS
President, The St. Paul Companies, Inc., St. Paul

GRANT KEEHN
Vice Chairman of the Board, The Equitable Life Assurance Society of the United States, New York

J. HOWARD LAERI
Vice Chairman, First National City Bank, New York

WILLIAM H. LANG
President, Foley Brothers, Inc., St. Paul

PHILIP H. NASON
President, The First National Bank of Saint Paul, St. Paul

FREDERICK K. WEYERHAEUSER
Retired Chairman of the Board, Weyerhaeuser Company, St. Paul

ROBERT B. WILSON
President, Equity Management Company, Portland, Oregon

OFFICERS

JOHN M. BUDD, President, St. Paul

ROBERT W. DOWNING, Executive Vice President, Executive Department, St. Paul

CLARK A. ECKART, Vice President, Executive Department, Seattle

M. M. SCANLAN, Vice President, Marketing Department, St. Paul

JOHN L. ROBSON, Vice President, Operating Department, St. Paul

ANTHONY KANE, Vice President and General Counsel, St. Paul

JOHN A. TAUER, Vice President and Comptroller, St. Paul

THOMAS C. DE BUTTS, Vice President, Labor Relations Department, St. Paul

THOMAS J. LAMPHIER, Vice President, Administration, Executive Department, St. Paul

RICHARD M. O'KELLY, Secretary and Treasurer, St. Paul

The Empire Builder, speeding into the early dusk of a Fall afternoon, passes Glacier National Park in the Montana Rockies.

TRANSFER AGENTS

JOHN E. ADAMS, JR., Assistant Secretary and Assistant Treasurer, New York

ROBERT W. LADDEN, Cashier and Transfer Agent, New York

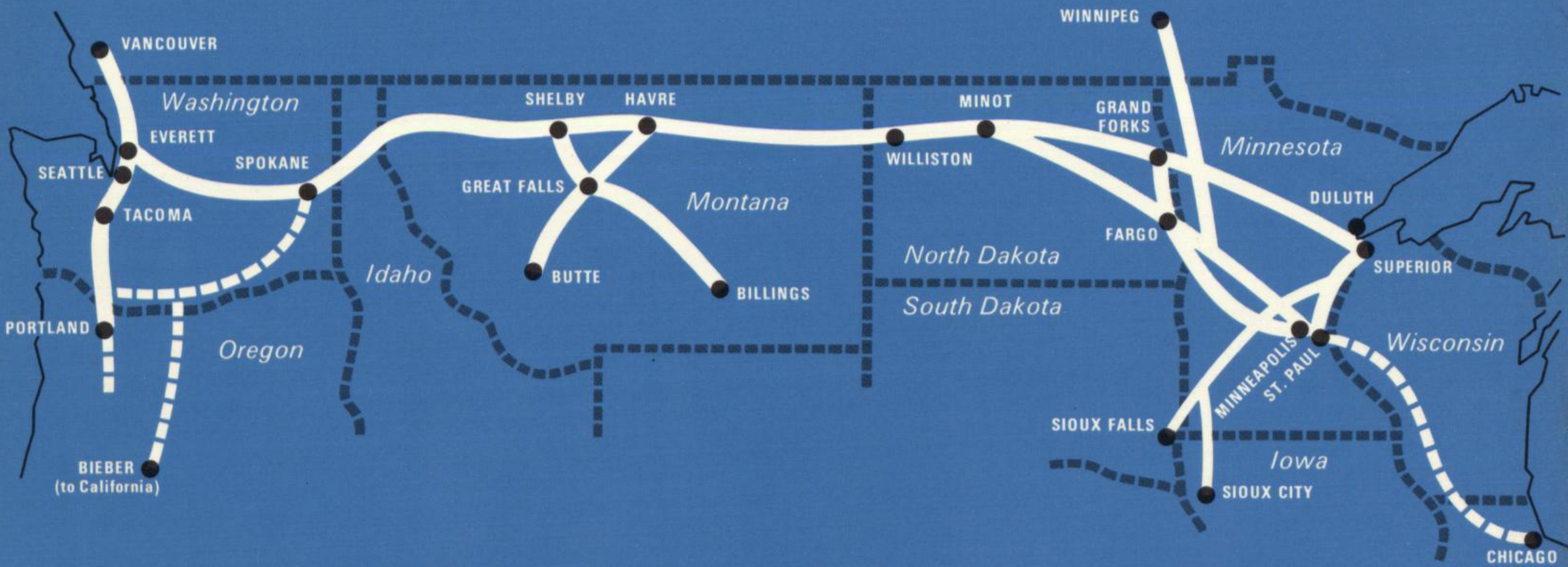
THOMAS A. LINEHAN, Transfer Agent, New York

GARRETT F. STEINHIBEL, Assistant Secretary and Transfer Agent, St. Paul

MARTIN H. WEBER, Assistant Treasurer and Transfer Agent, St. Paul

GENERAL OFFICES *Great Northern Building, St. Paul, Minnesota 55101*

FINANCIAL OFFICES *40 Wall Street, New York, N.Y. 10005*



GREAT
NORTHERN

GREAT NORTHERN RAILWAY COMPANY
ST. PAUL, MINNESOTA 55101