Chicago Milwaukee Corporation Annual Report for 1973

CHICAGO MILWAUKEE CORPORATION

report to the stockholders

for the
twelve months
ended
December 31,
1973

CHICAGO MILWAUKEE CORPORATION
516 West Jackson Boulevard • Chicago, Illinois 60606

To the Stockholders:

Chicago Milwaukee Corporation results in 1973 showed a substantial improvement over those for the full year of 1972. Consolidated net income for the year reached $11,399,000, compared with a deficit of $397,000 the previous year after an extraordinary item of $963,000, as identified in the accompanying earnings table.

Consolidated operating revenues rose to $370,935,000 in 1973 from $319,238,000 for the 12 months of 1972. Consolidated operating income rose from a negative $6.0 million in 1972 to $3.3 million in 1973, an increase of $9.3 million.

Other income also rose, interest income increasing $1.6 million to $2.4 million; gains on timber sales increasing $2.6 million to $5.4 million; and gains on property sales increasing $0.9 million to $7.9 million.

For the Milwaukee Road subsidiary the year was marked by an increase of 5.9 per cent in carloadings which compares favorably with the 4.7 per cent carloading gain achieved by the railroad industry as a whole.

Non-Rail Acquisitions

Results reported for 1973 in the accompanying table include the operations of companies acquired in 1973. Hi-Way Paving, Inc., is included for nine months and Aslesen Company is included for two and one-half months. These operations were both profitable in 1973 and although they did not materially affect the 1973 results, it is estimated that they will produce revenues in 1974 in excess of $25 million.

On January 24, 1974, an agreement in principle to purchase the operations of Vulcan-Hart Corporation and Hanson Porcelain Company, Inc., from Walter E. Heller Corporation was announced. Walter E. Heller became subject to the Bank Holding Company Act upon its acquisition of American National Bank and Trust Company of Chicago early last year and is divesting itself of these companies under the terms of such act. Vulcan-Hart Corporation is one of the leading manufacturers of equipment for the institutional food service market. It manufactures a full line of gas and electric food preparation, handling and storage equipment. Hanson Porcelain Company, Inc., manufactures porcelain enameling for manufacturers of lighting reflectors and commercial stoves and ovens. Vulcan-Hart Corporation accounts for over 20 per cent of Hanson's sales. For the calendar year ended December 31, 1973 the two firms' sales were approximately $29 million.

Fourth Quarter

Consolidated net income for the holding company amounted to $2,657,000 in the fourth quarter of 1973, compared with $704,000 in the same period of 1972. Operating revenues in the 1973 quarter period were $99,381,000 compared to 1972 revenues of $84,407,000.

Year-end adjustments in the 1973 fourth quarter were largely offsetting and, taken as a whole, had only a minor effect on the results. They are mentioned here because this minor effect compares with an unfavorable pre-tax earnings effect of $1.8 million from year-end adjustments in 1972. The latter consisted principally of added provisions for vacation pay and personal injury claims, which were generally applicable to the full year and not exclusively to the fourth quarter.

Although year-end adjustments had little impact on the 1973 fourth quarter results, other items affecting the railroad subsidiary were clearly evident. The sharp drop in housing starts, beginning in August, affected lumber traffic, and the decline in automobile sales reduced rail carloadings of autos and parts. Grain traffic continued strong, but did not equal the exceptionally high level reached in the 1972 quarter.

As predicted in our September-quarter report, fourth quarter results reflect sharply higher payroll taxes for the railroad subsidiary as a result of the Railroad Retirement amendments of 1973. This legislation translated into law the national labor agreements liberalizing pension benefits of railroad employees. It also shifted to the railroads themselves all cost in excess of an amount equal to that borne by employees in other industries under the Social Security system. Payroll taxes rose sharply in the fourth quarter to an amount $2.6 million greater than in the corresponding 1972 quarter.

This payroll tax increase became effective October 1, 1973. Further increases went into effect January 1, 1974 in the form of a higher employee compensation base used for computing Railroad Retirement Act taxes. Under the implementing federal legislation referred to, railroads were accorded authority to file for freight rate increases sufficient to cover the higher taxes. Such increases, totaling 2.6 per cent, have been approved by the Interstate Commerce Commission effective in two stages, on October 1, 1973 and January 1, 1974.

The adverse effect on fourth quarter results of the items noted above and of the oil crisis was cushioned by a stronger-than-normal "other income" performance, the principal factors of which are detailed elsewhere in this report. An added factor is that retirement charges from abandonments of uneconomic railroad branch lines were lower in the 1973 quarter because of a court-imposed moratorium on all such proceedings.

The Oil Crisis

The oil crisis had an immediate effect on the railroad subsidiary's operating costs. The cost of fuel for train operation was $1.8 million higher in the fourth quarter of 1973 and $3.3 million higher in the full year than in the 1972 periods. Steps to reduce a significant amount of diesel fuel consumption have been taken and the Railroad Company's supply of fuel has generally been equal to the minimum requirement for full operations. It is hoped that this condition will continue throughout the year 1974. Obviously, it is dependent on availability of fuel as affected by the current energy crisis, allocation requirements by government order, and compliance therewith by suppliers.

The Interstate Commerce Commission has authorized publication on 10-day notice of rail rate surcharges to recoup certain lawful increases in fuel costs. The first such surcharge, amounting to 2.1 per cent and covering fuel price increases from October 1, 1973 to January 10, 1974, is scheduled to take effect January 31, 1974. A proposed 5 per cent general freight rate increase is being considered by the Interstate Commerce Commission with a decision scheduled on February 22, 1974. The increase is considered to be based in part upon fuel price increases prior to October 1, 1973. Also being considered is an increase on export grain and a decision on this matter is also expected on February 22.

(OVER)

Bond Interest

Interest expense as reported in the accompanying Summary of Consolidated Operations includes both fixed interest charges and contingent interest. All fixed interest is provided for and continues to be paid in full as it falls due.

The increases in interest expense, for both the December quarter and the year reflect provision in the 1973 periods for the current-year contingent interest on the Series A General Mortgage bonds and the "Terre Haute" bonds of the subsidiary Railroad Company. No contingent interest provision was required or made in 1972. Payment of this interest, like the interest on the Series B General Mortgage bonds and 5 per cent Income Debentures, is contingent upon railroad earnings as defined in the respective debt indentures and is governed by priorities specified by the indentures.

Holders should note that not all of the earnings reported herein are railroad earnings and, further, that Interstate Commerce Commission accounting rules must be used in the available net income determinations that relate to contingent interest.

On the basis of preliminary determinations of railroad available net income for the year 1973, it appears that current-year (1973) contingent interest will be payable on April 1, 1974 on the Series A General Mortgage bonds on the "Terre Haute" bonds, that the full three-year contingent interest accumulation will be also payable at the same date on the same bonds, but that interest will not be payable in 1974 (with respect to 1973's operations) on the Series B General Mortgage bonds and the 5 per cent Income Debentures; nor will there be any dividends on railroad stock.

There being no dividend to the holding company from the railroad subsidiary as explained, the earnings from the non-rail acquisitions of the holding company do not as yet provide sufficient funds to permit any dividend on holding company stock, either preferred or common.

Preliminary available net income determinations, subject to possible year-end audit adjustments, are expected to be finalized and approved by the railroad board of directors in February.

Although the Corporation will pay no income taxes for 1973 because of available loss carryforwards, provision has been made for deferred taxes in accordance with the applicable generally accepted accounting practice. Deferred federal income taxes for the 1973 periods have been reduced in respect of available investment tax credits under the flow-through method. No recognition was given in prior periods to investment tax credits in computing deferred income taxes.

Other Matters

Studies by the Milwaukee Road and the Burlington Northern of the possible inclusion of the Milwaukee in the Burlington Northern system, were near completion at the close of the year. Announcements will be timely made on further developments.

Chairman of the Board

January 31, 1974

Highlights of Operations

Chicago, Milwaukee, St. Paul and Pacific Railroad Company

For the Milwaukee Road and the railroad industry as a whole, 1973 was a year of outstanding accomplishment.

The upward trend of carloadings throughout much of the year reflected principally the strength of the national economy and the continuing heavy demand for grain, both at home and throughout the world.

Even the fuel crisis, which continues to be a matter of immediate concern for all railroads, had by the end of the year begun to put the railroad industry in a new light. It is now generally felt by shippers and transportation experts that railroad advantages in fuel economy and as minimal land user and air polluter have put the industry in a more favorable position than heretofore with respect to governmental planning and traffic potential.

For the full 12 months of 1973, Milwaukee Road grain carloadings, including corn, showed an increase of 25.6 per cent over the previous year. Grain also led all other traffic categories in the total number of carloads carried and in the grain marketing process. This very complex matter, initially labeled a freight car "shortage" but later seen to involve many other factors, is still the subject of governmental investigation and railroad industry study.

Meanwhile, the Milwaukee Road increased its grain carrying capacity materially through a program of freight car acquisition and rebuilding, as previously reported. As a further means of easing the problem, the Milwaukee also began moving soybeans in containers from the Midwest to ports in the Pacific Northwest late in 1973.

Despite the uncertainties which developed in the automotive industry as the energy crisis became a national concern late in 1973, automobiles and other motor vehicles were among the principal revenue producing commodities handled by the railroad for the full year, with a carloading gain of approximately 5 per cent. Also among the principal revenue producing commodities showing carloading gains were lumber and paper products, although these categories were also adversely af-

the gain was governmental urging of electric utilities to switch from fuel oil to coal for their generating operations.

Piggyback/container movements provided one of the brightest spots in the Milwaukee Road's traffic picture, reaching their highest level since 1970. Loadings gained 12.9 per cent during the 12 months, and revenues were up 15.6 per cent.

Import/export traffic also increased significantly in volume, principally as a result of the accelerated export of grain products and an increase in the import movement of television sets, radios and related electronics. Although there is always some overlap in the measurement of import/export and piggyback/container traffic, due to the widespread use of containers in ocean shipping and for the transferring of commodities at dockside, it is significant that during the fourth quarter of 1973 alone Milwaukee Road import/export traffic showed a gain of 31 per cent in the number of units handled and a 49 per cent increase in revenue.

As the year progressed, the significance of the Milwaukee's service extension to

CHICAGO MILWAUKEE CORPORATION AND SUBSIDIARIES

Summary of Consolidated Operations (000 omitted)

	Quarter Ended December 31		Year Ended December 31	
	1973 (Note A)	**1972**	**1973** (Note A)	**1972**
Operating revenues	$99,381	$84,407	$370,935	$319,238
Operating expenses and costs	99,386	84,020	367,652	325,269
Operating income (loss)	(5)	387	3,283	(6,031)
Other income, net	5,125	2,830	18,573	13,283
	5,120	3,217	21,856	7,252
Interest expense	1,895	1,616	7,344	6,372
Minority interest	106	31	467	29
	2,001	1,647	7,811	6,401
Income before income taxes and extraordinary item	3,119	1,570	14,045	851
Deferred federal income tax	462	866	2,646	285
Income before extraordinary item	2,657	704	11,399	566
Extraordinary item—after deducting deferred federal income tax benefit of $924,000 and minority interest—Note B	—	—	—	(963)
Net income (loss)	$ 2,657	$ 704	$ 11,399	$ (397)
Income (loss) per share applicable to Common Stock:				
Income (loss) before extraordinary item	$ .83	$ .05	$ 3.67	$ (.74)
Extraordinary item	—	—	—	(.39)
Net income (loss)	$ .83	$ .05	$ 3.67	$ (1.13)

Note A—Figures for 1973 are preliminary, subject to completion of year-end audit by independent public accountants.

Note B—Charge from retirement of certain railroad properties, principally land, in connection with a downtown development project in Spokane, Washington.

Note C—Results shown in this summary are stated on the basis of generally accepted accounting principles.

Financial Highlights CHICAGO MILWAUKEE CORPORATION AND SUBSIDIARIES

	1973	1972
Operating revenues	$370,908,000	$319,238,000
Operating expenses and costs	367,089,000	324,659,000
Other income	17,580,000	12,641,000
Interest expense	7,346,000	6,376,000
Income before extraordinary item	11,399,000	559,000
Extraordinary item	—	(956,000)
Net earnings (loss)	11,399,000	(397,000)
Net current assets	9,591,000	(5,741,000)

Chicago Milwaukee Corporation
516 W. Jackson Boulevard,
Chicago, Illinois 60606
Annual Report 1973

Board of Directors

Terms Expiring:

1974 Tilden Cummings
William G. Karnes
Joseph A. Maun

1975 Laurence S. Kaplan
William J. Quinn
Arthur M. Wirtz

1976 Robert W. Lannan, Sr.
Worthington L. Smith
Robert S. Stevenson

Executive Committee

Tilden Cummings
William G. Karnes
Joseph A. Maun
William J. Quinn
Arthur M. Wirtz

NOTE: Ray Garrett, Jr. resigned as a director effective July 31, 1973.
Patrick L. O'Malley resigned as a director effective January 17, 1974.

Officers

William J. Quinn *Chairman of the Board, President and Chief Executive Officer*

Richard V. Nugent, Jr. *Assistant to Chairman of the Board*

Raymond K. Merrill *Vice President*

*P. Laurin Cowling *Vice President-Executive Department*

Richard F. Kratochwill *Treasurer*

James T. Taussig *Secretary*

*P. Laurin Cowling elected Vice President-Executive Department effective January 17, 1974

Annual Meeting

May 14, 1974, Chicago, Illinois
This Annual Report is not and must not be considered as proxy soliciting material, or as a report or document filed pursuant to the Securities Exchange Act, or any rule or regulation thereunder.

To the Shareholders:

Last year in our Annual Report we characterized 1972 as a "start-up and developmental year" for Chicago Milwaukee Corporation. A review of the improvement reflected in 1973 results demonstrates the accuracy of that statement.

The improved accomplishments of 1973 operations are detailed in the financial statement portion of this report. Consolidated operating revenues rose 16 per cent to $370,908,000 from $319,238,000 in 1972. Net earnings rose to $11,399,000 from a deficit of $397,000 (including 1972 extraordinary charge of $956,000) and the resulting earnings per share rose to $3.67 from a deficit of $1.14. Particularly significant was the materially improved showing of the Milwaukee Road subsidiary during 1973, marked as it was by the highest revenues and revenue ton mile figures ever obtained in its history.

The review of the Railroad's activities appearing later in the report indicates that the movement of grain dominated the traffic scene throughout the year, and the extension of service into the Louisville, Kentucky, traffic gateway ranked as the most promising new development. Among other things, it expanded to 16 the number of states served by the Milwaukee Road subsidiary and automatically created one of the longest single line railroad routings in the United States.

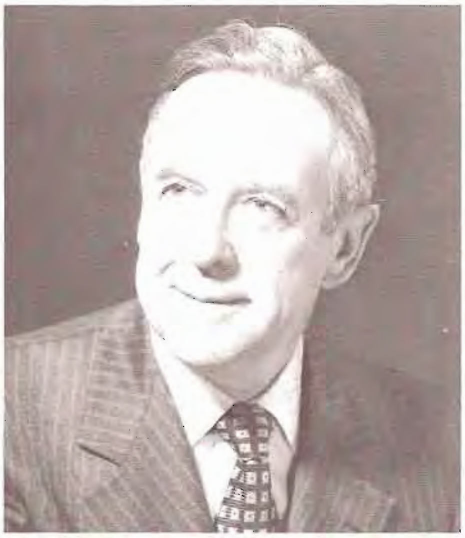
The energy crisis had a significant impact on the Railroad's operations. The price of fuel for train operations was $3.3 million higher than in 1972. Over 50 per cent of such increase occurred in the fourth quarter of 1973. The supply of fuel has generally been equal to the minimum requirements for full operations and management has taken actions to reduce a significant amount of diesel fuel consumption. It is hoped that the supply of fuel in 1974 will meet the minimum requirements for full operations and that additional price increases will be offset by timely rate increases. Obviously, maintaining adequate fuel supplies in 1974 will be dependent upon a number of variables which are not subject to the control of management. One favorable development resulting from the energy crisis has been a pronounced increase in the level of piggyback traffic.

The Chicago Milwaukee Corporation's program for diversification resulted in the acquisition during 1973 of Hi-Way Paving, Inc., a concrete paving contractor, and Aslesen Company, a 100 year old firm engaged in the distribution of institutional wholesale food supplies and food service equipment. In addition, Aslesen is involved in the design of food service facilities and the installation of equipment. The 1973 results include the operations of these companies from the respective dates of their acquisition. Both operations were profitable in 1973.

On February 28, 1974, the Corporation purchased the operations of the Vulcan-Hart Corporation and Hanson Porcelain Company, Inc., from Walter E. Heller International Corporation, which was required to divest these companies under the Bank Holding Company Act. Vulcan-Hart Corporation is one of the leading manufacturers of equipment for the institutional food service market. It manufactures a full line of gas and electric food preparation, handling and storage equipment. Hanson Porcelain Company, Inc. produces porcelain enameling for manufacturers of lighting reflectors and commercial stoves and ovens. For the calendar year ended December 31, 1973, the two firms' combined sales were approximately $29 million. Management feels that these acquisitions provide your Company with a significant base in the growing food service industry. It is anticipated these acquisitions, together with those in 1973, will produce revenues in 1974 approaching $50 million.

Joint operating studies regarding the possible inclusion of the Milwaukee Road in the Burlington Northern system were recently completed and the financial aspects of such an inclusion are now under review. This matter is one of far-reaching importance to your Company. Further significant developments concerning the inclusion will be announced on a timely basis.

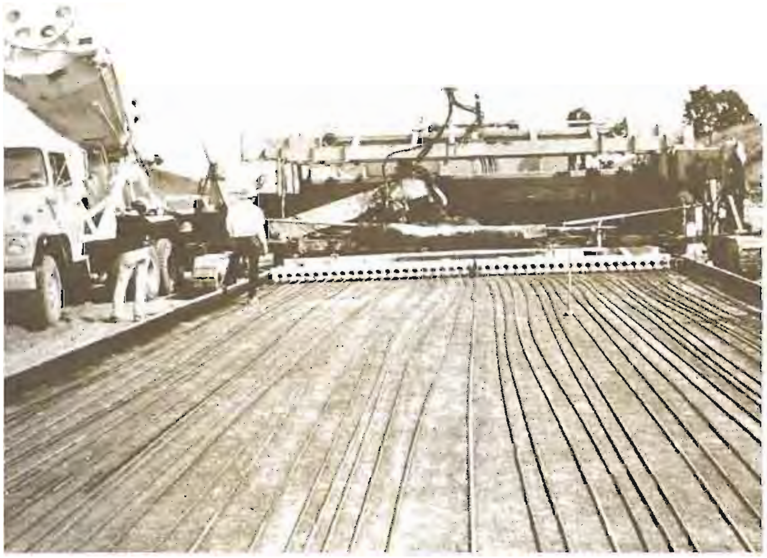
Many of the favorable developments which marked 1973 will continue to work to your Company's advantage as we meet the uncertainties of the year ahead.



William J. Quinn

William J. Quinn
Chairman of the Board
March 21, 1974

Hi-Way Paving, Inc., a subsidiary



Aslesen Company, a subsidiary

The traffic volume handled in 1973, and the new traffic trends that became evident, made this a good year for the Milwaukee Road.

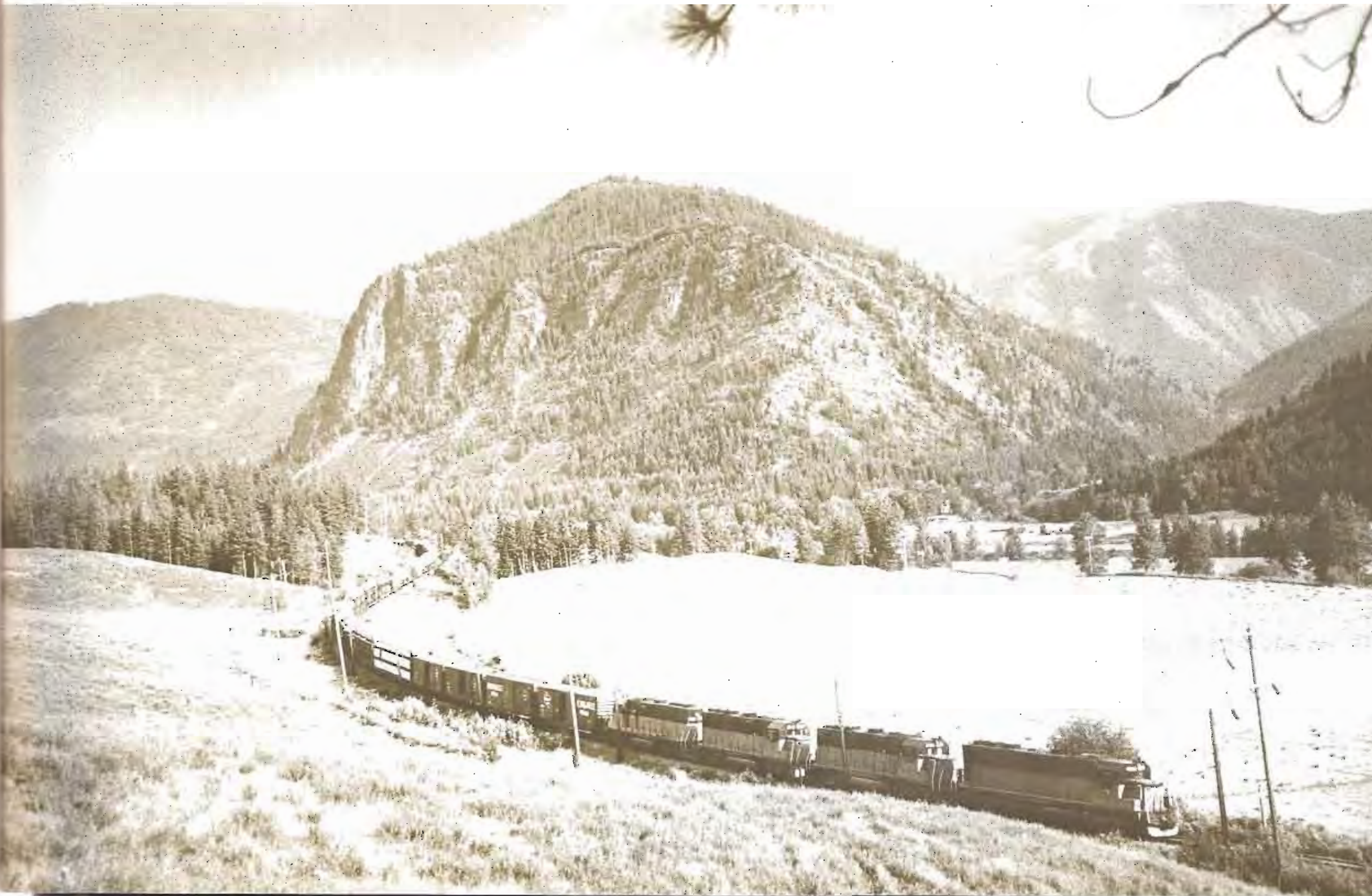
Aside from encouraging statistical results, the year was marked by other developments which can be regarded as basic and continuing improvements. Outstanding among these were the extension of freight service to Louisville, Ky., and the improvement of service via Portland, Ore.

Acting on conditions granted by the Interstate Commerce Commission in two separate merger cases, the Milwaukee Road reached Portland in the spring of 1971 and Louisville on March 1, 1973. The opening of these two major traffic gateways at the extreme ends of the 10,200-mile railroad system has already generated a substantial volume of traffic and created an important new potential. The 2,686 miles between Portland and Louisville constitute one of the longest single line railroad routes in the United States and one which fits conveniently into the plans of many shippers.

The heavy movement of grain that began in 1972 continued throughout 1973. Together with soybeans, grain dominated the traffic scene and helped create a new and helpful public awareness of the entire economy's reliance on the strength, capacity and efficiency of rail service. Other traffic trends enhanced this awareness and contributed materially to 1973 net results.

MARKET DEVELOPMENT AND PRICING SECTION ESTABLISHED

A major restructuring of the Railroad's Traffic Department enabled it to place greater emphasis on customer needs. In addition to the Field Sales Section, which continues to perform its highly important traditional function throughout the United States and much of Canada, a Market Development and Pricing Section was established in January of 1973. It consists of four profit centers organized along commodity lines and has direct system-wide responsibility for customer relations, market research and pricing as those functions relate to the handling of given commodities. The result has been a more orderly and productive approach to problems of service, equipment and pricing.



TRAFFIC AT HIGH LEVEL

Total operating revenues in 1973 were the largest in the Railroad's history, exceeding those of 1972 by 13.6 per cent. Carloadings increased by 5.9 per cent, compared with an industry increase of 4.7 per cent. Revenue ton miles—reflecting additional carloads, heavier loadings and longer hauls—also reached a new high for the Milwaukee Road, surpassing the 1972 performance by 11.7 per cent.

The 266,000,000 bushels of grain carried by the Milwaukee Road in 1973 made this its biggest grain year. Grain carloadings were up 25.6 per cent compared with 1972. In the year ahead, continued heavy movement of grain is expected, including the opportunity to participate in the movement of U.S. grain to the People's Republic of China.

Motor vehicles, an important source of traffic, showed a carload increase of 5 per cent in 1973, and revenues gained 12 per cent. Significantly, the long haul movement of motor vehicles to the Railroad's automobile marshalling yard at Kent, Wash., increased 11.9 per cent. Although energy-related problems may adversely affect business during the first part of 1974, loadings of domestic and foreign automobiles are expected to become stronger later in the year.

Among other commodities showing increased carloadings were lumber and paper products, despite freight car shortages and, in the case of lumber, high mortgage rates and other uncertain conditions which reduced the number of housing starts, particularly in the second half.

The upturn in coal traffic evident late in 1973 is expected to continue in 1974. Two major unit coal train operations involving vast quantities of coal from points in Montana and North Dakota will begin runs to midwestern electric generating plants in the fall of 1974 for stockpiling purposes. These operations will be the source of major new revenue for the Milwaukee Road, particularly after commercial power production starts in 1975.

FREIGHT TRAFFIC BY COMMODITY GROUPS

Commodity Groupings	Per Cent of Gross Freight Revenues	
	1973	1972
Farm products	16.1%	13.3%
Lumber products	15.2	15.7
Food and food products	13.2	14.0
Transport equipment	10.1	9.8
Pulp paper products	8.9	9.5
Chemicals	5.3	5.4
Primary metal products	5.3	5.3
Coal	2.9	3.1
All other	23.0	23.9
	100.0%	100.0%

PIGGYBACK/CONTAINER AND IMPORT/EXPORT TRAFFIC

Piggyback/container loadings gained 12.9 per cent over those for 1972, and revenues were up 15.6 per cent.

The growth in this traffic, as well as the importance of the Louisville gateway, was underscored in the fall of 1973 when a new piggyback/container terminal was opened in that city. At the same time, service was expanded to provide two daily trains each way between Louisville and Chicago. Traffic moving through the Louisville gateway has contributed substantially to system piggyback volume. A new piggyback/container facility was also provided at Terre Haute, Ind. A similar facility at Tacoma, Wash., was relocated and upgraded to triple its capacity in handling import and domestic traffic. A customs clearing facility was established in St. Paul, Minn.

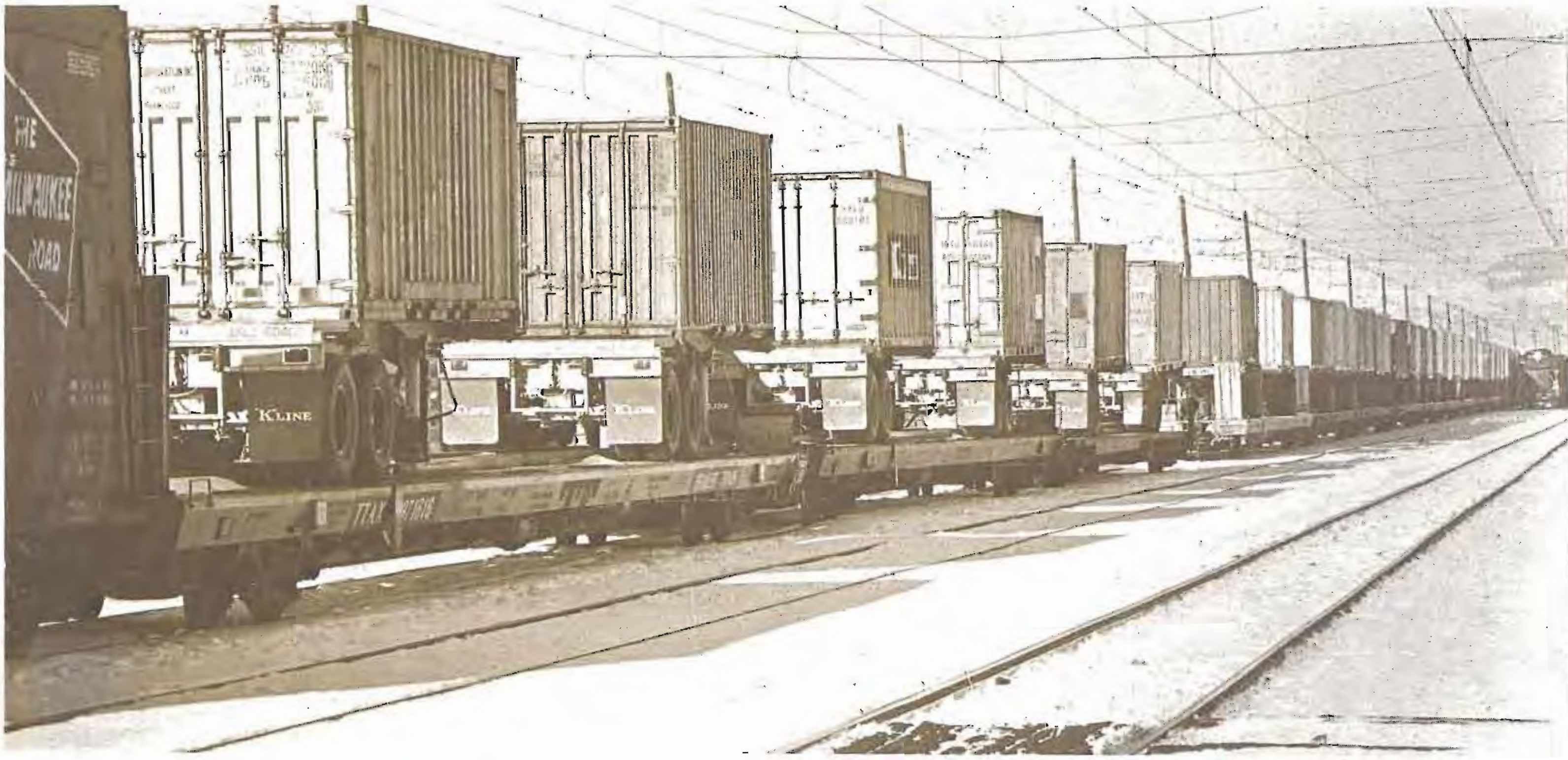
Import/export traffic showed a gain of 31 per cent in the number of units handled during 1973 over 1972, and a 49 per cent increase in revenue.

FREIGHT RATES INCREASED

The Interstate Commerce Commission approved railroad freight rate increases totaling 2.8 per cent, effective in increments on October 1, 1973, January 1, 1974 and March 16, 1974, to cover higher payroll taxes concurrently assumed by the railroads.

Recognizing the cost/rate squeeze of the railroads, the Commission approved, effective January 31, 1974, a freight rate surcharge of 2.1 per cent covering diesel fuel oil price increases between October 1, 1973 and January 10, 1974. As this report was being written, a new tariff had been filed with the Commission increasing the surcharge to 2.5 per cent, effective March 9, subject to later revision.

The Commission also granted a general freight rate increase of 4 per cent, effective March 9. An increase of 10 per cent on grain and grain products for export, which became effective on February 22, 1974, is expected to produce less than a 10 per cent gain, however, being limited to an increase of not more than six cents per hundredweight.



OPERATIONS IMPROVED

Physical operations of the railroad were expanded and improved to accommodate the heavier volume of traffic moving in 1973. One additional daily transcontinental freight train in each direction was added between St. Paul—Minneapolis and Seattle—Tacoma, and new connecting service was added between Tacoma and Portland to handle increased traffic moving via the latter gateway.

Recognizing the poor economics of attempting to maintain light density lines of railroad and to provide satisfactory freight operations over them, the Milwaukee Road and other railroads have been working together to effect economies through the elimination of duplicate service. This involves determining where duplicate service exists and reaching agreements whereby the two railroads make joint use of only one line between given points, at the same time maintaining customer service. During 1973, the Milwaukee and other railroads entered into contracts covering the joint use of approximately 130 miles of trackage. Contracts are being prepared to cover an additional 240 miles of line.

As announced in the 1972 Annual Report, the direct interchange of freight cars between the Milwaukee Road and other railroads in several of the major terminals has speeded the movement of carloads to consignees and effected needed economies.

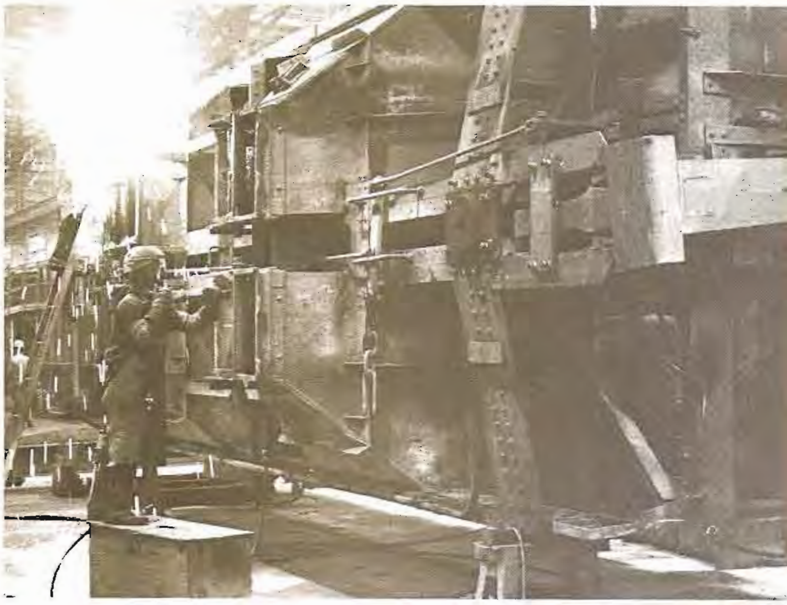
A "runthrough" operation typical of still another type of coordination between railroads was set up by the Milwaukee Road and the Union Pacific at Council Bluffs, Ia., where both lines have terminals. The Milwaukee Road locomotives and cabooses now work through to North Platte, Neb., and those of the U.P. run over the Milwaukee to Chicago, which has resulted in a saving of terminal time and the maintaining of fast transcontinental train schedules between Chicago and Denver, Salt Lake City, Los Angeles and San Francisco. Similar arrangements are under study with other railroads.

FREIGHT CAR AND LOCOMOTIVE PROGRAMS

The Railroad acquired 32 new diesel locomotives and 900 freight cars in 1973. Among the cars were 500 jumbo covered hoppers for grain, 200 box cars of 100-ton and 70-ton capacity, 100 mechanical refrigerators and 100 other cars of various types. Milwaukee Road shop forces upgraded 18 diesel locomotives and rebuilt 640 freight cars.

In 1974 the Railroad will acquire 46 more new diesel locomotives and 1,386 new freight cars. The 1974 rebuilding program will include another 18 diesel locomotives and 727 freight cars.

Following endorsement by the Association of American Railroads, Trailer Train Company announced early in January 1974 that it planned to acquire and operate a free-running pool of 10,000 50-foot wide-door box cars. This $180 million program would supplement the large fleets of freight cars now owned or leased by the individual railroads. The plan still requires Interstate Commerce Commission approval. Trailer Train is owned by 32 major railroads, including the Milwaukee Road.



FUEL, MATERIALS AND LABOR COSTS

Although the Milwaukee Road's supply of diesel fuel oil has generally been equal to the minimum requirement for full operation, shortness of supply and steadily escalating prices created problems as 1973 progressed. Service levels have been maintained, however, and it is hoped that this will continue throughout 1974.

The price of diesel fuel increased $1.8 million in the fourth quarter of 1973 alone and was up $3.3 million in the full year, compared with 1972 prices. During the four months immediately preceding the preparation of this report, the average price the Railroad paid for diesel fuel increased approximately 100 per cent and gives no indication yet of leveling off.

Sharply higher prices for cross ties and all other supplies were among the more troublesome operating expense items confronting the Railroad throughout 1973.

Close attention to operating efficiency enabled the Railroad to hold the ratio of expense to revenues at 80.3 per cent, the lowest level achieved since 1967, and to perform a substantially higher level of transportation service with fewer manhours of labor. Nevertheless, labor contracts entered into on a nationwide basis in 1973 resulted in Milwaukee Road labor costs increasing $14,100,000 over the 1972 level. In addition, payroll taxes increased approximately $4,500,000. A further wage increase averaging 4 per cent for certain railroad crafts went into effect on January 1, 1974.

SUBURBAN PASSENGER SERVICE AND MASS TRANSIT DEVELOPMENTS

Ridership on the Milwaukee Road's suburban passenger trains in the Chicago area continued to increase in 1973, gaining 7.3 per cent over the previous year. Revenues also improved slightly during the year, primarily as a result of growth in patronage and a modest fare increase which became effective on October 1, 1973. However, higher costs of fuel, materials, wages and fringe benefits offset these gains and produced a loss of approximately $2.3 million for the full year.

Legislation creating a Regional Transportation Authority for the six-county northeastern Illinois area, including Chicago, was passed by the Illinois State Legislature in November 1973, subject to approval by the voters in a referendum on March 19, 1974. The RTA will control all public transportation resources in the six-county metropolitan Chicago area. It will have the authority and the funds to provide mass transit services and to arrange a service contract with the commuter railroads, rapid transit lines and bus systems.

Federal and Illinois capital improvement grants, either approved or pending approval, totaling $38.2 million, have enabled the three mass transit districts created by communities on the Milwaukee Road's commuter lines to place orders for 15 new locomotives and 41 bi-level coaches, all of which will be delivered in 1974. This equipment will augment existing equipment and be operated by the Railroad under agreements with the mass transit districts or the RTA.

INDUSTRIAL DEVELOPMENT AND REAL ESTATE

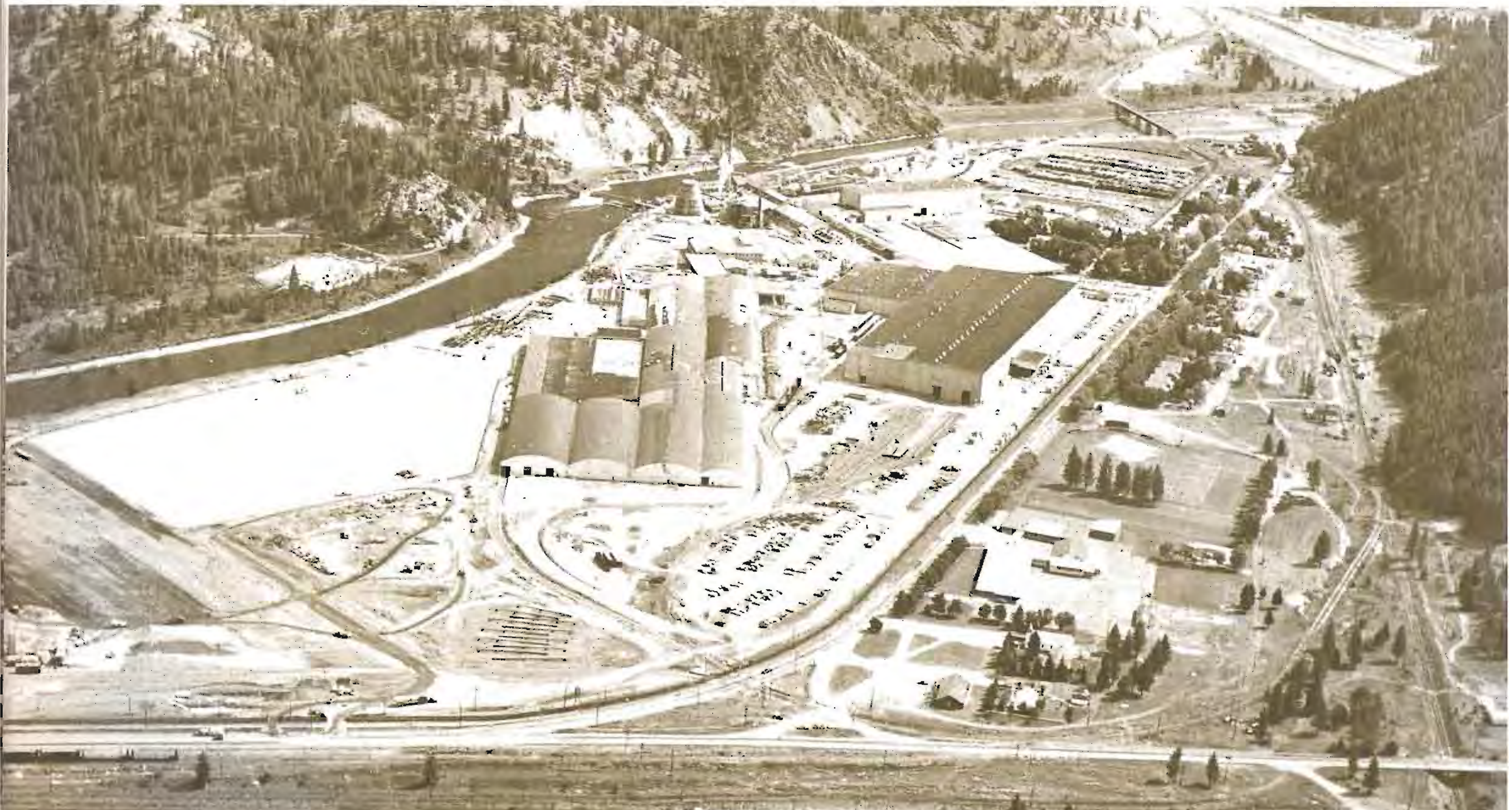
Industrial development and real estate activities accelerated during 1973. A total of 116 industries established plants on the Milwaukee Road or expanded existing facilites. Together, these industries represent an estimated annual increase of $18.5 million in freight revenues.

The largest of the many new industries to locate on Milwaukee Road trackage was an electric generating plant at Big Stone City, S.D., the coal for which will be hauled exclusively by the Milwaukee.

Among the many other new industries located on line in 1973 are a major new regional grain shipping facility at Great Falls, Mont., an automotive industry plant near Milwaukee, Wis., for the manufacture of pollution control devices; a large plywood plant at Bonner, Mont., a facility at Edgerton, Wis., for the production of automobile and farm machine axles; and a paper shipping center at Green Bay, Wis.

LEGISLATION, MERGERS AND RELATED MATTERS

Legislation On January 2, 1974, the Regional Rail Reorganization Act of 1973 became law. It is designed to carve out a viable privately owned rail system in the Northeast from seven bankrupt railroads to provide essential rail service. The Department of Transportation has also drafted legislation which would provide loan guarantees for railroads in all parts of the country for acquisition and maintenance of railroad plant, acquisition of rolling stock, elimination of discriminatory taxation of railroads, and expedition of branch line abandonments. Passage of this legislation, with suitable modification, would be of substantial help to the rail industry.

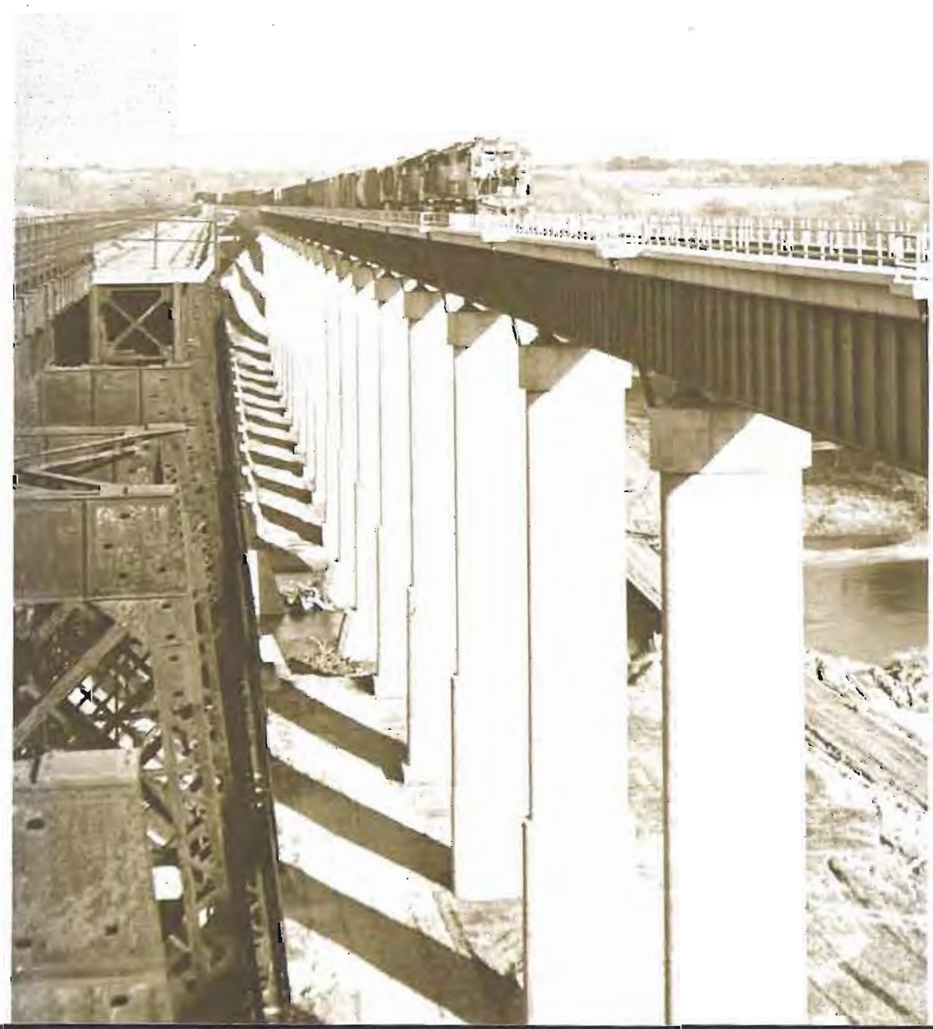


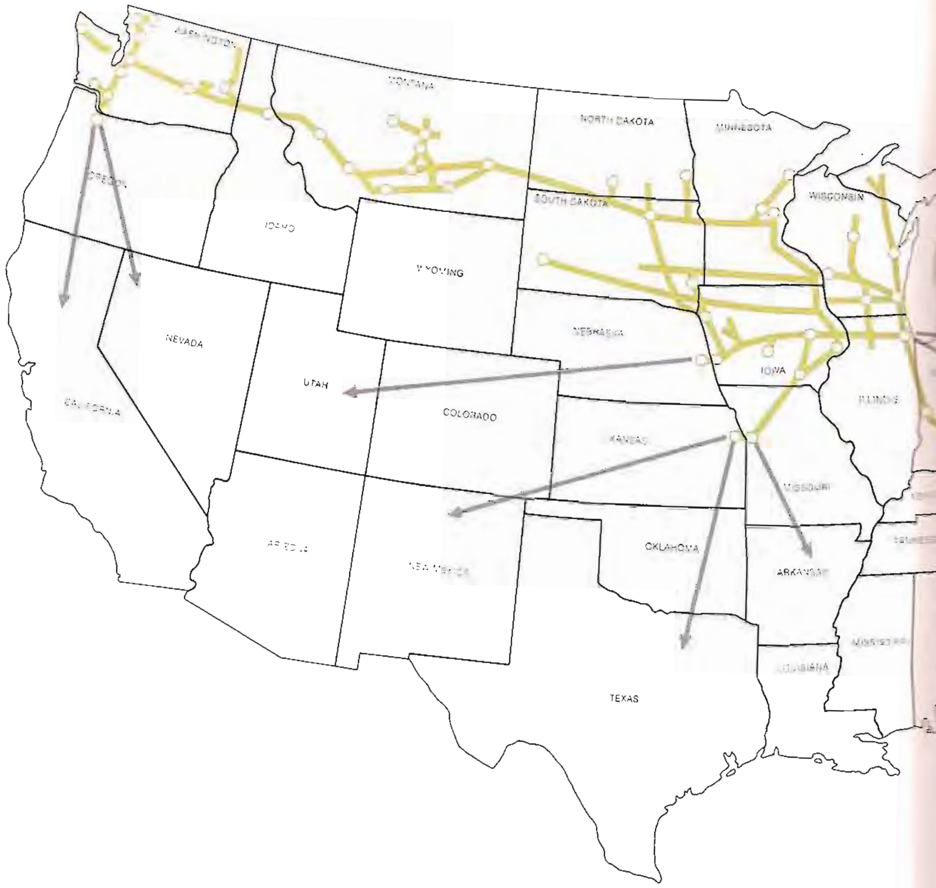
Abandonment of Branch Lines Efforts by the railroads to relieve themselves of losses through abandonment of deficit branch lines have been snagged by the decision of a United States District Court in New York which would require the Interstate Commerce Commission to make an environmental impact statement or finding at the commencement of any abandonment proceeding. Pending appeal from this decision, the Commission has held in abeyance abandonment requests by the Milwaukee and other railroads. It is hoped this delay will soon be eliminated by an overruling of the Court's decision, or through the adoption of new procedures by the Commission.

Milwaukee Inclusion with Burlington Northern On March 9, 1973, the Milwaukee Road filed with the Interstate Commerce Commission a petition for inclusion with the Burlington Northern system. The latter expressed interest and the two railroads have cooperated in extensive joint studies, now completed, of possible savings and improved service by a unified system.

The Milwaukee Road and Burlington Northern have retained separate investment banking firms as their financial advisors. If the managements of the two railroads reach agreement, the proposed terms of inclusion will be promptly submitted to the respective stockholders and to the Interstate Commerce Commission for approval.

Acquisition of Rock Island by Union Pacific—Southern Pacific—Santa Fe As stated in last year's stockholders report, an Administrative Law Judge of the Interstate Commerce Commission, in addition to recommending the partition of the Rock Island among the Union Pacific, Southern Pacific and Santa Fe, recommended a consolidation of the western railroads into four major systems. The Commission is expected to issue its decision shortly, adopting or rejecting in whole or in part the Administrative Law Judge's recommendations. Prior to its request for inclusion with the Burlington Northern, the Milwaukee Road filed a petition for inclusion with the Union Pacific or Southern Pacific as a condition to acquisition by either company of any part of the Rock Island. This petition is being held in abeyance until it is determined if the Burlington Northern inclusion case will be progressed before the Interstate Commerce Commission. Accordingly, the final outcome of the Rock Island proceedings could be of great significance to the Milwaukee Road.

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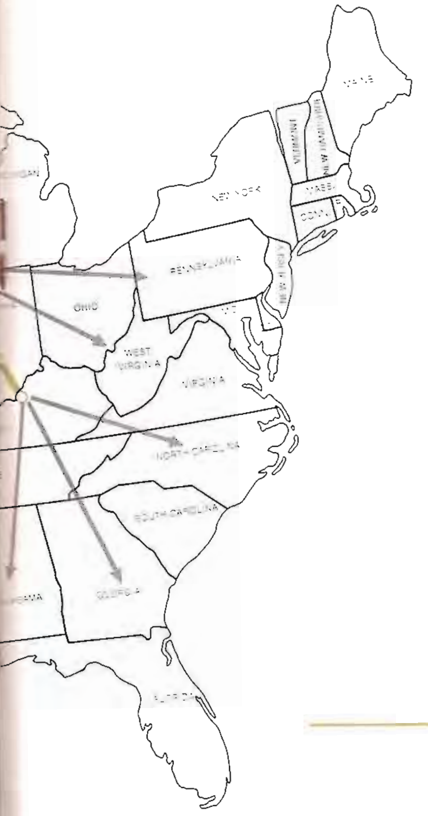

THE MILWAUKEE ROAD

America's Resourceful Railroad

Chicago Milwaukee Corporation and Subsidiaries

Consolidated Balance Sheets

December 31, 1973 and 1972

ASSETS		1973	1972
		(amounts in thousands)	
Current Assets			
	Cash and temporary cash investments	$ 33,625	$ 13,957
	Accounts receivable	33,585	31,040
	Inventories	21,068	19,095
	Other current assets	3,948	4,881
	Total current assets	92,226	68,973
Special Funds		12,890	7,023
Investments			
	Affiliated companies	22,246	23,111
	Other companies	1,235	1,362
	Total investments	23,481	24,473
Properties (notes 2 and 4)			
	Transportation properties		
	Road	643,171	646,132
	Equipment	297,951	312,635
		941,122	958,767
	Less allowances for depreciation and amortization	300,597	302,423
		640,525	656,344
	Other property, less depreciation	12,510	9,311
	Total properties	653,035	665,655
Other Assets and Deferred Charges		11,992	10,526
	Total assets	$793,624	$776,650

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY		1973	1972
		(amounts in thousands)	
Current Liabilities			
	Notes payable to banks	$ 4,090	$ 4,090
	Accounts payable	40,216	34,003
	Payroll and vacation pay	16,846	15,159
	Accrued taxes	8,815	8,157
	Other current liabilities	2,414	3,219
	Current maturities of long-term debt	10,254	10,086
	Total current liabilities	82,635	74,714
Long-Term Debt (note 4)		219,463	221,517
Deferred Federal Income Taxes (note 3)		34,925	32,271
Reserves and Other Liabilities		24,743	28,379
	Total liabilities	361,766	356,881
Minority Interest		19,320	18,850
Contingent Liabilities (notes 11 and 12)			
Shareholders' Equity (notes 1, 5 and 6)			
	Capital stock		
	$5 Prior Preferred Stock—without par value (stated value $100 per share), nonparticipating, noncumulative. Authorized 518,652 shares, issued and outstanding 477,946	47,795	47,795
	Common Stock—$1.00 par value per share. Authorized 15,000,000 shares, issued and outstanding 2,451,708	2,452	2,452
		50,247	50,247
	Capital in excess of par value	318,771	318,551
	Retained earnings	43,520	32,121
	Total shareholders' equity	412,538	400,919
	Total liabilities and shareholders' equity	$793,624	$776,650

Chicago Milwaukee Corporation and Subsidiaries

Consolidated Statements of Earnings and Retained Earnings

Years ended December 31, 1973 and 1972

		1973	1972
		(amounts in thousands except per share figures)	
Operating Revenues	Transportation:		
	Freight	$336,972	$298,532
	Other	25,647	20,706
	Non-transportation	8,289	—
		370,908	319,238
Operating Expenses and Costs	Transportation:		
	Maintenance of way and structures	59,074	57,902
	Maintenance of equipment	51,456	52,982
	Transportation	151,092	132,036
	Traffic and general	31,639	29,416
	Taxes other than federal income taxes	30,827	26,924
	Equipment and joint facility rents, net	35,127	25,181
	Non-transportation	7,611	—
	Other	263	218
		367,089	324,659
	Operating income (loss)	3,819	(5,421)
Other Income			
	Gain on sales of property and timber, net	13,404	9,840
	Interest	2,490	857
	Minority interest in transportation subsidiary	(470)	(35)
	Miscellaneous, net	2,156	1,979
		17,580	12,641
	Total income	21,399	7,220
Fixed Interest		5,972	6,376
Contingent Interest (note 11)		1,374	—
		7,346	6,376
	Income before income taxes and extraordinary item	14,053	844
Deferred Federal Income Taxes (note 3)		2,654	285
	Income before extraordinary item	11,399	559
Extraordinary Item—after deducting deferred federal income tax benefit of $924,000 and minority interest of $40,000 (note 10)		—	(956)
	Net earnings (loss)	11,399	(397)
Retained Earnings, beginning of year		32,121	32,518
Retained Earnings, end of year		$ 43,520	$ 32,121
Per Share Earnings (Loss) Applicable to Common Stock			
	Before extraordinary item	$ 3.67	$ (.75)
	Extraordinary item	—	(.39)
	Net earnings (loss)	$ 3.67	$ (1.14)

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

Chicago Milwaukee Corporation and Subsidiaries

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1973 and 1972

	1973	1972
	(amounts in thousands)	
Source of Funds		
From operations:		
Income before extraordinary item	$11,399	$ 559
Add items not requiring outlay of working capital in the current period:		
Depreciation and retirement charges	17,604	18,955
Deferred federal income tax	2,654	285
Other	3,259	1,286
Working capital provided from operations	34,916	21,085
Salvage	4,527	4,772
Borrowing, including $6,985,000 related to 1973 business acquisitions	8,498	7,795
Release of funds on deposit with mortgage trustee	2,259	3,172
Federal and state mass transit capital grants	—	2,624
Miscellaneous sources, net	1,746	—
	$51,946	$39,448
Application of Funds		
Property additions and betterments	$ 8,934	$ 7,469
Debt retirement	11,063	14,331
Investment in rail terminal and other companies	881	2,373
Deposit of property sale proceeds with mortgage trustee	6,099	7,680
Car-hire funds earmarked for investment in equipment	730	677
Reclassification of accumulated contingent interest to current liabilities	4,194	—
Business acquisitions (note 1):		
Noncurrent assets acquired, at fair value, including property, plant and equipment of $2,279,000	2,942	—
Excess of purchase price over net assets acquired	1,771	—
Organization expenses	—	1,164
Miscellaneous applications, net	—	1,907
Increase in working capital	15,332	3,847
	$51,946	$39,448
Analysis of Changes in Working Capital		
Increase (decrease) in current assets:		
Cash and temporary cash investments	$19,668	$ 4,040
Receivables	2,545	549
Inventories	1,973	(1,683)
Other current assets	(933)	(462)
	23,253	2,444
Increase (decrease) in current liabilities:		
Notes payable to banks	—	(809)
Accounts payable	6,213	2,019
Payroll and vacation pay	1,687	(1,536)
Accrued taxes	658	94
Other current liabilities	(805)	884
Current maturities of long-term debt	168	(2,055)
	7,921	(1,403)
Increase in working capital	$15,332	$ 3,847

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

Summary of Significant Accounting Policies

Consolidation

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

Investment in the Corporation's railroad subsidiary, Chicago, Milwaukee, St. Paul and Pacific Railroad Company ("Railroad"), is carried at equity in underlying net assets. Railroad was acquired upon consummation of an exchange offer on January 14, 1972. At December 31, 1973 the carrying amount of investments in other subsidiaries exceeded underlying net assets by $2,505,000 included in the consolidated balance sheet as other assets and deferred charges ($1,761,000), properties ($617,000) and long-term debt reduction ($308,000), less undistributed earnings since acquisition of $181,000 included in retained earnings.

Revenue Recognition

Transportation freight revenues are recognized upon completion of service except as to interline shipments originating on-line, for which revenues are recorded when service begins. Passenger (commuter) revenues are accounted for on a cash basis, and other transportation revenues are recognized generally at the time service is performed. Revenues from long-term construction contracts are recognized under the percentage-of-completion method.

Investments

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

Transportation Properties

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

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

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

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

Inventories

Inventories are stated at cost which is not in excess of replacement market. Cost is determined generally by the first-in, first-out method.

Earnings Per Share

Earnings per share of common stock are based upon the average number of outstanding shares of common stock and common stock equivalents, and are computed after giving recognition to preferred dividend requirements.

Federal Income Taxes

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

Stock Options

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

1. Business Acquisitions

As of April 1, 1973 the Corporation acquired the capital stock of Hi-Way Paving, Inc., a highway construction subcontractor, and on October 16, 1973 the Corporation purchased the capital stock of Aslesen Company, which designs and installs food service equipment and distributes wholesale food supplies. The acquisitions were accounted for by the purchase method and, accordingly, results of operations of the two companies are included in the consolidated financial statements from the respective acquisition dates. Total purchase price was $7,190,000 in cash and notes plus additional amounts based upon post-acquisition earnings as defined in the purchase agreements. The excess of purchase price over fair value of the acquired net assets is being amortized to earnings over 40 years on a straight-line basis (see also note 6). Amounts paid based upon post-acquisition earnings will be treated as additional excess and amortized over the remainder of the 40-year term.

Consolidated results of operations on a pro forma basis as though the companies had been acquired as of January 1, 1972, and incorporating their results for fiscal years ended in 1973 and 1972, are as follows:

	1973	1972
	(amounts in thousands except per share figures)	
Operating revenues	$385,410	$339,325
Income before extraordinary item	11,790	1,051
Net earnings	$ 11,790	$ 95
Per share earnings (loss) applicable to Common Stock:		
Before extraordinary item	$ 3.83	$ (.54)
Extraordinary item	—	(.39)
Net earnings (loss)	$ 3.83	$ (.93)

2. Transportation Properties

Road properties for which ratable depreciation provisions are not made amounted to approximately $401 million at December 31, 1973 and $403 million at December 31, 1972.

3. Federal Income Taxes

Federal income tax liabilities have been settled through the year 1969. Based in part upon unaudited returns and estimated 1973 tax data, the Corporation had available at December 31, 1973 consolidated tax operating loss carryforwards of approximately $22,108,000, which will expire as follows: 1975—$6,300,000, 1976—$15,808,000.

The available investment credit carryforward as of December 31, 1973 amounted to approximately $15,288,000, which will expire as follows: 1974—$1,474,000, 1975—$1,941,000, 1976—$2,900,000, 1977—$2,861,000, 1978—$1,928,000, 1979—$2,262,000, 1980—$1,922,000.

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

	Per cent of pretax income	
	1973	1972
Federal corporate income tax rate	48.0%	48.0%
Increases (reductions) resulting from:		
Investment tax credit	(18.9)	
Income taxable at 30% capital gains rate	(9.7)	
Income taxable as dividend income	(1.3)	(15.7)
Miscellaneous items	0.8	1.5
Effective rate	18.9%	33.8%

The foregoing reconcilement for 1972 is without regard to the extraordinary item, which is reported net of a federal income tax benefit of approximately 48%.

Other income taxes consisting of various state income taxes are minor in both 1973 and 1972 and are included in operating expenses and costs.

4. Long-Term Debt

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

	Interest		Principal Amount	
	Fixed	Contingent	Dec. 31, 1973	Dec. 31, 1972
Chicago, Milwaukee, St. Paul and Pacific Railroad Company first mortgage bonds, Series A, 1994 (d)	4%	—	$ 49,235,300	$ 49,235,300
Chicago, Milwaukee, St. Paul and Pacific Railroad Company general mortgage income bonds, Series A, 2019	—	4½% (a)	24,684,700	24,684,700
Chicago, Milwaukee, St. Paul and Pacific Railroad Company general mortgage convertible income bonds, Series B, 2044 (e)	—	4½% (a)	31,127,400	31,127,400
The Bedford Belt Railway Company first mortgage bonds, 1994 (f)	2¾%	1½% (b)	178,000	178,000
The Southern Indiana Railway Co. first mortgage bonds, 1994	2¾%	1½% (b)	5,659,000	5,718,000
Chicago, Terre Haute and Southeastern Railway Company first and refunding mortgage bonds, 1994 (g)	2¾%	1½% (b)	7,170,000	7,184,000
Chicago, Terre Haute and Southeastern Railway Company income mortgage bonds, 1994	2¾%	1½% (b)	4,738,800	4,738,800
Chicago, Milwaukee, St. Paul and Pacific Railroad Company income debentures, Series A, 2055	—	5% (c)	55,634,000	55,634,000
Equipment obligations	4-9%	—	34,756,748	42,788,752
Other	6-9%	—	6,278,949	228,507
Total			$219,462,897	$221,517,459

Substantially all of the properties of Railroad and its investments in common stock of certain subsidiaries are pledged under the mortgages and equipment obligations. Investments in affiliated companies include $7,111,974 pledged as collateral to mortgage bonds.

Maturities of long-term debt, exclusive of contingent sinking fund requirements, during each of the years 1974-1978 inclusive are approximately $10,254,000, $8,702,000, $7,739,000, $6,817,000 and $6,382,000. Current debt maturities are included in current liabilities in the 1973 consolidated financial statements; reclassifications have been made in this and certain other respects in the 1972 statements to make them comparable with 1973.

(a) Cumulative to a maximum of 13½%.
(b) Cumulative to a maximum of 4½%.
(c) Noncumulative.
(d) Chicago, Milwaukee, St. Paul and Pacific Railroad Company first mortgage Series B bonds in the principal amount of $4,650,000 have been authenticated and pledged, along with a mortgage note receivable in the principal amount of $828,845 as collateral to note payable to bank.
(e) Convertible into Railroad common stock on the basis of one share of common stock for each $100 principal amount of bonds.
(f) Bonds held by Railroad include $100,000 principal amount pledged under Chicago, Terre Haute and Southeastern Railway Company first and refunding mortgage.
(g) Bonds held by Railroad include $1,515,000 principal amount pledged under Chicago, Milwaukee, St. Paul and Pacific Railroad Company first mortgage.

5. Leased Assets and Lease Commitments

Total rental expense included in operating expenses and costs amounted to $17,251,000 in 1973 and $13,118,000 in 1972. Of these amounts $14,326,000 in 1973 and $10,495,000 in 1972 represent rentals on noncapitalized financing leases. For purposes of the following disclosure, a distinction has been made between "financing" lease arrangements and other lease arrangements. A "financing" lease is one which, during the noncancelable lease period, either (a) covers 75 per cent or more of the economic life of the property or (b) has terms which assure the lessor a full recovery of the fair market value of the property at the inception of the lease, plus a reasonable return on his investment.

The foregoing rental expense figures are exclusive of net car-hire expenses incurred by Railroad on a per diem and/or mileage basis for the use of railroad rolling stock in interchange service with other railroads. Such expenses amounted to $18,915,000 in 1973 and $15,709,000 in 1972. Also excluded are railroad joint-facility "rents" of $4,609,000 in 1973 and $2,879,000 in 1972 representing essentially operating expenses shared with other joint owners or joint users.

The following table summarizes minimum rental commitments under all noncancelable leases as of December 31, 1973 (amounts in thousands):

Year or Period	Railroad Rolling Stock	Other Equipment	Real Property	Totals: Financing Leases	Totals: Other Leases
1974	$ 17,467	$ 462	$154	$ 16,691	$1,392
1975	16,263	455	92	15,679	1,131
1976	15,793	435	55	15,370	913
1977	14,947	300	41	14,487	801
1978	14,117	263	39	13,809	610
1979-1983	61,324	575	172	61,800	271
1984-1988	35,884	193	153	36,077	153
1989-1993	330	—	40	330	40
Totals	$176,125	$2,683	$746	$174,243	$5,311

With relatively minor exceptions the leases represented in the foregoing table do not contain renewal or purchase options other than options at termination of many of the rolling stock leases to renew or purchase the equipment on the basis of its then fair market value. The leases typically require the lessee to pay taxes, maintenance and other operating expenses applicable to the leased property. Leases represented in the foregoing table by rental commitments of $51,583,000 require the lessor to pay for maintenance, and some of these in turn include provisions for price-level escalation of lease payments attributable to maintenance.

The present value of minimum rental commitments under noncapitalized financing leases at December 31, 1973 and 1972 is summarized by the following table, which also indicates the level of interest rates implicit in the leases and used for purposes of discounting net lease payments to present value:

	Present Value		Interest Rates Used in Present Value Computations			
			Weighted Average		Range	
	1973	1972	1973	1972	1973	1972
	(amounts in thousands)					
Railroad rolling stock	$96,296	$87,064	6.88%	6.41%	4.54%-10.41%	4.54%-10.41%
Other equipment	1,963	1,476	7.77	7.97	4.05 -12.34	4.05 -12.34
	$98,259	$88,540				

Assuming all the above financing leases were capitalized, the related property rights were amortized on a straight-line basis over the lease term, and the interest costs were accrued on the basis of the outstanding present value lease commitment, net income for 1973 would have been reduced by $1,263,000 and the net loss for 1972 would have been increased by $569,000. Amortization included in the foregoing computation of net income impact is $9,477,000 and $7,167,000 in 1973 and 1972, respectively, and interest cost included in the computation is $6,512,000 and $4,423,000 in 1973 and 1972, respectively.

6. Stock Options and Incentives

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

Under the Stock Option Plan key officers of the Corporation and its subsidiaries may be awarded qualified and non-qualified options to purchase an aggregate of 150,000 shares of the Corporation's Common Stock at prices not less than 100% of fair market value at the date of grant. Options were granted in 1972 for the purchase of 27,500 shares at $9.75 a share and, in 1973, for the purchase of 22,500 shares at $9.00 a share, 500 shares at $6.50 a share and 500 shares at $10.00 a share. At December 31, 1973 the foregoing options totaling 51,000 shares were outstanding but not exercisable and 99,000 shares were available for option.

In connection with the business acquisitions made in 1973 (see note 1) the Corporation issued warrants entitling the purchasers of the warrants to purchase 60,000 shares of the Corporation's Common Stock at $8.00 a share and 50,000 shares at $10.00 a share. Consideration of $220,000 for the warrants was accounted for as an addition to capital in excess of par value. At December 31, 1973 the foregoing warrants were outstanding and exercisable as to the 50,000-share warrants but not exercisable as to the 60,000-share warrants.

7. Railroad Company Dividends

Under its debt indentures Railroad may pay dividends on its capital stock from available net income, as defined, only to the extent there is available net income remaining after specified requirements. The major requirements having priority under the indentures as of December 31, 1973 and 1972 are current contingent interest of approximately $5,561,000, accumulated contingent interest of approximately $4,202,000 in 1973 and $8,399,000 in 1972, and available net income deficit carryforwards of approximately $28,031,000 in 1973 and $26,802,000 in 1972.

8. Mass Transit Grants

Commuter operations of Railroad are expected to benefit from capital improvement grants approved in December 1972 by the Federal Urban Mass Transportation Administration and the State of Illinois. Recipient of the grants, totaling $26.9 million, is Northwest Suburban Mass Transit District formed by communities along the Railroad's west (Chicago area) commuter line. Funds are to be used principally to purchase new locomotives and coaches, which the District will lease to the Railroad for 25 years at an annual rental of $45,100. This lease and rental will also include the existing commuter fleet of 62 bi-level coaches, which was transferred in December 1972 to the District for a consideration of $2.624.472 as the Railroad's participation in the project. The $2,624,472, which was used to retire the outstanding equipment debt on the bi-level fleet, was taken into account as a reduction of the Railroad's carrying value of such equipment property on its balance sheet. The remaining book carrying value of $4,264,575 is being amortized over a period approximately equal to the lease term.

Other transportation revenues for 1973 include an emergency operation grant of $353,855 from the State of Illinois.

9. Pensions

Executive and supervisory employees of Railroad are covered by an unfunded non-contributory plan. The accounting practice followed is to accrue the cost of current benefit payments to beneficiaries under the plan, but not less than the actuarially computed normal cost plus 40-year amortization of prior service cost. Pension expense under this plan amounted to $1,441,000 in 1973 and $1,403,000 in 1972. The actuarially computed value of vested benefits was approximately $16,921,000 as of June 1, 1973.

10. Extraordinary Item

The 1972 extraordinary item is a charge for retirement of certain railroad properties, principally land, located in downtown Spokane, Washington, in connection with that city's "Expo '74" riverfront development project. The extraordinary item did not provide or utilize working capital.

11. Contingent Interest

Contingent interest expense for 1973 represents the current-year contingent interest on the Series A General Mortgage bonds and the "Terre Haute" bonds of Railroad. No contingent interest provision was required or made in 1972. Payment of this interest, like the interest on the Series B General Mortgage bonds and Five Per Cent Income Debentures, is contingent upon railroad earnings as defined in the respective debt indentures and is governed by priorities specified in the indentures.

Railroad "available net income" for the year 1973 is sufficient to require payment on April 1, 1974 of current-year (1973) contingent interest on the Series A General Mortgage bonds and on the "Terre Haute" bonds, plus the full three-year contingent interest accumulation on these same bonds, but is not sufficient to cover interest on the Series B General Mortgage bonds and the Five Per Cent Income Debentures.

On March 20, 1974 a class action was filed by a holder of Railroad Series B General Mortgage bonds seeking a redetermination of "available net income" for the years 1969 through 1973, and the payment of any additional contingent interest which the Court may find to be due on the Series B General Mortgage bonds. Such a redetermination of "available net income" could result in additional payments for such years under the Railroad mortgages in the amount of approximately $8,407,000 as additional contingent interest and approximately $1,435,000 as additional sinking fund payments. The accompanying consolidated balance sheet as of December 31, 1973, reflects a liability of $4,202,000 for contingent interest on the Series B General Mortgage bonds, which liability represents the full three-year accumulation for such bonds (see note 4). In the opinion of management and Railroad's independent public accountants, "available net income" has been correctly determined. Management and counsel believe that defendants have meritorious defenses to the action. It is the intent of management to vigorously contest the action.

12. Contingent Liabilities

Railroad is liable, jointly with other railroads, as guarantor of certain obligations of affiliated companies amounting to $61,792,800 at December 31, 1973. Also, the railroad is contingently liable as guarantor along with other railroads for its proportion (2.44%), and its proportionate share of any contingent obligations not met by other railroad participants, of obligations of Trailer Train Company aggregating $24,421,132. Certain lease agreements include guaranty by a subsidiary of the Corporation of approximately $50,409,000 invested indirectly in leased property by loan participants.

Railroad carries a service interruption insurance policy under which it may be obligated to pay additional premiums up to a maximum of $8,368,980 for certain work stoppages.

Railroad is a defendant in lawsuits brought by REA Express, Inc. against a number of railroads and other companies, seeking monetary damages and nullification of certain amounts heretofore treated as indebtedness to the railroads. The suits are in their early stages. Independent counsel believes that, under the present state of the law and on the basis of facts now known, the railroad has substantial defenses to all claims made in these suits.

13. Subsequent Events

In February 1974 the Corporation acquired all of the assets of Vulcan-Hart Corporation and Hanson Porcelain Co., Inc. for cash obtained in part through long-term bank financing. The two companies manufacture and sell equipment for the institutional food service market and porcelain enameling. The acquisition will be accounted for as a purchase, and operating results of the acquired companies will be included in the Corporation's financial statements beginning March 1, 1974.

See Note 11 for information concerning litigation filed in March 1974.

Accountants' Report

The Board of Directors
Chicago Milwaukee Corporation:

We have examined the consolidated balance sheets of Chicago Milwaukee Corporation and subsidiaries as of December 31, 1973 and 1972, and the related consolidated statements of earnings and retained earnings and changes in financial position for the years 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, the aforementioned consolidated financial statements present fairly the financial position of Chicago Milwaukee Corporation and subsidiaries at December 31, 1973 and 1972, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & CO.

Chicago, Illinois
February 28, 1974 (except as
to note 11 the date of which is
March 20, 1974)

Registrars

The First National City Bank of New York, New York, N.Y. 10022
Continental Illinois National Bank and Trust Company of Chicago, Chicago, Illinois 60690

Stock Transfer Agents

The Chase Manhattan Bank, New York, N.Y. 10015
The First National Bank of Chicago, Chicago, Illinois 60670