

REMARKS BY DAVID C. BEVAN, VICE PRESIDENT, FINANCE
THE PENNSYLVANIA RAILROAD COMPANY
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You have been kind enough to ask me to report to you on the affairs of the Pennsylvania Railroad so many times here in New York that I almost feel like a member of the Society. However, I think it is interesting to note that whether business is up or business is down there has been one outstanding characteristic with respect to all my appearances before you and which I have commented on in the past. My timing has always without exception been poor.

To start with, today is Friday, the 13th. We have the usual imponderables with which we must attempt to cope in making any prognostications. With respect to our so-called proxy contest, characteristically Mr. Phillips is still suing us. We have an important mail case pending which can have a very important effect, both on our earnings and our cash position. We hope we are on the eve of some of the most important remedial legislation in Washington of the past 25 years. Earningswise the industry is experiencing one of the most difficult years in its history, and as far as the Pennsylvania Railroad is concerned we have been in the red for six consecutive months, and I fear that not only will we be in the red for the second time in our history but our deficit will attain substantial proportions. Tossing all these factors into our electronic brain, it is obviously an easy matter to come up with a precise and definite forecast, both short and long term.

Actually, in our judgment the problems currently confronting the railroad industry are so critical that they far overshadow and outweigh the difficulties of any one company. Under the circumstances, I therefore propose to comment briefly and in an abbreviated form on the 1957 operations of the Pennsylvania Railroad, what we are doing currently, and how we evaluate the future in terms of our own company. After that I will spend the rest of the time discussing the gravity of the situation as far as the

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industry overall is concerned and our analysis of the outlook for the industry in the light of events as we foresee them.

In 1957 revenues of the Pennsylvania Railroad totaled \$987-million or just slightly less than those obtained in 1956. As a result of a sizable increase in expenses, however, our net income showed a sharp drop from \$41-million to \$19-million. Up until the fourth quarter of 1957 we were hopeful that we might be able to show earnings not too far below those of the preceding year, and this was because during the first nine months carloadings were only about 6% below those of the previous year. But from then on the picture changed drastically. In October carloadings were down 13%, in November 16%, and in December 22%. In addition, despite the fact that business was declining at an accelerated rate, on November 1st we were forced to raise wages 12¢ an hour under our labor agreements, 7¢ constituting a straight wage increase and 5¢ representing a so-called cost-of-living adjustment. This increase boosted our wage costs on an annual basis \$28-million. On May 1st another cost-of-living adjustment boosted our wages 4¢ an hour additionally.

At this point I would like to state as emphatically as I know how that these annual wage increases, that threaten to become a regular pattern in all American industry, constitute a real threat to the stability of our economy and without question represent a built-in form of inflation not controllable by the credit policies of our government. I say that they represent an inflationary movement since no attempt is made to gear them to increased efficiency in productivity.

In 1957 the return on our investment in railroad property amounted to 1.80%. In all honesty I must point out that at no time during the last five years has the Pennsylvania Railroad realized a return of as much as 3%. This represents a condition confronting our industry as a result of the fact that we are regulated, ironically enough, as a monopoly when we are in reality an industry that is fiercely competitive, and to compound our troubles all of our competitors in the transportation industry, with the exception of the pipelines, are being substantially subsidized.

Our total debt reached an all-time high of approximately \$1.1-billion in 1952. Since then, I am happy to say that in every year we have been able to show a net reduction not only in our total indebtedness but in both our equipment and bonded indebtedness individually. Last year, despite our unsatisfactory earnings, we did not change this pattern. Overall our debt declined \$28-million. During the past five years the net reduction aggregates \$182-million, and we anticipate that by the end of this year this figure will be over \$200-million.

Since from time to time some people who are not too familiar with our picture have queried our debt reduction program, I think it is only fair to state that the greatest portion of this debt reduction was accomplished solely through meeting current maturities. The amount of voluntary debt reduction, if it can be called that, has been relatively small. Actually we do not consider it voluntary debt reduction but rather dictated by the necessity of bringing down to manageable size large near-term maturities. For example, our \$49-million of non-callable Consolidated Mortgage 4-1/2's of 1960 as of the end of 1957 had been reduced to \$39-million. We plan to cut these further by 1960 to \$35-million, and then it is anticipated that they will be refinanced through the issuance of additional debt by Pennsylvania Company, a 100% owned subsidiary, and I might add, a crown jewel. We have also gradually reduced the \$125-million of General Mortgage 4-1/2% Bonds, which are non-callable and due in 1965, to a present level of \$80-million. The amount of these, if we are successful in maintaining the program to which we have adhered during the last five years, should be reduced to approximately \$40-million by maturity, at which time we expect to refinance this amount through a new blanket mortgage which from that time on will constitute the main debt vehicle for financing of the Pennsylvania Railroad System.

At the end of 1956 our program called for holding working capital even during the year 1957, but to be perfectly frank, because of the unexpectedly sharp decline in business in the last quarter we were unable to adhere to this program and actually reported a loss in working capital for the year of about \$22-million. Unfortu-

nately I must say that our working capital position at the end of 1957, and as of now, is substantially below a proper level, and without qualification, I can also say that this is true for the railroad industry overall. As far as the Pennsylvania Railroad is concerned, we do have a so-called temporary cushion in that four years ago we arranged a \$50-million standby credit with our banks, which is available to us on an emergency basis as a short term loan. We understand that other railroads either have or are attempting to arrange similar credits because of their own inadequate working capital. Up to date we have not been forced to utilize our credit and we continue to hope that the emergency will not be such as to make it necessary.

As most of your know, in the fourth quarter of last year our Board considered it necessary to reduce our regular quarterly dividend from 35¢ to 20¢. Total dividends paid during the year therefore amounted to \$1.25 as against \$1.55 in 1956. This was done with the greatest reluctance since we had hoped that after the initiation of a policy of paying regular quarterly dividends we would be able to maintain them at the levels established. However, because of our limited working capital position and the continuing accelerated decline of business the Board felt that the interests of the stockholders would be best protected by such action. In line with this thinking, so far this year no dividends have been paid, and obviously each month that we operate in the red dims the prospect for dividends this year.

The drastic drop in business which started in October has continued so far this year. For the first four months we reported a deficit of \$19,626,948. It is a foregone conclusion that we will be substantially in the red for the first half year, and as of now, based on our current thinking as to business, July will be a very bad month.

As to the outlook for the final six months, with all the uncertainties involved and the uncertainties which I have previously mentioned, I can only say that for that particular six months we hope to be in the black but obviously we can give no guaranties at this point.

The only thing in forecasting that I feel reasonably safe in stating is that at least in the third quarter we do not anticipate one difficulty which we had in February and March. To add to all of our other problems and troubles during the first quarter we had two snow storms which in loss of revenues and increased expenses cost us an estimated \$10-million. We see no possibility of a recurrence of this difficulty in the third quarter, but again we cannot predict but merely hope that we will be lucky in the fourth quarter in this respect.

There are almost as many terms as there are people to describe the present business situation. I guess it depends on where you sit. In any event, as far as the railroad industry is concerned this is not a "lull" or "rolling readjustment", and as far as the Pennsylvania Railroad is concerned I can say flatly that our business as a whole has suffered a major decline and of such proportions that it could easily be classified as a depression. At the present time, on a unit volume basis, our freight traffic for example is running about 26% below a year ago. As a partial offset to this, management has done its best to retrench. Today we are operating with 80,000 people, which is the smallest force on record. We do expect some improvement to occur later this year but here again we are not looking for miracles. This is going to be a very bad year for the railroad industry and probably the worst year in history for the Pennsylvania Railroad.

Despite this dire prediction, as to the long term outlook we are optimistic. However, this optimism is predicated on a very strong belief that both Congress and the public realize that the past treatment of the railroad industry has weakened our overall economy and has actually endangered our national defense. We are confident therefore that past errors will be partially rectified in the near future, and that additional steps will be taken over the long term to put the railroad industry on a proper competitive footing. I will speak more about this shortly.

As a complete realist, which I think I am, in no way do I want to attempt to gloss over the fact that in my judgment the railroad industry today is facing a most

serious situation. Unfortunately, until comparatively recently, I do not believe that there were too many railroad officers who fully grasped the seriousness of the problems confronting the industry, and practically no one outside the industry appreciated the undermining of the railroad industry which has been going on for a long period of years. Today the industry is facing an acute emergency. It needs important short term help, and much corrective action on a long term basis must also be forthcoming. There should also be a full realization that, irrespective of any and all action which we hope may be taken, the recovery of the patient is not going to occur overnight. You do not undermine the financial strength of an industry, damage it competitively, and then expect it to bounce back in a few short weeks.

On February 5, 1957, I testified in Chicago before the Mediation Board in the trainmen's case, at which time I outlined the serious situation. My remarks were discounted not only by labor leaders but by some railroad officers who thought I was painting an overly dark picture merely to attempt to hold down labor's wage demands. At that time I said, and I quote:

"I consider it necessary to emphasize at the outset that despite the high level of prosperity in the postwar period for business in general, the railroad industry today is in a most critical position, and because of this every decision affecting its welfare must be weighed very carefully because at this stage a wrong conclusion would effect irreparable damage to the industry. In other words, we are dealing with a patient which is seriously ill and which cannot withstand very much more in the way of additional adversity."

On May 1, 1957, testifying before a Senate Committee, I concluded my testimony with this sentence. "Irrespective of what else may be said on the subject, I can assure you the length of time during which this trend toward insolvency can be continued is limited, and we are probably nearer to that limit than many people realize."

Needless to say, since that time we have had much in the way of additional adversity, both in the form of spiraling wage and other costs, inadequate rate increases,

and now a major decline in business. I can cite just a few figures with respect to working capital which I think will forcefully bring home to you the precarious situation the industry now finds itself in. I might add, before presenting the present facts, that in my judgment probably the major reason why such a large percentage of the railroad industry went into bankruptcy in the 1930's was the result of fallacious thinking on the part of most people that because the railroad industry was a so-called utility it did not need much in the way of working capital. Actually, if you analyze the situation the railroad industry should have far more working capital than almost any industrial group that you can name.

Basically, railroad corporate structures include a much higher percentage of debt, and most of us have large annual maturities of equipment debt which are peculiar to the railroad industry. In the case of a great many of us our economy is tied to heavy industry with its drastic cyclical fluctuations, and on the down side we are far worse off than are the coal or the steel industry because when we experience a decline in our freight revenues we lose profitable business but still have to maintain our unprofitable passenger business.

However, to get back to the working capital figures, I will present them not as commonly quoted according to I.C.C. accounting, but on a realistic adjusted basis. After eliminating materials and supplies from current assets, which certainly do not constitute a liquid item, and also after including in current liabilities debt due within one year because like every other current liability it must be paid, at the end of 1945 the railroad industry had working capital adjusted, as I've mentioned, of \$1.4-billion. This working capital represented at that time about 4-1/2 months payroll. Ten years later, on the same basis, working capital had declined almost two-thirds and amounted to \$550-million. This represented payroll coverage of 40 days. Another drastic decline occurred during 1956 when it went to \$300-million, or payroll coverage for 20 days. At the end of 1957 it was down to \$138-million, barely sufficient to meet payroll for 10 days. So far this year there has been a further decline, and as of now we estimate

that overall on the adjusted basis outlined the industry probably has a working capital deficit.

Ironically, and please bear this in mind, this tremendous decline in working capital, which is just one characteristic of the situation, has occurred during one of the most profitable periods for the American economy. As far as the railroad industry is concerned this has been a period of profitless prosperity.

Basically I believe I am an optimist. As a matter of fact I think you have to be to survive in the railroad industry today under existing conditions, but at the same time I think we must face up to facts and be intellectually honest in our analysis of the situation. The foregoing I am sure sounds pretty bleak to all of you, but there are some rays of light in this cloudy sky. The I.C.C. as now constituted personnelwise in our opinion is a definite improvement over some of the past Commissions. In recent months we have been extremely encouraged by the attitude of the Senate Committee on Interstate and Foreign Commerce, of which Senator Magnuson is Chairman, by the intensive studies undertaken by the Surface Transportation Subcommittee, of which Senator Smathers is Chairman, and by the work of the House Committee on Interstate and Foreign Commerce, headed by Congressman Harris. Every indication is that almost without exception the personnel of these various committees mentioned not only are aware of the seriousness of the situation confronting the railroad industry but we believe they have been a vital force in calling it to the attention of the balance of Congress on a non-partisan basis, and in arousing the sympathetic understanding of the public generally as a result of the intensive hearings they have conducted.

Throughout we have tried to be constructive in our criticism, and I think the most tangible evidence of this is the testimony given by our President, James M. Symes, before the Smathers Committee in Washington on January 13, 1958. While pointing out how precarious the situation was confronting the railroad industry and the reasons for it, Mr. Symes at the same time placed in the record a well-rounded program to correct present evils and ills. I sincerely believe that his testimony should be required reading

for anyone who wishes to understand fully the problems besetting us and the remedies suggested.

In the same category I also class the testimony of Walter Tuohy, President of the C. & O., who summarized on behalf of the railroads their testimony at the end of the hearings.

You are all probably aware of the fact that on Wednesday of this week the Senate passed by a voice vote the so-called Smathers bill, and on Thursday the House Interstate Commerce Committee took favorable action on similar legislation. While time makes it impossible for me to outline the corrective proposals contained in the Smathers bill itself, the following are the more important things that are included in this bill:

- 1.) It gives the I.C.C. much broader authority over rates and fares charged for transportation within a state.
- 2.) It gives the I.C.C. power to permit abandonment or change in interstate train and ferry services.
- 3.) It clarifies the authority of the I.C.C. to regulate competitive rates.
- 4.) It authorizes government guarantee of loans up to a maximum of \$700-million under certain conditions.
- 5.) It tightens the exemption for motor carriers hauling so-called agricultural products.
- 6.) It restricts the exemption for private carriers to businessmen providing their own transportation.

Obviously this does not constitute the complete legislative program as desired by the railroad industry. However, we do consider it a most encouraging and far-reaching step forward. We cannot emphasize too strongly, however, that except for one feature, nothing is contained in the program which will overnight give the railroads immediate relief. Most of them are long range in character and benefit. We are hopeful that the guaranteed loans feature will be instrumental in keeping a number of railroads which have been hit the most severely as a result of the drastic decline in business from

receivership. This should prove of benefit not only to the industry itself but to our overall economy.

Naturally we regret that in the Senate, as the result of an amendment, the I.C.C. at the outset apparently will not have jurisdiction over the abandonment and change in unprofitable intrastate service. However, the mere fact that Congress recognizes the necessity of giving the Commission jurisdiction over interstate service may well serve as a forerunner to full authority ultimately. If we are outrightly optimistic we might even hope that the final bill will contain this authority but I am not predicting this.

Despite the fact that in its final action the Senate eliminated the "construction reserve" feature from the bill, we are hopeful that during this session of Congress it will be passed as a separate measure, and at the moment this is actively being considered by the Senate Finance Committee.

We are also hopeful that Congress in its wisdom, now that it recognizes the serious predicament of the railroads, in its bill to renew existing excise taxes will make an exception of the 10% passenger excise tax and the 3% tax on freight. You undoubtedly have noticed from time to time a number of statements to the effect that although the need for this is recognized, it cannot be done without opening the door to the elimination or reduction of other excise taxes. To us this makes no sense whatsoever, and we consider statements of this character as excuses rather than reasons. We only have to look at the subsidies granted to all other segments of the transportation industry which have not been enjoyed by the railroad industry to see that uniform action has not been the rule in the past. We are spending a substantial portion of our budget for national defense. The elimination of these railroad excise taxes, by the government's own figures, would not result in any loss of revenue. Therefore it is neither logical nor consistent not to further bolster our national defense without cost.

One other legislative action taken which has received little notice up to date has far-reaching significance in our opinion. Senator Smathers has introduced

a resolution to provide for a thorough study of the national transportation system and its problems, to be made under the jurisdiction of the Senate Interstate Commerce Committee. That resolution has been approved by that Committee and on Wednesday of this week was acted upon favorably by the Senate Rules Committee. It is contemplated that such a study will include, among other things, the question (1) as to the need for regulation; (2) the area of federal policy dealing with government assistance provided the various forms of transportation and the desirability of a system of user charges to be assessed against those using such facilities; and (3) federal policy on the subject of consolidations and mergers in the transportation industry.

If this resolution is approved, and we have every confidence that it will be, it means that Congress recognizes the necessity of conducting further studies as to how to strengthen the industry. For a long while we have recommended user charges. If these should be instituted, the benefit to the railroad industry would be far-reaching. Needless to say, with our current studies being carried on with the New York Central, recognition of the necessity of consolidations and mergers would be of utmost value to us. We believe that one of the long-term solutions of the railroad problem is the reduction in the number of Class I railroads to approximately 10 or 15. With this number we believe that much greater efficiency of operation can be attained, with better service to our shippers and to the public generally.

One further comment on legislation. Although bills are in both the House and Senate covering the proposal to have a government agency acquire and lease equipment to the railroads, time is so short that realistically we anticipate no final action on these bills at this session. However, the necessity for such an agency is greater today than ever before. I have already given you figures which point up the deplorable working capital position of the industry. At the same time, because of this situation coupled with current lack of earning power, maintenance in the railroad industry is far below normal levels and the percentage of bad order cars is constantly rising. In April the sharpest increase in bad order cars in any month since July, 1949, occurred. On May 1, 1958,

Class I railroads reported 116,000 cars or roughly 6-1/2% of ownership in bad order. This was 9,500 more than a month earlier, 26,000 more than on January 1, 1958, and 40,000 more than in May, 1957.

As a result of the current condition of equipment and the inability to make commitments for new equipment at this time, we estimate that when business starts to turn upward, if it should reach 1956 volume in a relatively short period of time, and I am speaking of six to eight months after the first upturn is indicated, we believe that this country may have possibly the worst car shortage in its history. Although the railroads will be criticized for this, financially they are just not in a position to prevent it. Therefore I again reiterate that the leasing plan is of paramount importance and we hope that it will be acted on as promptly as possible at the next session of Congress.

In closing, I want to thank you for your kind attention and say just two things. As far as the near term outlook is concerned the roughest period may still be ahead of us. On this point I hope I am overly pessimistic. As to the long term outlook not only for the Pennsylvania Railroad but for the entire industry, I am completely optimistic and enthusiastic, and no matter how rough the going is in-between, one way or another we are going to keep the Pennsylvania Railroad on an even keel until we have had an opportunity to benefit from the long term potential.