The Outlook for the Pennsylvania Railroad as of

MAY 10, 1955

J. M. SYMES

ALL OF YOU have received copies of our 108th Annual Report for the year 1954. I am not going to burden you this morning by repeating many of the statistics in that Report. Instead, I will endeavor to review with you some of the conditions that caused the figures—some of the problems that are confronting us—and give you a progress report on our plans for solving those problems. If there are any questions pertaining to the figures in the Report, we will, of course, be glad to answer them here this morning.

I will go back and review conditions that caused our post-war problems resulting in inadequate and irregular dividend payments to our stockholders—and an unusually low market price for our stock. Here is the situation—briefly.

Pennsylvania a War Casualty

Frankly, the Pennsylvania Railroad was a war casualty. The traffic load thrown upon us was much beyond our economic capacity to handle—from the standpoint of facilities and equipment. By reason of manpower and material shortages during those years, we were unable to maintain and improve our property for the long-term good. Earnings that should have gone into the property were siphoned away in high taxes. So, we came out of the war with worn-out equipment and facilities. On top of this came inflation—the greatest in

our history—and being regulated by outmoded laws, entirely misfitted for such conditions, we could not raise rates anywhere nearly commensurate with increased costs—and the lag between costs and rates dealt us a hard blow. Notwithstanding these difficulties—that is, a war worn-out plant, inability to set our prices in keeping with the times, and the lag between cost increases and price increases, we knew that if the Pennsylvania Railroad was to survive and again become a leader in the transportation field, it would require the largest and most costly improvement program in the history of our Company—and it would have to be at a much faster rate than could be accomplished from our normal cash flow—that is, from earnings, depreciation, and disposal of certain assets no longer required for transportation purposes. In short, it required placing additional debt on the property—to the extent of 224 million dollars from 1946 to 1952.

Long-Term Benefit

This improvement program I refer to has amounted to approximately one billion dollars in the post-war period—and that is a lot of money—and I can only say that "thank goodness" our management and our Board of Directors had the courage and foresight to go forward with that program, for, we can now be sure that it was for the long-term benefit of our stockholders, our creditors, our employes, and our patrons.

Certainly, all of us in management, and our Board of Directors in particular, were exposed to a certain amount of stockholder-criticism because of the large improvement program undertaken in the face of rather meager earnings. The temptations were great during the post-war years to substantially curtail that program. But I shudder when I think of what the situation might have been on our property today had we *not* gone forward with that program. Looking back from today's vantage point I should think the stockholders could well be proud of the vision and courage displayed by their Board of Directors in guiding their ship through a rough and troublesome storm during this post-war period.

Basis for Optimism

I have expressed our regrets that our earnings were not better for 1954 —and have told you in the Annual Report that the primary reasons were the terrific sharp decline in traffic volume, particularly steel and coal, which mean so much to our railroad, plus continuing added costs. I also expressed optimism going into this year —to a much greater extent than any of the post-war years. The results for the first four months of this year— while not entirely satisfactory—do indicate a basis for that optimistic statement.

For the first four months of this year, as compared with last, we now estimate that gross revenues will be up about 6¾ million dollars, or around 2½%. Operating expenses will be less by nearly nine million dollars, or 3⅔%. This should produce net income of a little over eleven million dollars as compared with a deficit of 3¾ million a year ago. These figures are on a strictly comparative basis— meaning we are approximately 15 million dollars better off with regard to net income during the first four months this year than during the same period a year ago. Incidentally, our earnings for the first four months are the best in the last ten years. So, it now appears that some of the reasons for our optimism are beginning to show in actual results. I need not add, I believe to this group of informed railroad investors, that we still have a long way to go before we will earn a return on our capital investment that is comparable to some railroads in the West and South, to say nothing of manufacturing industries generally.

Capital Improvements

I would like to discuss a little more fully our reasons for a more optimistic viewpoint now than during the last six or seven years:

1st—The concentrated and costly improvement program of the postwar period required to rehabilitate our property, as result of over-loading and over-working our facilities in World War II, is largely behind us. Instead of the billion dollar improvement program I have referred to in the last six or seven years, it will be on a much reduced basis and more nearly normal in the years ahead. Of equal importance, expenditures from here on can be earmarked on a more uniform basis for all of the things requiring modernization and improvement, instead of pyramiding expenditures for particular "must jobs," such as passenger equipment, diesel locomotives, freight cars, and roadway expenditures. In other words, we believe we are now in a position to keep our entire plant modern and efficient by the expenditure of less dollars, and we will be able to spread them over a wider field of improvements.

Reduction in Debt

2nd—I have told you that to go forward with the post-war improvement program required added debt on the property—in the way of equipment obligations. But, fortunately, the trend was reversed in 1953—when a net reduction of thirty and one-half million dollars of debt in the hands of the public was made—and last year there was an additional reduction of fifty-two million dollars. This eighty-three million dollar debt reduction in two years reduced fixed charges by more than two and one-half million dollars annually. We plan to continue

that program of debt reduction in the years ahead with further improvement in annual fixed charges.

3rd—Business is on the up-turn and we believe it will continue at a fairly high level during the year. For the first four months our freight business shows an increase of ten percent over the same period a year ago as expressed in net ton miles. While the passenger business has declined—showing a decrease of five percent in passenger miles as compared with a year ago—this reduction is more than offset by the upward trend in freight business. A substantial share of the increased revenue from freight business should be carried through to net income.

Stabilization of Costs

4th—The inflationary spiral of increasing costs has now leveled off, and, barring some unforeseeable situation, we do not expect to find ourselves caught again in the terrific squeeze of increased costs without increased rates—at least to the same extent that has occurred during the post-war period—which was largely responsible for our unsatisfactory showing during that period. In short, we believe that inflation and social gains of our people will, in the future, move more nearly in keeping with increased productivity.

5th—A marked and progressive improvement has been made in reducing our passenger operating deficit—

from 72 million dollars in 1951 to 61 million dollars in 1952—to 57 million dollars in 1953—and to 44 million in 1954. While this is a substantial improvement the passenger deficit remains a major problem to our Company. We expect further progress from here on. Realistically, we do not see much future for rail transportation in extremely long passenger hauls where the time element is so much of a factor. By the same token, we believe there is a favorable future for rail transportation in passenger hauls between metropolitan areas involving distances of one hundred to a thousand miles. The Pennsylvania Railroad is well situated to serve this potential mass travel market between large cities. Our objective is to develop a low-cost high capacity lightweight and somewhat faster train for such service. We and several other railroads are moving off in this development by acquiring new trains—and we believe that we will be able to reduce the capital investment per seat to the point where, by proper fares and merchandising, we can tap a potential travel market that will further reduce and we hope eventually eliminate our passenger deficit.

TrucTrain Service

6th—We are progressively developing a TrucTrain service for the transportation of highway trailers on specially designed railroad flatcars. We are providing a complete service by the railroad, and we are also moving trucks for common-carrier motor truck operators. The service is now operating between Chicago, St. Louis, Cincinnati, Pittsburgh, Philadelphia and New York. It will be further extended from time to time. We have in service 200 new flatcars, 75 feet long, capable of handling two of the larger truck trailers—and are building 220 additional cars for this service at Altoona. We expect this traffic to grow rapidly and become an important profitable addition to our business.

7th—We believe that our drive for the adoption of educational methods for improving public and employe relations is definitely on the up-swing—and will redound to the benefit of all. I would like to take this opportunity to publicly express appreciation for the cooperative attitude being displayed by all of our employes and their Brotherhood leaders in helping to solve many of our problems. With management and labor working together as a "team"—and we really are—I think the return from this will be even greater to all of us in the way of accomplishments than that which was made possible by our expenditures for capital improvements.

Outlook in Washington

8th—Subsidy remains one of the greatest evils in transportation and is causing artificial barriers that are harmful to a sound National Transportation Policy. All the railroads seek is equality of competitive opportunity—and if we approach that condition I think the railroads will give a good account of themselves. Many of you will recall that last Summer President Eisenhower appointed a Cabinet Committee to study the over-all transportation situation in this country and come forward with recommendations for improving it. The Cabinet Committee report has recently been submitted to the President and endorsed by him in principle. I think it is one of the finest documents ever presented on the subject. The report is somewhat lengthy —but it recognizes three very important fundamentals:

New Transportation Policy

1st—The report recommends a new Transportation Policy for the country be adopted by Congress—along the lines of equality of competitive opportunity—with a fair deal to all and favors to none.

2nd—It recognizes that the railroads are the backbone of our transportation system in the event of war, and that for them to remain that way they must be healthy and strong—both physically and financially.

3rd—It recognizes that regulation of transportation is entirely outmoded and suggests changes for bringing regulation more in line with present day conditions.

The railroad industry intends to support the Cabinet Committee report one hundred percent, and while, no doubt, there will be certain exceptions taken to some of the recommendations, nevertheless, we believe there is a splendid chance that we shall soon see some legislation that will be helpful to the entire transportation industry in this country, including the railroads.

So, with the outlook based on these factors, we felt justified in placing the stock on a regular quarterly dividend basis, thereby assuring, as far as possible, a minimum return to our stockholders—and with the hope that it will be supplemented by an extra dividend at the end of the year—dependent, of course, on estimated results for the year, plus an appraisal of the future.

Stockholder Committee

Some of you will recall that several years ago, as result of discussion at an Annual Meeting, a Stockholders' Committee was appointed for the purpose of helping management in the area of governmental and labor relations. At the Annual Meeting last year, a question was raised as to the future status of this Committee, and the Board of Directors was asked to consider the subject. The Committee itself met recently and reviewed the question of its future from its own standpoint. It was the unanimous recommendation of the Committee that it be dissolved—because the specific conditions for which the Committee was created have greatly diminished, and there does not now appear to be any real need for such a Committee for this purpose. The Board of Directors considered the recommendation of the Committee of the Stockholders, and accepted and approved their recommendation—that the Committee be dissolved.

Now to specifically touch upon some of the major improvements that are taking place on our Railroad—which I am sure will be of interest to you.

We are proceeding with the construction of Conway freight terminal—20 miles west of Pittsburgh on our Eastern Division. We expect to place part of this new terminal in service by late Summer and complete it by the end of next year. We believe this will be the most modern freight terminal in the country. It is designed for mass mechanized methods to handle nearly 10,000 cars a day. It will not only result in economy of operation where we expect to obtain a 30% annual return on the investment, but also result in improved service to our customers.

Car Repair Shop

The new Hollidaysburg freight car repair shop is also progressing and we expect to place part of it in service by September of this year—and have it completely in service next year. This will be the largest and most modern freight car repair shop in the country, capable of producing heavy repairs for 50 cars a day.

Again the principles of mass production were employed in planning this new shop—and we expect a 20% annual return on the investment.

Pittsburgh passenger terminal improvements are well under way and we expect that most of the remaining work will be finished this year. This project has been going on for a number of years and we will be happy when that improvement is behind us—not only because of the large expenditure involved but also to adequately meet the requirements of our service.

Ore Capacity Increased

The new Ore Pier here in Philadelphia, for handling import ores to interior furnaces, was completed a little over a year ago—and the traffic has already outgrown its original capacity. Because of this we are installing an additional unloading machine on the Pier which will be finished this Summer—and increase the capacity of the Pier to eight million tons annually. This is a very attractive piece of business to our Company—in that the ore is moving west in hopper cars, which for the most part without this ore movement, would be required to move empty to the western part of the State.

We are doing everything within our power to improve revenues on our property. Passenger fare experimentations are taking place constantly—in the way of family plans where the wife and children pay reduced fares—group fares with substantial reductions—special round trip fares—one day excursions—and shoppers' tickets in commutation areas during off peak periods.

Freight Rate Reductions

The same is true with respect to our freight service—where certain rate reductions are being made on specific commodities to recapture traffic from our competitors, as well as hold what we now enjoy.

The general freight rate increase approved by the Interstate Commerce Commission in 1952 was granted on a temporary basis—and unless otherwise changed will expire December 31st this year. The railroads have petitioned the Commission for incorporation of this increase into the permanent rate structure. Without them, the reduction in revenues to the carriers in 1956 would be disastrous.

Additionally, we and other Eastern Carriers have or will petition the Interstate Commerce Commission for a larger share in the Divisions of through rates with the Western and Southern Carriers—because of our relatively shorter hauls, plus much greater terminal expenses in the congested areas we serve. We cannot anticipate the decision of the Commission in these cases, but we believe

recognition of equities in the issues will be helpful to our Railroad.

Real Estate Developments

You are all interested, I'm sure, in certain major real estate developments involving our properties which have been mentioned in the newspapers.

The Penn Center development in Philadelphia, arising on the property that was the site of old Broad Street Station and its "Chinese Wall" approach, is progressing rapidly. Tenants are already moving into the first building—a twenty-story modern office building between 15th and 16th Streets on the Market Street side. It is owned and constructed by Uris Brothers of New York. I am happy to report this morning that it is now approximately 100% rented and that Uris Brothers—who also have the north half of the same block—are hopeful of starting their second twenty-story office building on that site within the near future.

The block between 17th and 18th Streets north of Pennsylvania Boulevard has been acquired by the Sheraton Hotel Corporation as the site for one of the finest hotels in the country, and they expect to start construction immediately. It is scheduled for completion next year.

South of the hotel, between Market Street and Pennsylvania Boulevard, it is expected that construction will start shortly on the new Transportation Building—and that immediately west thereof, between 18th and 19th Streets, a twenty-story apartment building will soon be started.

The new Pennsylvania Boulevard is now under construction from City Hall to 20th Street—and should be completed to the River next year, including a new bridge over the Schuylkill River tying into our Pennsylvania Station and the Schuylkill Expressway.

All told, there are approximately 18 acres of property on the old Broad Street Station site and the abandoned rail line to the River. Its development is moving in the right direction for the ultimate benefit of its tenants, of the City of Philadelphia and for the Pennsylvania Railroad.

Modern New York Station

In New York we are expecting to conclude some similar arrangements in the near future. Pennsylvania Station was constructed on Manhattan Island forty-five years ago. With the growth of New York, it is now being looked upon as an attractive real estate development. We have agreed to an option to sell the air rights west of the Station site—between 9th and 10th Avenues. That is the property between the west end of the Station and the tubes under the Hudson River. We are hopeful that a large development will take place in this area.

Additionally, we are negotiating for the construction of a modern passenger station and for the sale of air

rights over it from the street level up—between Seventh and Eighth Avenues, and between 31st and 33rd Streets. The Pennsylvania Railroad spent many millions of dollars years ago to provide a passenger station on Manhattan Island—and if we can dispose of the air rights on the property at a substantial figure and still have a station on Manhattan Island—and I am sure a better station to meet present day requirements—it will be well worthwhile.

We have similar real estate developments in other cities—not as large as the ones enumerated—but for the most part they are in the development stage—and any announcement of the plans now would be premature and perhaps adversely affect negotiating arrangements.

Long Island Rail Road

In connection with New York, allow me to review briefly the status of the Long Island Rail Road. Since the bankruptcy proceedings in 1949, which became necessary as result of excessive taxation, and the inadequacy and delays in obtaining fare adjustments, there has been much litigation involving this property. It was qualified as a Railroad Re-Development Corporation on August 12, 1954. In its status as a Railroad Re-Development Corporation, which can continue for twelve years, the Long Island Rail Road gained certain exemptions from excessive taxation and the right to charge fares sufficient to produce revenues to cover operating expenses, taxes, and the cost of an exceptionally large rehabilitation program involving both road and equipment. To carry on this program, the Pennsylvania was required to make a loan of 5 ½ million dollars to the Long Island for which we will receive bonds to be repaid during the twelve year period. Other than these new bonds, and equipment obligations to be issued to banks, the Long Island is not permitted to pay anything on account of principal or interest on its securities, or dividends on its stock, as long as it remains a Railroad Re-Development Corporation. All litigation in connection with the reorganization of the Long Island is now behind us. We think the plan now in effect is a workable one, and to the best long-term interest of the Pennsylvania Railroad. We will not be required to pay out any more money to take care of deficits. To make the plan a success required the contribution on the part of three interests—the commuters in the way of increased fares—the State and communities in the way of reduced taxes—and the Pennsylvania Railroad in the way of not receiving any return on the outstanding bonds, or dividend payments on the stock. On the other hand, we will not, as stated, be required to advance any additional funds—and with the large rehabilitation program we will eventually have a much better property than exists today. The plan

has been well received in all quarters and we are convinced, as I have stated, that it is to the best interest of the Pennsylvania Railroad—all things considered—as well as offering the only way open to restore proper rail service to the people of Long Island.

Another point which I think I should cover, even at the risk of speaking at length this morning, is our effort for industrial development. One of the most important functions of railway management is to locate new industry along their railroad and, in that respect, our entire personnel has been quite active. Last year, 229 new industrial plants were located on our Railroad, and 63 existing plants were expanded. It is estimated that these new plants, plus the expansions, will produce approximately eighteen million dollars annually in the way of added freight revenue. Industrial growth along our line is continuing this year, and there are several very large projects now under consideration that will, if located on our line, result in a substantial increase in traffic.

Adjustments in Plant

With the relocation of industry, and change in the traffic flow over various segments of our ten thousand miles of railroad line, plus new techniques in railroading, it is only natural that rail facilities should likewise be changed to meet these conditions. The amount of track required on main lines, or in terminals, or in sidings some years ago might very well be more than is required under existing and future conditions. So, we are moving forward with a program on our Railroad that will shrink facilities where they are no longer needed, and expand facilities where they may best meet present and future requirements. We are sure the end result of this program will be to have a railroad equipped to handle present day traffic requirements economically and efficiently, and not a plant designed to handle an outmoded different traffic pattern. In short—we are changing our plant and equipment to meet present and future requirements—and not trying to fit our customers' requirements into our present plant and equipment. We are sure this program will be mutually beneficial—by reducing costs and improving the service for our shippers.

In closing, let me express my appreciation to all of you who have come here today, and my hope is that during the luncheon hour my fellow directors and officers and I will have a chance to visit with as many of you as possible who wish to discuss some point in which you have a particular interest. I have tried to answer as many of the most likely questions that may be in your mind in my all-too-lengthy statement, to which you have so kindly given me your attention. Thank you very much for that courtesy.