BOSTON AND MAINE CORPORATION

135th ANNUAL REPORT 1967

Boston and Maine Corporation

BOARD OF DIRECTORS

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DEAN M. BOYLAN, Milton, Mass.
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BURT KLEINER, Beverly Hills, Cal.
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JACK M. OSTROW, Beverly Hills, Cal.
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STANLEY S. WEITHORN, Manhasset, N. Y.

Executive Committee—Chairman: MR. STACK; Vice Chairman: MR. RESNIC; Members: MESSRS. BURSTEIN, GOLDFELD, MULHERN,* OSTROW and REARDON.

* Serves ex officio

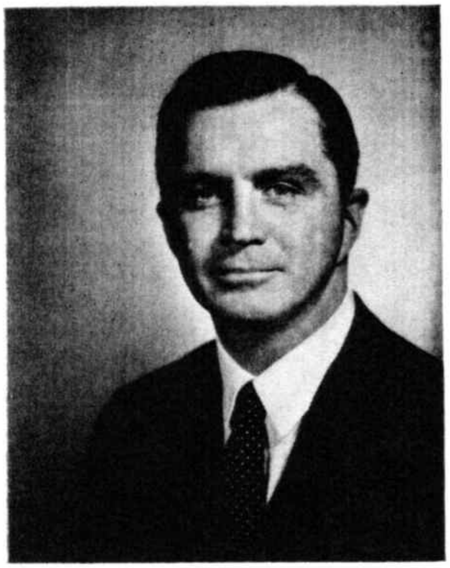
OFFICERS

RICHARD J. MULHERN, Chairman of the Board and President
RALPH W. PICKARD, First Vice President
WILFRED H. HOLLAND, Vice President-Operations
RICHARD J. SULLIVAN, Vice President-Traffic
WILLIAM A. KIRK, Vice President-Industrial Development
WHITCOMB HAYNES, General Manager
RAYMOND F. SWEENEY, Chief Engineer
CHARLES F. YARDLEY, General Manager-Piggyback
HAROLD SIAGEL, Vice President and General Manager, Boston & Maine Transportation Company
PAUL C. DUNN, Assistant Vice President-Equipment
JOHN J. NEE, General Counsel
THOROLD S. CURTIS, Treasurer
W. FREDERICK WILSON, Assistant to the President
HARRY BLAKE, Secretary

TRANSFER AGENTS

Old Colony Trust Company, One Federal Street, Boston, Mass.
Manufacturers Hanover Trust Company, One Whitehall Street, New York, N. Y.

As of February 27, 1968



RICHARD J. MULHERN

President's Report

In 1967, a year marked by declines in revenues and earnings among Eastern railroads, the Boston and Maine Corporation was able to achieve gains in rail freight revenues over the preceding year while reflecting in other respects the same adverse factors that affected the general financial performance of other Eastern lines.

Contributing substantially to the net loss of $3,332,081 for the year were increases averaging in excess of 5% in wage rates and fringe benefit costs. These resulted from national settlements reached by national industry committees and labor organizations. During the year work stoppages in industries whose plants are served by the Boston and Maine brought about losses in freight revenues estimated at $500,000. Extreme cold and heavy snows in the first quarter of the year impeded efforts to generate revenue volumes needed to absorb rises in labor costs incurred later in the year. Severe weather in February and March drastically curtailed Boston and Maine overhead traffic to and from Maine points. Similar conditions hampered operations of connecting trunkline carriers, exercising adverse impacts on Boston and Maine interchange traffic and revenues.

An interim increase in freight rates, achieved by the railroad industry in mid-August of 1967, is expected to improve Boston and Maine revenues by $1,000,000 on an annual basis.

After hearings held in the final months of 1967, the Interstate Commerce Commission ruled on February 15, 1968, that the rate increase was to be permanent. Subsequently, the industry initiated action to obtain an additional increase in freight rates in order to meet increases in wages, materials and other costs. It is expected that by early March of 1968 a master tariff will be filed with the ICC seeking approval of selective commodity rate increases, as well as increases for accessorial services. The industry's efforts will be concentrated on obtaining approval for application of these increases by May 1968.

Logan International Airport in Boston has undertaken a runway extension program that will require 6,000,000 cubic yards of fill. Another 5,000,000 cubic yards of fill will be needed to complete highway extensions in areas of Massachusetts served by the Boston and Maine. The particularly advantageous aspect of this traffic is that it does not require any interchanges with other railroads. Both the sources of supply and the receiving facilities of the customers are located on the Boston and Maine. This means that all the revenue derived from this traffic will accrue to the Boston and Maine.

As noted in ensuing sections of this report, the concluding months of 1967 were marked by initiation of large volume movements of commodities and materials to meet growing demands of current industrial expansion and construction programs scheduled to begin in 1968.

Your management has been a busy one. The lifeline of any railroad, the Traffic Department, has been reorganized to effect a greater degree of vitality and aggressiveness, as subsequent details in this report will indicate.

B&M's interline piggyback business produces substantial revenue from the use of company-owned and term-leased piggyback trailers by other railroads.

To meet the requirements of this expanding piggyback business, the Board of Directors approved in February 1968 the acquisition of 400 piggyback trailers under an eight-year lease contract.

During 1967, the Railroad re-negotiated its contract with the Massachusetts Bay Transportation Authority for a six-months extension was to grant the Authority time to seek further funds from the Massachusetts legislature to enter into a long term arrangement with the Railroad for provision of passenger service within the state. The extension relieved the Railroad of substantial prospective labor costs, as outlined elsewhere in this report.

Of vital importance to the Boston and Maine was the necessity of accomplishing an extension of the Corporation's First Mortgage debt, which was due August 1, 1967, in the amount of $46,339,000. Your Management is pleased to report that this extension was negotiated on terms that did not require an increase in the rate of interest on this maturity.

There follows a review of the major developments of 1967 and the prospects for 1968:

MERGER PROCEEDINGS

On January 15, 1968, the Supreme Court of the United States issued a decision affirming the Interstate Commerce Commission Order in the Penn-Central case. At the same time, the Court upheld ICC rulings on the inclusion of the Boston and Maine, Erie Lackawanna and Delaware and Hudson in the Norfolk and Western system. The Court's decision also affirmed the financial terms of the ICC Order.

As a result of ICC proceedings and judicial reviews and decisions up to this point, the status of the Boston and Maine with respect to inclusion in one or another of the emerging Eastern railroad systems can be summarized as follows:

1—The stockholders of Erie Lackawanna have voted to accept the terms of inclusion in the N&W system as contained in the ICC Order;

2—The shareholders of Delaware and Hudson will be required to vote in May on whether they find the ICC terms of their railroad's inclusion in the N&W system acceptable;

3—Depending on that vote, stockholders of the Boston and Maine—if so required—will soon thereafter be presented with the question of their railroad's inclusion in the N&W system and will decide the issue by their vote.

Because of inquiries from stockholders during the year, your Management believes it appropriate in this report to advise all B&M shareholders that they, and they alone, have the right to determine by their vote whether they choose to accept or reject the financial terms of B&M's inclusion in the N&W system.

In the Annual Report for 1966, your Management expressed its firm opposition to the terms recommended for B&M's inclusion in N&W. That position remains unchanged. Your Management continues to feel strongly that these terms are grossly inequitable to B&M shareholders.

As this Annual Report was being prepared for publication, the Interstate Commerce Commission was in the process of hearing the petition for merger of the Norfolk and Western and the Chesapeake and Ohio-Baltimore and Ohio system. As part of their merger proposal, these applicants would include Boston and Maine and four other Eastern railroads in a subsidiary of the merged system to be known as "Dereco." The financial terms proposed for inclusion of Boston and Maine in the "Dereco" subsidiary are the same as those authorized by the ICC in its Order on B&M's inclusion in the N&W system.

Your Corporation is represented in these proceedings and your Management is pursuing the same principles and objectives previously stated to you—the owners of this Corporation—namely, we are unalterably opposed to the "Dereco" proposal unless the share exchange ratio is substantially revised to reflect more realistically the true value of B&M's contribution to the merged system proposed by N&W and C&O-B&O. Your Management believes B&M is worth considerably more to a combined N&W-C&O-B&O system than to N&W alone. We also believe that the Supreme Court decision left it to the ICC to render a final judgment on this point, and your Management's efforts are now being concentrated in Washington at the ICC hearings towards the end of demonstrating our contention that B&M stockholders are entitled to more equitable terms than those proposed by N&W and C&O-B&O.

Meanwhile, your Management has taken steps to seek alternative routes to a merger that would best serve the public interest, as well as the interests of the stockholders. A joint study has been conducted with the Delaware and Hudson to determine whether a combination of the two lines would produce a more efficient system and significant financial benefits. The study resulted in findings that substantial savings could be achieved if the two properties were put together. This avenue, together with other alternatives, will be further explored in order to achieve a fair and equitable result for stockholders of the Boston and Maine.

Undoubtedly, further developments relative to the policies of your Corporation will take place between the time this report goes into print and the date of the annual meeting of Boston and Maine shareholders. As developments affecting the matters set forth in this report ensue, your Management plans to report them as they occur.

FREIGHT SERVICE

Consolidated freight revenues in 1967 were $54,252,178 as compared with $53,804,961 in the preceding year.

Dependability of Boston and Maine rail service was a determining factor in a decision by the Public Service Company of New Hampshire to fuel with B&M-delivered coal its expanded generating facilities at Bow, N. H. The B&M is New Hampshire's principal rail carrier. The state is currently enjoying one of the highest industrial growth rates in the nation, resulting in sharp increases in power requirements.

In September 1967 the Boston and Maine increased its unit train coal service to the Public Service Company and is presently delivering to Bow, N. H. every six days a 93-car train of 100-tons-per-car capacity directly from the Consolidation Coal Company mines at Fairview, W. Va. This service is to be doubled by March 1968, when B&M will begin delivery of 9,300-ton unit trains to Bow every three days. The railroad's coal revenues will increase by approximately $1,000,000 on an annual basis.

Concluding months of 1967 also witnessed inception of large volume movements of fill for highway and airport construction programs that began late in the year. In its initial stages in 1967, this traffic contributed $408,000 to Boston and Maine freight revenues. In 1968, this traffic is expected to produce more than $3,000,000 in additional freight revenue.

During the year, the Boston and Maine participated in the introduction of a new concept in utilization of bulk distribution facilities located at three points on the B&M. The railroad is now benefiting from growing bulk chemical traffic which employs specially designed cars and transfer equipment to speed truck deliveries to numerous customers.

Late 1967 movements of potato traffic from northern Maine were down because of decisions by growers to withhold shipments in the face of unfavorable market and pricing conditions. Future trends of this traffic are in some doubt because of steadily increasing consumer use of processed potatoes at the expense of the fresh-grown product.

PIGGYBACK SERVICE

Boston and Maine piggyback revenue of $3,439,000 in 1967 was a slight increase over revenue of $3,421,000 in 1966. The substantial annual growth trend that had marked B&M's piggyback service since its inception was impeded in 1967 because long haul trucking companies cut back on their use of Eastern railroads' Plan I piggyback services. In 1966 this traffic represented approximately 19% of B&M's total piggyback volume. In 1967 this figure declined to approximately 13%.

Substantially offsetting the Plan I revenue decline were revenue increases from other piggyback traffic. These increases, amounting to 5.3%, reflected increased revenue contributions to B&M of freight forwarder and shipper association piggyback traffic, as well as increased individual shipper-receiver activity on door-to-door trailerload volume.

To strengthen the competitive posture of B&M's piggyback service, arrangements were successfully concluded with the Erie Lackawanna and Delaware and Hudson for the operation of through piggyback service between Boston and Chicago with intermediate service to Cleveland. The service was initiated with the use of pooled locomotive power of the three railroads. Designed to overcome former train delays at interchange points, initial runs of the new service demonstrated the ability to reduce former overall running time between Boston and Chicago by nine hours, making it possible to provide customers with second-morning daybreak deliveries between these two points and Cleveland. In its early stages, this improved service showed that it could overcome a former competitive disability and help to restore substantial piggyback traffic to B&M after diversion to other carriers in the past several years.

PER DIEM

Since last year's report there have been significant and favorable developments in Management's efforts to achieve additional per diem settlements. Per diem payments represent net rentals the Boston and Maine is required to pay other roads whose freight cars move over the B&M. Since the B&M is primarily a terminating carrier, such payments always far exceed the rentals it can obtain on its own cars.

In 1967 B&M effected a net reduction of $418,000 in per diem payments claimed by other roads from the B&M. Over the last three years, B&M has reached settlements with other railroads that have aggregated $1,460,000.

Late in January, 1968 the ICC issued its report in cases involving the level of past and future per diem. The formula reached by the ICC sustained in major respects the arguments advanced by the Boston and Maine over a period of years as to the basis on which future per diem rate levels should be fixed. This decision by the ICC is the subject of appeals.

PASSENGER OPERATIONS

In December 1967, the Board of Directors authorized the Management to enter into an agreement with the Massachusetts Bay Transportation Authority providing for the continuation through June 30, 1968 of the passenger service operated under prior contract with the Authority. To maintain this service on a fully compensatory basis during the period of the six-month extension, your Management insisted on a number of clearly specified conditions. They were:

1—A provision that the Authority pay any incremental costs occurring as a result of wage increases to passenger service employees covered by protective union contracts between December 31, 1964 and June 30, 1968;

2—A provision that the Authority is to assume protective payments to so-called non-protected employees in the event their status changes to place them in protected categories during the term of the agreement, or because of a retroactive protective agreement entered into by railroad labor and management;

3—A provision that the Authority assume two-thirds of the cost of B&M's legal liability insurance premiums;

4—An agreement to provide that the base value for the purposes of computation for rate of return on investment under the contract shall be increased from $65,000 to $75,000 per Budd car;

5—A provision that the Authority notify the B&M on or before March 31, 1968 whether it would seek an extension of the contract beyond the June 30, 1968 termination date, and whether it planned to exercise its option to purchase any or all of the Railroad's Budd car equipment.

These conditions were accepted by the Authority after they were passed on by your Board of Directors. In addition to insuring against any financial loss on operation of the passenger service, they give the Railroad flexibility in any negotiations that might arise in connection with the possible sale of passenger equipment, either to the Authority or other potential purchasers. The terms of the extension also have the advantage of establishing clearly defined timetables against which the Authority must act to notify B&M of its intentions.

During 1967, the Railroad completed steps initiated in the first half of the year to eliminate its last remaining passenger service, other than the fully reimbursed contract service operated for the Massachusetts Bay Transportation Authority.

INDUSTRIAL DEVELOPMENT

Construction of new and expanded industrial plants in Boston and Maine territory during 1967 totaled about 1,600,000 square feet of building and resulted in the installation of some 11,000 feet of track and 14 connections. It is anticipated that these facilities will bring additional rail movement on the B&M of approximately 5,500 cars per year.

A monthly business review published in New England by the Federal Reserve Bank of Boston noted in its January 1968 issue that planning for heavy construction projects in the region was up 3% in the first 11 months of 1967 over the like period of 1966. This upward trend is reflected in the Boston and Maine's outlook for 1968. Approximately 1,800,000 square feet of buildings served by the B&M are under construction or are scheduled for completion during the year. Plants now programmed for completion in 1968 are expected to increase rail volume by another 4,300 cars annually.

IMPROVEMENTS

Capital expenditures for road property and equipment in 1967 totaled $2,036,000.

To serve equipment needs for movement of fill, as noted in a foregoing section of this report, 99 hopper cars of 70-ton capacity were leased from the Pennsylvania Railroad and another 18 units of the same capacity were leased from the Portland Terminal Company. These cars, supplemented by 91 privately owned cars were utilized in late 1967 when the movements of fill were initiated. In 1968, as fill operations resume early in the year, Boston and Maine will lease an additional 200 cars of 70-ton capacity to serve the volume requirements of the airport and highway construction programs.

Five 100-ton covered hopper cars were purchased for chemical service, and 10 Boston and Maine 50-foot box cars were completely overhauled and placed in service to meet requirements of paper shippers. Additional units of work equipment to effect increased productivity and economy in the maintenance of track and fixed property were purchased during the year at a capital investment of more than $210,000.

Other substantial improvements included:

—118 single track miles of stone-ballasted main track were resurfaced and lined. New and relay rail laid during the year totaled 1,397 tons; while 56,937 cross ties (new and relay) were installed compared with 45,800 ties installed in 1966;

—Installation of three gravel unloading facilities and upgrading of 5.8 miles of branch line to facilitate movement of heavy gravel cars;

—Overhead clearances were improved at Andover, Mass., and 13 new sidetracks, a total of 9,420 feet of track, were installed;

—Ten miles of automatic signal system on double track were completely rebuilt and respaced. Two new and one rebuilt Centralized Traffic Control projects involving a continuation of the single tracking program were completed during the year, permitting retirement of 21.41 miles of second track;

—Major repairs went forward at Hoosac Tunnel with chemical treatment at the east end to reduce water leakage on track and ice formation. Installation of 375 linear feet of Armco Liner Plate inside the tunnel to reinforce the brick lining was completed.

SYSTEMS AND RESEARCH

During the year, the Systems and Research Department developed a low cost computer-oriented car location system to support the Traffic Department's service program. This system is now providing needed daily tracing service directly to the Railroad's shippers. In addition, the Boston and Maine's Car Service Department, traffic representatives and off-line traffic solicitors are now being provided with daily car activity reports, which are put to profitable use in customer contacts. An important by-product has been the establishment of quality control procedures for maintaining service standards designed to further the Railroad's marketing program.

EMPLOYEE RELATIONS

The pattern of wage increases in the railroad industry was five to six percent with one exception in the case of unions representing mechanics and allied crafts. That dispute went through all the processes of law and eventually resulted in a brief strike on many railroads, not including the B&M.

At the request of the President, Congress enacted legislation for final and binding settlement mandated by what came to be known as the Morse Board. The decision of this Board was that mechanics would be entitled to increases aggregating 18% in 1967 and 1968.

Except for those employees covered by the Morse Board report, all contracts are again open either on January 1 or July 1 of this year. Settlement has already been made with the largest organization representing the clerks and allied workers providing an increase of 2½% January 1, 1968, 3½% July 1, 1968, 2% January 1, 1969, and 3% July 1, 1969. The settlement includes a moratorium on changes in rates of pay, rules, or working conditions until January 1, 1970.

The increases in wages beginning in 1967 clearly exceeded any achieved or prospective increases in productivity and are a part of the inflationary problem affecting all American industry.

LONG-TERM DEBT CHANGES

The Boston and Maine met substantial obligations for equipment and road property in 1967. This resulted in a net reduction in long-term debt of $3,039,694 as reflected in the following table:

Balance at beginning of year	$81,027,943
Increases:	
Equipment and Road Property obligations for new acquisitions	226,008
Collateral Note	750,000
	82,003,951
Decreases:	
Equipment and Road Property obligations paid	2,848,219
Principal payments made on Collateral Trust Indentures and Collateral Notes	1,166,987
Other	496
Balance at end of year	$77,988,249

MORTGAGE BONDS EXTENSION

The Corporation successfully accomplished extension of the Boston and Maine's First Mortgage Bonds, Series TT, in the amount of $46,339,000 to a new maturity date of July 1, 1970. Assents to the extension were received from the holders of more than 85% of the Bonds.

A FINAL NOTE

The Management is grateful to all the security holders of the Boston and Maine for their interest and support of the efforts that are being made to improve the quality of this Corporation's service to the public and to enlarge its opportunities for achieving merger on terms that will provide the Corporation's owners with a fair and fully acceptable return on their investment.

Your Management has been in office for little more than one year. It has devoted itself to the introduction of enterprising, innovative programs aimed at increasing revenues and absorbing, insofar as possible, the rising costs of operation.

Your Board of Directors, as now constituted, represents very large shareholdings in the Corporation and interests that are national in scope. Equally important, your Directors represent a greater and more diversified range of business, financial and corporate skills and experience than has been available to this Corporation in many years.

The common objective of your Board of Directors and your Management is to seek—and to find—the most feasible and productive means of enhancing the values of your investment in the Boston and Maine.

The Corporation is grateful to all employees for their cooperation during the past year.

OPINION OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF THE
BOSTON AND MAINE CORPORATION

We have examined the balance sheet of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1967 and the related statement of operations and accumulated deficit for the year. 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.

As described in Note 6 to the financial statements the company may obtain significant reductions in the provision for disputed per diem charges as the result of either settlements that may be reached with various railroads or a recent decision by the Interstate Commerce Commission.

The company records depreciation of roadway and structures, replacements of rails, ties, etc. and disposition of these assets in accordance with accounting practices uniformly prescribed for all railroads, as briefly explained in Note 3 of the notes to financial statements. The accumulated reserves for roadways and structures generally have been substantially less than the related costs of those properties which have been disposed of in prior years. The deficiency of these reserves, the amount of which is presently indeterminable, has been increased by the fact the reserves which have been provided have been substantially reduced or, for certain classes of assets, eliminated entirely by charges for losses on retirements which have been unusually large in recent years. We have concluded that the railroad's reserves are inadequate and that neither the depreciation accounting method nor the replacement accounting method, described in Note 3, provide for, or would have provided for, the retirement losses or obsolescence of the magnitude experienced.

In our opinion, subject to the indicated reduction in the provision for disputed per diem charges described in Note 6 to the financial statements, and, except for the inadequacy of reserves and provisions for depreciation and obsolescence discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1967 and the results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PRICE WATERHOUSE & CO.

Boston, Massachusetts
March 7, 1968

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF OPERATIONS AND RETAINED EARNINGS (ACCUMULATED DEFICIT)

	Year ended December 31	
	1967	1966
OPERATING REVENUES:		
Freight	$ 54,252,178	$ 53,804,961
Passenger	4,259,940	4,082,652
Other (including passenger service contract payments–$2,900,164 in 1967, $2,932,917 in 1966) (Note 9)	5,881,460	6,186,423
	64,393,578	64,074,036
OPERATING EXPENSES (NOTE 3):		
Transportation	29,796,153	28,674,249
Maintenance of way and structures	8,432,647	8,491,951
Maintenance of equipment	9,932,354	9,024,791
Traffic, general and miscellaneous expenses	4,791,709	4,899,171
	52,952,863	51,090,162
NET REVENUE FROM OPERATIONS	11,440,715	12,983,874
OTHER OPERATING CHARGES:		
Payroll, property and state excise taxes, etc.	4,982,379	4,832,742
Net rents for equipment and joint facilities (Notes 6 and 11)	6,240,868	5,283,450
	11,223,247	10,116,192
OPERATING INCOME	217,468	2,867,682
NONOPERATING INCOME, NET–including net gain on recurring disposals of land, $314,779 in 1967 and $384,970 in 1966	782,730	680,557
INCOME BEFORE FIXED CHARGES, CONTINGENT INTEREST AND EXTRAORDINARY ITEMS	1,000,198	3,548,239
FIXED CHARGES:		
Rent for leased lines, etc.	450,587	450,609
Interest:		
First mortgage bonds	2,780,337	2,786,601
Equipment trust certificates	260,875	323,485
Conditional sale contracts	175,373	267,714
Guaranteed notes and other	275,024	325,546
Amortization of long-term debt expense	174,524	237,884
	4,116,720	4,391,839
LOSS BEFORE CONTINGENT INTEREST AND EXTRAORDINARY ITEMS	(3,116,522)	(843,600)
CONTINGENT INTEREST (page 14)	748,140	748,140
LOSS BEFORE EXTRAORDINARY ITEMS	(3,864,662)	(1,591,740)
EXTRAORDINARY ITEMS:		
Net gain on disposal of Yard 8 land in 1967, Yard 9 land in 1966	282,369	493,077
Merger proceeding expenses (Note 4)	(167,773)	(478,306)
Settlement of disputed per diem charges, less related legal fees (Note 6)	417,985	575,265
Mystic Terminal lease settlement	—	(700,000)
	532,581	(109,964)
NET LOSS	(3,332,081)	(1,701,704)
RETAINED EARNINGS AT BEGINNING OF YEAR	2,633,866	4,335,570
RETAINED EARNINGS (ACCUMULATED DEFICIT) AT END OF YEAR	$ (698,215)	$ 2,633,866
PER SHARE OF COMMON STOCK:		
Loss before extraordinary items	$ (3.75)	$ (1.55)
Extraordinary items	.52	(.10)
Net Loss	$ (3.23)	$ (1.65)

Based upon average shares outstanding and assuming all preferred shares to have been converted at the beginning of the year.

ASSETS

	December 31 1967	December 31 1966
CURRENT ASSETS:		
Cash	$ 3,086,017	$ 2,914,093
Marketable securities, at cost (approximate market)	230,717	1,105,627
Special deposits	137,936	181,550
Accounts and notes receivable	6,014,326	5,636,296
Inventories of materials and supplies, at cost or less	2,799,108	2,813,438
Prepayments and other current assets	428,748	386,813
TOTAL CURRENT ASSETS	12,696,852	13,037,817
PROPERTIES (NOTES 3 and 9):		
Roadway and structures, including improvements to leased properties—$13,887,667 in 1967, $13,989,332 in 1966	172,931,713	173,522,256
Equipment	65,888,421	66,372,038
	238,820,134	239,894,294
LESS:		
Depreciation of roadway and structures	(6,553,207)	(5,741,774)
Depreciation of equipment	(27,968,425)	(26,245,021)
	204,298,502	207,907,499
Miscellaneous physical properties, less depreciation—$118,746 in 1967, $38,848 in 1966	3,564,594	3,573,742
	207,863,096	211,481,241
INVESTMENTS AND OTHER ASSETS:		
Investments in leased lines (Page 14 and Note 2)	3,619,596	3,611,790
Other investments (Page 14)	1,502,557	1,247,194
Deposits with trustees for first mortgage bonds and equipment obligations	1,843,081	1,930,293
Other assets and deferred charges	2,846,901	2,395,947
	9.812,135	9,185,224
	$230,372,083	$233,704,282

BALANCE SHEET

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31 1967	December 31 1966
CURRENT LIABILITIES:		
Accounts payable	$ 9,940,221	$ 8,304,156
Accrued vacation pay	2,046,849	1,962,993
Accrued interest	1,374,867	1,401,257
State and local taxes	3,519,985	3,224,261
Estimated current portion of injury and damage claims	1,327,224	1,346,173
TOTAL CURRENT LIABILITIES (excluding long-term debt due within one year)	18,209,146	16,238,840
LONG-TERM DEBT DUE WITHIN ONE YEAR (Page 14)	3,590,168	3,917,409
LONG-TERM DEBT (Page 14):		
First mortgage bonds	46,338,860	46,339,356
Income mortgage bonds	18,703,500	18,703,500
Equipment and other obligations	9,355,721	12,067,678
	74,398,081	77,110,534
OTHER LIABILITIES AND DEFERRED CREDITS:		
Provision for disputed per diem charges (Note 6)	11,133,456	10,946,958
Provision for injury and damage claims	993,124	1,091,212
Accrued depreciation on leased property and liabilities to leased lines	3,609,771	3,517,586
Unearned interest accrued on income mortgage bonds	7,481,400	6,733,260
Other	2,559,103	2,419,254
	25,776,854	24,708,270
STOCKHOLDERS' EQUITY (NOTE 4):		
Capital stock (Note 7):		
5% Preferred stock $100 par value:		
Authorized and issued—107,235 shares in 1967, 152,987 shares in 1966	10,723,500	15,298,700
Common stock, $1 par value:		
Authorized—4,000,000 shares		
Issued—843,828 shares in 1967, 763,679 shares in 1966	843,828	763,679
Additional capital (Note 7)	97,528,721	93,032,984
Retained earnings (Accumulated deficit) (Note 8)	(698,215)	2,633,866
	108,397,834	111,729,229
Contingent obligations and commitments (Note 11)		
	$230,372,083	$233,704,282

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF INVESTMENTS IN LEASED LINES
DECEMBER 31, 1967

	No. of shares owned	*% owned*	*Cost*	*Boston and Maine equity in book value of underlying net assets*	*Approximate value based on current market quotations*
Northern Railroad	21,006	68.4	$2,148,704	$2,160,771	$1,491,426
Stony Brook Railroad	1,829	61.0	151,015	192,234	124,372
Vermont & Massachusetts Railroad	11,647	36.5	1,319,877	2,044,572	815,290
			$3,619,596	$4,397,577	$2,431,088

The shares in leased line companies have been acquired over the period from 1937 to 1967. At December 31, 1967, all of the shares were pledged to secure long-term debt. Annual rentals of the leased lines, under long-term leases, amount to approximately $405,000 plus certain federal and state taxes of the leased line companies which currently aggregate about $185,000 per year. Dividends received from the leased line companies amounted to $205,000 in 1967 and 1966. The leased line companies distribute on a current basis substantially all of their net income as dividends. The book value of the underlying net assets of each company has remained approximately the same during the period Boston and Maine has owned shares in the respective companies.

STATEMENT OF LONG-TERM DEBT
DECEMBER 31, 1967

	Portion due	
	Within one year (a)	*After one year (a)*
FIRST MORTGAGE BONDS, Series TT, 6% due July 1, 1970(b)		$46,338,860
INCOME MORTGAGE BONDS, Series A, 4½% (4% cumulative), due July 1, 1970(c)		18,703,500
EQUIPMENT AND OTHER OBLIGATIONS:		
Equipment Trust Certificates, Series 1, 4½% to 6% due March 1971 secured by equipment with an aggregate original cost of $22,462,000 and by deposits of $426,000 with trustee as of December 31, 1967	$1,234,000(d)	3,701,000
Guaranteed notes 5% due to 1977 secured by $1,752,600 principal amount of Series TT bonds, capital stock of leased lines, capital stock and notes of certain wholly-owned subsidiary companies and "other investments," carried at cost of $15,576	566,667	3,800,000(e)
Conditional sale contracts and mortgage and collateral notes maturing at various dates from 1968 to 1990 secured by equipment and real estate with an aggregate original cost of $14,601,000 and "other investments" carried at cost of $715,058	1,789,501	1,854,721(e)
		9,355,721
	$3,590,168	$74,398,081

(a) Amounts outstanding are exclusive of bonds owned by the companies—$1,752,600 of Series TT bonds pledged against guaranteed notes and $559,000 of income mortgage bonds which are unpledged and $1,000 of equipment trust certificates owned by the company.

(b) In July of 1967 the holders of the first mortgage bonds approved an extension of the maturity date to July 1, 1970. The first mortgage bonds are secured by substantially all the road properties and equipment of the company, its operating franchises, leases and agreements subject to the prior lien of equipment trust obligations and conditional sale contracts in the case of certain property and equipment as indicated in the statement above. Interest is payable semiannually at the indicated rate. The first mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually on or before May 1, to deposit with the trustee cash equal to the lesser of (a) 1% of the outstanding TT bonds or (b) net income of the railroad before contingent interest minus "net income deficit," as defined, subsequent to 1964. Under the terms of the sinking fund provision no sinking fund deposit is required in 1968. The bondholders in approving the aforementioned extension of maturity also approved an amendment to the trust indenture to permit expanded use by the company of proceeds from sales of mortgaged property for payment of real estate taxes and capital improvements. Any proceeds remaining after such utilization will be applied to the redemption of bonds by lot. There were no proceeds available in 1967 for the redemption of bonds.

(c) The income mortgage bonds are secured by a second mortgage on the same properties as those securing the first mortgage bonds. Interest is payable at the rate of 4½% per annum if "available net income" is sufficient and, if not earned, is cumulative and payable not later than the maturity of the bonds at the rate of 4% per annum. The income mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually, on or before September 1, to deposit with the trustee $482,870 in cash or Series A bonds (at the lesser of their principal amount plus accrued interest, or their cost to the company) if "available net income" is sufficient. There has been no sinking fund obligation since 1958.

(d) The same amount matures each year to maturity.

(e) Payable at varying amounts each year to maturity.

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 1—PRESENTATION OF CONSOLIDATED STATEMENT OF OPERATIONS AND PRINCIPLES OF ACCOUNTING

The accompanying financial statements are prepared in accordance with generally accepted accounting principles and, as to the parent company and its transportation subsidiaries, follow accounting practices and procedures prescribed by the Interstate Commerce Commission. The presentation of certain items in the consolidated statement of operations may differ in certain respects from the manner in which they will be incorporated in the company's annual report to the ICC.

NOTE 2—BASIS OF CONSOLIDATION

The accompanying financial statements include the accounts of Boston and Maine Corporation and its wholly-owned subsidiary companies. The company's investments in unconsolidated leased line companies which are less than wholly owned are summarized on page 14.

NOTE 3—PROPERTIES

Amounts reflected for properties largely represent the aggregate of acquisitions and additions (by merger, purchase, construction or otherwise), less retirements, recorded under the system of accounting prescribed by the Interstate Commerce Commission. In accordance with such accounting requirements, the company commenced providing straight-line depreciation on roadway and structures, other than rail, ties, ballast and other track materials, on January 1, 1943. Equipment has been systematically depreciated on the straight-line basis since its acquisition. The recorded cost, less salvage, of all depreciable properties retired or sold is charged to the depreciation reserves. This practice resulted in charging to the reserve net losses of approximately $500,000 in 1967 and $600,000 in 1966 incurred upon the retirement of properties which in accordance with generally accepted accounting principles would have been reflected in the company's consolidated statement of operations.

Rails, ties, ballast and other track materials in the amount of approximately $41,300,000 at December 31, 1967 reflect "replacement" accounting, which has been considered an acceptable alternative in the railroad industry to the more widespread practice of depreciation accounting. Under this method replacements in kind are charged to maintenance expense and only improvements and additions are capitalized. The amounts capitalized are not depreciated. Retirements of such properties, less salvage, are also charged to maintenance expense.

The accompanying statement of operations includes charges for depreciation totaling $4,283,000 in 1967 and $4,397,000 in 1966.

NOTE 4—MERGER PROCEEDINGS

Reference is made to pages 3 to 5 of the company's 1967 annual report to stockholders for a description of various merger possibilities presently being considered.

NOTE 5—FEDERAL INCOME TAXES

At December 31, 1967, the companies had loss carry-overs for federal income tax purposes of $24,000,000 available to apply against taxable income in varying amounts through the year 1974. Under existing law $7,000,000 will expire in 1968 unless applied against taxable income, if any, for the year.

NOTE 6—DISPUTED PER DIEM CHARGES

The company is party to a dispute with other railroads over per diem rates for freight car rentals. For various reasons, including its situation as a so-called terminal line, the company incurs more rentals than it earns. Since August 1953, payment has been made to other railroads at rates which are less than the rates adopted by the Association of American Railroads. Except in those instances where final settlement agreements have been concluded for lower rates, full provision has been made by charges to operations at AAR rates.

In January 1968, the Interstate Commerce Commission rendered a decision supporting in large part the Boston and Maine's position in the dispute. This decision, which is the subject of appeals, provides that per diem for the future will be settled on a time and mileage basis which will result in more favorable treatment to short-haul carriers such as the Boston and Maine than present AAR rates.

Management believes that the $11,133,456 provision at December 31, 1967 reflected in the accompanying balance sheet for open disputed per diem will eventually be settled at substantially less than 50 percent of that amount. In 1967 and 1966 the company settled disputed liabilities of $1,010,151 and $1,027,279, respectively, with several other railroads which resulted in extraordinary credits, less related legal fees, of $417,985 and $575,265, respectively. Disputed amounts accrued and charged to operations, before credits for the above settlements, amounted to $1,200,000 in 1967 and $1,125,000 in 1966.

NOTE 7—CAPITAL STOCK, STOCK OPTIONS AND ADDITIONAL CAPITAL

The 5% preferred stock is redeemable at any time at $100 per share plus accumulated unpaid dividends and is convertible at the option of the holder into common stock at the rate of 1¾ shares of common stock for each share of preferred stock. Additional capital was increased by $4,495,134 in 1967 in connection with the conversion of 45,752 shares of preferred stock into 80,066 shares of common stock.

Dividends on preferred stock, if not paid, are cumulative only if and to the extent (not exceeding 5% per annum) that earnings are available. On this basis there were no cumulative unpaid dividends at December 31, 1967. If earnings are sufficient, the company is required to set aside annually one half of one per cent of the par value of the authorized preferred stock as a sinking fund for redemption of preferred stock, before dividends are paid on the common stock. There was no cumulative sinking fund obligation as at December 31, 1967.

At December 31, 1966, there were outstanding options granted to certain employees to purchase 31,257 shares of common stock of the company at prices ranging from \$6.00 to \$19.38 per share, or an aggregate of \$507,000. During the year options for 83 shares were exercised. The \$603 excess of the proceeds over the par value of such shares was credited to additional capital. No options were granted during the year. Options for 2,783 shares expired during the year. At December 31, 1967, there were outstanding options to purchase 28,391 shares at \$6.00 to \$19.38 per share, or an aggregate of \$462,000, of which options for 11,696 shares were then exercisable at an aggregate consideration of \$188,000. Under the present stock option plans, further options for 13,019 shares could be granted to key supervisory personnel at the fair market value at the time of the grant. Options generally become exercisable in instalments over a four year period beginning one year after the date of grant and remain exercisable through the fifth year after the date of the grant (through the tenth year for options granted prior to 1965).

NOTE 8—RESTRICTIONS ON DIVIDENDS AND ADDITIONAL BORROWINGS

The indentures securing the first mortgage bonds, the income mortgage bonds and the guaranteed notes contain various restrictive provisions under which at December 31, 1967 the company could not pay dividends on or make purchases of any class of its capital stock. The indenture securing the first mortgage bonds also contains restrictions on additional borrowings.

NOTE 9—PASSENGER SERVICE

The company is obligated under a contract with Massachusetts Bay Transportation Authority expiring on June 30, 1968 to continue certain passenger service within a twenty mile radius of Boston. The contract provides generally that the company will be reimbursed for the excess of passenger service expenses, as defined, over passenger service revenues and includes options for the Authority to lease or purchase passenger rights of way and passenger equipment at prices to be determined upon exercise of the options. Reference is made to pages 6 and 7 herein for further information.

NOTE 10—PENSION AND RETIREMENT PLANS

The Railroad Retirement Act provides pensions for most of the company's employees. The cost to the company is in the form of railroad retirement taxes which are included in the accompanying statement of operations under payroll tax accruals. The company also has a retirement plan which provides additional pensions for officers and supervisors. Costs of this plan are borne by the company and amounted to \$123,000 in 1967 and \$85,000 in 1966, based on normal cost plus interest on unfunded prior service costs and in 1967 an amount to amortize past service costs over a period of forty years. At December 31, 1967, the estimated amounts of vested benefits under the plan exceeded pension fund assets by approximately \$1,300,000.

NOTE 11—CONTINGENT OBLIGATIONS AND COMMITMENTS

In addition to the matters referred to elsewhere in the financial statements and notes, the company had the following contingent obligations and commitments at December 31, 1967:

The company rents approximately 1,650 freight cars and piggyback trailers under long-term leases which expire at various dates to 1977. Current annual rentals under the various leases amount to approximately \$750,000. The company also rents its general offices under a lease expiring in 1972, renewable thereafter, which provides for a current annual rental of about \$256,000.

The company is plaintiff or defendant in numerous lawsuits which, in the opinion of company officials and counsel, will not have a material effect on its financial position. Several pending proceedings are derivative stockholders' suits. Recovery, if any, in these actions would inure to the benefit of the company.