BOSTON AND MAINE CORPORATION

136th ANNUAL REPORT 1968

Boston and Maine Corporation

BOARD OF DIRECTORS

HAROLD C. ARCARO, Providence, R. I.
DEAN M. BOYLAN, Milton, Mass.
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JACK M. OSTROW, Beverly Hills, Cal.
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Executive Committee—Chairman: MR. RESNIC; Vice Chairman: MR. GOLDFELD;
Members: MESSRS. BURSTEIN, KAPLAN, MULHERN*, OSTROW and REARDON.
* Serves ex officio

OFFICERS

RICHARD J. MULHERN, Chairman of the Board and President
RALPH W. PICKARD, First Vice President
CHARLES F. YARDLEY, Vice President-Operations
RICHARD J. SULLIVAN, Vice President-Traffic
WILLIAM A. KIRK, Vice President-Industrial Development
FRED L. ESTEY, General Superintendant
HAROLD SIAGEL, Vice President and General Manager,
Boston & Maine Transportation Company
RAYMOND F. SWEENEY, Chief Engineer
PAUL C. DUNN, Chief Mechanical Officer
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 March 17, 1969

RICHARD J. MULHERN

President's Report

In 1968 the principal development affecting the interests of the Shareholders of Boston & Maine Corporation was the establishment of a holding company to be known as Boston & Maine Industries, Inc. The action was taken to create opportunities for developing additional sources of income by making possible the acquisition of business enterprises in fields other than the railroad industry.

A prospectus explaining in detail the terms of a share exchange offer was mailed by Boston & Maine Industries, Inc., to all Shareholders of Boston & Maine Corporation on February 14, 1969. Acceptance of the exchange offer of Boston & Maine Industries was recommended by your Board of Directors and your Management. Copies of the prospectus may be obtained by writing to Boston & Maine Industries, Inc., at 150 Causeway Street, Boston, Mass. 02114.

The decision to pursue the formation of a holding company was impelled by the continuing impacts of rising operating costs and competitive transportation pressures on the Corporation's revenues. Similar experience in recent years has led a number of other railroad companies and systems to establish corporate structures enabling them to open up new sources of revenue and income through programs of business diversification.

The share exchange offer of Boston and Maine Industries became effective as of the date of publication of this annual report.

MERGER PROCEEDINGS

Under an Order dated February 10, 1969 the Interstate Commerce Commission extended to May 1, 1969 the time within which inclusion of the Boston & Maine Corporation in the Norfolk & Western system is to be accomplished. The proposed inclusion will be submitted to the Shareholders of Boston & Maine Corporation.

As noted in the Annual Reports for 1966 and 1967, your Management and Board of Directors have recommended that the Shareholders reject inclusion in the Norfolk & Western system on the ground that the financial terms prescribed by the Interstate Commerce Commission are inequitable to Shareholders of Boston & Maine Corporation. Under these terms, shares of Boston & Maine Corporation would be exchanged for shares of Dereco, Inc., a controlled subsidiary of the Norfolk & Western, in a ratio of one share of Boston & Maine Preferred Stock for 0.175 of a share of Class A Dereco Preferred, and one share of Boston & Maine Common Stock for 0.10 of a share of Class B non-cumulative Dereco Preferred.

At the close of business on the New York Stock Exchange on March 12, 1969 Boston & Maine Preferred was quoted at 43 bid, 44½ asked, while Boston & Maine Common closed at 25. Dereco Class A Preferred was quoted at 67 bid, 68¾ asked, while Dereco Class B Preferred closed at 66¾. Thus, under the terms of the Interstate Commerce Commission Order, a share of Boston & Maine Preferred Stock would have had a value of between $11.73 and $12.03 as against the $43 to $44.50 range quoted in the open market. Boston & Maine Common would have been exchangeable into shares of Dereco Class B Preferred at a per-share price of $6.67 as against the $25 per share quoted in the open market. The ICC Order contained a provision permitting both classes of Dereco Preferred Stock to be converted five years after issuance of the shares —if the shareholder so elects—into Common Stock of the Norfolk & Western on a share-for-share basis.

Inclusion of the Boston & Maine in the Norfolk & Western system would require an affirmative vote of the holders of two-thirds of the outstanding Common and Preferred Stock of Boston & Maine Corporation. The Board of Directors of Boston & Maine Industries has made it plain it will vote the 80% or more of Boston & Maine Corporation shares acquired as a result of the exchange offer against the proposed inclusion.

It should be noted that rejection of the inclusion would not foreclose the possibility of achieving merger of the Boston & Maine into a large trunkline system by means other than the specific terms of the ICC Order.

FREIGHT SERVICE

On taking office late in November, 1966 your Management pledged that "every available opportunity for improving and streamlining the Railroad's performance—department by department—will be fully and vigorously pursued."

Priority attention was given to the Traffic Department. In restructuring the Department special emphasis was devoted to the use of advanced marketing methods to expand existing business and attract new customers. The first results were reflected in an increase of $242,000 in freight revenues for 1966 as compared with the prior year. In 1967, consolidated freight revenues rose by $447,000 over results for 1966.

On a consolidated basis, freight revenues in 1968 totalled $58,642,000 as compared with $54,252,000 in 1967, a rise of $4,390,000. Contributing substantially to this increase was revenue derived from the movement of 37,000 carloads of earth fill in connection with the extension of Route 95 at Revere-Saugus, Mass. This traffic involved four shuttle trains of up to 62 cars per train per day. It is anticipated that these movements will resume in early Spring, 1969 and will continue for about five weeks producing an additional 5,000 carloads.

Other developments expected to affect freight revenues in 1969 are these:

—With the introduction of a second unit train of 93 cars in March, 1968 the Boston & Maine will handle approximately 1,200,000 tons of coal in 1969 to serve the Public Service Company of New Hampshire at Bow, N. H.;

—To meet customers' equipment requirements, the Boston & Maine leased one hundred and fifty-eight 50-foot cushion underframe DF type box cars and purchased an additional twenty-six. Assignments and movements of this equipment are being reviewed and monitored to realize the greatest potential gross revenue. Since entering service, the leased cars have been off-line seventy-six percent of the time, thus contributing to a reduction of B&M's net per diem debit;

—The Gillette Safety Razor Company will be completing its distribution and manufacturing facility at Andover, Mass., commencing operations by April or May, 1969;

—Throughout 1969 the Boston & Maine will continue to handle large movements of construction materials to the Merrimack, N. H., site of the Anheuser-Busch brewery, which is scheduled for completion in 1970;

—In 1968 the Interstate Commerce Commission approved freight rate increases totalling approximately 5%. Freight revenues in 1969 are expected to reflect a full twelve-month benefit from these increases. It should be noted, however, that the rate increases were sought by the railroads because of spiraling wage and material costs, which are continuing.

PIGGYBACK SERVICE

Gross piggyback revenue in 1968 totalled $4,308,000, an increase of 25.2% over 1967.

To accommodate increased volume and meet customers' equipment requirements, the Boston & Maine leased 400 new aluminum 40-foot van trailers bringing the total B&M trailer fleet to more than 1,000 units.

Productivity of the Boston Yard was increased substantially by the acquisition of a new "Piggypacker," which loads and unloads trailers to and from flat cars and has a 35-ton lifting capacity. Also under way is an expansion of parking facilities in the Boston Yard to improve the handling of trailers to and from the loading area.

OPERATIONS

In undertaking efforts to increase revenues, your Management also made plain its recognition of the vital need to reshape the Railroad's operations in order to keep pace with changing economic circumstances. Particularly challenging was the urgency of coping with the rapidly spiralling increases in costs of labor and materials, major factors in the net loss before extraordinary items of $5,382,000 for 1968, as well as the deficits of prior years.

On assuming office, therefore, your Management undertook steps to parallel the restructuring of the Traffic Department with a study to determine whether various sectors of the Railroad's operations could be made more efficient and productive. Involved in the study were detailed analyses of the operations of through and local freight trains and the Railroad's major yards. The study utilized the latest analytical procedures, including the use of computers to simulate actual day-to-day railroad operating problems and management processes for which solutions and improvements were being sought.

Major objectives of the study were improvement of service to the Railroad's customers, reduction of per diem expense and other costs through a scientifically determined rescheduling of operations. Also included in the study was a review of the Railroad's material stores and supply operations.

Implementation of the study's findings and the changes they point to has been assigned to the Operating Department, which has been reorganized and is concentrating special attention on the problem of reducing the imbalance between operating costs and revenues. In approaching these objectives, the Operating Department is making greater and more productive use of the Railroad's computerized data system with a view towards developing more current cost and efficiency information that will enable operating officers to identify problem areas more rapidly.

Initial application of steps suggested by the study has yielded these encouraging results:

—Yard service has been improved significantly by planning work on a basis that is enabling the Railroad to deliver traffic to its customers in the greater Boston area one full day ahead of previous schedules with accompanying benefits to the Railroad in the form of reduced per diem expense;

—Changes in the scheduling of through freight trains for morning departure are effecting improved service, better utilization of equipment and savings in per diem costs;

—Revised operating practices and material advances in communications have increased yard productivity by improving classification procedures, contributing still further to the efforts to control per diem expense;

—Under an improved manpower utilization program, B&M agents will soon be making regular, personal contact with the Railroad's customers to keep in current touch with customer problems and needs in order to meet service requirements on a more efficient and economical basis;

—Procedures for handling the Railroad's stores and materials have been streamlined through the elimination of duplicate facilities.

To conserve, insofar as possible, the gains achieved in freight revenues, your Management has assigned the highest priority to the task of reducing and controlling operating costs.

PASSENGER SERVICE

In August, 1968 your Board of Directors authorized Management to enter into an extension of the agreement with the Massachusetts Bay Transportation Authority providing for continuation through July 31, 1969 of passenger service operated under prior contract with the Authority. Among other matters the extension agreement provided:

—The Authority's option to purchase the Reading line of the Boston & Maine would expire on July 31, 1969. All other options previously granted the Authority for purchase of B&M rights-of-way used in the operation of passenger business would terminate on July 31, 1972 if not previously exercised;

—The Authority specifically agreed to indemnify and hold the Railroad harmless for any uninsured losses arising from injuries to persons or damage to property, occasioned in whole or in part by the operation of passenger service during the term of the contract with B&M as amended;

—The Authority is to pay any incremental costs resulting from wage increases to passenger service employees covered by a protective union contract for the period between December 31, 1964 and July 31, 1969.

Passenger service currently operated by the Railroad is limited solely to that for which the Railroad is fully reimbursed by the Massachusetts Bay Transportation Authority under the contract as extended to July 31, 1969.

IMPROVEMENTS

Capital expenditures for road property and equipment in 1968 totalled $2,208,000.

Improvements included:

—Lining and resurfacing of 287 single track miles of stone-ballasted main track. Additionally, relay rail laid during the year totalled 1,280 tons, while 95,835 cross ties (new and relay) were installed in 1968 compared with 56,937 ties installed during the prior year;

—Installation of flashing light crossing protection signals at six crossings to expedite operations of earth fill unit trains. Similar protection was extended to three other crossings under the Railroad's program of automatic highway crossing protection;

—Rebuilding and respacing of 12 miles of automatic signal system on double track as part of a program to rebuild a C. T. C. system originally installed in 1929. Completion of this program early in 1969 will permit abandonment of a tower at an appreciable annual saving;

—Continuation of a major repair program in the Hoosac Tunnel with the injection of concrete grout behind 575 linear feet of new Armco liner plate eliminating water seepage in that area;

—Completion of highway bridge construction and design programs in cooperation with the State of Vermont and the Commonwealth of Massachusetts.

PER DIEM

Further gains were achieved during the year in reduction of the Railroad's per diem indebtedness. Per diem payments represent net rentals the Boston & Maine is required to pay other railroads whose freight cars move over the B&M. As B&M is primarily a terminating carrier, such payments always far exceed the rentals it can obtain on its own cars.

In 1968, B&M effected a net reduction, less related expenses, of $1,712,000 in per diem payments claimed by other roads from B&M. Over the last four years, B&M has reached settlements on per diem debt to other railroads that have reduced the B&M's per diem indebtedness by $3,222,000 net of related expenses.

Early in 1968, the Interstate Commerce Commission issued a report in connection with cases involving the level of past and future per diem payments. The formula reached by the ICC sustained in major respects the position advanced by the Boston & Maine over a period of years as to the basis on which future per diem rate levels should be fixed. The ICC decision continues to be the subject of appeals.

LONG-TERM DEBT CHANGES

The Boston and Maine met substantial obligations for equipment and road property in 1968. This resulted in a net reduction in long-term debt of $3,481,000 as reflected in the following table:

Balance at beginning of year	$77,988,000
Increases:	
Equipment and Road Property obligations for new acquisitions	112,000
	78,100,000
Decreases:	
Equipment and Road Property obligations paid	2,770,000
Principal payments made on Collateral Trust Indentures and Collateral Notes	819,000
Other	4,000
Balance at end of year	$74,507,000

SYSTEMS AND RESEARCH

The potential of Boston & Maine's computer-oriented Car Location System was expanded during 1968 to provide shippers with reports of the movements of more than 16,000 freight cars daily. The system also incorporates movement control of B&M's new, assigned cars to insure their maximum utilization. An additional service to shippers is the daily reporting to B&M's Traffic Department of cars held out for repairs.

Further strides were made in 1968 on a service evaluation and quality control program undertaken in 1967 to provide operating management with new and improved tools for measuring service.

During 1968 research was continued on vendor and industry progress of computer and systems advances. Plans for installation of systems sponsored by the Association of American Railroads, i.e., ACI (Automatic Car Identification), TRAIN (TeleRail Automated Information Network) and UMLER (Universal Machine Language Equipment Register), were under continuing study and procedures are being developed for their implementation.

INDUSTRIAL DEVELOPMENT

New plant facilities completed during 1968 totalled 1,450,000 square feet of building area and required some 23,000 feet of trackage to serve needs estimated to increase Boston & Maine traffic by approximately 3,000 carloads per year.

Additional space approximating 1,400,000 square feet is now under construction or scheduled for completion during 1969 and is expected to result in added rail traffic of

3,200 cars per year.

One of the largest single industrial projects in the history of New Hampshire was initiated when construction of the Anheuser-Busch Company's new $40,000,000 brewery began at Merrimack, N. H. In addition to movements of construction materials during the building program, B&M will benefit from substantial traffic after the plant is completed and goes into operation.

EMPLOYEE RELATIONS

In the railroad industry changes in rates of pay, employment conditions, and fringe benefits are established as a result of national negotiations covering substantially all major carriers.

The applicable contracts for 1968 called for total increases of approximately 7 percent. For 1969 the pattern is about 5 percent.

As has been the case since at least 1967 increases in employment costs exceeded increases in productivity and were only partially met by adjustment in freight rates. The situation is a facet of the inflation permeating the economy.

A FINAL NOTE

The Boston & Maine is grateful to all employees for their cooperation during the past year.

R. J. Mulhern

R. J. Mulhern

OPINION OF INDEPENDENT ACCOUNTANTS

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

We have examined the balance sheet of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1968 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.

The company historically has recorded depreciation of roadway and structures, replacements of rails, ties, etc. and dispositions of these assets in accordance with accounting practices uniformly prescribed for all railroads as briefly explained in Note 3 to the financial statements. Pursuant to these requirements, depreciation reserves for roadway and structures have been accumulated by annual charges to operations only since January 1, 1943 and therefore these reserves are substantially less than amounts which would have resulted from a systematic amortization of the cost of the properties since their acquisition. In addition, the deficiency in these reserves has been increased by the fact that amounts which have been provided have been substantially reduced by charges for losses on retirements. These factors make it impracticable to reconstruct the accumulated depreciation accounts of roadway and structures and no reasonable estimate can be made of the deficiency in these accumulated reserves, although it is believed that a fair annual charge to operations for depreciation has been made during the year. The accompanying statement of operations and accumulated deficit has been adjusted to reflect losses upon major retirements of properties for the year and retroactively adjusted for 1967 and certain prior years as described in Note 1 to the financial statements, although these adjustments aggregating $20,213,000 have not been recorded on the books of the company.

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

In our opinion, except for the inadequacy of accumulated reserves for depreciation and obsolescence of roadway and structures included in the balance sheet of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1968, as discussed in the second paragraph above, and subject to the indicated reduction in the provision for disputed per diem charges described in Note 6, the financial statements referred to above present fairly the financial position of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1968 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, after giving retroactive effect to the restatements, which we approve, of the transactions described in Note 1 to the financial statements.

PRICE WATERHOUSE & CO.

Boston, Massachusetts
March 5, 1969

ASSETS

	December 31 1968	December 31 1967
CURRENT ASSETS:		
Cash	$ 2,110,000	$ 3,086,000
Marketable securities, at cost (approximate market)	116,000	231,000
Special deposits	149,000	138,000
Accounts and notes receivable	7,162,000	6,014,000
Inventories of materials and supplies, at cost or less	2,872,000	2,799,000
Prepayments and other current assets	710,000	429,000
TOTAL CURRENT ASSETS	13,119,000	12,697,000
PROPERTIES (Page 13 and Notes 3 and 9):		
Roadway and structures, including improvements to leased properties—$14,094,000 in 1968, $13,888,000 in 1967	174,414,000	175,303,000
Equipment	66,054,000	65,888,000
	240,468,000	241,191,000
Less:		
Depreciation of roadway and structures	(24,932,000)	(23,587,000)
Depreciation of equipment	(34,671,000)	(32,235,000)
	180,865,000	185,369,000
Miscellaneous physical properties, less depreciation—$318,000 in 1968, $302,000 in 1967	3,347,000	3,381,000
	184,212,000	188,750,000
INVESTMENTS AND OTHER ASSETS:		
Investments in leased lines (Page 13 and Note 2)	3,643,000	3,620,000
Other investments (Page 13)	1,471,000	1,502,000
Deposits with trustees for first mortgage bonds and equipment obligations	1,418,000	1,843,000
Other assets and deferred charges	1,415,000	2,847,000
	7,947,000	9,812,000
	$205,278,000	$211,259,000

BALANCE SHEET (NOTE 1)

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31 1968	December 31 1967
CURRENT LIABILITIES:		
Accounts payable	$ 12,033,000	$ 9,940,000
Accrued vacation pay	2,011,000	2,047,000
Accrued interest	1,375,000	1,375,000
State and local taxes	3,791,000	3,520,000
Estimated current portion of injury and damage claims	1,619,000	1,327,000
TOTAL CURRENT LIABILITIES (excluding long-term debt due within one year)	20,829,000	18,209,000
LONG-TERM DEBT DUE WITHIN ONE YEAR (Page 13)	2,781,000	3,590,000
LONG-TERM DEBT (Page 13):		
First mortgage bonds	46,335,000	46,339,000
Income mortgage bonds	18,703,000	18,703,000
Equipment and other obligations	6,688,000	9,356,000
	71,726,000	74,398,000
OTHER LIABILITIES AND DEFERRED CREDITS:		
Provision for disputed per diem charges (Note 6)	10,322,000	11,134,000
Provision for injury and damage claims	1,021,000	993,000
Accrued depreciation on leased property and improvements thereto	2,595,000	2,560,000
Liabilities to leased lines	1,718,000	1,700,000
Unearned interest accrued on income mortgage bonds	8,230,000	7,481,000
Other	1,524,000	2,559,000
	25,410,000	26,427,000
STOCKHOLDERS' EQUITY (Notes 3, 4 and 6):		
Capital stock (Note 7):		
5% Preferred stock, $100 par value:		
Authorized and issued—92,348 shares in 1968, 107,235 shares in 1967	9,235,000	10,723,000
Common stock, $1 par value:		
Authorized—4,000,000 shares		
Issued—869,910 shares in 1968, 843,828 shares in 1967	870,000	844,000
Additional capital (Note 7)	98,992,000	97,529,000
Accumulated deficit (Note 8)	(24,565,000)	(20,461,000)
	84,532,000	88,635,000
Contingent obligations and commitments (Page 13 and Notes 10 and 11)		
	$205,278,000	$211,259,000

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF OPERATIONS AND ACCUMULATED DEFICIT (Note 1)

	Year ended December 31	
	1968	1967
Operating revenues:		
Freight	$ 58,643,000	$ 54,252,000
Passenger	4,604,000	4,260,000
Other, including passenger service contract payments amounting to $3,195,000 in 1968 and $2,900,000 in 1967 (Note 9)	5,763,000	5,882,000
	69,010,000	64,394,000
Operating expenses (Notes 3 and 11):		
Transportation	32,050,000	29,796,000
Maintenance of way and structures	9,107,000	8,433,000
Maintenance of equipment	11,198,000	9,932,000
Traffic, general and miscellaneous	5,303,000	4,792,000
	57,658,000	52,953,000
Net revenue from operations	11,352,000	11,441,000
Other operating charges:		
Payroll, property and state excise taxes, etc. (Note 10)	5,279,000	4,983,000
Net rents for equipment and joint facilities (Note 6)	7,328,000	6,241,000
	12,607,000	11,224,000
Operating income (loss)	(1,255,000)	217,000
Nonoperating income (expense), net—including net gains (losses) on recurring disposals of land and major depreciable properties amounting to ($13,000) in 1968 and $15,000 in 1967 (Notes 1 and 3)	465,000	483,000
Income (loss) before fixed charges, contingent interest and extraordinary items	(790,000)	700,000
Fixed charges:		
Rent for leased lines, etc. (Page 13)	451,000	451,000
Interest (Page 13):		
First mortgage bonds	2,780,000	2,780,000
Equipment trust certificates	198,000	261,000
Conditional sale contracts	93,000	175,000
Guaranteed notes and other	246,000	275,000
Amortization of long-term debt expense	76,000	175,000
	3,844,000	4,117,000
Loss before contingent interest and extraordinary items	(4,634,000)	(3,417,000)
Contingent interest (Page 13)	748,000	748,000
Loss before extraordinary items	(5,382,000)	(4,165,000)
Extraordinary items (Note 1):		
Net gain on disposal of Yard 8 land	—	283,000
Net loss on seizure by eminent domain of land and freight facilities	(334,000)	—
Losses on extraordinary disposals of depreciable properties (Notes 1 and 3)	—	(650,000)
Merger proceeding expenses (Note 4)	(100,000)	(168,000)
Settlement of disputed per diem charges, less related expenses (Note 6)	1,712,000	418,000
	1,278,000	(117,000)
Net loss	(4,104,000)	(4,282,000)
Accumulated deficit (Note 1):		
Beginning of year	(20,461,000)	(16,179,000)
End of year	$(24,565,000)	$(20,461,000)
Per share of common stock (Note 7):		
Loss before extraordinary items	$ (5.22)	$ (4.04)
Extraordinary items	1.24	(.11)
Net loss	$ (3.98)	$ (4.15)

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

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF INVESTMENTS IN LEASED LINES
DECEMBER 31, 1968

	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	21,343	69.6	$2,172,000	$2,200,000	$1,366,000
Stony Brook Railroad	1,829	61.0	151,000	192,000	119,000
Vermont & Massachusetts Railroad	11,647	36.5	1,320,000	2,045,000	792,000
			$3,643,000	$4,437,000	$2,277,000

The shares in leased line companies have been acquired over the period from 1937 to 1968. At December 31, 1968, 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 $205,000 per year. Dividends received from the leased line companies amounted to $206,000 in 1968 and 1967. 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, 1968

	Portion due	
	Within one year	*After one year (a)*
FIRST MORTGAGE BONDS, Series TT, 6% due July 1, 1970(b)		$46,335,000
INCOME MORTGAGE BONDS, Series A, 4½% (4% cumulative), due July 1, 1970(c)		18,703,000
EQUIPMENT AND OTHER OBLIGATIONS:		
Equipment Trust Certificates, Series 1, 4½% to 6% due March 1971 secured by equipment with an aggregate original cost of $22,764,000 and by deposits of $30,000 with trustee	$1,234,000(d)	2,468,000
Guaranteed notes 5% due to 1977 secured by $1,753,000 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 $16,000	567,000	3,233,000(e)
Conditional sale contracts and mortgage and collateral notes maturing at various dates from 1969 to 1990 secured by equipment and real estate with an aggregate original cost of $4,504,000 and "other investments" carried at cost of $715,000	980,000	987,000(e)
		6,688,000
	$2,781,000	$71,726,000

(a) Amounts outstanding are exclusive of bonds owned by the companies—$1,753,000 of Series TT bonds pledged against guaranteed notes and $559,000 of income mortgage bonds which are unpledged.

(b) 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 1969. The amended trust indenture permits use by the company of proceeds from sales of mortgaged property for payment of certain 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 1968 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 STATEMENT OF OPERATIONS AND PRINCIPLES OF ACCOUNTING

Except for the matter described in Note 3, the financial statements included herein 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 except as indicated below.

In 1968 the company adopted generally accepted accounting principles for accounting for retirements of depreciable properties which resulted in a charge to 1968 operations of $450,000 for losses on recurring disposals of major depreciable properties which under the ICC accounting principles used previously in reporting to shareholders would have been charged to the reserves for depreciation. There were no extraordinary disposals of depreciable property in 1968. The extraordinary net loss on disposition of land and freight facilities in 1968 related in large part to non-depreciable properties.

The company has restated its statement of operations for 1967 to reflect adjustments deemed appropriate to present the statement of operations in accordance with generally accepted accounting principles, as follows:

1. The loss before extraodinary items for 1967 was increased by $300,000 from $3,865,000 to $4,165,000 for losses on recurring disposals of major depreciable properties originally charged to reserves for depreciation (see Note 3).
2. Extraordinary items for 1967 were reduced by $650,000 from a net credit of $533,000 to a net charge of $117,000 for losses on extraordinary disposals of depreciable properties originally charged to reserves for depreciation (see Note 3).

In addition, the accumulated deficit and the reserves for depreciation at January 1, 1967 were increased by removing from the reserves for depreciation net losses aggregating $3,723,000 on prior dispositions of equipment and certain net losses from 1955 to 1966, inclusive, aggregating an estimated $14,451,000 for major retirements of depreciable roadway and structures. Also, losses of $639,000 incurred on dispositions of track in 1964 and 1965 were retroactively charged to the accumulated deficit at January 1, 1967. These losses originally were charged to a property reserve account entitled "other elements of investment." The balance of "other elements of investment" amounting to $3,010,000 was reclassified from roadway and structures accounts to the reserves for depreciation. This property reserve account arose in a prior year as the result of the company's adjusting the detailed ledger balances of roadway and structures to the basis carried in its valuation department cost records in accordance with ICC uniform instructions to all railroads.

NOTE 2–PRINCIPLES OF CONSOLIDATION

The accompanying financial statements include the accounts of Boston and Maine Corporation and those of its wholly-owned subsidiary companies. The company's investments in unconsolidated leased line companies which are less than wholly-owned are summarized on Page 13.

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, adjusted as described in the following paragraph.

In accordance with such ICC 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 a straight-line basis since its acquisition. Following these accounting practices, the recorded cost, less salvage, of depreciable properties retired or sold is charged to the depreciation reserves. In recent years the company has experienced a change in the nature of its operations which resulted, among other things, in the elimination of passenger service, other than that operated under contractural arrangement (see Note 9). The resulting retirements of major depreciable properties have generated losses which originally were charged to the reserves for depreciation. Under generally accepted accounting principles these losses would have been charged to operations either as losses on recurring disposals or as extraordinary items. These factors make it impracticable to reconstruct the accumulated depreciation accounts and no reasonable estimate can be made of the deficiency in the accumulated reserves for roadway and structures. As described in Note 1, the accompanying statement of operations and accumulated deficit reflects these items as charges to operations or the accumulated deficit for net losses on dispositions of equipment and certain dispositions of roadway and structures for 1955 to 1968, inclusive. These charges for losses aggregating $20,213,000 at December 31, 1968 have not been recorded in the books of the company. This treatment is permitted by the Interstate Commerce Commission for purposes of reporting to shareholders and others.

Rails, ties, ballast and other track materials in the amount of approximately $41,500,000 at December 31, 1968 reflects replacement accounting, which has been considered an acceptable alternative in the railroad industry to the more widespread practice of depreciation accounting. Under this method the costs of replacements in kind are charged to maintenance expense and only the costs of 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, calculated on a straight-line basis, totaling $4,329,000 in 1968 and $4,283,000 in 1967.

NOTE 4–EXCHANGE OFFER AND MERGER PROCEEDINGS

Reference is made to pages 2 and 3 for a description of the exchange offer made by Boston and Maine Industries, Inc. and the proposed merger with the Norfolk and Western Railway Company, both of which are presently being considered.

NOTE 5–FEDERAL INCOME TAXES

At December 31, 1968, the companies had net operating loss carry-overs for federal income tax purposes of approximately $20,200,000 available to apply against taxable income in varying amounts through the year 1975. These loss carry-overs expire as follows:

December 31	
1969	$ 1,900,000
1970	300,000
1971	4,300,000
1972	4,200,000
1973	2,900,000
1974	3,100,000
1975	3,500,000
	$20,200,000

Under existing law the period available to railroads to carry accumulated net operating losses forward is seven years assuming continued operations as a railroad. If there should be a change in business, as defined in the Internal Revenue Code, the period would be reduced to five years.

The more important differences in the timing of expenses recorded on the books and these deductions for tax purposes are summarized as follows:

1. Depreciation of roadway and structures is not deducted for tax purposes until disposition of an item of property.

2. Additions to the reserves for injury and damage claims are not deductible for tax puproses. These expenses are deductible when a claim is paid.

3. A substantial portion of the increase or decrease in the reserve for disputed per diem does not affect the determination of taxable income.

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 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 $10,322,000 provision at December 31, 1968 reflected in the accompanying balance sheet for open disputed per diem will eventually be settled at less than that amount.

In 1968 and 1967, the company settled disputed liabilities of $2,132,000 and $1,010,000, respectively, with several other railroads which resulted in extraordinary credits, less related expenses, amounting to $1,712,000 and $418,000, respectively. Disputed amounts accrued and charged to operations, before credits for the above settlements, amounted to $1,320,000 and $1,197,000, in the respective periods.

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 $1,462,000 in 1968 in connection with the conversion of 14,887 shares of preferred stock into 26,052 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, 1968. 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, 1968.

At December 31, 1967, there were outstanding options granted to certain employees to purchase 28,391 shares of common stock of the company at prices ranging from $6.00 to $19.38 per share, or an aggregate of

$462,000. During the year options for 30 shares were exercised. The $280 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 521 shares expired during the year. At December 31, 1968, there were outstanding options to purchase 27,840 shares at $6.00 to $19.38 per share, or an aggregate of $456,000, of which options for 16,710 shares were then exercisable at an aggregate consideration of $274,000. Under the present stock option plans, further options for 13,540 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.

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, 1968 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 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 at prices to be determined and agreed upon. The agreement expires July 31, 1969, except that certain options expire in 1972. The Authority has indicated a desire to negotiate the acquisition of the so-called "Reading Branch." Reference is made to page 6.

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 $186,000 in 1968 and $123,000 in 1967, based on normal cost, interest on unfunded prior service costs and an amount to amortize past service costs over a period of forty years, and determined on the basis of the "frozen initial liability" method. At December 31, 1968, the estimated amounts of vested benefits under the plan exceeded pension fund assets by approximately $2,800,000.

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, 1968:

The company rents approximately 2,200 freight cars and piggyback trailers under long-term leases which expire at various dates to 1983 at a current annual rent of approximately $1,145,000. In addition motor vehicles are rented at an annual rent of $700,000 and the company's general offices are rented under a lease expiring in 1972, renewable thereafter, which provides for a current annual rental of about $250,000.

As a guarantor jointly with other railroads, the company is contingently liable for the principal and interest on certain outstanding conditional sale agreements of Trailer Train Company.

The company is obligated for varying periods under joint facility and other agreements covering the use of terminals, tracks, equipment, etc. The company is required, under some of the agreements, to pay its portion of related maintenance and other expenses, which are included in operating expenses.

The company is plaintiff or defendant in numerous law-suits 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.