The Road to Progress...

Annual Report 1963

THE PENNSYLVANIA RAILROAD COMPANY

On the cover: TrucTrains in the Pennsylvania's fast, dependable piggyback service meet on a winter night.

THE PENNSYLVANIA RAILROAD COMPANY

117th ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 1963

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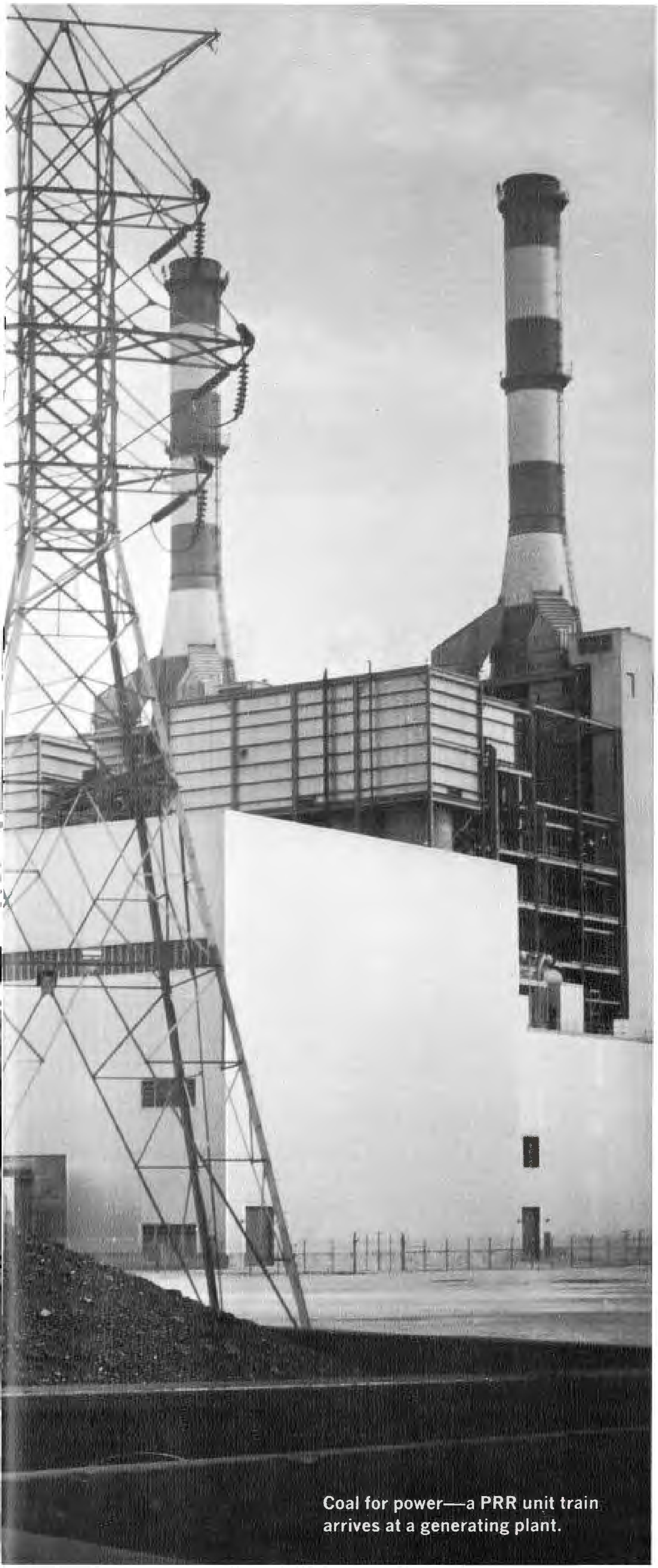


Coal for power—a PRR unit train arrives at a generating plant.

HIGHLIGHTS OF THE YEAR

Earnings of $9,158,870 best in six years.
Dividend doubled to 50 cents per share.
Operating expenses reduced by $15.6 million.
Operating ratio of 80.57 lowest since 1944.
Debt decreased by $19.3 million.
Passenger deficit reduced by $4 million.
Hearings concluded on pending merger.
Modern passenger and commuter coaches acquired.
Sixty-six new locomotives added.
Record 63,790 gross ton miles per freight train hour.
Best on-the-job safety record in 24 years.
Nearly 200 industries located on P.R.R.
TrucTrain terminals increased to 33.
Car control computer center activated.
Unit coal train operations expanded.
Originated coal tonnage highest since 1957.
"Operation Beaver" housekeeping campaign begun.
Stock interest in Buckeye Pipe Line Company acquired.
Stadium proposed on air rights at Philadelphia.
New station facilities started at New York.

DIRECTORS

Richard K. Mellon .... *Chairman of the Board, Mellon National Bank and Trust Company, Pittsburgh*
C. Jared Ingersoll .... *Chairman of the Board, Muskogee Company, Philadelphia*
James E. Gowen .... *Former Chairman of the Board, Girard Trust Bank, Philadelphia*
Philip R. Clarke .... *Chairman of the Executive Committee, Montgomery Ward & Co., Inc., Chicago*
James M. Symes .... *Chairman of the Executive Committee, The Pennsylvania Railroad Company, Philadelphia*
Joseph H. Thompson ...... *Chairman of the Board, Hanna Mining Company, Cleveland*
R. G. Rincliffe .... *Chairman of the Board, Philadelphia Electric Company, Philadelphia*
Otto N. Frenzel .... *President, Merchants National Bank and Trust Company, Indianapolis*
William L. Day .... *Chairman of the Board, The First Pennsylvania Banking and Trust Company, Philadelphia*
Gaylord P. Harnwell .... *President, University of Pennsylvania, Philadelphia*
Thomas L. Perkins .... *Partner, Perkins, Daniels and McCormack, New York*
Edward J. Hanley .... *Chairman of the Board and President, Allegheny Ludlum Steel Corporation, Pittsburgh*
Allen J. Greenough .... *President, The Pennsylvania Railroad Company, Philadelphia*
Howard Butcher, III ...... *Partner, Butcher & Sherrerd, Philadelphia*
Stuart T. Saunders .... *Chairman of the Board, The Pennsylvania Railroad Company, Philadelphia*
David C. Bevan .... *Chairman of the Finance Committee, The Pennsylvania Railroad Company, Philadelphia*
Fred Carpi .... *Vice President, Sales, The Pennsylvania Railroad Company, Philadelphia*

SYSTEM OFFICERS

Stuart T. Saunders........ *Chairman of the Board*

David C. Bevan .... *Chairman of the Finance Committee*
Allen J. Greenough .... *President*

David E. Smucker .... *Vice President, Operations*
Fred Carpi .... *Vice President, Sales*
J. Benton Jones .... *Vice President, Purchases and Real Estate*
John B. Prizer .... *Vice President and General Counsel*
James W. Oram .... *Vice President, Public and Employe Relations*
Guy W. Knight .... *Vice President, Labor Relations*
Park M. Roeper .... *Vice President, Transportation and Maintenance*
Morton S. Smith .... *Vice President*
John D. Morris .... *Director, Special Services*
Bayard H. Roberts .... *Secretary*
William R. Gerstnecker .... *Treasurer*
William S. Cook .... *Comptroller*

REGIONAL OFFICERS

Herbert M. Phillips .... *Vice President and General Manager, Western Region*
George C. Vaughan .... *General Manager, Eastern Region*
George M. Smith .... *General Manager, Central Region*

March 1, 1964

LETTER FROM THE CHAIRMAN OF THE BOARD

In 1963, The Pennsylvania Railroad Company entered a progressive new phase of restored financial health and renewed growth.

On a consolidated basis, the Pennsylvania Railroad System's net income of $24 million nearly doubled that of 1962, and the $9.2 million earnings for the railroad reversed the $3.2 million deficit of 1962. These profits permitted us to raise our dividend to 50c a share. System debt was reduced by $19.3 million.

These encouraging financial results reflect dedicated emphasis by your Company's officers and employes on increasing efficiency, reducing costs, improving our competitive position, and marketing our services more aggressively.

We made significant progress in 1963 in rigorous control of our costs. The 1963 operating ratio of 80.57 was the best in 19 years, and we are determined to bring it down substantially in the year ahead. Our 63,790 gross ton miles per freight train hour was the highest mark in the Company's history. We lowered our annual passenger deficit to $33.9 million for 1963, about $4 million less than our 1962 loss.

Although we invested $73.4 million in 1963 to improve our ability and capacity to handle freight and passenger traffic, we laid plans for even greater improvements. We have programmed 1964 capital expenditures of $120 to $125 million, allocating some $90 million of this for new freight cars and locomotives.

"Operation Beaver," our continuing clean-up program inaugurated in December, symbolizes our determination to do a better housekeeping job. In addition, it has helped to bolster employe morale and to increase public awareness of the Pennsylvania's efforts for revitalization.

Late in 1963 we mapped out a reorganization of the Company's entire managerial and administrative structure by reducing our nine regions to three. This new structure, effective March 1, 1964, will provide less complicated lines of responsibility to system headquarters and enable us to utilize our management resources more effectively.

In 1963, we moved closer to consummation of our proposed merger with the New York Central, which was initiated by James M. Symes, who served the Company with great distinction. Our case advanced through public hearings and the record was closed in October. Our optimism about approval is bolstered by decisions of the Interstate Commerce Commission during 1963 which have given momentum to the merger movement. We are hopeful of a favorable report from the ICC examiner by the Fall of 1964.

Along with our merger, we are moving toward further diversification of our transportation services. In 1963, we formulated plans for acquisition of the Buckeye Pipe Line Company. Our non-transportation activities advanced through extended development of air rights over our facilities at several important locations.

The Pennsylvania is determined to regain its position of leadership. We intend to accomplish this through our basic programs of reorganization, consolidation and diversification for expansion of our activities and earning power.

We intend to explore and develop to the utmost the challenging potentials of the Pennsylvania. The goals we are setting for ourselves are real and attainable. Above all, we will be flexible and alert to take advantage of change and opportunity.

The management of the Pennsylvania is striving to create an atmosphere that will encourage maximum, enthusiastic effort and vigorous performance. In the year ahead, we hope to show results that will enhance your investment.

Stuart T. Saunders

February 26, 1964 — Stuart T. Saunders

FINANCIAL SUMMARY

FOR THE PENNSYLVANIA RAILROAD COMPANY AND CONSOLIDATED SYSTEM

	1963		1962		1961	
	P.R.R. Co.	Consolidated	P.R.R. Co.	Consolidated	P.R.R. Co.	Consolidated
Revenue from Operations ...	$840,111,654	$857,529,021	$850,655,325	$866,509,810	$820,141,440	$835,592,998
Other Income	26,673,182	37,953,246	27,069,515	39,955,302	33,478,658	39,758,653
Operating and Other Expenses	818,377,423	835,061,343	840,800,959	857,087,394	809,272,917	825,336,529
Fixed Charges	39,248,543	36,366,924	40,133,766	36,877,552	40,831,595	37,681,447
Net Income	9,158,870	24,054,000	*(Def.)* 3,209,885	12,500,166	3,515,586	12,333,675
Times Fixed Charges Earned.	1.23	1.66	0.92	1.34	1.09	1.33
Return on Investment	1.30%	1.33%	0.80%	0.85%	0.78%	0.80%
Depreciation Charges	$52,350,224	$55,473,695	$53,123,833	$55,962,301	$53,542,301	$56,273,520
Working Capital	30,931,255	37,134,379	35,200,462	57,049,568	38,262,892	52,143,809
Long Term Debt Due Within One Year	35,351,959	43,590,989	44,320,304	51,566,823	45,734,488	56,770,383
Long Term Debt Due After One Year	492,751,236	737,648,879	529,175,646	748,963,915	551,832,944	778,431,802
Capital Expenditures (*See Note Q*)	73,440,997	87,889,291	49,154,393	54,488,298	48,235,242	53,066,440
PER SHARE OF P.R.R. CO. STOCK (*See Note F*)						
Net Income	$0.68	$1.78	*(Def.)* $0.24	$0.93	$0.27	$0.94
Dividends Paid	$0.50	$0.50	$0.25	$0.25	$0.25	$0.25
Taxes	$4.45	$4.64	$4.93	$5.10	$4.99	$5.20
Net Worth—*Book Value*	$102.35	$130.12	$102.99	$130.21	$105.41	$132.87

Consolidated System figures include results for The Pennsylvania Railroad Company, its leased lines, and certain companies whose stock is owned 100%. For explanation see Page 28, Note A.

See notes, Pages 28 and 29

New computer center speeds data processing.

FIRM CONTROL OVER COSTS IMPROVES FINANCIAL RESULTS

In 1963 the Pennsylvania Railroad System earned consolidated net income of $24 million or $1.78 a share of stock, compared with 1962 earnings of $12.5 million or 93 cents per share.

Net income of The Pennsylvania Railroad Company was $9,158,870, in comparison with a $3,209,885 deficit for 1962.

The 50-cent dividend paid to stockholders in December was twice the amount paid in each of the previous five years.

Earnings for 1963 were the best in six years and resulted from steadily increasing efficiency, aggressive cost control and over-all operating economies.

Nearly all of the 1963 net was accounted for by a strong fourth quarter, when the railroad earned $8.6 million, compared with $1.8 million the same period a year earlier. This sharp increase in net was achieved although operating revenues of $214 million for the quarter were only 2 per cent more than the $209 million for the last quarter of 1962.

Gross operating revenues totaled $840.1 million, as compared with $850.7 million in 1962.

Freight revenues of $642.6 million were $6.8 million, or 1.1 per cent, less than in 1962.

Passenger revenues decreased $2.8 million, or 3.1 per cent, to $90.3 million. Revenues from handling express increased nearly a million dollars to $11.3 million, but there was a decrease of $1.8 million in revenues from other operations—mail, dining car service, switching and other services.

Our improved operating ratio was 80.57, the lowest figure since 1944. Railway operating expenses were reduced to $676.8 million, a cut of $15.7 million, or 2.3 per cent.

Although traffic volume in net ton miles showed a slight increase, we handled the larger volume with fewer employes—the work force numbering 62,674 at the end of the year as compared with 64,041 at the end of 1962.

Taxes amounted to $60 million, a decrease of $6.2 million, due to declines of $1.6 million in federal income taxes of certain lessor companies, $3 million in real estate taxes and $1.6 million in payroll taxes.

Net railway operating income amounted to $28.8 million, an increase of $10.9 million over 1962.

Income of $26.7 million from sources other than operating the railroad was slightly under the previous year's figure of $27 million.

An increase of $11.5 million in income available for fixed charges brought the 1963 total to $48.4 million.

Expenditures for 1963 capital improvements totaled $73.4 million, of which $30 million was spent for new equipment, $29.8 million for rehabilitation or improvements to equipment, and $13.6 million for additions and improvements to roadway.

Purchases of fuel, materials and supplies totaled $88.6 million in 1963, down $13.9 million from the previous year. Inventory at the end of 1963 amounted to $49.1 million compared with $50.9 million at the end of 1962.

Debt Reduction Continues

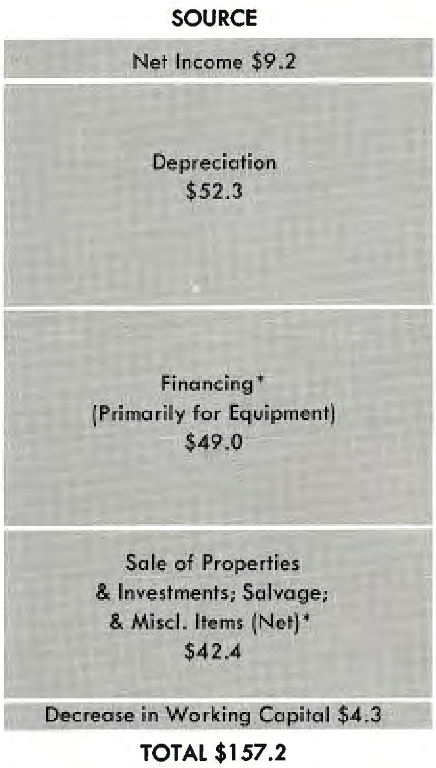
Debt of the Pennsylvania Railroad System was reduced $19.3 million in 1963, continuing the decreases in both equipment and bonded debt accomplished in every year since 1952. During this period, debt has been reduced by $335 million or 30 per cent below the $1 billion, 116 million peak in 1952, as shown on the accompanying chart. In the same period fixed charges have been reduced from $44.2 million to $36.4 million, despite a considerable rise in interest rates.

The series of general mortgage bonds maturing in 1965 and in 1968 have been reduced to approximately $45 million each. The 1965 issue originally amounted to $125 million, and the 1968 series totaled $50 million.

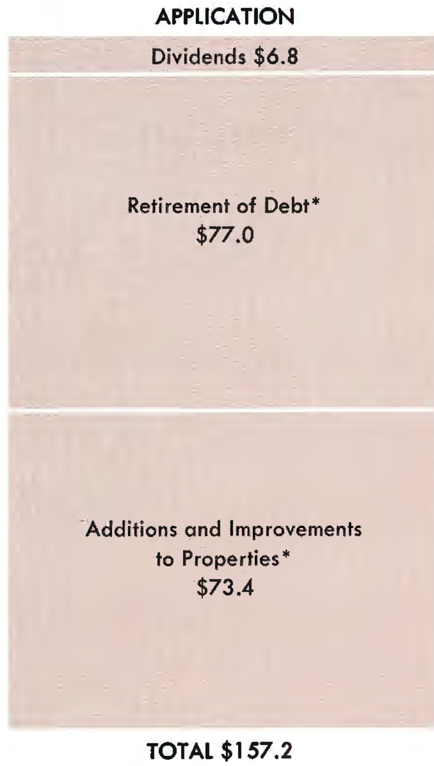
During 1963, $48.2 million of new equipment debt was incurred. Equipment obligations paid, however, totaled $52 million, resulting in a net reduction of $3.8 million.

These debt reductions have substantially improved the Railroad's credit position.

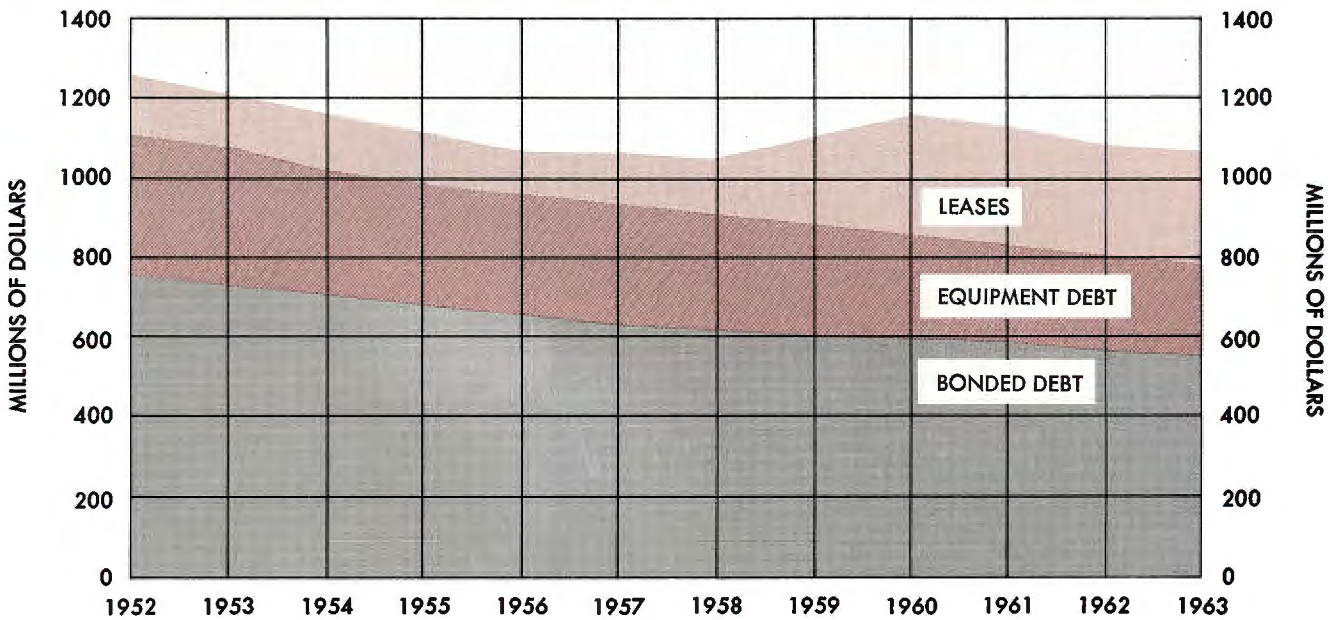
THE PENNSYLVANIA RAILROAD COMPANY SOURCE AND APPLICATION OF FUNDS, 1963 (IN MILLIONS)



These charts show the Company's principal sources of funds in 1963 and the major items for which these funds were used. The figures marked* include pertinent transactions of leased lines and their subsidiaries.



THE PENNSYLVANIA RAILROAD SYSTEM (CONSOLIDATED BASIS) FUNDED DEBT AND LEASE OBLIGATIONS PUBLICLY HELD



	12/31/52	12/31/63	Decrease	
Bonded Debt	$ 765.3	$ 548.2	$217.1	28.4%
Equipment Obligations	350.7	233.0	117.7	33.6%
Funded Debt	$1,116.0	$ 781.2	$334.8	30.0%
Lease Obligations	134.8	279.6	*Inc.* 144.8	*Inc.* 107.4%
TOTAL	$1,250.8	$1,060.8	$190.0	15.2%

NEW CONCEPTS AND TECHNIQUES BUILD FREIGHT VOLUME

In 1963 we initiated several programs designed to stimulate sales and earnings. Faster schedules, new services, new rate concepts and more aggressive salesmanship all were aimed at building freight traffic volume. Steps were taken to add more and better equipment, particularly high-capacity, damage-free specialized equipment which is increasingly in demand.

Operations were shaped to meet the needs of shippers and to improve our competitive position. For example, a new service was established in February from Potomac Yard, near Washington, D.C., to New England destinations to accommodate perishables and other TrucTrain traffic from the South. In September, a new train was inaugurated from Baltimore to Harrisburg, Pa., for connection with high-speed westbound trains, and an eastbound train which formerly terminated at Harrisburg was extended to operate through to Baltimore, serving TrucTrain and automobile unloading facilities en route at York, Pa.

TrucTrain Service Grows

Our piggyback service continued to grow in 1963. Revenues totaled $33.4 million, an increase of 5.3 per cent over 1962. The number of highway trailers carried rose by 7 per cent to more than 200,000.

A new department was established during the year to direct TrucTrain sales, operations and terminals. It is producing closer coordination which will make this fine service even more efficient in responding to the needs of shippers.

New TrucTrain terminals were added at Terre Haute, Indiana, and York, Pa., bringing our total to 33. Through the acquisition of 880 trailers of various types, our TrucTrain trailer fleet was increased to 2,315.

The investigation by the Interstate Commerce Commission of trailer-on-flat-car services by railroads (Ex Parte 230) resulted in recommendations by examiners of regulations which are generally favorable to the growth of this vital service.

The examiners found that piggyback offered "one of the most dynamic formulas for the transportation of freight this country has ever seen." They rejected virtually all of the restrictions suggested by the railroads' competitors and found that wide latitude must be afforded for pricing and service innovations to give the public the greatest benefit possible.

Transportation of Automobiles Up

Our movement of new automobiles continued to show a healthy expansion in 1963, with revenues increasing more than 20 per cent over 1962 to $5.9 million. We transported 15,767 rack-equipped flatcars loaded with assembled automobiles, compared with 11,704 in 1962.

Coal Traffic Increases

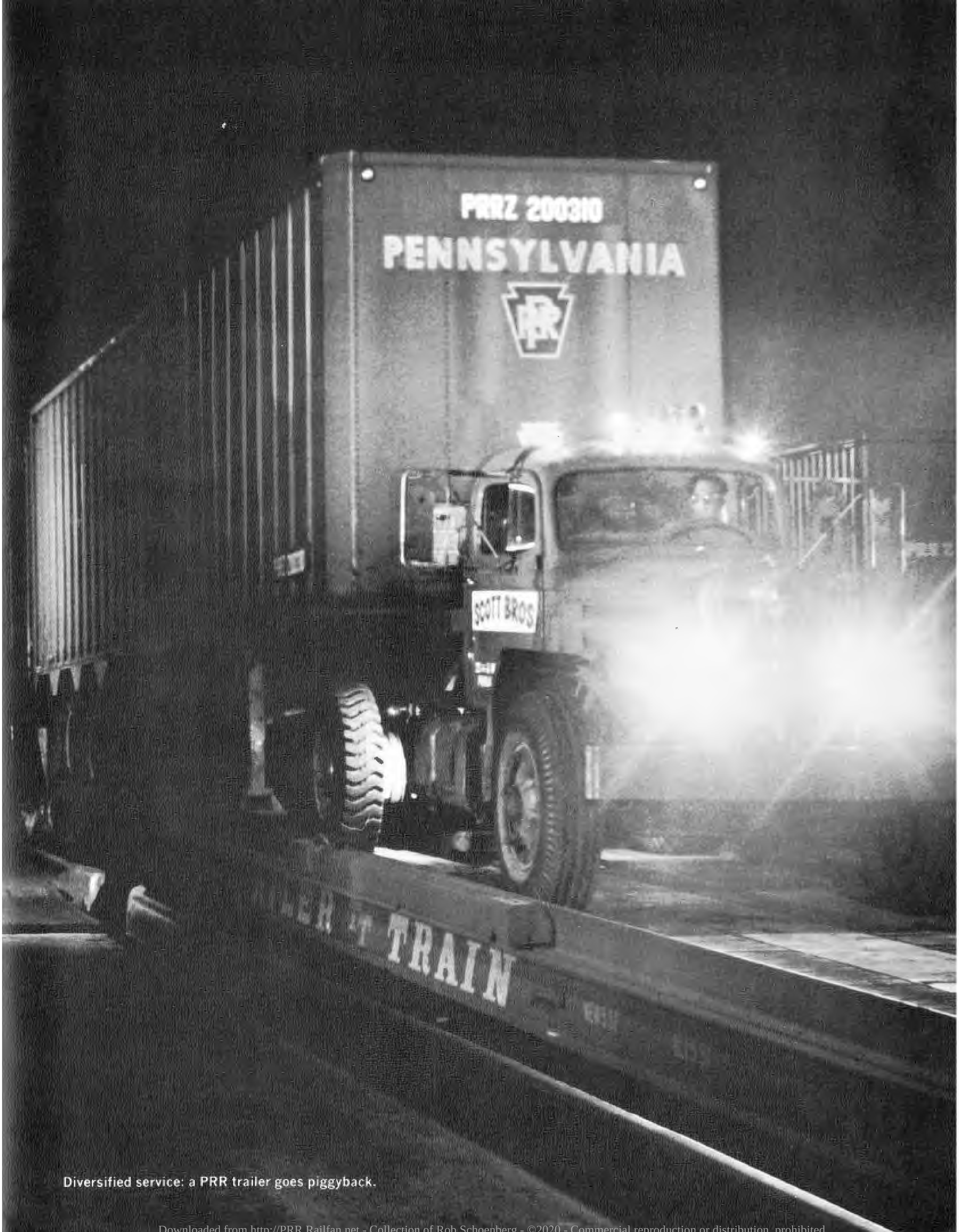
Under the stimulus of aggressive marketing, improved services and reduced rates, coal tonnage originated on our railroad increased nearly 10 per cent in 1963 to almost 27 million tons and the highest level since 1957. As a result of increased coal business, our South Amboy, N.J., coal pier dumped 3,141,971 net tons of coal in 1963—72 per cent more than in 1962, and the best total since 1951. Total coal dumpings increased to 15.9 million tons in 1963, up 15.8 per cent over 1962.

New tariffs on trainload lots are attracting an increasing volume of steam coal, largely for utility use. These rates provide for reductions of up to $1.50 a ton on trainloads of 7,000 net tons or more, originating at not more than two mines. At the end of 1963, we were operating more than 160 of these unit trains per month, which were transporting coal at a rate of more than 13 million tons a year.

We laid plans for a unit train, to begin operating in April, 1964, serving The Pennsylvania Power and Light Company. Our railroad will provide motive power and crews to haul 74 hoppers of 100-ton capacity, owned by P.P.&L., on scheduled runs between new mines and P.P.&L. power plants. This train will operate over 75,000 miles a year and handle 1,100,000 tons of coal, making 150 loaded trips a year, compared with the national average of 24 trips made by open top hoppers.

The Pennsylvania is participating in the interline unit train movement six days a week of metallurgical coal from Kentucky and West Virginia to steel mills in the Chicago area.

As a result of rate reductions for volume movement by rail effective last August, the only coal pipeline in the country was shut down on August 15.



Diversified service: a PRR trailer goes piggyback.

Unit Train Movement of Grain

The unit train concept was extended to the movement of grain under a tariff developed by the Pennsylvania and a connecting Western line and published in December. The resulting improvement in rates is enabling us to share in the seasonal movement from Duluth, Minnesota, to Buffalo of grain which would otherwise remain in storage until the Great Lakes thaw and then move by water.

Rates Adjusted to Obtain More Volume

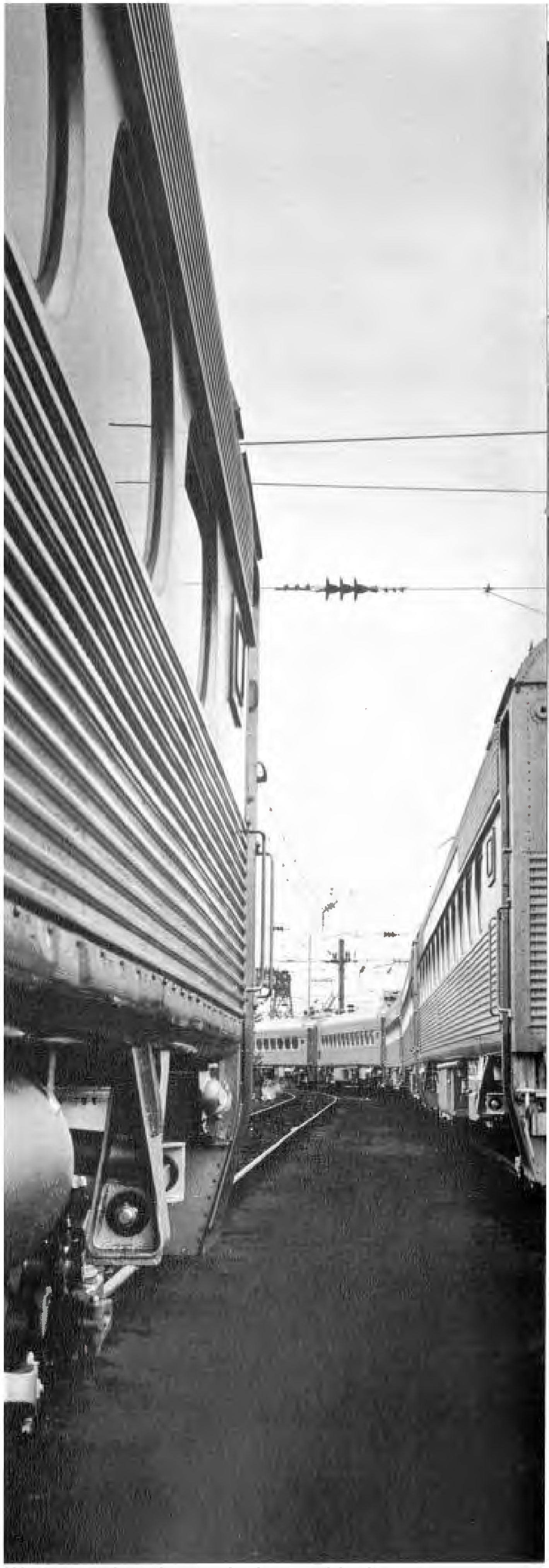
We are continuing to adjust freight rates to get and keep traffic. Incentive rates have been particularly effective in promoting heavier loading of both standard equipment and the new high-capacity cars, and progress in establishing annual volume rates on merchandise traffic has helped prevent loss of substantial tonnages to private transportation. A number of innovations in pricing are under consideration as a means of further stimulating TrucTrain traffic.

PASSENGER SERVICE FEATURES IMPROVED EQUIPMENT

Our passenger deficit was reduced in 1963 by $4 million, bringing it down to $33.9 million. This was less than half the peak deficit of $71.7 million in 1951. The steady decline in passenger business continued. We carried 44,654,036 passengers compared with 44,828,078 in the preceding year. Passenger miles (the number of passengers times miles traveled) were down 7.6 per cent. Revenues from passenger fares dropped 3 per cent to $90.3 million, compared with $93.2 million in 1962.

We are seeking to eliminate passenger trains that are beyond hope of economic recovery because continuance of unneeded and unjustified trains can only impair the quality of passenger service where it is needed. Our policy, however, is to improve our productive passenger service in every way possible, to expand it where it can produce greater returns, and to study constantly the possibilities for further development.

The New York-Washington service, which accounts for almost two-thirds of our passenger revenues, was augmented during the year by the addition of 50 stainless-steel coaches converted from sleeping cars, and plans were made to add 20 more. These



New air-conditioned cars provide the best in suburban service.

cars will provide 5,320 comfortable seats—almost four times their former capacity—and make three one-way trips between Washington and New York daily, traveling almost 700 miles every 24 hours. This high utilization of modern equipment has substantially upgraded our busiest passenger route.

Initial plans were made for an advertising and promotion campaign to encourage travel by our railroad in 1964 to the New York World's Fair. This campaign will stress the fact that the Pennsylvania offers the most comfortable and direct route to the Fair. Special low fares will be featured on various routes and occasions, as well as package tours including tickets to the Fair itself.

To encourage maximum use of the New York-Washington service, weekend coach tickets were again sold between principal cities at one-third less than regular round-trip coach fare. Between March and November the sale of 228,500 such tickets produced $1.4 million in revenue.

During the year we placed in operation 38 new stainless-steel air-conditioned electric suburban cars leased from the City of Philadelphia. These fast, comfortable cars provide the finest suburban service in the country.

The Pennsylvania has pioneered in emphasizing the need for public financial support of suburban rail transportation. Losses from such services account for about 40 per cent of the deficit from all passenger operations. In New Jersey and the Philadelphia area we received $3.4 million under arrangements with state and local governments for providing improved services in 1963. This reduced the deficit in these areas to some $12 million.

'OPERATION BEAVER' KEYNOTES A 'NEW LOOK' PROGRAM

In December, the Pennsylvania launched "Operation Beaver," a program to improve the appearance of the railroad and to point up our concern for the comfort and convenience of passengers and shippers. A clean-up, fix-up campaign enlisted the efforts of all employes. Interior and exterior cleaning of passenger cars was stepped up, hundreds of passenger and freight stations were given a thorough scrubbing, trash was removed from yards, and offices, employe work areas and locker rooms were cleaned. Many facilities were repaired and painted, and a number of old structures were razed.

In addition to continuing attention to good housekeeping, "Operation Beaver" encompasses a broad program to improve passenger service by concentrating on equipment condition and employe performance. This plan calls for special daily inspection of passenger cars to assure prompt correction of defects affecting passenger comfort and convenience, for more thorough cleaning of cars, and for special employe training, especially in matters of courtesy and customer relations.

IMPROVEMENTS ARE KEYED TO SERVICE, SPEED AND EFFICIENCY

The Pennsylvania spent $73.4 million in 1963 to improve the railroad—$59.8 million for equipment and $13.6 million for additions and improvements to roadway. The total was $16.8 million more than in 1962.

During the year we acquired 66 new locomotives for freight operations – 13 electric and 53 diesel-electric units—and retired 128 obsolete diesel-electric units and nine electric locomotives. We now have a motive power fleet of 2,328 diesels and 256 electric locomotive units.

Additions to P.R.R. motive power helped to increase over-all efficiency by hauling heavier trainloads at higher sustained speeds. The 1963 figure of 63,790 gross ton miles per train hour was the highest on record for the P.R.R.

In December, the Company sought bids from locomotive builders on additional high-speed, heavy-duty freight diesels for through service on main line routes, and plans were made to order 50 units for delivery in the first half of 1964.

New Car Program Expanded

Of the 645 new freight cars placed in service in 1963, 500 were box cars equipped with cushion underframes, and 120 were 100-ton covered hoppers. In addition, 5,281 freight cars and 60 passenger cars were rehabilitated.

With the acquisition of 127 sets of racks for carrying assembled automobiles on flat cars, we now have 434 rack-equipped cars in service.

One of the primary aims of our capital expenditures program is to improve our capacity to handle freight business and to provide cars needed by our shippers, including large-volume, damage-free, specialized equipment. Accordingly, plans were completed to spend $90 million in order to acquire 6,142 freight cars and 50 locomotives and to rehabilitate another 7,550 cars in 1964.

Most of the cars will be built in our shops. Two thousand will be 100-ton, roller-bearing hopper cars, 1,000 will be 70-ton hoppers, and 1,000 will be 85-ton ore cars to augment our present fleet of 2,000. The program also includes 1,575 new box cars, 678 of which are larger than we have previously owned, and 97 flat cars, 380 covered hoppers and 100 gondola cars.

We have programmed expenditures of $7.6 million to rehabilitate 442 passenger coaches, diners and head-end cars, and to acquire 20 modern stainless steel coaches.

Roadway and Facilities

During the year 46 miles of new rail and 110 miles of fit rail were installed in main tracks. Of the total, 43 miles were continuous welded rail. Ties were renewed in 500 miles of track, and 2,400 miles were resurfaced and realigned.

Centralized traffic control was extended to an additional 49.7 miles of track, bringing our total to 1,495 miles.

Automatic highway crossing protection was installed at 46 grade crossings during the year.

Among important construction projects in 1963 were the following:

Consolidation and modernization of shop facilities were begun at Altoona, Pa., for the maintenance and heavy repair of diesel locomotives and passenger cars. The new shop will also repair diesel and electric locomotive motors and parts. It will cost approximately $5 million and save about $4 million a year.

Work was begun on enlarging the locomotive inspection and repair facilities at Conway, Pa., in

More special purpose equipment:
these big covered hoppers feature new design.


More cars for more business:
Altoona shops push equipment program.

order to make use of improved procedures and practices. Inspection and maintenance presently performed at several points on the railroad will be transferred to this enlarged installation.

A mechanized freight car cleaning facility, functioning by assembly line methods, was installed at Enola, Pa. The facility is supplying clean cars to meet requirements in central Pennsylvania territory, and it is expected that similar facilities will be built at other points on the railroad during 1964. The new techniques employed do a better and more uniform job, with less delay to cars.

Work was started late in the year on new freight car repair facilities at Enola Yard.

Modernization of Accounting

The extensive program to modernize our accounting began to show results in 1963. As part of the program we initiated a system of responsibility budgeting and reporting, supplemented by work measurements based on engineering standards. This, together with a standard cost system in the Operating Department, will give us more complete and current control figures and will make possible substantial operating economies.

We also began to make use of a new electronic data processing center at Philadelphia designed to coordinate freight car movement and control. When completely operative, the center will assemble daily information about every car on our lines—its whereabouts, contents and status. This will greatly speed delivery and improve our service to shippers. Similar information on empty cars will increase car utilization and expedite return of off-line cars to owner railroads, giving us better control over equipment so that we can minimize car rentals. The center will also produce statistics and market data which will benefit our sales effort. It will place us in the vanguard of the railroad industry with respect to electronic data processing.

During the year the Stores Department was reorganized into the Material Management Department. Use of a computer for controlling inventory and the reordering of supplies, permits reduction of inventory and cuts materials handling costs.

NEW PLANTS AND EXPANSIONS FOR FUTURE TRAFFIC

In 1963, plans were made to locate 189 new industrial plants on our railroad, and to expand 89 existing plants. These represent a potential in new traffic for the P.R.R. of 57,500 carloads of freight a year. They will increase employment and business activity in 174 on-line communities.

During the year we sold 55 tracts of industrial property with a total of 255 acres for $1.4 million, and bought 12 tracts containing 468 acres for future industrial use at a cost of $461,000. At the end of 1963, the Company owned 11,146 acres of land particularly suited for industry, with a valuation of $5.3 million.

In order to develop our area's mineral resources, our geologists are working with a major stone producer in exploring for high quality limestone and dolomite for the steel industry. In another area we are investigating deposits of shale suitable for conversion into lightweight aggregates, for which there is an increasing demand.

MERGER WITH NEW YORK CENTRAL MOVES NEARER

Hearings before the Interstate Commerce Commission on the proposed merger of the Pennsylvania and the New York Central railroads were concluded in October, 1963, after 128 days of testimony since August, 1962, by 461 witnesses, who submitted 290 prepared statements and 347 exhibits. The official transcript totaled nearly 20,000 pages, in the longest railroad merger hearing ever held before the Commission.

These proceedings gave us the opportunity to document the problems faced by Eastern railroads and to demonstrate why a constructive program of mergers is needed to meet the situation. We showed how the merger would improve service and would enable us to make a greater contribution to the industrial development of our territory.

The public interest requires that the East be served by strong rail systems able to support and con-


New industries build PRR freight traffic.

tribute to economic growth and development and to compete vigorously with one another and with other forms of transportation. Merger of the Pennsylvania and New York Central would result in such a system and would provide healthy, balanced competition with two other main systems which are taking shape in the Eastern area.

Already the P.R.R. and the N.Y.C. have begun coordinating many projects which will result in mutual savings of substantial magnitude. We are working on joint use of facilities such as fuel tanks, preblocking of cars for interchange traffic, exchange of materials to reduce inventories, cooperative testing and research, and standardization of locomotive and car design.

Recent approval by the Commission of the merger of the Atlantic Coast Line and the Seaboard Air Line railroads is an encouraging indication that the urgency for rail mergers is recognized in Washington. This strengthens our conviction that our merger will be approved.

PLANS MADE TO ACQUIRE BUCKEYE PIPE LINE COMPANY

As a step in a long-range program of diversification, we purchased approximately one-third ownership of Buckeye Pipe Line Company in 1963 and in February, 1964, made plans to acquire 100 per cent ownership of Buckeye's 2,688,743 shares of stock outstanding.

Subject to approval by the Interstate Commerce Commission and of Buckeye shareowners, we will offer Buckeye stockholders .385 of a share of a new issue of Pennsylvania Company 4⅝ per cent cumulative preferred stock, $100 par value, for each share of Buckeye stock. The new preferred will be redeemable after three years at the option of the holder for Norfolk & Western Railway Company common stock at $137 per share.

If approved, the proposal will involve a maximum issue of approximately 720,000 shares of preferred stock having an aggregate par value of about $72 million. If all the stock is ultimately redeemed, this would require about 525,000 shares of N&W common stock now held by the Pennsylvania Company, a wholly owned subsidiary of The Pennsylvania Railroad Company.

Buckeye operates a 7,500 mile network of pipe lines for transporting crude oil and petroleum products in New Jersey, New York, Pennsylvania, Ohio, Michigan, Indiana and Illinois. It is a sound and growing company, and would be operated after acquisition as a separate company with the same business and personnel policies and management as at present.

PRODUCTIVE USE OF REAL ESTATE STRESSED

After a decade of development, two new office buildings nearing completion in Penn Center will bring to nearly $100 million the investment so far in improvements on present and former railroad property in mid-city Philadelphia. With completion of the new buildings, structures built in Penn Center since 1953 will include a hotel, five modern office buildings, a parking garage, two apartment buildings and a shopping concourse.

Thus far we have realized some $25 million in sales of Penn Center property and we are receiving about $550,000 annually in rentals of property and concessions within the Center.

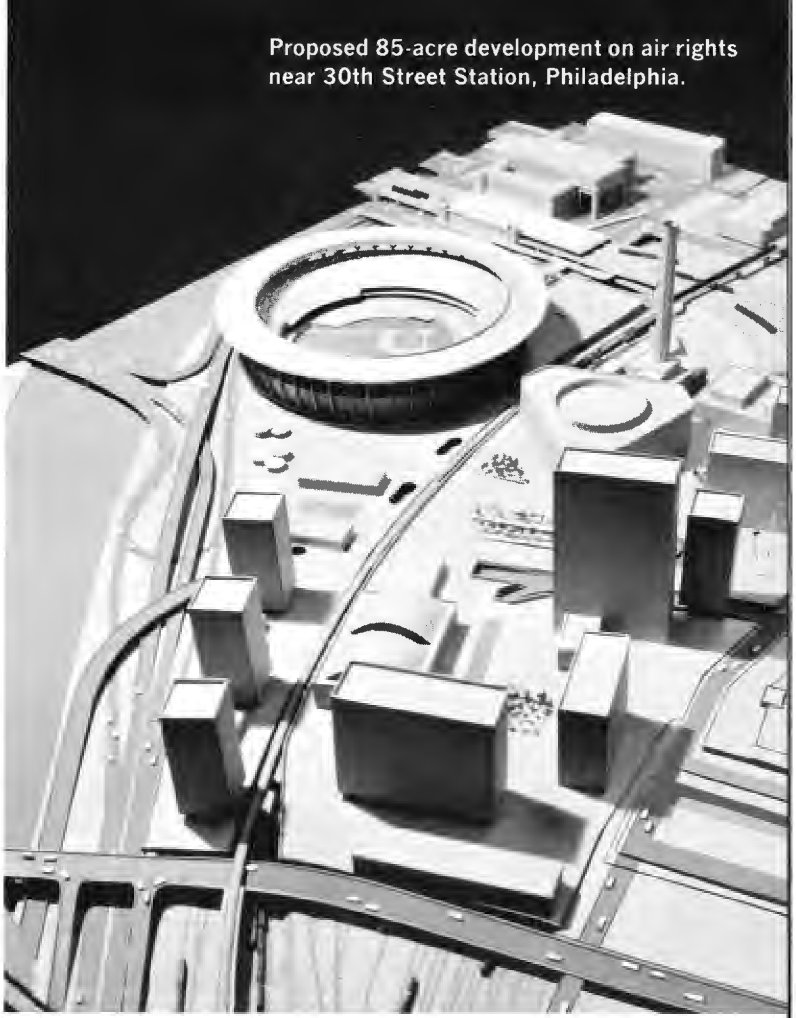
We are proposing an 85-acre development on air rights over our yards near 30th Street Station in Philadelphia, with multiple buildings which would complement plans for a projected University City in the area. Our proposal includes a double-deck stadium seating 60,000 people, with parking facilities, on 17 acres, leaving 68 acres for other purposes. The development would stimulate use of our passenger service, particularly in slack periods such as weekends and evenings, as well as provide additional income from real estate.

At Penn Station in New York, work was started in 1963 on the new Madison Square Garden complex and the modernization and relocation of our station facilities which was described in last year's annual report. This project will cost approximately $100 million, of which some $25 million will be borne by the Railroad as the cost of station improvements. It also will provide a focal point which will bring about increased use of rail services of both the Pennsylvania and Long Island Rail Road. We will have a 25 per cent interest in the new Madison Square Garden.

Gateway Center at Chicago is expected to cost the developers another $100 million. Work has begun on the first of three 20-story office buildings that will utilize air space over tracks at Chicago Union Station.

In 1963 we received $5.8 million from sales of 352 properties totaling 3,357 acres. Rentals from leases


New Madison Square Garden will rise over Penn Station, New York.


Proposed 85-acre development on air rights near 30th Street Station, Philadelphia.


Two new buildings increase Penn Center investment to $100 million.


Gateway Center, to be built on air rights at Chicago.

of railroad property and from concessions at stations and on trains increased during the year. The total was $17.2 million, compared with $15.9 million in 1962.

LABOR RELATIONS

After repeated refusals over the past two years of the railroad unions to accept decisions of authoritative, impartial boards on modernization of work and pay rules, Congress passed an emergency law in August requiring compulsory arbitration of two key issues—the number of men in a freight crew and the elimination of firemen on freight and yard locomotives.

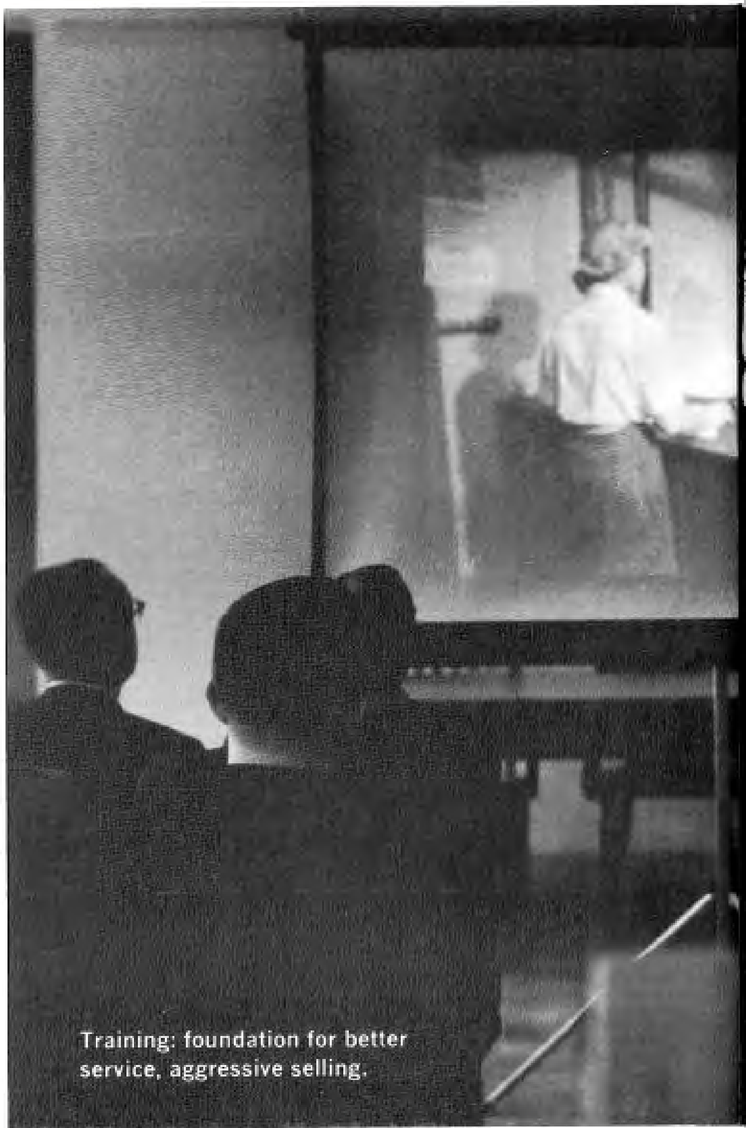
A seven-man arbitration board—of which Guy W. Knight, Vice President, Labor Relations is a member—representing management, labor and the public announced its award on November 26. Although this award was sound and fair, with generous benefits prescribed for men adversely affected, the unions flatly refused to accept it and have challenged it in the Federal courts, contending the law was unconstitutional and that the board exceeded its powers. In a well-reasoned opinion, the court decided against both union contentions. The unions appealed the decision, but the Court of Appeals affirmed the judgment of the lower court.

The unions have evidenced their intention of making a further appeal to the Supreme Court but we are confident that eventually the railroads will be enabled to make the sizeable savings which, in justice, should have been made long ago.

Demands by the Brotherhood of Railroad Trainmen for a 25-cent hourly increase in wages and added fringe benefits have been met in full on a national basis by an agreement whereby $23 a month per employe is set aside for group insurance. This is specified to be a wage equivalent.

Negotiations began in December and are continuing with both the Brotherhood of Locomotive Engineers, who in December demanded pay of $40 per trip for tour of duty with additional pay for added work, and the Brotherhood of Locomotive Firemen and Enginemen who made similar demands in December, including minimum daily earnings of $35 for firemen.

The Pennsylvania has authorized the Carriers Conference Committee to represent it in negotiations on a national basis of demands by the nonoperating unions for a pay increase of about 29 cents an hour and additional fringe benefits.



Training: foundation for better service, aggressive selling.

TRAINING PROGRAMS STEPPED UP

Recognizing the need for well-trained, productive employes, supervisors and managers, the Pennsylvania expanded training and developmental programs during the year. These included sales training programs for freight and TrucTrain sales personnel, supervisory training programs for yardmasters and maintenance of equipment gang foremen and foremen, and training to upgrade the craft skills of electricians. As a basis for sound future training, a Company-wide survey of employe skill needs is under way.

Training of personnel who deal with passengers continued, with emphasis on courtesy and service, and on case studies of typical incidents and situations. Over the years this training has contributed to a steady improvement in employe performance.

Plans were also formulated for more concentrated and extensive training in customer relations and

service merchandising for passenger train crews, passenger station personnel, and dining car employes.

Work Force Declined

During 1963 the Company's work force averaged 62,905, a decline of 3,610 or 5.4 per cent from the preceding year. A substantial portion of this reduction came from normal attrition, such as retirements, deaths and resignations.

Average earnings per employe were $6,885, up 3.2 per cent from 1962. In addition, the Company spent an average of $911 per employe for other items of benefit to employes, including support of Railroad Retirement funds for annuity and survivor payments, unemployment compensation, the Company's own Supplemental Pension Plan, and employe group life and group health and accident insurance.

Safety

Our safety record was the best in 24 years. The employe injury rate was 4 per cent below the preceding year on the basis of man-hours worked, making 1963 the seventh consecutive year of improved safety performance. The rate of injuries to employes has been reduced to less than half the 1956 rate and the rate of direct costs resulting from accidents to employes has been reduced approximately $4 million during the same period.

LEGAL DEVELOPMENTS

Revenues of the Pennsylvania would be improved in three cases by final decisions giving the Eastern railroads a larger share of freight rates on traffic with other sections of the country. The Interstate Commerce Commission granted the increased shares to the East in cases involving traffic with the Far West and the Midwest, but both decisions are being contested in court. Examiners who heard the Southern case also recommended an increase for the East. On the basis of testimony presented in the three cases, final decisions in our favor should add between $8 million and $9 million to annual revenues of the Pennsylvania.

Last April the U.S. Supreme Court held unlawful the I.C.C.'s policy of prohibiting reduced rail rates aimed at attracting business. This approval by the Court of "hard competition" for the transportation industry will allow the railroads more freedom in pricing and a better opportunity to realize their economic potential.

ADMINISTRATIVE STRUCTURE OF COMPANY REORGANIZED

In late 1963, we began making plans for reorganization of the managerial and administrative structure of the Railroad by reducing the number of regions from nine to three—Eastern, Central and Western, with headquarters in Philadelphia, Pittsburgh and Chicago. When the plan was put into effect early in 1964, each region was divided into four operating divisions, based at New York, Philadelphia, Baltimore and Harrisburg for the Eastern Region; Pittsburgh, Altoona, Cleveland and Buffalo for the Central Region; and Chicago, Indianapolis, Fort Wayne and Columbus for the Western Region.

The three regions provide simpler and more efficient administrative units with less complicated lines of responsibility and coordination. The 12 divisions afford closer direction of day-to-day operations, with more adaptability to local traffic patterns and physical characteristics.

Under the new plan we expect to save some $2½ million annually, and at the same time attain the flexibility necessary for prompt managerial decisions to meet changing business conditions.

EXECUTIVE CHANGES

James M. Symes, who became President on June 1, 1954, and Chairman of the Board on November 1, 1959, retired on September 30, 1963. During 47 years of service, Mr. Symes proved to be an outstanding officer not only as the chief executive of this Company, but as a leader in the railroad industry. As a director and Chairman of the Executive Committee, he will continue to give the Company the benefit of his extensive knowledge and experience.

Stuart T. Saunders succeeded Mr. Symes as Chairman of the Board on October 1. Mr. Saunders was formerly President of the Norfolk and Western Railway Company.

David C. Bevan, who had been Vice President, Finance, was elected Chairman of the Finance Committee and chief financial officer, effective October 1.

John B. Hollister retired as a director on September 30, after 15 years of effective and astute service on the Board.

On October 1, James P. Newell retired as Vice President, Operations and as a director. He was succeeded by David E. Smucker, who had been President of the Detroit, Toledo and Ironton Railroad Company.

Walter W. Patchell retired as Vice President, Special Services, on September 30. His duties were assumed by J. D. Morris, Director, Special Services.

On October 1, A. Paul Funkhouser, formerly Assistant General Counsel of the Norfolk and Western Railway Company, became Assistant Vice President of the Pennsylvania, reporting to the Chairman of the Board.

R. E. Franklin was appointed Chief Mechanical Officer on February 1, succeeding L. E. Gingerich, who retired.

On October 1, Henry W. Large was granted a leave of absence to become President of the Wabash Railroad Company. He was succeeded by H. M. Phillips as Vice President and Regional Manager, Northwestern Region.

C. G. Magruder was appointed Assistant Vice President, Freight Sales, to succeed I. T. Marine, who retired on July 1. On the same date, W. K. Chapman was also appointed Assistant Vice President, Freight Sales.

When the three-regional organization became effective March 1, 1964, Mr. Phillips remained at Chicago as Vice President and General Manager of the Western Region. George C. Vaughan was appointed General Manager of the Eastern Region and George M. Smith was named General Manager of the Central Region. Morton S. Smith remained at Pittsburgh as Vice President.

ANNUAL MEETING

The annual meeting of stockholders will be held in the Sheraton Hotel, 1725 John F. Kennedy Boulevard (formerly Pennsylvania Boulevard), Philadelphia, Pa., on Tuesday, May 12, 1964, at 2 P.M., Daylight Saving Time.

The complete Annual Report of the Company includes a series of statistical tables which are not included in this copy. If you wish a copy of that Report please address your request to the Secretary, The Pennsylvania Railroad Company, Six Penn Center Plaza, Philadelphia, Pa. 19104

GENERAL OFFICES—Transportation Center, Six Penn Center Plaza, Philadelphia, Pa. 19104

STOCK TRANSFER OFFICES—

PHILADELPHIA:
1808 Transportation Center
Six Penn Center Plaza

NEW YORK CITY:
Pennsylvania Station
380 Seventh Avenue

CHICAGO:
Continental Illinois National
Bank & Trust Company of Chicago
231 South LaSalle Street

BOSTON:
The First National Bank of Boston
45 Milk Street

World trade links: PRR unloads foreign ore for steel industry . . .

. . . delivers grain dockside for shipment abroad.

CONDENSED INCOME STATEMENT

	Year 1963	Year 1962	Increase or Decrease
THE COMPANY HAD OPERATING REVENUES FROM			
Transportation of Freight (*Note B*)	$642,610,681	$649,451,025	D $6,840,344
Transportation of Passengers	90,322,234	93,164,417	D 2,842,183
Handling of Mail	47,505,158	47,959,010	D 453,852
Handling of Express	11,305,761	10,363,999	I 941,762
Other Operations	48,367,820	49,716,874	D 1,349,054
	840,111,654	850,655,325	D 10,543,671
THERE WAS DEDUCTED			
Operating Expenses	676,847,525	692,499,296	D 15,651,771
Federal Income Taxes (*Note C*)	(*Credit*) 463,728	1,124,552	D 1,588,280
Payroll Taxes	34,472,821	36,097,294	D 1,624,473
Other Taxes	26,196,206	29,133,796	D 2,937,590
Equipment and Joint Facility Rents	74,245,421	73,890,974	I 354,447
	811,298,245	832,745,912	D 21,447,667
LEAVING NET RAILWAY OPERATING INCOME OF	28,813,409	17,909,413	I 10,903,996
THE COMPANY HAD OTHER INCOME (*from Dividends, Interest on Securities owned, and Miscellaneous sources*)	28,789,363	29,156,182	D 366,819
Less Income from Leased Lines Securities held (*eliminated from Leased Lines Rental below*)	2,116,181	2,086,667	I 29,514
	26,673,182	27,069,515	D 396,333
	55,486,591	44,978,928	I 10,507,663
MISCELLANEOUS CHARGES WERE	7,079,178	8,055,047	D 975,869
LEAVING A BALANCE AVAILABLE FOR FIXED CHARGES	48,407,413	36,923,881	I 11,483,532
FIXED CHARGES			
Leased Lines Rental (*after deducting Income from Leased Lines Securities held*)—(*Note H*)	16,735,351	16,792,270	D 56,919
Interest on Funded Debt	22,412,449	23,217,745	D 805,296
Other	100,743	123,751	D 23,008
	39,248,543	40,133,766	D 885,223
LEAVING A NET INCOME OF	9,158,870	(*Deficit*) 3,209,885	I 12,368,755
Times Fixed Charges Earned:			
Before Federal Income Taxes	*1.22*	*0.95*	
After Federal Income Taxes	*1.23*	*0.82*	
NET INCOME PER SHARE OF STOCK (*Note F*)	*$0.68*	*(Deficit) $0.24*	

CONDENSED STATEMENT OF RETAINED INCOME

	Year 1963	Year 1962	Increase or Decrease
BALANCE, JANUARY 1	$712,634,830	$719,063,336	D $6,428,506
Add: Net Income for the year	9,158,870	(*Deficit*) 3,209,885	I 12,368,755
Other Credits (*Note D*)	7,351,542	20,307,294	D 12,955,752
	729,145,242	736,160,745	D 7,015,503
Deduct: Dividends Paid	6,755,458	3,362,289	I 3,393,169
Other Debits (*Note E*)	10,673,684	20,163,626	D 9,489,942
	17,429,142	23,525,915	D 6,096,773
BALANCE, DECEMBER 31	711,716,100	712,634,830	D 918,730

See notes, Pages 28 and 29

RAILROAD COMPANY

CONDENSED BALANCE SHEET

	December 31, 1963	December 31, 1962	Increase or Decrease
ASSETS			
CURRENT ASSETS			
(*cash, temporary cash investments, material and supplies, accounts receivable, etc.*)	$178,153,046	$177,465,195	I $687,851
SPECIAL FUNDS			
(*insurance, sinking and other funds*)	46,847,378	57,891,710	D 1,1,044,332
INVESTMENTS (*Note G*)			
In Affiliated Companies (*stocks, bonds, notes and advances*)	895,641,178	867,963,963	I 27,677,215
In Other Companies (*stocks, bonds, notes and advances*)	2,952,005	6,189,243	D 3,237,238
	898,593,183	874,153,206	I 24,439,977
PROPERTIES (*Note O*)			
Transportation Property and Equipment	1,834,225,962	1,888,816,883	D 54,590,921
Less: Accrued Depreciation and Amortization	711,742,834	735,322,076	D 23,579,242
	1,122,483,128	1,153,494,807	D 31,011,679
Miscellaneous Physical Property	15,341,315	15,753,202	D 411,887
Less: Accrued Depreciation	1,080,411		I 1,080,411
	14,260,904	15,753,202	D 1,492,298
	1,136,744,032	1,169,248,009	D 32,503,977
OTHER ASSETS AND DEFERRED CHARGES			
(*including items in process of adjustment*)	23,800,963	39,267,834	D 15,466,871
Total	2,284,138,602	2,318,025,954	D 33,887,352
LIABILITIES			
CURRENT LIABILITIES			
(*traffic balances, wages, taxes, interest, other accounts payable, etc.*)	$147,221,791	$142,264,733	I $4,957,058
LONG-TERM DEBT DUE WITHIN ONE YEAR	35,351,959	44,320,304	D 8,968,345
LONG-TERM DEBT DUE AFTER ONE YEAR			
Bonded Debt	312,573,000	333,941,000	D 21,368,000
Equipment Trusts	34,152,000	42,657,000	D 8,505,000
Equipment—Conditional Sale Agreements	144,807,468	151,449,562	D 6,642,094
Miscellaneous Obligations	1,218,768	1,128,084	I 90,684
	492,751,236	529,175,646	D 36,424,410
RESERVES			
(Insurance, pensions and welfare, casualty and others)	36,471,538	29,904,384	I 6,567,154
OTHER LIABILITIES AND DEFERRED CREDITS			
Amount Payable to affiliated companies	40,591,380	36,371,020	I 4,220,360
Items in process of adjustment and Deferred Credits	37,061,573	38,353,916	D 1,292,343
Accrued Depreciation—Leased Property	108,581,675	112,200,182	D 3,618,507
	186,234,628	186,925,118	D 690,490
SHAREHOLDERS' EQUITY			
Capital Stock—(*Note F*)	135,429,150	134,520,880	I 908,270
Capital Surplus (*paid-in and premium on capital stock*)	538,962,200	538,280,059	I 682,141
Retained Income:			
Appropriated (*funded debt retired, and sinking fund reserves*)	26,102,000	24,680,000	I 1,422,000
Unappropriated	685,614,100	687,954,830	D 2,340,730
Retained Income	711,716,100	712,634,830	D 918,730
Shareholders' Equity	1,386,107,450	1,385,435,769	I 671,681
Total	2,284,138,602	2,318,025,954	D 33,887,352

For Contingent Items—see Note M

Communication by trainphone improves freight train movement.

Buckeye Pipe Line Company pump station.

PENNSYLVANIA RAILROAD SYSTEM

CONDENSED CONSOLIDATED INCOME STATEMENT (*Note A*)

	1963	1962	1961	1960	1959
Income					
Railway operating revenues (*Note B*)	$840,528,812	$851,058,396	$820,614,648	$844,139,943	$888,198,422
Revenues from miscellaneous operations	17,000,209	15,451,414	14,978,350	14,445,745	14,407,985
Dividend income (*Note K*)	23,738,916	22,634,488	23,494,827	19,171,505	18,964,974
Other	14,214,330	17,320,814	16,263,826	23,570,284	12,504,214
	895,482,267	906,465,112	875,351,651	901,327,477	934,075,595
Operating Charges and Other Deductions					
Railway operating expenses	677,649,384	693,203,429	672,763,153	700,103,893	730,106,337
Equipment and joint facility rents (*net*)	74,091,964	73,779,046	64,616,809	69,105,814	58,029,537
Expenses of miscellaneous operations and other deductions	20,545,903	21,487,769	19,483,530	19,475,629	19,032,853
Provision for taxes:					
Federal income (*Note C*)	CR. 463,728	897,434	1,112,698	1,191,989	1,106,898
Payroll Taxes	34,792,324	36,435,989	34,265,526	37,491,763	35,726,978
Other Taxes	28,445,496	31,283,727	33,094,813	35,100,319	35,242,753
	835,061,343	857,087,394	825,336,529	862,469,407	879,245,356
Income available for fixed charges and other corporate purposes	60,420,924	49,377,718	50,015,122	38,858,070	54,830,239
Fixed Charges					
Leased Lines Rental (*after deducting income from leased lines securities held*)—(*Note H*)	12,546,521	12,412,021	12,713,460	12,848,594	13,187,039
Interest on funded debt (*other than included in leased lines rental*)	23,635,301	24,247,713	24,685,178	24,570,326	24,716,500
Other	185,102	217,818	282,809	295,344	272,246
	36,366,924	36,877,552	37,681,447	37,714,264	38,175,785
NET INCOME	24,054,000	12,500,166	12,333,675	1,143,806	16,654,454
Times Fixed Charges Earned					
Before Federal income taxes	*1.65*	*1.36*	*1.36*	*1.06*	*1.47*
After Federal income taxes	*1.66*	*1.34*	*1.33*	*1.03*	*1.44*
NET INCOME PER SHARE OF PRR CO. STOCK	(*Note F*) *$1.78*	*$0.93*	*$0.94*	*$0.09*	*$1.26*

CONDENSED CONSOLIDATED STATEMENT OF RETAINED INCOME

	1963	1962	1961	1960	1959
BALANCE, JANUARY 1	$986,024,625	$987,182,632	$986,439,702	$1,000,122,897	$1,008,237,135
Add: Net Income for the Year	24,054,000	12,500,166	12,333,675	1,143,806	16,654,454
Other Credits (*Note D*)	5,634,933	10,078,466	748,019	1,839,031	1,942,755
	1,015,713,558	1,009,761,264	999,521,396	1,003,105,734	1,026,834,344
Deduct: Dividends Paid	6,755,458	3,362,289	3,291,939	3,291,939	3,291,939
Other Debits (*Note E*)	14,118,424	20,374,350	9,046,825	13,374,093	23,419,508
	20,873,882	23,736,639	12,338,764	16,666,032	26,711,447
BALANCE, DECEMBER 31	994,839,676	986,024,625	987,182,632	986,439,702	1,000,122,897

See notes, Pages 28 and 29

PENNSYLVANIA

CONDENSED CONSOLIDATED

	1963	1962	1961	1960	1959
ASSETS					
CURRENT ASSETS					
Cash	$57,278,007	$67,895,182	$62,940,811	$64,740,363	$87,169,091
Temporary cash investments (*principally at cost*)	4,519,735	18,399,452	26,161,189	25,876,077	21,530,279
Accounts receivable	36,637,906	35,647,953	40,841,363	37,308,468	41,623,012
Material and supplies	49,327,739	51,090,131	54,558,437	56,792,620	52,052,770
Other	38,390,493	27,333,321	30,896,564	26,101,481	33,308,542
	186,153,880	200,366,039	215,398,364	210,819,009	235,683,694
SPECIAL FUNDS					
Capital and sinking funds	23,585,139	37,038,638	25,967,861	5,886,071	10,697,958
Other	14,098,199	13,043,527	12,404,733	10,922,460	10,484,021
	37,683,338	50,082,165	38,372,594	16,808,531	21,181,979
INVESTMENTS AND ADVANCES					
(*at cost or less*): (*Note G*)					
Affiliated Companies (*Note I*)					
Investments	201,733,169	204,157,131	179,013,392	180,279,023	174,914,105
Advances	16,496,512	16,874,777	17,603,421	17,163,966	18,114,026
	218,229,681	221,031,908	196,616,813	197,442,989	193,028,131
Other Companies (*Note J*)	112,775,732	85,513,973	109,790,997	114,180,698	112,844,576
	331,005,413	306,545,881	306,407,810	311,623,687	305,872,707
PROPERTIES (*Note O*)					
Railway transportation property	3,128,036,054	3,134,142,563	3,166,684,617	3,179,070,903	3,185,498,479
Other property	105,310,466	93,892,953	95,879,207	92,012,283	87,041,040
	3,233,346,520	3,228,035,516	3,262,563,824	3,271,083,186	3,272,539,519
LESS: Accrued depreciation, amortization and depletion:					
Railway transportation property	946,181,284	960,502,140	965,229,032	955,040,310	935,128,647
Other property	20,888,113	18,104,792	17,501,422	14,203,787	12,625,776
	967,069,397	978,606,932	982,730,454	969,244,097	947,754,423
Net investment in property and equipment	2,266,277,123	2,249,428,584	2,279,833,370	2,301,839,089	2,324,785,096
OTHER ASSETS AND DEFERRED CHARGES					
(*including items in process of adjustment*)	24,761,391	39,899,003	33,474,609	32,115,308	35,629,471
TOTAL	2,845,881,145	2,846,321,672	2,873,486,747	2,873,205,624	2,923,152,947

See notes, Pages 28 and 29

RAILROAD SYSTEM

BALANCE SHEET AS OF DECEMBER 31 *(Note A)*

	1963	1962	1961	1960	1959
LIABILITIES					
CURRENT LIABILITIES					
Accounts and wages payable	$95,664,110	$90,119,683	$96,506,995	$82,175,885	$87,136,210
Tax liabilities	30,482,882	32,150,369	42,599,990	42,543,605	43,132,913
Other	22,872,509	21,046,419	24,147,570	26,451,389	26,025,404
	149,019,501	143,316,471	163,254,555	151,170,879	156,294,527
LONG-TERM DEBT DUE WITHIN ONE YEAR	43,590,989	51,566,823	56,770,383	46,114,843	87,151,395
LONG-TERM DEBT DUE AFTER ONE YEAR					
Pennsylvania Railroad Company	442,837,236	479,261,645	500,910,943	518,464,072	533,918,695
Bonds of leased lines	200,258,093	203,935,718	208,015,037	215,977,987	217,765,487
Subsidiary companies (*other than leased lines*)	94,553,550	65,766,552	69,505,822	72,541,767	43,628,605
	737,648,879	748,963,915	778,431,802	806,983,826	795,312,787
RESERVES (*Insurance, pensions and welfare, casualty and others*)	36,490,495	29,942,360	16,175,906	15,401,573	15,369,289
OTHER LIABILITIES AND DEFERRED CREDITS (*including items in process of adjustment*)	33,964,699	37,299,100	24,987,407	20,223,955	21,732,663
PUBLICLY HELD INTERESTS IN EQUITY OF CONSOLIDATED COMPANIES OTHER THAN THE PENNSYLVANIA RAILROAD COMPANY					
Preferred stock	23,746,951	23,761,751	23,804,551	23,808,551	23,869,451
Common stock	30,964,679	31,116,929	31,589,029	31,633,579	31,877,244
Retained Income and Capital Surplus	28,262,420	28,785,538	28,884,115	28,820,426	28,865,143
	82,974,050	83,664,218	84,277,695	84,262,556	84,611,838
PENNSYLVANIA RAILROAD CO. SHAREHOLDERS' EQUITY					
Capital Stock—(*Note F*)	135,429,150	134,520,880	131,677,540	131,677,540	131,677,540
Capital Surplus (*paid-in, premium on capital stock, other*)	580,629,984	579,907,802	579,784,634	579,779,446	579,730,613
Retained Income:					
Appropriated (*funded debt retired, and sinking fund reserves*)	27,192,533	25,761,778	25,753,024	24,322,266	24,309,130
Unappropriated	967,647,143	960,262,847	961,429,608	962,117,436	975,813,767
Retained Income	994,839,676	986,024,625	987,182,632	986,439,702	1,000,122,897
Net amount by which System equity in net assets (*at date of acquisition*) of companies consolidated exceeds the related investment therein	51,293,722	51,115,478	50,944,193	51,151,304	51,149,398
Shareholders' Equity	1,762,192,532	1,751,568,785	1,749,588,999	1,749,047,992	1,762,680,448
TOTAL	2,845,881,145	2,846,321,672	2,873,486,747	2,873,205,624	2,923,152,947

For Contingent Items—see Note M
See notes, Pages 28 and 29

Note A: The condensed consolidated financial statements represent income and financial condition of:

(1) The Pennsylvania Railroad Company.

(2) Companies, the common and preferred stocks of which were owned 100 per cent., directly or indirectly, for the entire year—except The Long Island Rail Road Company.

(3) Companies operated under agreements, principally long term leases, and West Jersey and Seashore Railroad Company whose lease was assigned to the Pennsylvania-Reading Seashore Lines in 1933 with a guarantee of rental.

Where the term System is used in the following notes, it represents this group of companies. The term Company refers to The Pennsylvania Railroad Company.

Note B: Freight Revenue does not include proportion of division of trans-continental freight rates which will be realized if the Interstate Commerce Commission's Order in Docket No. 31503, effective July 1, 1963, is upheld by the courts. The amount for the period July 1 to December 31, 1963, inclusive, is approximately $3,688,227.

Note C: Federal income tax accruals for the years 1959, 1960, 1961, 1962 and 1963 represent the portion of leased lines rental payments by the Company attributable to Federal income taxes of those lessor companies for which separate income tax returns are required. For 1963 these accruals have been reduced $71,650 by the use of accelerated depreciation and guideline lives, and $360,697 by the investment credit.

No Federal income taxes were accrued by the Company for itself or for lessor companies included in its Consolidated Tax Returns for the years 1962 or 1963, nor was any benefit reflected in either year as a result of accelerated depreciation, guideline lives permitted by Revenue Procedure 62-21, or the investment credit authorized by the Revenue Act of 1962.

It is estimated that, if it were not for net operating loss carryovers, the accrual of Federal income taxes for 1963 would have been increased $866,438 for the Company and $1,934,251 for the System.

Note D: Other Credits to Retained Income in 1962 include adjustment of Federal Income tax accruals for prior years of $7,409,030 for both Company and System. For the Company, years 1962 and 1963 include credits of $12,328,352 and $5,033,005, respectively, resulting from sale of 162,438 shares in 1962 and 51,345 shares in 1963 of Norfolk & Western Ry. Co. common stock to a wholly owned subsidiary, the Pennsylvania Company, and year 1963 also includes $1,752,347 from sale of 17,188 shares of Norfolk & Western Ry. Co. common stock to outside interests. For the System, years 1962 and 1963 include, respectively, credits of $1,143,260 for the sale of 212,449 shares of Norfolk & Western Ry. Co. 4% Adjustment Preferred Stock and $5,067,240 for the sale of 54,500 shares of Norfolk & Western Ry. Co. common stock.

Note E: Other Debits to Retained Income for the System include book value of securities deposited in the Supplemental Pension Fund in amounts of $11,664,200 in 1959 and $5,335,800 in 1960; also charges from sale and retirement of property of $10,169,922 in 1959, $5,347,888 in 1960 and $7,082,351 in 1961. Year 1962 includes charges from sale and retirement of property of $6,510,523 for the Company and $6,524,734 for the System; also $13,300,526 adjustment of insurance reserves for both Company and System. Year 1963, for both Company and System, includes charges of $9,976,548 for prior year adjustments in accordance with generally accepted accounting principles and for the System, $4,095,678 from sale of Lehigh Valley R.R. Co. stock.

Note F: Par value of capital stock is $10 per share. Of 17,400,000 shares authorized 13,167,754 shares had been issued and were outstanding on December 31, 1959 to 1961, inclusive, 13,452,088 shares, on December 31, 1962 and 13,542,915 shares on December 31, 1963. The increase in shares outstanding during 1962 and 1963 is the result of issuance of 284,334 shares and 52,827 shares, respectively, in exchange for Lehigh Valley Railroad Company stock together with exercise by key employes of options for 38,000 shares during 1963. All per share figures have been based on shares outstanding at the close of the respective years.

Under the Restricted Stock Option Plan for key employes of the Company and its subsidiaries, approved by the Stockholders at the 1957 Annual Meeting, on January 1, 1963, there were 672,604 shares available under the Plan with 365,000 shares issuable under outstanding options and 307,604 unoptioned shares available for granting of options. During 1963 options for a total of 28,000 shares expired, options for a total of 38,000 shares were exercised, and options for a total of 296,650 shares were granted of which options for 42,013 shares are subject to ratification and approval by the Stockholders at the 1964 Annual Meeting. On December 31, 1963, of the 677,145 shares available under the Plan, a total of 595,650 shares were issuable under all outstanding options, 38,000 had been exercised and 43,495 unoptioned shares remained available for the granting of options. Exercise price for shares granted in 1957 remains at $21.00, except for 1,000 shares as to which the exercise price was $19.00. Of the shares granted in 1963, 39,000 shares are subject to exercise price of $21.75 and 257,650 shares at $24.50. In accordance with the Plan, proceeds from the sale of stock are required to be used for capital expenditures.

Note G: $24,956,000 par value Pennsylvania Railroad Company investments are pledged under indentures. $55,205,525 par value of investments of other system companies are so pledged. Of the aggregate par value of $80,161,525 of investments pledged, $27,924,850 represent system securities which have been eliminated in consolidated figures. See also Notes I and J concerning pledged securities.

Note H: Summary of Net Rental Paid to Publicly Held Interests

Rental:	1963	1962	1961	1960	1959
Dividends on stocks of leased lines	$ 7,214,950	$ 7,234,060	$ 7,256,978	$ 7,261,495	$ 7,280,914
Interest on funded debt of leased lines	11,452,898	11,529,756	11,847,080	11,975,987	12,279,796
Other	183,684	115,121	88,562	89,598	94,278
	18,851,532	18,878,937	19,192,620	19,327,080	19,654,988
Deduct—Income from leased lines securities owned:					
Dividends to subsidiaries	3,273,791	3,271,576	3,265,156	3,261,520	3,254,585
Interest—					
to company	2,116,181	2,086,667	2,071,525	2,074,502	2,079,125
to subsidiaries	915,039	1,108,673	1,142,479	1,142,464	1,134,239
	6,305,011	6,466,916	6,479,160	6,478,486	6,467,949
Net rental paid to publicly held interests	12,546,521	12,412,021	12,713,460	12,848,594	13,187,039

Note I: The amount shown in the condensed consolidated Balance Sheet for Investments and Advances—Affiliated Companies, include the following investments in companies whose properties are operated by their own organizations:

The Long Island Rail Road Company

The Long Island Rail Road Company (the capital stock of which is owned 100 per cent. by the System) qualified on August 12, 1954 as a railroad redevelopment corporation under Chapter 824 of the laws of New York of 1954, and its indebtedness was adjusted. The stock is included in Investments at $47,639,171. No dividends have been received from The Long Island Rail Road Company since 1933. The railroad reported Net Income under the Redevelopment Statute as follows:

1963	$ 665,874	1960 Deficit	$1,140,148
1962	$2,289,024	1959	$ 333,545
1961	$ 587,165		

However, if full interest charges were accrued, all years except 1962 would have resulted in Deficits.

Wabash Railroad Company

The System investment in Wabash Railroad Company is represented by slightly more than 99 per cent. interest in common stock at December 31, 1959 to December 31, 1960, inclusive, and by 99.50 per cent. interest at December 31, 1961 to December 31, 1962 and by 99.51 per cent. interest at December 31, 1963; and by 62.12 per cent. interest in preferred stock at December 31 of each year. The stocks are included in Investments at approximately $14,500,000 at December 31, 1959, and $14,600,000 at December 31, 1960 to December 31, 1963, inclusive.

At December 31, 1963 there were pledged 43,257 shares of preferred stock with Trustee of a collateral trust indenture of Pennsylvania Company.

Detroit, Toledo and Ironton Railroad Company

Detroit, Toledo and Ironton Railroad Company capital stock, of a par value of $20,000,000, representing 81.52 per cent. ownership is included in System investments at cost of $21,100,000 at December 31, of each year.

At December 31, 1963 there were pledged 49,758 shares of stock with Trustee of a collateral trust indenture of Pennsylvania Company. The Wabash Railroad Company also owned $4,532,900 par value Detroit, Toledo and Ironton Railroad Company capital stock, representing 18.47 per cent. of the outstanding stock at December 31, of each year.

Lehigh Valley Railroad Company

The System investment in capital stock of Lehigh Valley Railroad Company is represented by 25.16 per cent. interest in 1959, 26.81 per cent. interest in 1960 and 1961, 89.08 per cent. interest in 1962, and by 80.78 per cent. interest in 1963. The stock is included in Investments at $20,535,971 at December 31, 1959, $20,715,620 at December 31, 1960 and December 31, 1961, $26,239,017 at December 31, 1962, and $22,449,427 at December 31, 1963. The decrease in year 1963 was as a result of sale in December of 250,000 shares. At December 31, 1963 the Company was contingently obligated under an extended option to purchase a like number of shares. In January, 1964 the option was exercised and the transaction was consummated.

Funded debt of Lehigh Valley Railroad Company in principal amount of $3,482,000, at a cost of $957,165, was owned by the System at December 31, 1959 to December 31, 1961, inclusive, principal amount of $6,868,500 at a cost of $2,296,745 was owned at December 31, 1962, and principal amount of $7,328,500 at cost of $2,599,087 was owned at December 31, 1963.

Note J: In addition to the investments discussed in Note I the System has a substantial investment in the Norfolk and Western Railway Company and the Buckeye Pipe Line Company, whose properties are operated by their own organizations. The amount of such investments is included in the condensed consolidated Balance Sheet under the caption Investments and Advances—Other Companies.

Norfolk and Western Railway Company

The System investment in Norfolk and Western Railway Company is represented by 57.96 per cent. interest in 4% preferred stock at December 31, 1959, 58.90 per cent. interest at December 31, 1960, 54.36 per cent. interest at December 31, 1961, 39.55 per cent. interest at December 31, 1962 and December 31, 1963; by 4.19 per cent. interest in 6% cumulative preferred stock at December 31, 1960, and by 15.51 per cent. interest at December 31, 1961 to December 31, 1963; by 32.62 per cent. interest in common stock at December 31, 1959, 32.59 per cent. interest at December 31, 1960, 32.53 per cent. interest at December 31, 1961, 32.49 per cent. interest at December 31, 1962, and by 31.63 per cent. interest at December 31, 1963. The stocks are included in Investments at a cost of: 4% preferred—$10,490,439 at December 31, 1959, $10,280,693 at December 31, 1960, $9,071,597 at December 31, 1961, $4,843,944 at December 31, 1962, and December 31, 1963; 6% preferred—$236,944 at December 31, 1960, and $926,036 at December 31, 1961 to December 31, 1963, and common—$62,987,317 at December 31, 1959 to December 31, 1962, inclusive, and $61,477,076 at December 31, 1963.

At December 31, 1963 there were pledged 1,689,407 shares of common stock with Trustees of collateral trust indentures of Pennsylvania Company.

Buckeye Pipe Line Company

The System investment in Buckeye Pipe Line Company at December 31, 1963 is represented by a 31.16% interest in common stock and is included in investments at a cost of $28,169,476. Since that date, settlement has been made for additional stock increasing System holdings to 890,614 shares, at a cost of $30,028,188 representing a 33.16% interest in common stock. In February, 1964, plans were announced to acquire 100 per cent. ownership through issuance of Pennsylvania Co. Preferred Stock.

Note K: Dividend Income to the System includes amounts received from the Wabash Railroad Company; Detroit, Toledo and Ironton Railroad Company and Norfolk and Western Railway Company, as follows:

	1963	1962	1961	1960	1959
Wabash	$5,333,721	$5,928,575	$7,713,790	$2,356,878	$2,949,023
D. T. & I.	2,290,000	1,700,000	1,840,000	2,000,000	2,930,000
N. & W.	14,479,033	13,577,365	12,508,963	12,515,588	11,794,402

Note L: Equity in undistributed Net Income and Net Assets of the Wabash Railroad Company; Detroit, Toledo and Ironton Railroad Company; Lehigh Valley Railroad Company and Norfolk and Western Railway Company, as indicated by the financial reports of those Companies, is summarized as follows:

Equity in Undistributed Net Income Per Share of P.R.R. Co. Stock

	1963	1962	1961	1960	1959
Wabash	$ .14	$ .03	$ .01	Deficit	Deficit
D. T. & I.	.06	.08	.03	$ .05	$ .02
L. V.	Deficit	Deficit	Deficit	Deficit	Deficit
N. & W.	.52	.56	.55	.57	.60

Equity in Net Assets Per Share of P.R.R. Co. Stock

	1963	1962	1961	1960	1959
Wabash	$12.26	$12.18	$12.39	$12.82	$12.62
D. T. & I.	2.78	3.18	3.17	3.14	3.28
L. V.	5.53	6.45	2.09	2.28	2.20
N. & W.	18.67	18.57	18.81	18.52	17.84

Note M: The Company has contingent liabilities (not included as liabilities in the foregoing balance sheet) aggregating $556,934,790 as of December 31, 1963 by endorsement as guarantor or by agreement, including agreements to make advances, in respect of the principal of obligations, and of interest thereon of companies in which the Company has an interest. $287,743,280 of these contingent obligations have been entered into jointly or jointly and severally with other companies. The System owns $67,884,510 of obligations for which it has sole contingent liability.

The System has contingent liabilities (not included as liabilities in the Balance Sheet) aggregating $294,280,280 as of December 31, 1963, in respect of the principal of obligations issued by non-consolidated companies, including terminal companies, in which the System has an interest. $290,830,280 of these contingent obligations have been entered into jointly or jointly and severally with other companies.

In addition there are other contingent liabilities, indeterminate in amount, of the System companies, in respect to taxes, personal injuries and property damage, and other matters.

Note N: The System has certain obligations under long term equipment leases. The remaining rentals payable under these leases, representing amortization of the lessors' cost of the equipment amount to $199,800,000. Of the foregoing amount $8,950,000 is attributable to equipment leased in 1963. Total rentals in 1963 for all equipment acquired under these lease arrangements amounted to $28,500,000.

Note O: Properties represented by road and equipment are required to be revalued in accordance with Interstate Commerce Commission Order dated April 17, 1963. The Order fixes valuation for the Company on the basis of an Interstate Commerce Commission physical inventory as of June 30, 1918, at 1910-1914 prices and reflects additions and retirements since that date. Under the provisions of the Order, the properties of the Company are determined to have a value of $36,491,414 in excess of the amounts at which they have been carried in the accounts. Of this, $4,425,296 has, as directed by the Interstate Commerce Commission, been applied to the reported amounts. The remaining additional value of the properties, in the amount of $32,066,118, is excluded from the reported net value of the properties, but will be included in subsequent periods in accordance with the Order.

Note P: In accordance with generally accepted accounting principles, to the extent applicable, certain charges to income are reported on a current basis rather than at the time of settlement. Principal changes in accounting for the Company which have been adopted provide for (1) deferred compensation to designated officers, (2) expenses and recoveries incident to repairs to railroad cars by other than the owning railroad, (3) differences between companies resulting from revenue adjustments and (4) depreciation on property not used in transportation. Also, the salvage value, amounting to $5,554,183 at December 31, 1963, estimated to result from retired equipment through disposition in the ensuing year, is reported as a current asset.

Note Q: The amounts shown under P.R.R. Co. include expenditures by P.R.R. Co. for Lessor companies together with, in 1963, $21,896,029 net expenditure for equipment leased to P.R.R. Co. by a wholly owned subsidiary of a Lessor company.

THE PENNSYLVANIA RAILROAD COMPANY

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