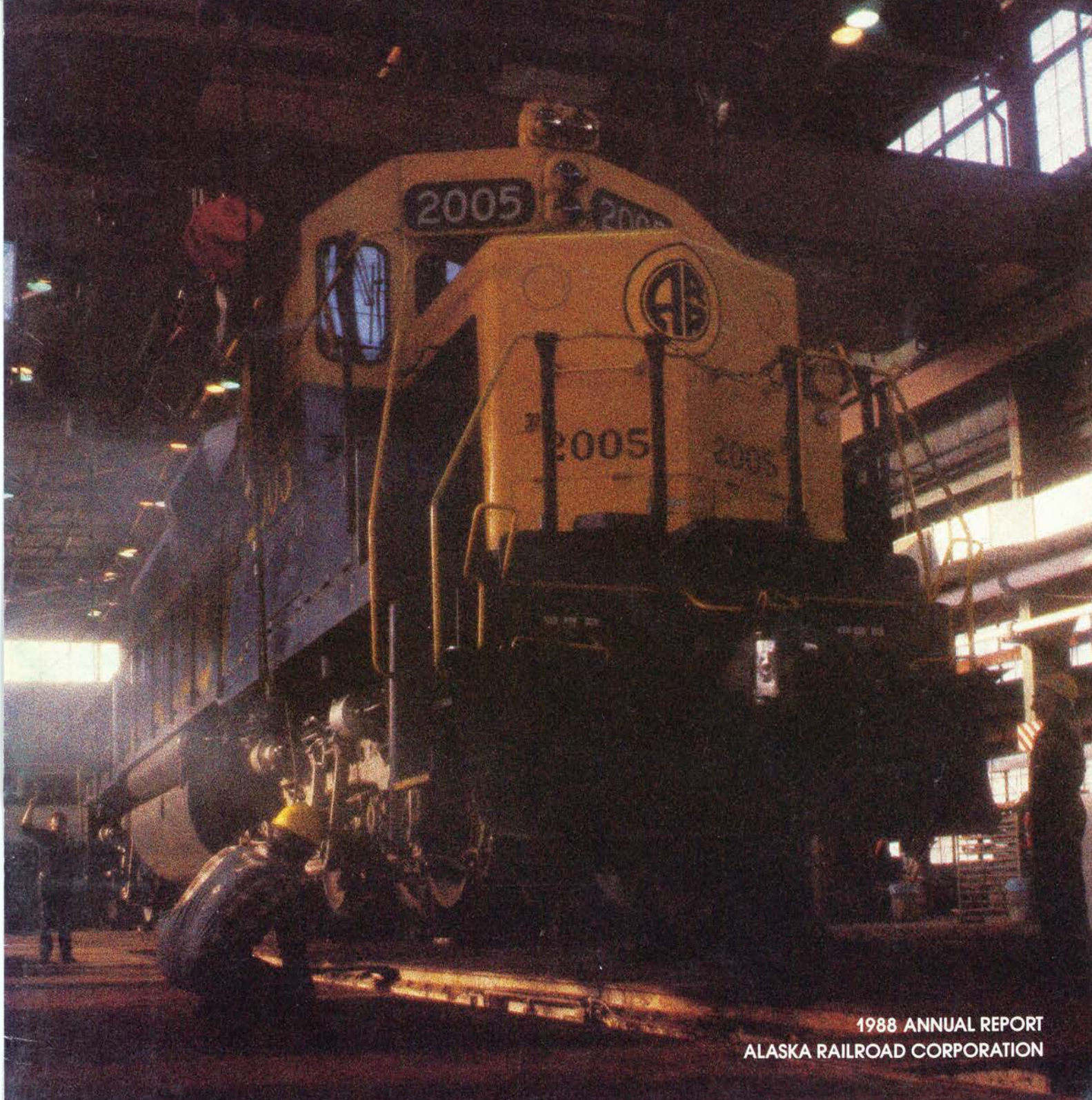


ALASKA RAILROAD 1988



Dear Alaskans:

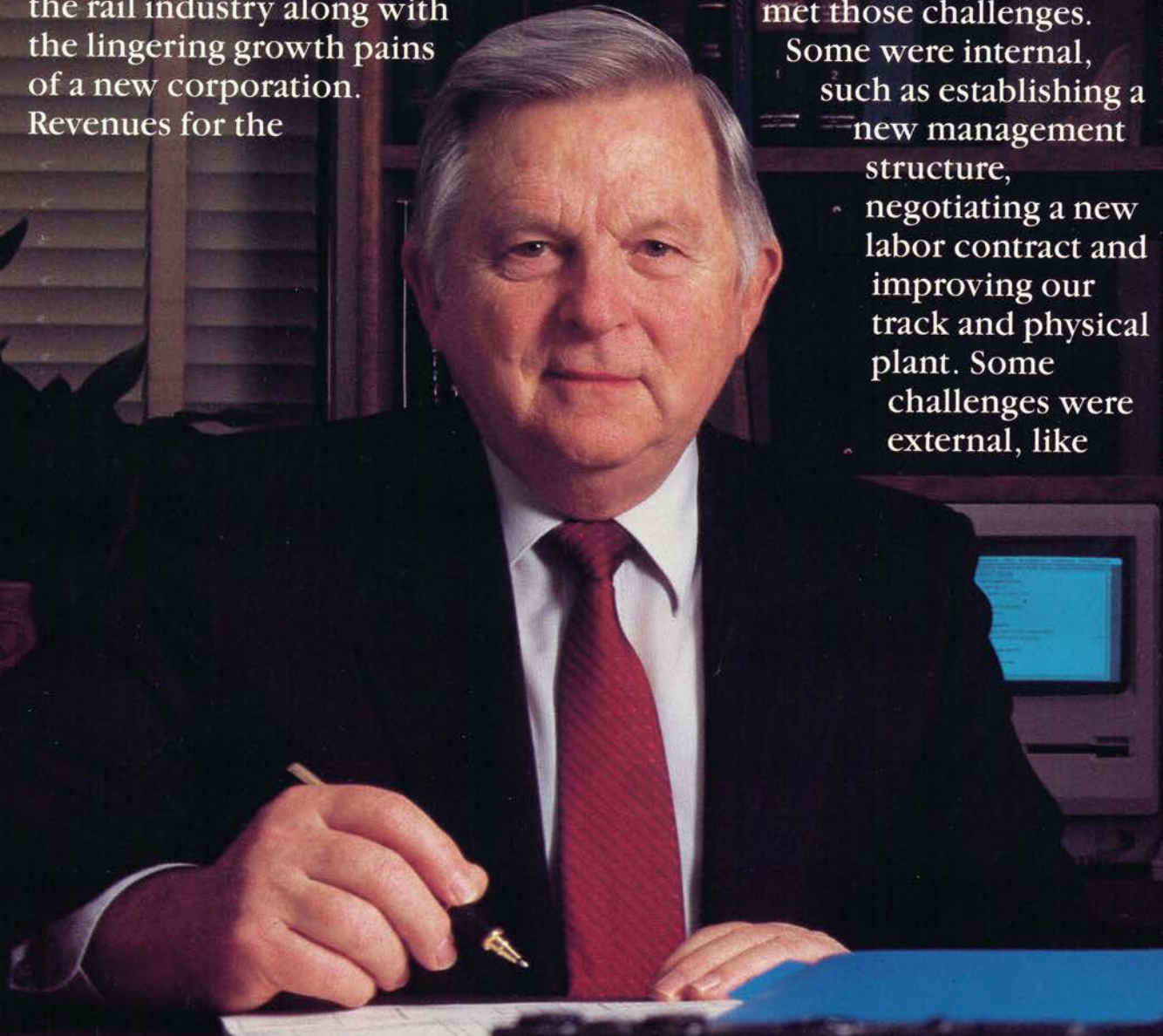
Railroading is an old industry in America, begun in the days when the horse and buggy were mainstays of travel. Today the industry faces stiff competition from other modes of transportation and is continually working to adapt to the technological innovations of modern times. I am pleased to report that in 1988 the Alaska Railroad cleared the hurdles of the rail industry along with the lingering growth pains of a new corporation. Revenues for the

year reached \$59 million. After expenses, a near-record \$5.8 million net income was available for reinvestment in capital improvements.

The four years since the state of Alaska purchased the Alaska Railroad from the federal government have been years of growth and change unmatched in the 65-year history of the rail line. Each year there were new opportunities.

Each year in our annual report we have reported that we have met those challenges.

Some were internal, such as establishing a new management structure, negotiating a new labor contract and improving our track and physical plant. Some challenges were external, like



aggressive competition, a 100-year flood and a sluggish state economy. This year I am pleased to announce that we were equal to the obstacles posed by the past year and have emerged a stronger, more efficient, more competitive member of Alaska's transportation system.

This year our annual report takes on a different look. In addition to recounting what transpired in 1988, it is also a look at what role we play in our communities and what kind of transportation system the Alaska Railroad might be tomorrow.

I hope you will take time to read all about our accomplishments. When you do, I believe you will have a better grasp of who we are and what has made the Alaska Railroad a success.



Frank G. Turpin
President and CEO

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Our efforts to expand into new markets added new revenue sources in 1988 while we steadily increased our share of existing commodities.



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Capital projects totaled \$7.9 million in 1988 to upgrade or maintain our track, roadbed and equipment so we can provide the best service to our customers.



SERVING OUR COMMUNITIES .. 10

The Alaska Railroad and our employees play a big role in the communities we serve.



TOWARD A BRIGHTER FUTURE..... 12

What does tomorrow hold for the Alaska Railroad? What are the options? A look at three possible directions for the future.



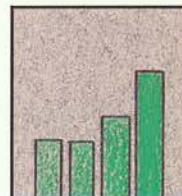
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Meet the board of directors which establishes policy and directs the focus of the Alaska Railroad.



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The 1988 audit reports \$59 million in revenue and \$53.2 million in expenses for a net gain of \$5.8 million.



FRONT COVER: Servicing a 120-ton locomotive is routine for Mechanical Department crews.



Creating New Markets

Like many companies, the Alaska Railroad has its bread-and-butter accounts, customers who are relied on each year to help produce the revenue needed to operate the railroad. The mark of a good company is its ability to improve the earnings from its bread-and-butter accounts while adding new customers. During 1988 the Alaska Railroad did just that.

At least 90 percent of the Alaska

Railroad's annual revenue is from freight. The lion's share of that freight revenue is derived from three

sources: petroleum, coal and the diverse products shipped in rail cars, called interline. In 1988 two new revenue sources were added, timber and hazardous wastes, while petroleum and rail car traffic were increased. The result was a 14 percent rise in freight revenue from \$39.4 million in 1987 to \$44.8 million in 1988.

The outlook is good for future movements of timber and hazardous wastes, the two new revenue sources

More than 1.4 million tons of coal were hauled by the Alaska Railroad in 1988 for both local and foreign consumers.

developed in 1988. Our first major movement of hazardous wastes was from a Fairbanks battery yard, which yielded 40 carloads of lead contaminated soil. We began hauling logs in 1988 after a nearly 10-year hiatus. About 2.8 million board feet of logs were transported from the Interior and Matanuska Valley for shipment* to Korea and Japan.

Negotiations began in 1988 to export another of Alaska's natural resources to Japan: coal. A leading Japanese energy company plans to re-open the Wishbone Hill coal mine near Palmer, hauling the product to Seward by rail car. The coal would be exported to Japan for use as a power source for oil refineries.

Meanwhile coal is already being hauled by the railroad from the family-owned Usibelli mine at Healy. About 1.4 million tons were shipped by rail in 1988, of which about half was exported to Korea for power generation. The remainder was used to fuel several

power plants in the Interior, including those operated by the Fairbanks North Star Borough, the University of Alaska Fairbanks and three military installations.

Oil field supplies are moved regularly on the Alaska Railroad. Most enter the state at the Port of Whittier via the water carriers

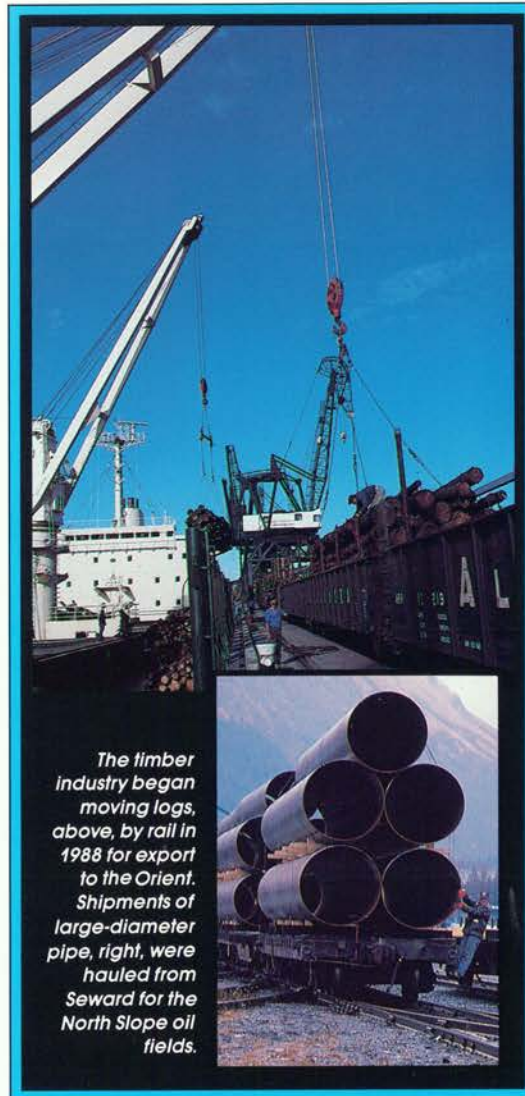
Alaska Hydro-Train and Canadian National Railways' AquaTrain. Products frequently hauled are friction reducing agent for the trans-Alaska pipeline, drilling compounds and anti-freezing chemicals. During 1988 shipments of large-diameter and drilling pipe for the North Slope oil fields sharply

increased and pipe revenue doubled from \$718,000 in 1987 to \$1.4 million in 1988. This resurgence in pipe shipments indicates a turnaround in the oil industry may be just around the corner.

Petroleum products, the highest revenue producer on the railroad, increased 56 percent from about 170 million gallons in 1987 to about 265 million gallons in 1988. These products, including gasoline, diesel and several types of jet fuel, are hauled in tank cars between the state's two largest cities, Anchorage and Fairbanks.

In addition to increased freight revenues, the Alaska Railroad has had a steady rise in

passengers over the past four years. Ridership improved by 14 percent, climbing from 316,000 passengers in 1987 to 361,000 in 1988. Their most popular destination? Surveys show most want a glimpse of Mount McKinley, America's tallest peak, at Denali National Park.



The timber industry began moving logs, above, by rail in 1988 for export to the Orient. Shipments of large-diameter pipe, right, were hauled from Seward for the North Slope oil fields.



PETROLEUM

Petroleum shipments of jet fuel, gasoline, heating oil and diesel fuel account for 29 percent of freight revenue. There were 266 million gallons of petroleum products shipped in 1988, a 56 percent increase over 1987. MAPCO Petroleum and Tesoro Alaska are the two major petroleum shippers. They supply fuel for international and domestic airlines, trucking companies, fishing vessels, gasoline distributors and the military.



COAL

Shipments from the Usibelli Coal Mine at Healy are directed at two markets: local and export. In 1988 there were 1.4 million tons of coal moved on the Alaska Railroad, which accounted for approximately 27 percent of freight revenue. Local consumers in Interior Alaska use the coal to fuel power plants at the Fairbanks North Star Borough, the University of Alaska Fairbanks and three military installations. About half the coal moved by rail is hauled to Seward for export to Korea Electric Power Company. A test shipment also was hauled to Seward in 1988 for export to Japan.



INTERLINE

Rail cars from such railroads as the Burlington Northern, Southern Pacific, Union Pacific and Canadian National frequently are moved interline on the Alaska Railroad from the lower 48 states and Canada. Interline contributes 18 percent of freight revenue. This traffic enters and leaves Alaska via the water carriers Alaska Hydro-Train and Canadian National Railways' AquaTrain. Both dock at the Port of Whittier. Shipments include machinery, heavy equipment, oil field supplies, animal feed, flour, news print, and liquid petroleum gas. There were also 7,000 automobiles and light trucks hauled interline in 1988 including new Ford and General Motors vehicles.



PIPE

Pipe tonnage nearly doubled from 17,000 in 1987 to 32,000 in 1988, indicating a rise in oil exploration and production in Alaska. Shipments arriving in 1988 at the Port of Seward included 60-inch-diameter pipe, the largest ever moved to the North Slope. Commitments at year-end to haul pipe to the oil patch further indicate improvement in the industry.



INTERMODAL

Freight shipped by several modes is referred to as intermodal. On the Alaska Railroad, this freight is composed of trailers and containers moved on flat cars. Most of the shipments are received from the barge lines Alaska Hydro-Train at Whittier and Sea-Land and TOTE, which dock at Anchorage. Items shipped in trailers and containers include groceries, beverages, building supplies, electronic equipment, and automotive parts and supplies. This traffic totals about 14 percent of freight revenue.



PASSENGERS

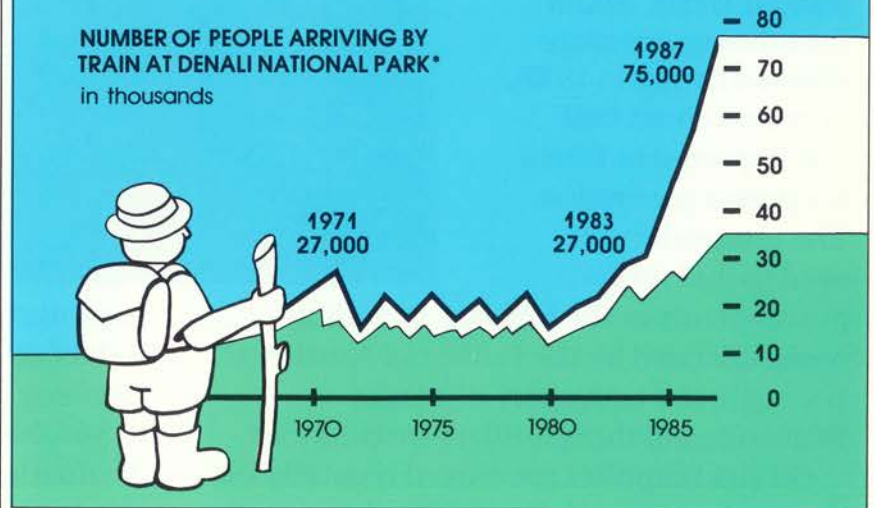
Ridership jumped 14 percent in 1988. Of the 361,000 travelers, nearly 44 percent rode the summer express trains between Anchorage and Fairbanks which make an intermediate stop at Denali National Park. Another 42

percent took the Whittier Shuttle, the only land access to the city of Whittier. The remainder of the 1988 passengers rode charters and specials or took the self-propelled rail diesel cars to Seward.

PASSENGER RIDERSHIP 1985-1988

Year	1985	1986	1987	1988
Passengers	257,000	280,000	316,000	361,000

NUMBER OF PEOPLE ARRIVING BY TRAIN AT DENALI NATIONAL PARK* in thousands



* source: NPS



GRAVEL

There was a slight increase in 1988 of gravel shipments by rail. The gravel is hauled from three producers in the Matanuska-Susitna Valley to distribution centers in Anchorage. Housing starts and private building programs remained flat in 1988; as a result, the major demand for gravel, as in 1987, was for municipal and state-funded public works programs.



REAL ESTATE

The Real Estate Department oversees all permits and leases for use of corporate property. During 1988 the department entered into 13 new long-term leases, helping to offset a drop in revenue resulting from a decline in commercial real estate values. These 13 new leases represent annual revenues of more than \$55,000. The department also began to market the corporation's properties by displaying "for lease" signs on vacant parcels and listing properties in the local Multiple Listing Service.



MISCELLANEOUS LOCAL

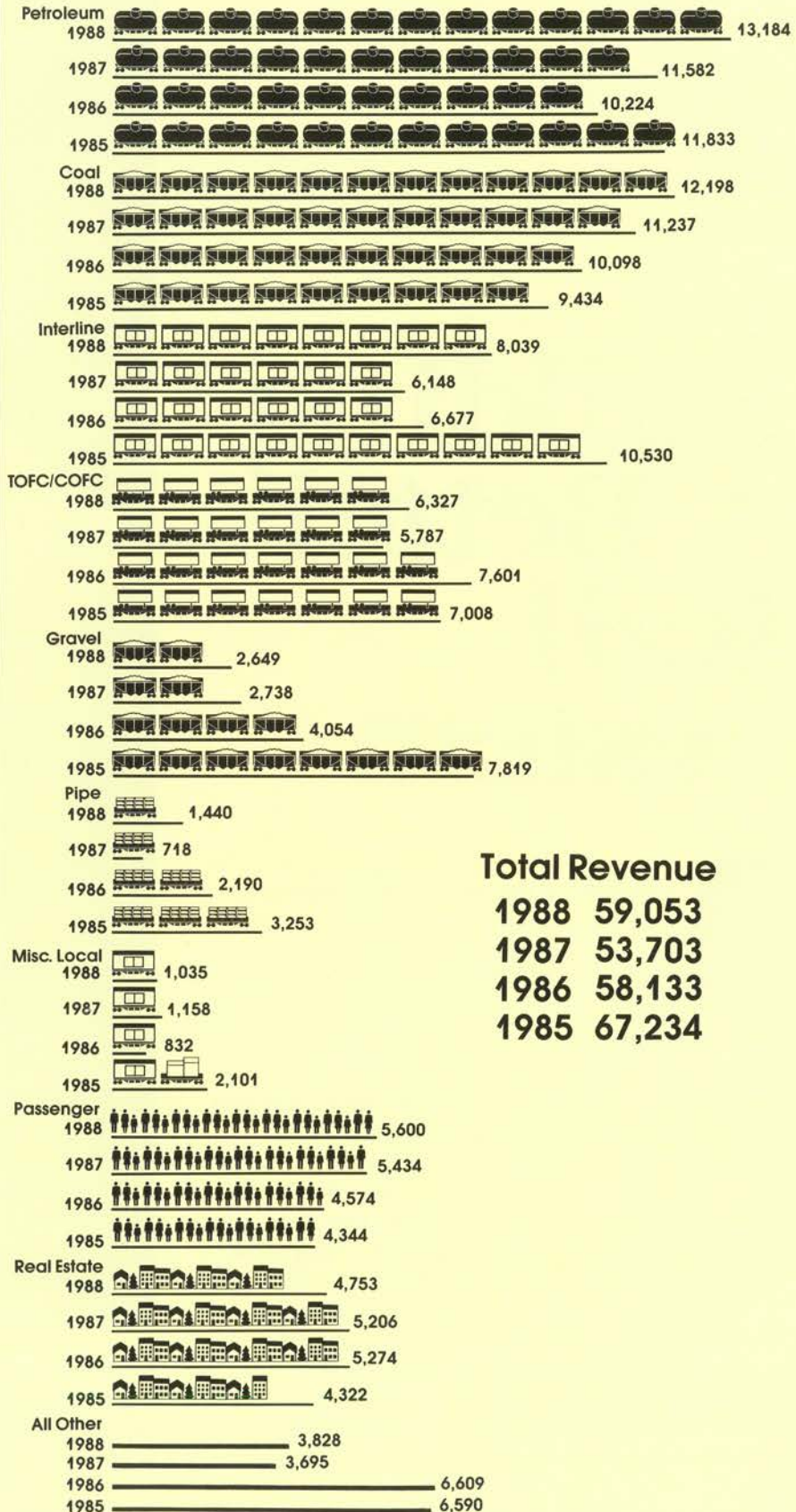
The majority of this freight is moved between Anchorage and Fairbanks and includes such items as construction equipment and supplies. A new revenue source was added to this category in 1988: logs. There were 2.8 million board feet of logs hauled by the railroad from the Interior and Matanuska Valley for export to Korea and Japan. These were the first such shipments in 10 years. Shipments are expected to continue in 1989 with logs from Nenana.

ALL OTHER

Revenue is also derived annually from reimbursable construction and maintenance projects, wharfage, surplus sales, earned interest, dockage, switching, and baggage storage.

1988 to 1985 REVENUE BY COMMODITY

(Thousands of Dollars)



Total Revenue

1988	59,053
1987	53,703
1986	58,133
1985	67,234

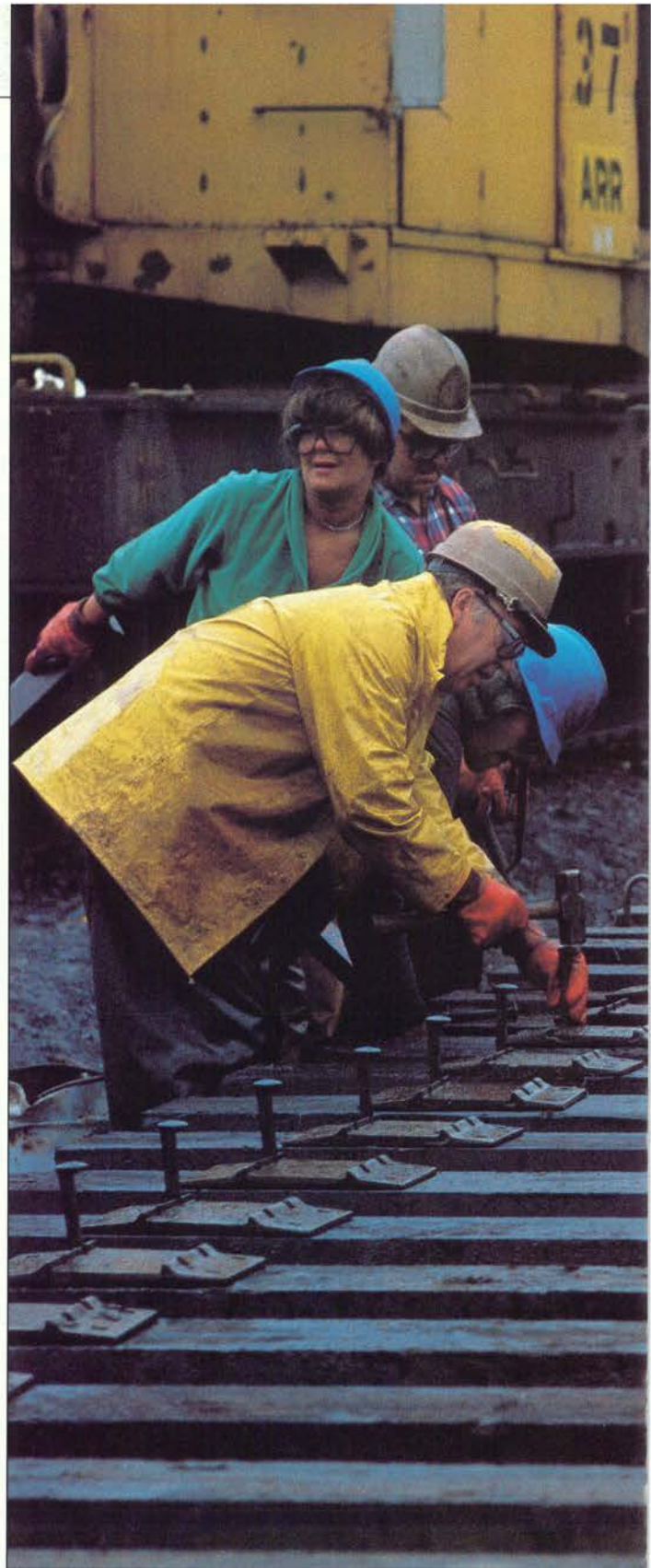
Building A Better Rail System

Railroads are like the U.S. Constitution, the basics were built two centuries ago. Since then there have been small changes and improvements to keep up with the times.

During 1988, the Alaska Railroad was on a similar path, continuing to replace or improve equipment and portions of the line so freight and passengers could be moved more efficiently.

Total capital improvements for the year were \$7.9 million. About 40 percent of the work was track-related: bridge upgrades, rail, ties and ballast replacement, tunnel upgrade, equipment installation and dock repairs. Other capital expenditures were to construct or upgrade facilities, improve communications, purchase equipment, and develop or purchase new computer programs or hardware.

Since state ownership, emphasis has been placed on maintaining equipment and track at



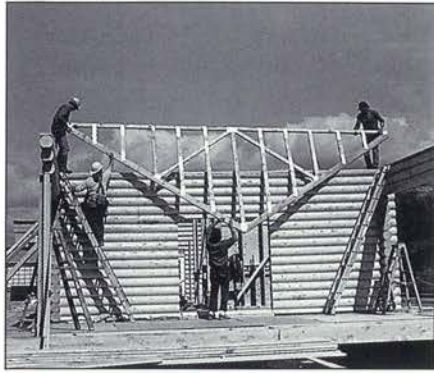
optimum levels, finding new methods of improving the basics, and introducing cost-saving equipment and methods essential to building a better and more efficient transportation company.



Maintenance crews built track panels for use in improving a portion of track in the Whittier Tunnel. The remainder of the tunnel and the Portage Tunnel are slated for rehabilitation over the next several years.

Like the Constitution, the basics of the Alaska Railroad have been in place for many years, but it has been necessary to continue to make improvements and changes to meet the needs of

today and tomorrow. Listed on the following two pages are a few of the projects which highlighted 1988.



New Denali Station

A 1,200-square-foot passenger depot, above, was built at Alaska's most popular park. It is constructed of spruce logs from Alaska's Kenai Peninsula and includes a waiting room, baggage-check area and restroom facilities. In addition, a passenger shelter was constructed at Talkeetna.

Head-End Power System

Locomotive No. 3009, below, became the second engine to have installed a self-contained, dual voltage, head-end power source. These two are the only GP40-2 engines equipped in this manner, making power cars almost obsolete and allowing an additional revenue-producing car to be hauled. The locomotives provide electricity for summer passenger equipment and for Keep From Freezing service in winter. The Mechanical Department has begun work on No. 3011, which should be completed by summer of 1989.



Seward Passenger Service

The thrice-weekly summer service between Anchorage and Seward was continued in 1988 because of its popularity in 1987. With community assistance, a passenger waiting shelter was built in Seward to protect travelers.

Ridership on this route improved nearly 40 percent over 1987. As a result, in 1989 a five-times-weekly service is planned.



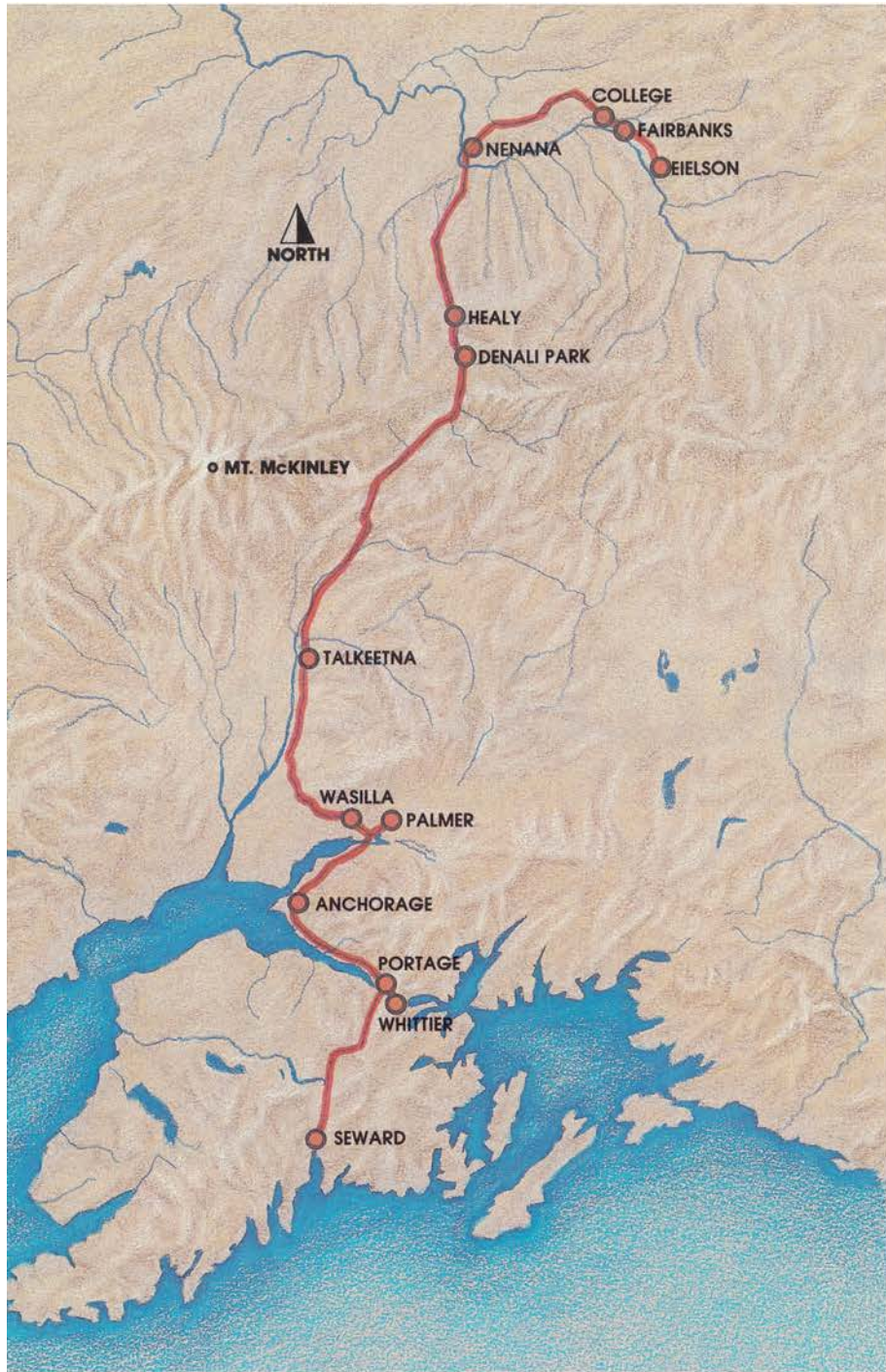
Whittier Tunnel Rehabilitation

Welder Tom Eastham, above, worked on the first phase of a multi-year program to upgrade the tunnels between Portage and Whittier. Crews completed half of the 13,344-foot Whittier Tunnel in six days, replacing ballast and ties, installing a new drain system and improving clearance. This was the first substantial track improvement in the tunnels in their 40-year history.

Automated Ticketing System

Information Systems installed this system in Fairbanks, Anchorage and Portage, replacing the manual procedures used for 65 years. In addition, a new telephone call sequencer was designed for the ticket offices by the Telecommunications and Signaling Department to improve routing and wait time for passenger requests.



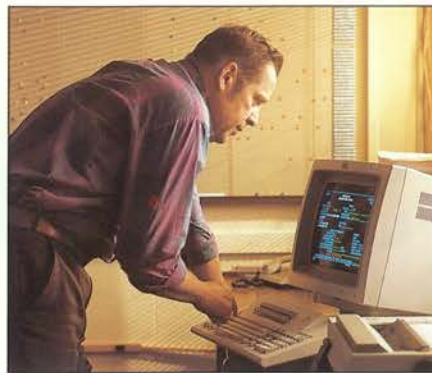


The Alaska Railroad serves more than 500 miles from Seward to Fairbanks.

Experimental Steel Tie Program At Portage

The 1988 tie program included the experimental installation of 189 steel ties near Portage. Maintenance of Way personnel plan to install 5,000 steel ties to test their performance in Alaska conditions. The Engineering Department also conducted

its regular summer maintenance by rebuilding eight grade crossings, turning nearly 21,000 feet of curve-worn rail, laying nearly 17,000 feet of new rail, installing more than 10,000 ties and surfacing 200 miles of track.



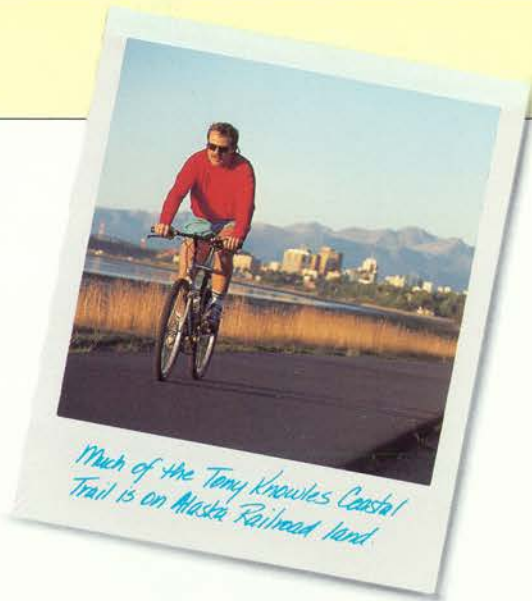
Crew Calling Computerized

Crew Dispatcher Don Barker, above, works with the automated crew-calling system, designed by Information Systems for the Transportation Department to improve crew management. Except for those with fixed starting times, train crews are called to work on a rotating basis. The new computer program tracks time worked for payroll purposes and ensures crew members are called in the proper order.

Nenana Defect Detector

The second to be installed, joining last year's detector at Willow, this state-of-the-art equipment detects hot wheels, hot bearings, high or wide clearance problems and dragging equipment on passing trains. About 10 seconds after a train clears the detector, crews are notified by radio of any problems. The equipment improves train efficiency and helps reduce operating costs.

Serving Our Communities



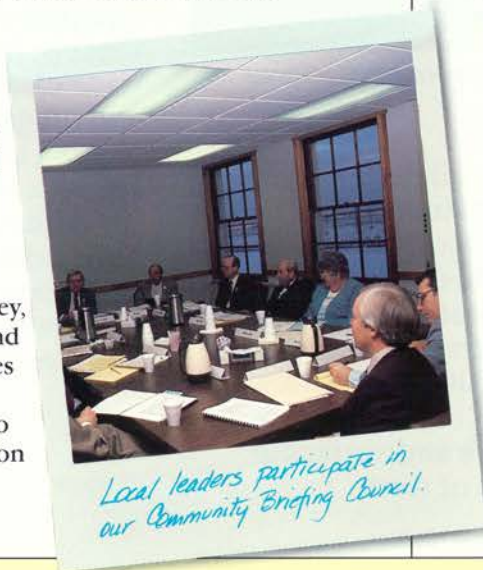
Much of the Tony Knowles Coastal Trail is on Alaska Railroad land.

TO HAVE GOOD NEIGHBORS, A COMPANY MUST BE A GOOD NEIGHBOR.

The phrase “getting involved” sounds so simple, but it takes a measure of effort. Getting and staying involved in community issues is a big part of the Alaska Railroad’s overall philosophy.

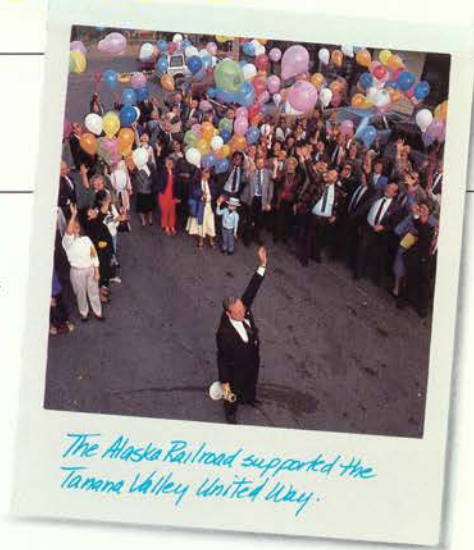
We want people to know who we are, what we are, why we operate as we do, and how they benefit when we do our work well. The Alaska Railroad could no more ignore the communities in which we operate than we could ignore our customers. The Alaska Railroad must work in harmony with each community to create a winning environment for all. Our employees are active, too, in supporting non-profit groups and organizations to make their communities better places to live.

In an effort to enhance our community relationships, the Alaska Railroad created a Community Briefing Council composed of representatives appointed by local governments in Fairbanks, Nenana, Matanuska-Susitna Valley, Anchorage, Whittier and Seward. These delegates meet quarterly with railroad management to exchange information on topics relating to each



Local leaders participate in our Community Briefing Council.

community, such as land use and policy, community events, passenger service needs, railroad operations, road and highway crossings, and port operations.



The Alaska Railroad supported the Tanana Valley United Way.

Community input is also needed for our Citizens Advisory Committee, whose members determine how we distribute our charitable contributions budget. Last year over \$50,000 was dispersed to more than 100 non-profit entities, including those funded by United Way.

Another \$40,863 was contributed by Alaska Railroad employees in support of the United Way agencies in Anchorage, the Kenai Peninsula, Mat-Su Borough and Fairbanks. Our employees also serve on numerous committees and boards, act as coaches and scout leaders, and volunteer countless hours to non-profit organizations throughout the Railbelt.

Corporate contributions to our neighbors frequently go beyond financial assistance. Other donations include railroad ties, passenger or freight transportation, right-of-way and land use, and many other items.

These contributions help generate goodwill by

allowing the Alaska Railroad to get involved with varied community projects in which we otherwise wouldn't have a role.

Used railroad ties are possibly the single most-requested item. Hundreds of ties were donated in 1988 to the Eagle Scout Troop 229 in Eagle River, the Alaska Zoo, Chugiak Children's Services, and the North Pole Chamber of Commerce, to name just a few.

Many organizations request passenger tickets for fundraising activities such as raffles and prize drawings. The Alaska Railroad granted tickets in 1988 to more than 50 non-profit agencies up and down the Railbelt. In addition, the Alaska Railroad operated special trains last year to community events such as the Willow Winter Carnival and the Alaska State Fair.

While these trains provide little income to the railroad, they are an immeasurable factor in bringing our neighbors together. Other specials in 1988 included a train for the opening of the state prison in Seward, a Whittier-Anchorage trip for the Prince William Sound Coalition, and a Christmas train for underprivileged and handicapped children in association with the Anchorage YMCA.

The railroad, in conjunction with Alaska Hydro-Train, provided transportation for one trailer per month of food from Seattle to Anchorage. The Food Bank of Alaska used the food to feed many hungry families or individuals who were temporarily without the means to purchase food.

The Alaska Railroad tries to accommodate even the most complicated requests. One such appeal in 1988 was for transportation of the McDonalds Fire Safety House. A scale version of an actual home, the house is a mobile educational tool for teaching fire safety to elementary school children in communities from Fairbanks to the Kenai Peninsula.

At the Alaska Railroad we want children to learn about railroad safety, too. Our Health, Safety and Environment Department annually schedules "Operation Lifesaver" programs at Railbelt elementary schools. This national program promotes railroad safety for all ages. In 1988, 14 schools hosted presentations, reaching an estimated 3,000 children.

The railroad's land use procedure is another community-oriented arrangement which has become corporate policy. The railroad owns



Joyce Maines teaches students railroad safety.

about 36,000 acres of land, of which a large part is right-of-way. Some of the land is bordered by cities and towns. Many of these parcels of land are leased to various local governments at little or no charge.

For instance

railroad property is leased by the Mat-Su Borough for a 141-acre park in Talkeetna, by the City of Seward for a marina site, by the Municipality of Anchorage for a number of recreational areas including six acres used for construction of the Tony Knowles Coastal Trail, and by the state of Alaska for the Whittier ferry terminal.

The Alaska Railroad recognizes that our future land-use decisions could be of great interest to the public. Therefore, in 1988 the corporation offered the public an opportunity to pinpoint those lands in which citizens or communities have a particular interest. As a result, a High Public Interest Lands Procedure was developed, establishing a method for future leasing and development of such property.

Our history of community service and cooperation is important to us. The Alaska Railroad accepts our role as a major corporate entity in Alaska with serious responsibilities to our neighbors. As the eighth largest employer in the state, the railroad has become an effective leader in business and civic matters. We will continue to strive to be one of the most community-oriented businesses in Alaska.

"Thank you very much for getting us the used railroad ties...they are making North Pole a better and more beautiful community."

— North Pole Community Chamber of Commerce

"The 'off-campus training'... was WONDERFUL! Of course the highlight of the morning was the trip to the shops where we saw, among other things, how wheels are made round again!"

— Anchorage Museum of History and Art Docents Program

"Thanks for the good support in making our Ice Festival 1988 the best one ever! We could not have done it without your enthusiasm and corporate dollars."

— Greater Fairbanks Chamber of Commerce



Railroad employees challenged Alaska Airlines to raise money for United Way.

TOWARD A BRIGHTER FUTURE

The Alaska Railroad Corporation has established itself as a viable component of the transportation network in Alaska. It has proven it can successfully manage itself even in the worst of economic times. The question is, where do we go from here? Three alternatives readily present themselves as answers. First, the state can continue to operate the railroad as it is. Second, the state can sell the railroad to the private sector. Third, the state can use the railroad to develop Alaska's tremendous storehouse of natural resources such as timber and minerals. Let's explore each of these options in more detail.

The Status Quo

The current management and organization of the railroad was established in 1984 with the passage of the Alaska Railroad Corporation Act (ARCA). This act created the corporation as an entity separate from state government with a

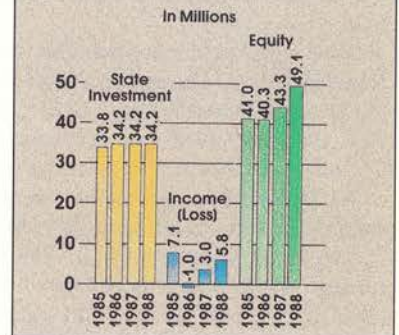
mandate to conduct its operations on a self-sustaining basis, and provide safe, efficient, economical levels of transportation. The railroad has more than met that challenge and is one of the most successful state operations along with the Alaska Permanent Fund. One of the common elements both the railroad and the fund have is their financial independence from state government.

The legislation which created the corporation must remain intact and the concept of a for-profit business must be the central theme for the status quo to continue to be a viable alternative.

A Private Line

The sale of the railroad to the private sector was one of the primary goals of the legislature when ARCA was passed. The legislature intended "to create a viable economic entity...pending eventual sale of the railroad to the private sector..." This alternative could allow the state to reap a

INVESTMENT ANALYSIS



substantial return on its investment because the value of the railroad has appreciated considerably since state ownership.

However, a privately owned railroad might discontinue operating unprofitable passenger service to isolated Bush communities along the railbelt. Further, private ownership could preclude the state from influencing the direction the railroad might take, especially with respect to future economic development. Nevertheless, many joint ventures between state and private companies have proven to be successful and it is possible this form of cooperation could be successful between the state of Alaska and a private Alaska Railroad.

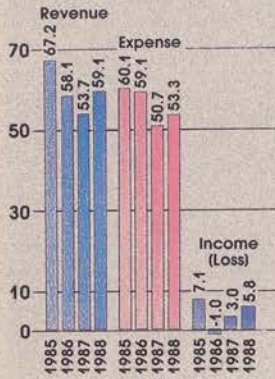
A Development Tool

Throughout Alaska's history, the Alaska Railroad has been instrumental in opening up the interior of Alaska to development and has given the most populous stretch of Alaska its name, "the Railbelt area", which stretches from the ports of Seward and Whittier through Anchorage to Fairbanks.

Originally the railroad was envisioned by private business as a means of opening up the Matanuska Valley coal fields and the gold mines and gold streams near Fairbanks. The railroad accomplished this mission, but until the state purchase in 1985 did little to expand upon its original charter.

FINANCIAL

In Millions



The state is the second-largest landowner in Alaska behind only the federal government and controls access to vast natural resources. When Alaska was given the opportunity to purchase the railroad from the federal government the railroad was viewed as a means to move to market the tremendous timber resources located along the railbelt. State leaders believed the railroad could be expanded into areas of great mineral deposits to build the infrastructure so sorely needed within the state. In other words, a state-owned railroad was envisioned as a tool for economic development which would “jump start” long-range projects where private concerns would not have the financial ability to build the transportation network.

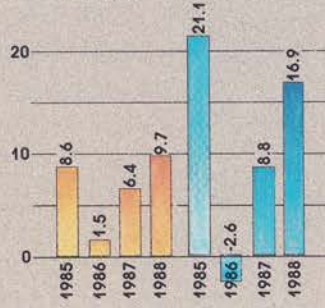
Expansion Routes

What are some of these projects? Discussions have ranged from expansion to the North Slope to linking with the Canadian rail network in British Columbia. The

REINVESTMENT AND RETURN

Funds Available
In Millions

Rate of Return
In Percent



list is potentially endless and is only limited by the imagination; but a few of the more practical plans include:

Extending the railroad from Nenana to the Yukon River would allow for an additional six weeks of traffic and deeper draft barges than are currently available by using the Tanana River as a waterway to the Yukon.

Relocating the Anchorage Yard to Eagle River would open the Port of Anchorage for industrial development or provide for expansion of tourist-related projects such as the Municipality of Anchorage’s Ship Creek Development Project.

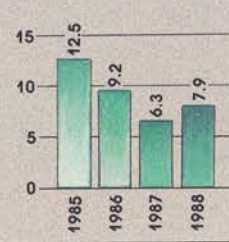
Relocating the Fairbanks Yard would free land for development in downtown Fairbanks.

Extending the railroad to Fire Island would help provide world-class services to the proposed new port just west of Anchorage.

Extending the railroad from Houston to Point MacKenzie would serve a new port proposed by the Mat-Su Borough along Knik Arm.

CAPITAL SPENDING PROGRAM

In Millions
Program Expenditures



Non-contiguous expansion of the railroad along the western coast of Alaska would open year-round deep-water ports in Norton Sound near Nome, as well as provide for development of the Ambler mining district, rich in copper and other strategic mineral reserves.

Tomorrow And Beyond

A 1988 Commonwealth North study of the railroad and its future stated, “Alaska is one of the few places in the world where a wealth of mineral resources has failed to develop significant railroad activity since the early 19th century. Railroads are the key to developing northern countries. Canada and Russia both have demonstrated this. Only in Alaska have we been slow to take advantage of this fundamental economic truth.”

So, what is the future of the Alaska Railroad? These are just three of the many answers. The issues should be explored through healthy public debate and finally resolved by the real owners of the railroad — the citizens of Alaska.

Expansion Routes



1. HOUSTON TO WEST COOK INLET



2. NENANA TO TANANA



3. NOME TO BROOKS RANGE AND SEWARD PENINSULA

BOARD OF DIRECTORS

Since joining the Alaska Railroad Corporation Board of Directors in 1988, I have witnessed a dedicated commitment to make this railroad a highly resourceful and capable business. Every employee, corporate manager and board member has had a role in making the Alaska Railroad a successful transportation company.

This commitment is readily demonstrated by the way the railroad operates today: efficient, enthusiastic, and service oriented. We have become more competitive because we work smarter. We prove ourselves daily by handling freight and passengers competently and manage our people fairly and effectively.


The Board of Directors has provided quality leadership by developing good corporate policies which serve as a framework for the future. On this framework, corporate management and employees have built a strong, self-sufficient corporation which will serve Alaskans for many years.

A note of thanks is due each employee and board member for their continued dedication and support of the Alaska Railroad. On their behalf, I am pleased to present this report on the railroad's successful record for 1988.

Sincerely,



George M. Sullivan, Chairman
Board of Directors



Members of the Board of Directors, left to right, include Frank Chapados, vice chairman; Mark Hickey, commissioner of transportation and public facilities; George Sullivan, chairman; Lewis Dickinson, and Gerald Valinske. Not shown are Myron Christy and Tony Smith, commissioner of commerce and economic development.

STATEMENT OF
MANAGEMENT'S
FINANCIAL
RESPONSIBILITY

ALASKA RAILROAD CORPORATION

P.O. Box 107500 • Anchorage, Alaska 99510-7500



February 17, 1989

Management is responsible for the preparation, integrity and objectivity of the Corporation's financial statements and other financial information appearing in this report. The financial statements are prepared in conformity with generally accepted accounting principles and in the judgement of management, present fairly and consistently the Corporation's financial position and results of operations.

Throughout 1988 the Corporation maintained a system of internal accounting controls and procedures which are continually reviewed and supported by written policies and guidelines and supplemented by audit review. The system provides reasonable assurance that assets are safeguarded against loss from unauthorized use and that the books and records reflect the transactions of the Corporation and are reliable for the preparation of financial statements. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgements by management.

The Board of Directors pursues its oversight responsibilities for the financial statements and corporate conduct through its Audit Committee. The Audit Committee is composed of directors who are not officers of the Alaska Railroad Corporation. It meets regularly with members of management and the independent accountants to discuss the adequacy of the Alaska Railroad's internal controls and financial statements.

During 1988, substantial progress was made in improving the Corporation's cash flow, resulting in the pay off of all short-term debt. Cash flow improvements resulted from a two-year effort to revamp the Corporation's credit and collection procedures.

The Corporation's financial statements are audited by Ernst and Whinney, independent certified public accountants. Their audit is conducted in accordance with generally accepted auditing standards which include a study and evaluation of the Corporation's system of internal accounting controls. The report of the independent accountants is below.

Marvin J. Yetter
Vice President, Finance

REPORT OF INDEPENDENT AUDITORS

Board of Directors
Alaska Railroad Corporation
Anchorage, Alaska

We have audited the accompanying balance sheets of Alaska Railroad Corporation as of December 31, 1988 and 1987, and the related statements of income, equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the

financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Alaska Railroad Corporation as of December 31, 1988 and 1987, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Anchorage, Alaska
February 17, 1989

FINANCIAL STATEMENTS

Balance Sheets

	December 31	
	1988	1987
	(In Thousands)	
ASSETS		
CURRENT ASSETS		
Cash and temporary investments—Note C	\$ 1,862	\$ 1,915
Accounts receivable, less allowance for bad debts of \$425,000 in 1988 and \$655,000 in 1987	7,598	7,090
Operating materials and supplies	2,497	2,203
Other current assets	278	1,041
TOTAL CURRENT ASSETS	12,235	12,249
PROPERTY AND EQUIPMENT—Note E		
Road	27,374	22,884
Equipment	27,478	24,917
Road materials and supplies	1,701	1,438
Construction in progress	1,145	557
	57,698	49,796
Less accumulated depreciation	(11,084)	(7,206)
	46,614	42,590
Land—Note D	13,850	13,850
	60,464	56,440
OTHER ASSETS		
Restricted funds		135
Restricted lease proceeds—Note E	220	220
	<u>\$ 72,919</u>	<u>\$ 69,044</u>
 LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 2,039	\$ 2,209
Payroll liabilities	3,351	3,449
Notes payable		1,665
Current portion of long-term debt—Note F	290	199
Current portion of capital lease obligations—Note E	2,411	2,345
Other accrued liabilities	1,772	1,512
Deferred revenues	344	417
TOTAL CURRENT LIABILITIES	10,207	11,796
LONG-TERM DEBT, less current portion—Note F	2,362	449
CAPITAL LEASE OBLIGATIONS, less current portion— Note E	11,205	13,460
EQUITY		
Contributed capital	34,174	34,174
Retained earnings	14,971	9,165
	49,145	43,339
	<u>\$ 72,919</u>	<u>\$ 69,044</u>

See notes to financial statements.

FINANCIAL STATEMENTS

Statements Of Income

	Year Ended December 31,	
	1988	1987
	(In Thousands)	
Operating revenue:		
Freight—Note H	\$ 44,871	\$ 39,371
Passenger	5,601	5,434
Other	3,683	3,494
	54,155	48,299
Operating expense:		
Transportation	14,214	13,205
Ways and structures	11,263	10,119
Equipment	11,077	10,592
General and administrative	10,974	11,303
Depreciation	3,878	3,421
	51,406	48,640
INCOME (LOSS) FROM OPERATIONS	2,749	(341)
Other income (expense):		
Real estate, less direct expenses of \$315,000 in 1988 and \$385,000 in 1987	4,438	4,821
Interest income	145	198
Interest expense	(1,526)	(1,661)
	3,057	3,358
NET INCOME	\$ 5,806	\$ 3,017

See notes to financial statements.

Statements Of Equity

	Contributed Capital	Retained Earnings
	(In Thousands)	
Balance at December 31, 1986	\$ 34,174	\$ 6,148
Net income for the year ended December 31, 1987		3,017
Balance at December 31, 1987	34,174	9,165
Net income for the year ended December 31, 1988		5,806
Balance at December 31, 1988	\$ 34,174	\$ 14,971

See notes to financial statements.

FINANCIAL STATEMENTS

Statements Of Cash Flows

	Year Ended December 31,	
	1988	1987
	(In Thousands)	
OPERATING ACTIVITIES		
Net income	\$ 5,806	\$ 3,017
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,878	3,421
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	(508)	3,439
Increase in operating materials and supplies	(294)	(418)
Decrease in other assets	898	960
Decrease in accounts payable and accrued expenses	(268)	(1,869)
Increase (decrease) in other accrued liabilities	260	(663)
Decrease in deferred revenues	(73)	(112)
NET CASH PROVIDED BY OPERATING ACTIVITIES	9,699	7,775
INVESTING ACTIVITIES		
Purchase of road and equipment	(7,051)	(3,820)
Decrease (increase) in road materials and supplies	(263)	947
Decrease (increase) in construction in progress	(588)	788
NET CASH USED IN INVESTING ACTIVITIES	(7,902)	(2,085)
FINANCING ACTIVITIES		
Payments on short-term debt	(1,665)	(4,761)
Proceeds from long-term debt	2,402	
Payments on long-term debt	(248)	(183)
Payments on capital lease obligations	(2,339)	(1,964)
NET CASH USED IN FINANCING ACTIVITIES	(1,850)	(6,908)
DECREASE IN CASH AND CASH EQUIVALENTS	(53)	(1,218)
Cash and cash equivalents at beginning of year	1,915	3,133
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 1,862	\$ 1,915

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

December 31, 1988

Note A ORGANIZATION AND OPERATIONS

Congress authorized construction of the Alaska Railroad (Railroad) in 1914 and operations began in 1923. The federal government operated the Railroad until its sale to the State of Alaska in January 1985. The sale of the Railroad to the State of Alaska was authorized under the Alaska Railroad Transfer Act of 1982 (ARTA), which was signed into law on January 14, 1983. The Alaska Railroad Corporation (ARRC) is a public corporation created by the State of Alaska legislature to own and operate the Railroad and manage the Railroad's rail, industrial, port, and other properties. The ARRC commenced operations on January 6, 1985 and adopted the accounting policies of a commercial enterprise.

The ARRC operates 525 route miles, providing both freight and passenger services. The ARRC serves the Alaska cities of Anchorage and Fairbanks as well as the ports of Whittier, Seward, and Anchorage; Denali National Park; and military installations. Vessel and rail barge connections are provided from Seattle, Washington, and Prince Rupert, British Columbia.

Note B SIGNIFICANT ACCOUNTING POLICIES

CASH AND TEMPORARY INVESTMENTS: Temporary investments are carried at cost which approximates market value. For purposes of the Statements of Cash Flow, cash and cash equivalents include time deposits, certificates of deposit and repurchase agreements with original maturities of three months or less.

MATERIALS AND SUPPLIES INVENTORIES: Materials and supplies inventories are carried at the lower of cost (average cost) or market. Road materials and supplies include rail, ties, ballast, and other track materials. Because these items will generally be capitalized when placed into service, they are included in transportation properties.

PROPERTIES: Properties are stated at cost. Depreciation and amortization is computed on a straight-line basis over the estimated useful lives of the related assets. Preacquisition depreciable property is being depreciated on a straight-line basis over its estimated original remaining life of five years.

CAPITALIZED INTEREST: The ARRC capitalizes interest costs as part of the cost of constructing major facilities and equipment. Interest costs of \$114,000 and \$161,000 were capitalized in 1988 and 1987, respectively.

INCOME TAXES: As a public corporation, the ARRC is exempt from Federal and State income taxes.

Note C CASH AND TEMPORARY INVESTMENTS

All cash and temporary investments bear interest at competitive rates and are summarized at December 31, 1988 as follows, in thousands:

	Carrying Amount	Bank Statement Balance
Checking accounts	\$ (1,167)	\$ 418
Certificates of Deposit	1,000	1,000
Repurchase agreements	2,029	2,029
TOTAL CASH AND TEMPORARY INVESTMENTS	\$ 1,862	\$ 3,447
Insured by FDIC	\$ 200	\$ 200
Uninsured and uncollateralized	1,662	3,247

Note D LAND

Certain parcels of land are leased under agreements which are cancellable upon 90 days notice by the lessee. The lease terms vary from two to fifty-five years. Annual rentals on the leases were approximately \$4,753,000 in 1988 and \$5,206,000 in 1987.

Note E LEASES

The ARRC leases certain locomotives, freight cars, computer equipment and other property under capital leases. Future minimum lease payments for capital leases as of December 31, 1988 are summarized as follows, in thousands:

Year Ending		
December 31,	1989	\$ 3,558
	1990	3,584
	1991	3,410
	1992	3,222
	1993	2,286
	Thereafter	905
Total minimum lease payments		16,965
Less interest		(3,349)
Present value of net minimum lease payments (including \$2,411,000 classified as current)		<u>\$ 13,616</u>

Capitalized leased assets aggregated \$20,318,351 and \$20,168,351 at December 31, 1988 and 1987, respectively. The related accumulated amortization was \$4,146,811 and \$2,621,777 at December 31, 1988 and 1987, respectively. Amortization expense is included in depreciation expense in the statement of income.

A lease for freight cars requires that \$220,000 be kept on deposit with a financial institution for the term of the lease agreement.

NOTES TO FINANCIAL STATEMENTS

December 31, 1988

Note F LONG-TERM DEBT

Long-term debt at December 31, 1988 consists of the following, in thousands:

Note payable, unsecured, due in monthly installments of \$20,349 including interest at 8.15 percent	\$	449
Note payable, unsecured, due in annual installments of \$20,965, non-interest bearing		231
Note payable, secured by equipment, paid through freight credits, including interest at 8 percent		<u>1,972</u>
		<u>\$ 2,652</u>
Less current portion		<u>(290)</u>
		<u>\$ 2,362</u>

Long-term debt maturities are as follows, in thousands:

Year Ending		
December 31,	1989	\$ 290
	1990	313
	1991	84
	1992	1,818
	1993	21
	Thereafter	<u>126</u>
		<u>\$ 2,652</u>

Note G PENSION PLAN

The ARRC has a defined benefit pension plan (the Plan) that covers all nonrepresented permanent employees who have not remained in the Civil Service Retirement System and permanent employees who are members of collective bargaining units which have bargained to become covered by this plan. Benefits under this plan are generally based upon the employee's years of service and final average compensation. The ARRC's funding policy is to contribute to the Plan for each year the amount equal to the net periodic pension cost. Contributions are made continuously throughout the year.

The funded status of the pension plan at December 31, 1988 and 1987 is as follows, in thousands:

	1988	1987
Actuarial present value of benefit obligations:		
Accumulated benefit obligation-vested	\$ (1,528)	\$ (758)
Accumulated benefit obligation non-vested	<u>(1,370)</u>	<u>(1,145)</u>
	<u>\$ (2,898)</u>	<u>\$ (1,903)</u>
Projected benefit obligation for service rendered to date	\$ (3,602)	\$ (2,519)
Plan assets at fair value	<u>3,032</u>	<u>1,487</u>
Projected benefit obligation in excess of plan assets	(570)	(1,032)
Unrecognized net transition obligation	791	851
Unrecognized net (gain) loss	<u>(221)</u>	<u>181</u>
PENSION LIABILITY	<u>\$ -0-</u>	<u>\$ -0-</u>

Net pension costs are included in the following components, in thousands:

	1988	1987
Service cost—benefits earned during the period	\$ 1,463	\$ 244
Interest cost on projected benefit obligation	287	129
Return on plan assets	(171)	(25)
Net amortization and deferral	<u>55</u>	<u>8</u>
NET PERIODIC PENSION COSTS	<u>\$ 1,634</u>	<u>\$ 356</u>

Actuarial assumptions used in 1988 and 1987 to develop net periodic pension costs were:

	1988	1987
Assumed discount rate	8.5%	8%
Assumed salary increase rate	6%	7%
Expected long-term rate of investment return	8%	8%

Assets of the ARRC's pension plan are invested in fixed income securities and common stocks.

Federal employees who transferred to the ARRC will continue participation in the Civil Service Retirement System. The contribution required of the ARRC is 7 percent of the transferred employees' base pay. Pension expense related to the Civil Service Retirement System is \$1,114,000 and \$1,118,000 for 1988 and 1987, respectively.

Note H MAJOR CUSTOMERS

Two ARRC customers accounted for 24 percent and 15 percent of freight revenue for the year ended December 31, 1988. In 1987, two customers accounted for 22 percent and 16 percent of freight revenue.

Note I CONTINGENCIES

The ARRC is a defendant in a lawsuit filed by certain residents of Crown Point, Alaska against the ARRC and certain other defendants. This lawsuit arose from an incident on March 2, 1986 when a tank car containing a urea formaldehyde mixture leaked vapors after it was moved to a Railroad siding in Crown Point, Alaska. The ARRC is also a defendant in other legal proceedings related to the conduct of its business. Provision has been made in the financial statements for possible losses from litigation. In the opinion of management, the outcome of the litigation will not have a material effect on the financial position of the ARRC.

Note J INSURANCE

The ARRC is self-insured to certain limits for employee health benefits, and personal property and casualty damage. The ARRC is also self-insured against workers' compensation claims. The ARRC employs a full time "Risk Manager" who monitors all cases involving ARRC liability.



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