FRISCO

Annual Report 1965

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY

GENERAL OFFICES — 906 Olive Street, St. Louis, Mo. 63101

DIRECTORS

Term expires 1966

ROBERT E. GARRETT........................*Birmingham, Ala.*
J. E. GILLILAND........................*St. Louis, Mo.*
BRUCE K. GOODMAN........................*Evanston, Ill.*
HUGH L. HARRELL........................*Oklahoma City, Okla.*
F. G. MCCLINTOCK........................*Tulsa, Okla.*

Term expires 1967

E. L. BRUCE, JR........................*Memphis, Tenn.*
THOMAS E. DEACY, JR........................*Kansas City, Mo.*
GALE F. JOHNSTON........................*St. Louis, Mo.*
WM. A. MCDONNELL........................*St. Louis, Mo.*
ELLIOT H. STEIN........................*St. Louis, Mo.*

Term expires 1968

LESTER E. COX........................*Springfield, Mo.*
B. B. CULVER, JR........................*St. Louis, Mo.*
JUDSON S. SAYRE........................*Chicago, Ill.*
LEWIS B. STUART........................*St. Louis, Mo.*
C. P. WHITEHEAD........................*St. Louis, Mo.*

EXECUTIVE COMMITTEE

LESTER E. COX, B. B. CULVER, JR., J. E. GILLILAND, WM. A. MCDONNELL, JUDSON S. SAYRE, LEWIS B. STUART, C. P. WHITEHEAD

FINANCE COMMITTEE

WM. A. MCDONNELL, *Chairman* — ELLIOT H. STEIN — C. P. WHITEHEAD

OFFICERS

J. E. GILLILAND	*Chairman and President*	St. Louis, Mo.
R. C. GRAYSON	*Vice President-Operation*	Springfield, Mo.
E. D. GRINNELL, JR.	*Vice President and General Counsel*	St. Louis, Mo.
E. G. KREYLING, JR.	*Vice President-Traffic-Ind. Development*	St. Louis, Mo.
H. B. PARKER	*Controller*	Springfield, Mo.
J. K. BESHEARS	*Vice President-Personnel*	Springfield, Mo.
R. P. DECAMARA	*Vice President-Staff*	Springfield, Mo.
G. M. RAYBURN	*Secretary and Treasurer*	St. Louis, Mo.

TRANSFER AGENT

Transfer Agent for Common and Preferred Stock
First National City Bank, 55 Wall Street, New York, N. Y. 10015

REGISTRAR

Registrar for Common and Preferred Stock
Bankers Trust Company, 16 Wall Street, New York, N. Y. 10015

Registrar for Bonds, Debentures, and Equipment Trust Certificates
First National City Bank, 55 Wall Street, New York, N. Y. 10015

Annual meeting of Stockholders second Tuesday in May of each year

FRISCO FACTS

	1965	1964
Operating revenues	$148,678,860	$140,117,060
Operating expenses	$109,431,501	$107,576,716
Ratio of expenses to revenues	73.60	76.78

	1965	1964
Taxes	$ 15,068,307	$ 12,218,608
Taxes per share of Common Stock	$ 6.81	$ 6.46
Income available for fixed charges	$ 18,798,733	$ 15,418,301
Fixed charges	$ 5,790,976	$ 5,674,833
Times fixed charges earned	3.25	2.72
Contingent interest	$ 1,976,398	$ 2,620,112
Income before dividends	$ 11,031,359	$ 7,123,356
Preferred dividends — $5 per share	$ 1,237,050	$ 1,243,050
Earnings per Common share	$ 4.43	$ 3.11
Dividends per Common share	$ 1.50	$ 1.40

	1965	1964
Freight revenue	$138,314,321	$129,041,361
Tons — revenue freight	32,502,107	30,397,212
Ton miles — revenue freight (thousands)	11,114,325	10,444,139
Avg. revenue per ton mile — revenue freight	1.244¢	1.236¢
Gross ton miles (thousands)	25,086,593	24,199,812
Train miles — freight	8,018,343	7,810,554
Gross ton miles per train mile	3,129	3,098
Average miles hauled — revenue freight	341.96	343.59
Gross ton miles per train hour	69,739	66,457

	1965	1964
Passenger revenue	$ 1,103,953	$ 1,471,620
Passengers carried	170,678	218,406
Passenger miles	42,301,080	52,356,132
Average revenue per passenger mile	2.610¢	2.810¢
Average distance carried	247.84	239.72
Train miles — passenger	1,826,167	2,194,615

	1965	1964
Average number of employes	8,487	8,718
Miles of road operated	4,939	5,054

J. E. GILLILAND
Chairman and President

To Frisco Stockholders:

The Frisco had its best year since 1953. Earnings rose to $11 million, 54.9% higher than in 1964 and equal to $4.43 per Common share on a greater number of shares outstanding. Revenues were the highest ever recorded by the Company.

Our performance continued to improve as the number of cents spent from each revenue dollar for operating expenses declined. Our fixed facilities became more modern, our operations more mechanized, our freight cars more specialized and our locomotives more powerful. The economy of the territory we serve not only expanded but also became more diversified as light and heavy industries continued to follow the center of population westward and move into areas once considered wholly agricultural. The quality of our traffic improved as a better "traffic mix" and heavier loading lifted the average revenue we received per car.

We took a number of steps to improve our railroad. These are discussed in the pages which follow. We also revised our capital structure. In October, we called our 4½% Second Mortgage Income Bonds which, in principal amount, totaled $25.1 million. In March 1966, we called fifty per cent of the 247,410 shares of our outstanding Preferred Stock. By these changes, we reduced our contingent interest payments by more than $1.1 million annually, improved our equity-debt ratio and reduced our Preferred dividend requirements by more than $600,000 annually. A detailed discussion of both transactions may be found on page 7.

With other railroads, we continue to remain alert to the many ramifications of mergers or other types of consolidations. Throughout the railroad industry there are a number of mergers presently under discussion or in more advanced stages of progress. These proposed consolidations are receiving our close attention as we carefully appraise every course of action open to us to protect the interests of your Company. Since November 1965, the Frisco and the Southern Railway have been engaged in joint studies to explore the feasibility of some form of consolidation. These studies are being progressed as rapidly as possible; no conclusions have been reached as yet but our security holders and the public will be kept informed of developments.

Our energies continue to be directed toward fostering traffic growth by attracting new industries to our lines and by retrieving traffic formerly lost to other forms of transport. We have had dramatic success with automobile traffic. In the last five years, our revenue from the movement of new automobiles has increased from $1.6 million in 1960 to $12.0 million in 1965. Each year our share of total factory shipments has continued to rise. In June 1965, Chrysler Corporation began construction of a new 800,000 square foot truck assembly plant adjacent to its existing automobile assembly plant located on our line at Fenton, Missouri, near St. Louis. This new plant, which will begin operation in 1966, will have a rated capacity of 20 trucks per hour.

Other major installations announced include a $20-million TV manufacturing plant to be opened in 1966 by Radio Corporation of America on our line at Memphis, Tennessee; a $77-million paper, lumber and plywood mill to be completed in 1968 by MacMillan, Bloedel & Powell River, Ltd. on our line at Kimbrough, Alabama and a $50-million paper mill and plywood plant to be completed in 1969-70 by Weyerhaeuser Company on our line at Columbus, Mississippi.

In Southeastern Missouri, newly-discovered mineral deposits — among them lead, zinc and iron ores — also promise additional traffic in the years ahead. Known generally as the new Missouri Mineral Belt, the area is receiving an increasing amount of attention by lead mining and smelting interests. Recent announcements indicate that these development activities in Missouri will just about double domestic lead production by 1968. To serve these mines, mills and smelters, the Frisco has begun construction of a new line running from Keysville to Buick, Missouri, a distance of 32.7 miles. We expect the line to be in operation by the latter half of 1967.

Through a marketing and research program inaugurated several years ago we are searching for other ways of increasing traffic via the Frisco by offering selected rate adjustments, better train schedules, volume rates and modern equipment.

An integral part of our effort to offer improved service at the lowest possible price is a continuing cost-control program. Through increased efficiency, our operating ratio — the number of cents spent from each revenue dollar for operation — was reduced from 76.78 in 1964 to 73.60 in 1965, as the arbitration awards of 1964 enabled us to eliminate certain unnecessary crew assignments on freight trains and in our yard operations. Additional economies are expected from recent branch-line abandonments and from the elimination of eight unprofitable passenger trains in September 1965.

Looking ahead, we are encouraged by the vigor of the economy. Barring a downturn or a wheat crop failure, we expect 1966 to be another good year for the Frisco, although one in which we will have higher labor costs and greater expenditures for rail laying as we step up our replacement of lighter rail with new 132-lb. continuous welded ribbon rail on our high density lines.

In presenting the report which follows, the Directors join me in thanking our shareholders, patrons and employes for the understanding, help and loyalty which have made possible the results thus far attained.

Sincerely,

March 7, 1966

Chairman and President

NET INCOME

Net income of $11,031,359, before sinking funds, is the highest since 1953, and is equivalent to $4.43 per share of Common Stock versus $7,123,356, or $3.11 per share in 1964.

The improvement in earnings reflects higher revenues as well as a reduction in the number of cents spent from each revenue dollar for operation and was achieved despite declining tax credits. These tax matters are discussed in greater detail on pages 5 and 6.

For comparative purposes, net income for each of the past five years and the earnings per share of Common Stock are shown below:

	Net Income	Earnings per share of Common	Common shares outstanding at year end
1961........	$4,688,243	$1.78	1,837,936
1962........	6,051,007	2.51	1,842,236
1963........	6,754,496	2.93	1,865,111
1964........	7,123,356	3.11	1,891,287
1965........	11,031,359	4.43	2,213,125

DIVIDENDS

A dividend of $5.00 per share on the Preferred Stock was paid in quarterly instalments during the year. Four Common dividends of 37½ cents each were paid on March 15, June 15, September 15 and December 15, making a total of $1.50 for the year. These dividends were declared out of the earnings of 1964.

On January 25, 1966, the first quarterly dividend payment of $1.25 on the Preferred Stock was declared payable March 1, 1966 to holders of record February 4. To meet the requirements of the Company's Articles of Association with respect to the redemption of Preferred Stock, Preferred dividends for the remaining quarters of 1966 and all quarters of 1967 were declared payable on those shares which remain outstanding after the redemption date of March 16, 1966. See page 7.

Also on January 25, 1966, a dividend of $0.50 per share of Common Stock was declared payable March 15 to holders of record March 1.

These Preferred and Common dividends were declared out of the earnings of 1965.

OPERATING REVENUES

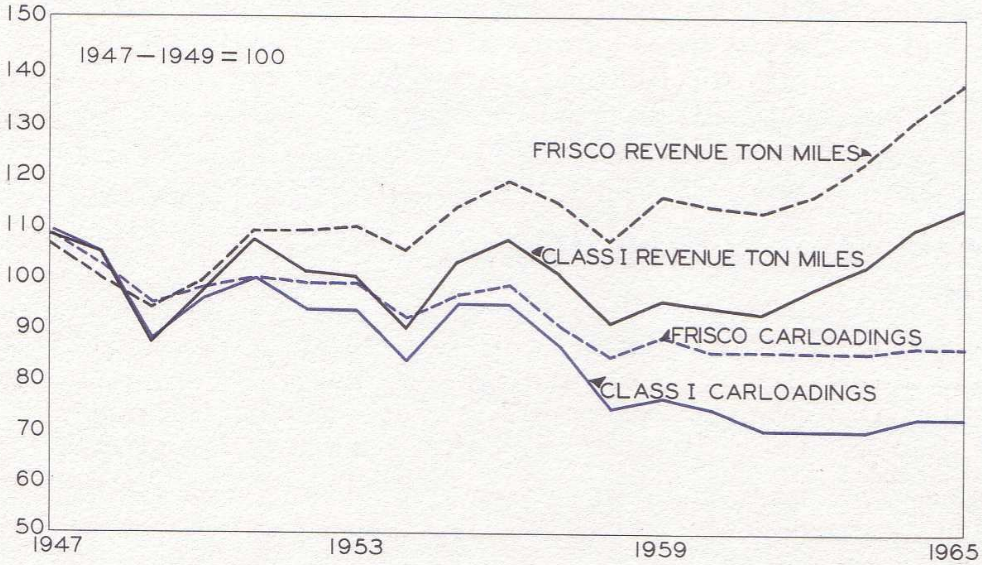
Operating revenues advanced strongly to $148,678,860, the highest in the history of the Company and 6.1% above the level of 1964, as the nation enjoyed excellent business activity.

Freight revenue set a new record of $138,314,321, up 7.2% from the 1964 level, with ton-miles of transportation service reaching a new all-time high. The year was one of continued economic expansion: industrial production rose 8%, automobile production climbed 22% and set a new record, steel production increased 6% and capital spending 16%. On the nation's farmlands, many major crops set new highs for yields. Winter wheat production was 6% above the 1959-63 average, cotton production nearly 3% above the average and soybean production 35% above the average.

Frisco revenues benefited from all of these influences. While carloadings of 760,447 were only 0.8% ahead of the year before, revenue ton-miles were up 6.4% and the average load per car increased 5.2%. The rail movement of commodities commanding a better-than-average revenue rate increased while lower-than-average rated traffic declined; as a result, the Frisco enjoyed a better "traffic mix" and its average revenue per car rose from $170.97 in 1964 to $181.89 in 1965.

Noteworthy were the gains scored in piggyback revenue and in the revenue received from the movement of new automobiles. These are discussed more fully on page 9. Revenue gains also were registered by paper and products, canned foods, iron and steel, ore and concentrates, forwarder traffic, forest products and flour-mill products.

Passenger revenue continued to fall from $1,471,620 in 1964 to $1,103,953 in 1965. In September, the operation of eight unprofitable passenger trains was discontinued with the approval of the Interstate Commerce Commission. A total of four trains remain in operation.



OPERATING EXPENSES

Operating expenses of $109,431,501 were up 1.7% as higher payroll costs, a greater volume of traffic, and enlarged programs for car rebuilding and rail laying exerted strong upward pressures on expenses. Despite these influences, increased efficiency and the elimination of certain unnecessary crew assignments on freight trains and in our yard operations enabled the Frisco to achieve an encouraging reduction in the number of cents spent from each revenue dollar for operation.

Year by year, the Frisco has continued to receive the benefits of a long range improvement program to modernize and mechanize its operations. Better rolling stock, more efficient yards, a sturdier roadbed and improved signaling and communication have been combined to soften the impact of rising costs. Below are shown the number of cents spent from each revenue dollar for the major subdivisions of operating expenses during 1965 as well as 1964.

	1965	1964
Transportation...........	36.18	38.34
Maintenance of Way......	13.05	12.82
Maintenance of Equipment	14.26	14.10
Other..................	10.11	11.52
Operating Ratio......	73.60	76.78

TAXES

Estimated taxes in 1965 totaled $15,068,307 versus $12,218,608 in 1964.

In 1965, net Federal Income tax credits were equivalent to $0.74 per share of Common Stock and increased Net Income to that extent; in 1964, these tax credits were equivalent to $1.00 per share of Common Stock.

For the year 1965, accelerated and guideline depreciation amounted to $2,523,000, or the equivalent of $1.14 per share of Common Stock which compares with $2,800,000 in 1964, or the equivalent of $1.48 per share of Common Stock.

Amortization of defense facilities (which terminated in 1965) was less than the amount of depreciation recorded in the accounts and charged to operating expenses in accordance with accounting requirements of the Interstate Commerce Commission. Therefore, Federal income tax accruals were increased and Net Income decreased in 1965 by $891,000, or the equivalent of a decrease of $0.40 per share of Common Stock which compares with $904,000 in 1964, or the equivalent of $0.48 per share of Common Stock. Since 1951, tax savings have accumulated to approximately $36,732,000.

Payroll taxes in 1965 totaled $5,206,442, an increase of 4.5% from the level of 1964. The Railroad Retirement tax during the first nine months was at the rate of 8⅛% and for the last three months at the rate of 7⅛% on employe earnings up to $450 per month; the Railroad Unemployment tax was at the rate of 4% on employe earnings up to $400 per month. On January 1, 1966, the Railroad Retirement tax rate was increased to 7.95% (of which 0.35% is for Hospital Insurance Benefits) on employe earnings up to $550 per month.

CHANGES IN WORKING CAPITAL

At year end, the Company had net working capital (excess of current assets over current liabilities) of $10,611,904 vs. $19,320,983 at the end of the previous year.

Sources of Funds (000)		
Net Income		$11,031
Depreciation & Other Non-Cash Charges		11,166
Proceeds Conditional Sale Agreement		1,849
Proceeds Equipment Trust Agreements		8,910
Proceeds Sale of Property & Salvage		2,012
Common Stock Issued — For Options Exercised $398 and For Conversion $11,999	$12,397	
LESS: Second Mortgage Income Bonds Converted	11,999	398
Miscellaneous		1,917
Total Sources		$37,283
Applications of Funds (000)		
Additions & Betterments — Road & Equipment		$20,578
Equipment Obligations Retired		7,255
Bonded Debt Retired:		
First Mortgage Bonds		850
Second Mortgage Income Bonds		13,100
Cash Dividends Paid		4,209
Total Applications		$45,992
Decrease in Net Working Capital		$ 8,709

Airslide car with roller bearings. Capacity: 2,600 cubic feet — 70 tons.

ELIMINATION OF SECOND MORTGAGE INCOME BONDS

The Company called for the redemption on October 20, 1965 of all of its outstanding Second Mortgage Income Bonds, Series A 4½%, totaling $25.1 million principal amount, at the redemption price of $1,036.125 per $1,000 principal amount of said Bonds. A total of $12,737,900 principal amount was presented for redemption and a total of $11,999,000 principal amount was converted into 299,975 shares of Common Stock, at the rate of 25 shares for each $1,000 Bond, in accordance with the conversion feature of the Bonds. A sufficient deposit has been made with the Trustee to redeem the remaining principal amount of $361,700 when presented.

As a result of eliminating the Second Mortgage Income Bonds, our shareholders' equity to long term debt ratio has improved from 1-1 at year end in 1964 to 1¼-1 at the same time in 1965.

Aerial view of Frisco's push-button yard at Tulsa, Oklahoma.

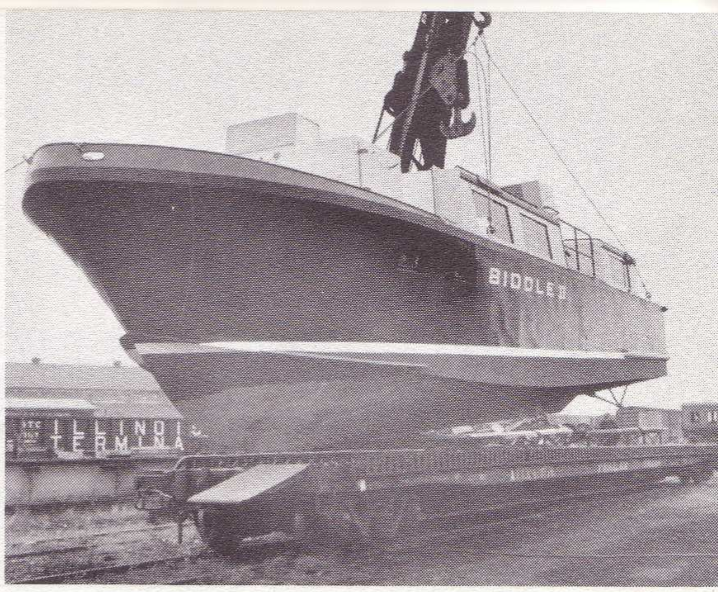
PREFERRED STOCK REDEMPTION AND CONVERSION

On January 25, 1966, the Board of Directors voted to call for redemption, on March 16, 1966, fifty per cent of the Company's outstanding Preferred Stock, Series A 5%, at the fixed redemption price of $100.00 per share plus $4.79 per share in declared dividends accrued but not previously paid. The shares called for redemption were selected by lot by the Company's Agent, the First National City Bank, New York, New York. Notices of redemption were published and mailed to Preferred stockholders on February 14, 1966.

Each Preferred share called for redemption was convertible into two shares of Frisco Common Stock up to, but not after, the close of business on March 1, 1966. Those Preferred holders who elected to convert and who held the Common Stock through March 1, 1966, received both the first quarterly Preferred dividend of $1.25 per share and the Common dividend of 50¢ per share.

Up to the close of business March 4, 1966, a total of 79,288 Preferred shares had been presented for conversion into 158,576 shares of Common Stock. Common Stock outstanding at the close of business on that date totaled 2,374,086 shares; Preferred Stock outstanding at that same time totaled 168,122 shares, including 47,230 shares called for redemption on March 16, 1966.

Piggyback or TOFC revenue on the Frisco rose 33% and set another new record in 1965.



A 59' boat loaded upon a railway flat car for movement via rail from the Mississippi River to the West Coast.

MULTI-LEVEL AUTO TRANSPORTS

Frisco revenue from the movement of new motor vehicles on multi-level railway equipment during the year 1965 rose 21.7% from the level of the year before and reached another all-time high of $12,059,142 as the Company hauled a total of 349,903 motor vehicles of various makes and models.

With each passing year, the movement of new motor vehicles via rail has shown consistent growth; in the last six years, revenue from this source has multiplied more than seven times and now constitutes almost nine per cent of all Frisco freight revenue.

The construction of a new Dodge truck assembly plant adjacent to Chrysler's existing automobile assembly plant on our line at Fenton, Missouri, near St. Louis, promises additional opportunities to enlarge our share of new factory shipments. The new plant will begin production in 1966.

TRAILER-ON-FLAT-CAR SERVICE (Piggyback)

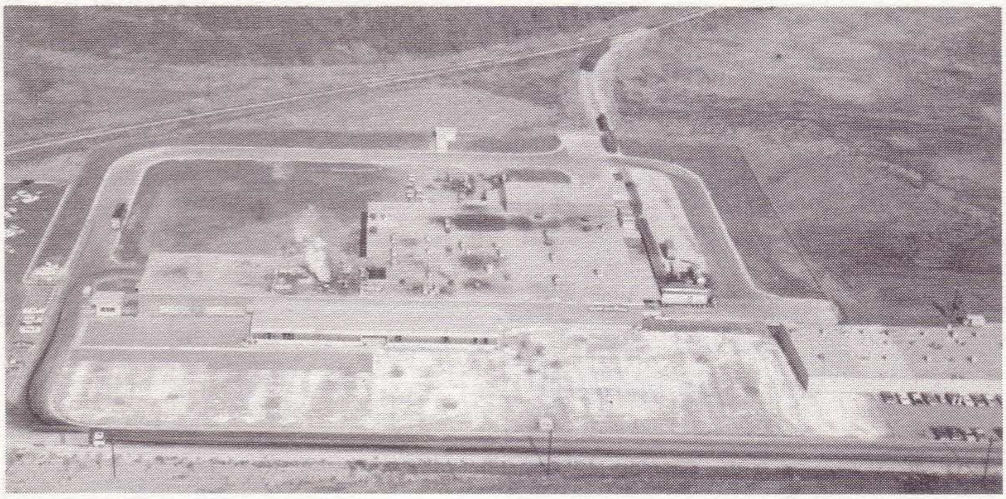
Piggyback service continued to demonstrate its growth potential as Company revenue from this source rose 33% from the level of the year before and continued unbroken a succession of new annual highs which stretch back to the inauguration of this service in 1955. In 1965, the Company loaded 26,004 highway trailers on railway flat cars for a total revenue of $4,576,580; in 1964, a total of 20,012 highway trailers were loaded on railway flat cars for a total revenue of $3,439,299.

In 1962, the Interstate Commerce Commission began a broad investigation of Trailer-on-Flat-Car service in the United States. In 1964, it handed down a decision which was in part adverse to your Company's interest. The Frisco joined with other railroads in an appeal to the U. S. District Court for the Northern District of Illinois in Chicago. That three-judge court has reversed the Commission's holding that motor and water carriers may use Trailer-on-Flat-Car service under railroad open tariffs. The court concluded that railroads may bar carriers of other modes from utilizing the railroads' open tariffs and that the use of such service by a motor carrier would be in violation of the requirement that it conduct its service by "motor vehicle" and "over public highways." The case is now on appeal in the Supreme Court.

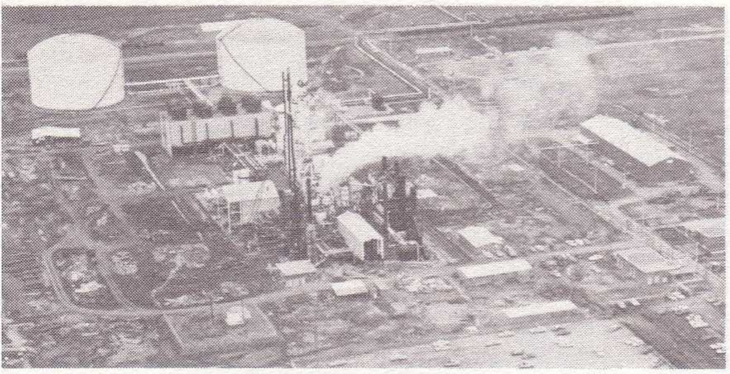
MARKETING

A specialized staff of traffic managers now is functioning as part of Frisco's efforts to improve sales. These managers are responsible for the Company's marketing strategy in such important industries as steel, cement, coal, chemicals, fertilizers, foods, and paper.

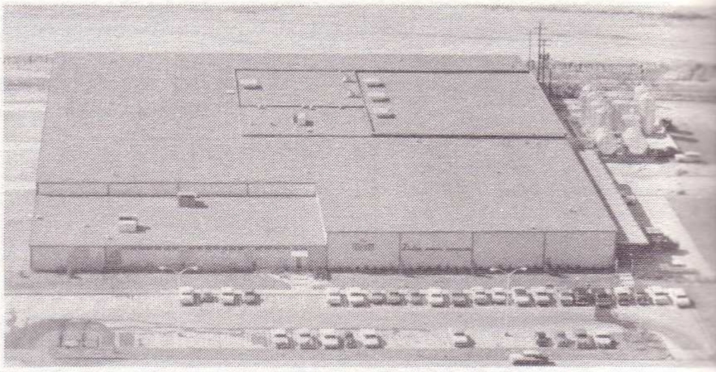
New plant of the Fischer Lime and Cement Company at Memphis, Tennessee.



Campbell Soup Company's new frozen food plant at Fayetteville, Arkansas.

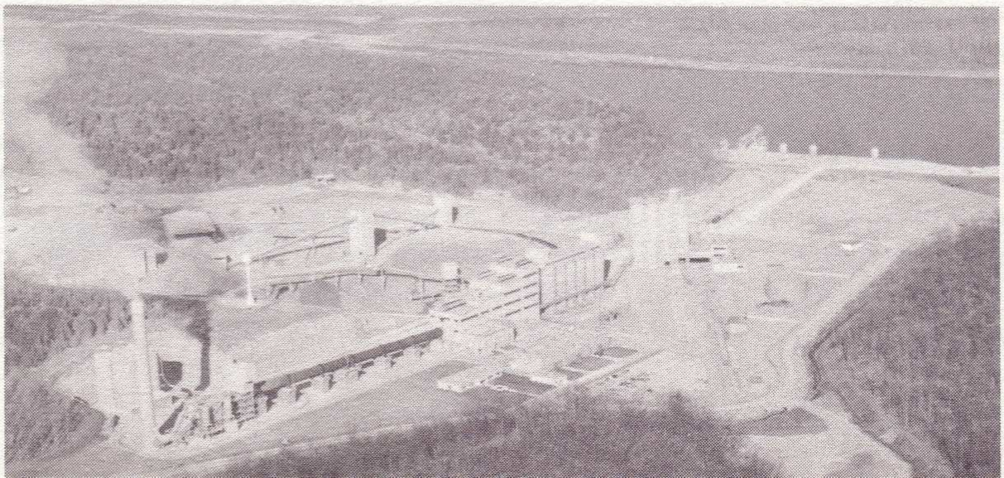


Continental Oil Company's new plant now under construction at Armorel, Arkansas.



Delta Chemical Corporation's new plant at Memphis, Tennessee.

New River Cement Company plant at Selma, Missouri.



Aggressive rate action designed to improve volume, quality of traffic, utilization of facilities, and profits continues to receive close attention. More emphasis is being placed on the total distribution concept as it is being practiced by our customers. Rates were published during the year which provide for unloading allowances and inter-modal transfer of commodities. Special attention was given to newsprint, wallboard, and cement rates. Past efforts and research in grain transportation are beginning to produce results and work will continue to improve Frisco's grain business both domestic and export.

Frisco's marketing efforts have been aided by sales and rate reports produced on electronic data processing equipment. New techniques and machines are being tested to improve our data information. Such areas as rate publication, automatic car movement reports direct to customers' computers, and quality control of service are being investigated.

Detailed studies are being conducted to determine the extent to which Frisco's markets will be affected by the opening of the Arkansas River to barge traffic in 1971. The studies will assist in formulating plans to continually provide the best in service for the area involved.

OPERATING RIGHTS ON VERDIGRIS AND ARKANSAS RIVERS

The Frisco Transportation Company — a wholly-owned subsidiary of your Company — filed an application with the Interstate Commerce Commission for authority to operate as a common carrier by water between points on the Arkansas-Verdigris rivers on the one hand and points on the Inland Waterways System on the other. The Frisco's previous application, together with those of all other applicants, was dismissed in 1963 as being premature.

INDUSTRIAL DEVELOPMENT

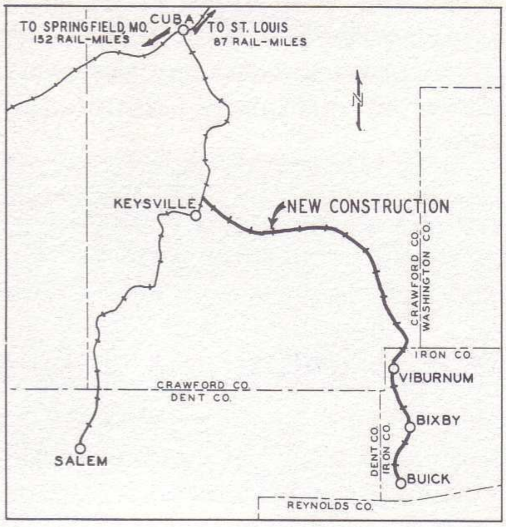
Capital spending in the economy as a whole rose 16% from the level of the year earlier and the Frisco had another better-than-average year for industrial development. A total of 122 new plants went into operation along the lines of the railroad with new rail tonnage estimated at more than 30,000 cars per year. These new installations involved an investment in land, buildings and equipment of $56 million and give employment to more than 2,600 persons. Plant expansion also was evident as 45 firms expanded their facilities with an investment of $6.4 million; the additional productive capacity thus created should generate another 2,500 cars of rail freight annually.

The diversity of the new plants was noteworthy. Out of a total of 122 new industries, 20 were manufacturing installations — producing such products as titanium dioxide, cement, missile parts, foundry items, furniture, asphalt, chemicals, concrete, lead oxide, etc. — and 41 were distribution warehouses, all erected in closer proximity to a growing consumer market in the Midwest, Southwest and Southeast. Their location within Frisco territory continues to add a better balance to what once was wholly an agrarian economy. As farm productivity rises, the number of persons engaged in agricultural activities declines and the trend toward industrialization continues. At year end, the number of new plants under construction or in the final stages of planning was at an all-time high. Additionally, there was a growing interest in the mineral resources of Southeast Missouri, as discussed on the next page.

To aid future industrial growth, the Company continues to develop its own industrial districts to insure the availability of suitable real estate for new plant construction. Paralleling these efforts, the Frisco also is encouraging private developers and local communities to take steps to insure the availability of attractive industrial sites.

NEW LINE

In accordance with authority received from the Interstate Commerce Commission in 1964, the Frisco proceeded with the construction of a new line of railroad, 32.7 miles in length, in Crawford and Iron Counties, Missouri. Grading and drainage work now is going forward and the new line is expected to be in operation by the last half of 1967. It will extend from Keysville, Missouri, on the Frisco's Salem Branch, pass through Viburnum and Bixby, and terminate near Buick, Missouri, as shown below and on center map.



The new line will serve directly the St. Joseph Lead Company's lead concentrate mill at Viburnum and a truck-rail transfer point for the Fletcher mill of the same Company at Buick. It also will serve the mill and mine of American Metal Climax, Inc. and Homestake Mining Company as well as a similar installation of Cominco American and Magnet Cove Barium Corporation, both of which now are under construction. In addition, the new line will serve a smelter to be constructed by American Metal Climax, Inc. and Homestake Mining Company to process lead concentrates produced by the two mills mentioned in the preceding sentence. The new line will involve a capital expenditure of $6.5 million and will produce estimated annual revenues of $2 million. Concrete crossties will be used.

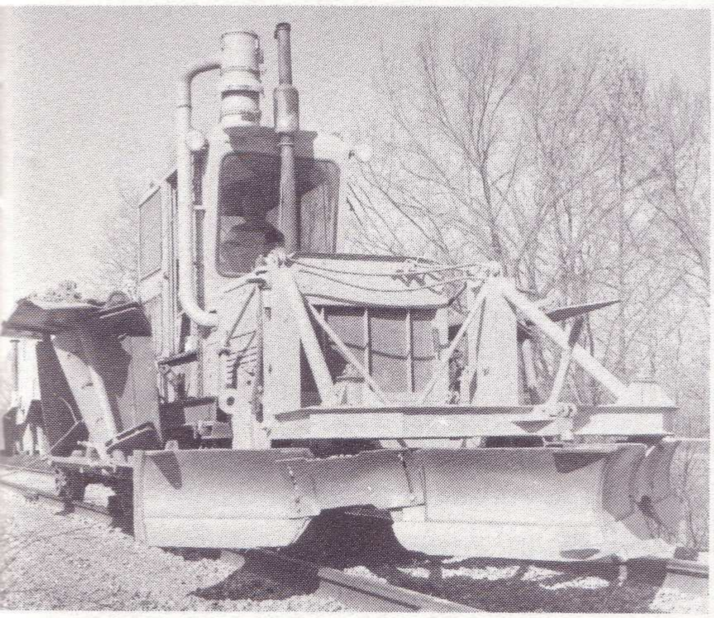
LINE ABANDONMENT

After receiving authority from the Interstate Commerce Commission, your Company has abandoned 103.5 miles of unprofitable branch-line railroad running between Nash, Missouri, and Pocahontas, Arkansas, 4.4 miles between De Bardeleben and Sipsey, Alabama and 8.7 miles between Scullin and Sulphur, Oklahoma.

2,500 horsepower Diesel-Electric locomotive installed in 1965.

Ditchdigger for burying cable.

Ballast regulator for cleaning and redistributing ballast.



MERGERS

Late in the year, the Frisco and the Southern Railway System began joint studies to explore the feasibility of some form of consolidation. These studies are being progressed as rapidly as possible but, as of the date of this printing, no conclusions have been reached. Security holders and the public will be kept informed of developments.

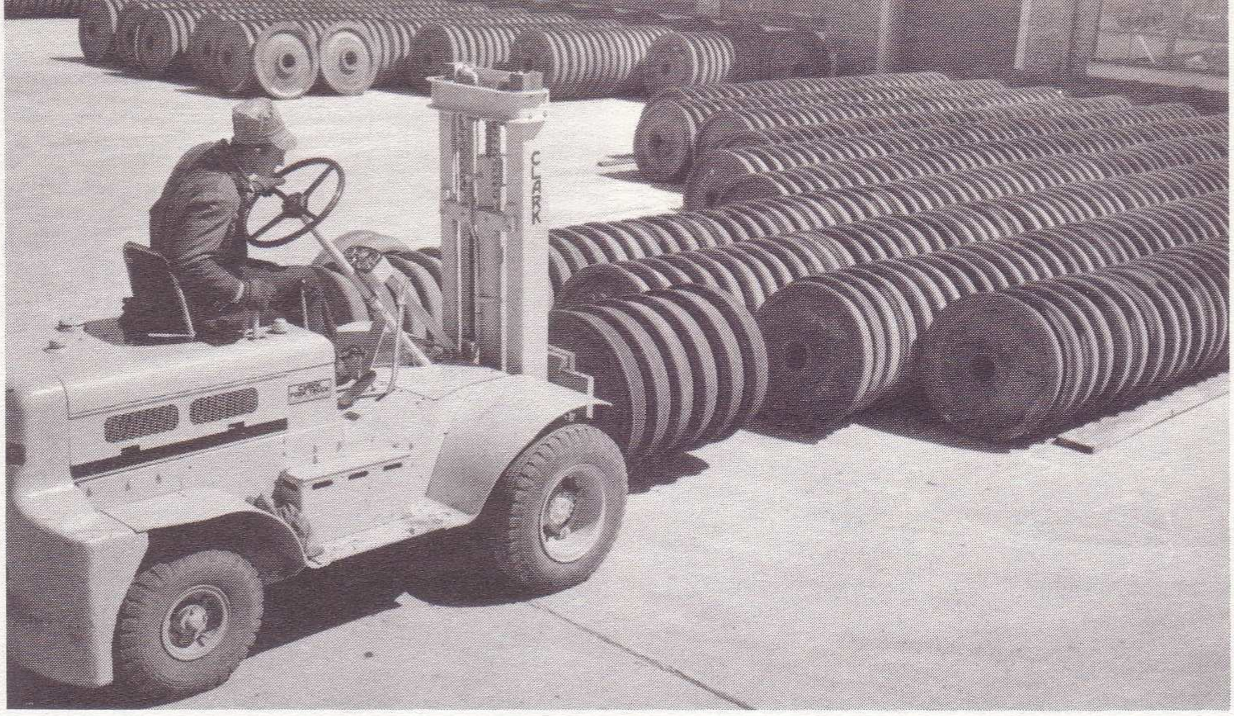
Earlier in the year, merger negotiations with the Atchison, Topeka and Santa Fe Railway Company were terminated due to the inability to agree upon mutually satisfactory merger terms.

Your Company has intervened in opposition to the Union Pacific — Southern Pacific — Rock Island proposals because of the substantial adverse effect these proposals, if authorized, would have on Frisco's ability to serve the shipping public. In January 1966, the Frisco filed its intervention in opposition to the Santa Fe's proposal to purchase a part of the Rock Island and to acquire trackage rights over the Rock Island between Kansas City and St. Louis. The Interstate Commerce Commission has ordered that all of the proposals to acquire portions of the Rock Island be consolidated for hearing on a single record. Hearings originally scheduled to begin on March 7, 1966, have been postponed to a later date to be determined by the I.C.C.

LITIGATION

Pending are two cases involving the division of interline revenue:

One involves the division of interline revenue on traffic to and from Transcontinental Territory. The Interstate Commerce Commission on January 22, 1964, served a supplemental report and order adverse to the Frisco's interest. An



Wheel shop where all wheel and axle work for the system is centralized.

appeal was taken to the United States District Court for the Southern District of California, which on February 17, 1965, entered its judgment setting aside the Commission's order and remanding the case to the Commission for further proceedings consistent with the Court's opinion. On April 16, 1965, an appeal was filed in the United States Supreme Court, where the case is now pending.

On September 29, 1965, the eastern and certain western railroads, including the Frisco, made an agreement relating to future divisions on transcontinental traffic. In an order served on January 17, 1966, the Commission partially modified its outstanding orders so as to approve the agreement.

Since October 1965, certain midwestern railroads, including the Frisco, have signed another agreement relating to future divisions on traffic between the midwest and the far west. Petition has been filed with the Commission seeking further modification of its outstanding orders to approve this agreement and an order is expected shortly. This agreement, if approved, together with the agreement mentioned in the previous paragraph, will have the cumulative effect of releasing about $750,000 which your Company has accrued in its accounts for possible repayment to other railroads, as mentioned in previous reports. The remainder of the accruals will be held in our accounts pending further action of the Commission or the Courts.

In a second proceeding, involving the division of interline revenue on traffic between Eastern and Southern Territories, the Commission on March 21, 1965, served a report and order to become effective on July 30, 1965, prescribing new divisions which were adverse to your Company's interests. On March 31, 1965, the southern railroads, including the Frisco, filed an appeal in the United States District Court for the Eastern District of Louisiana in New Orleans from the Commission's decision. No decision has been made by the Court at this time.

CAPITAL EXPENDITURES

To keep pace with the advancing techniques and technology of modern transport as well as to meet the increasing competition within the transportation industry, the Frisco spent $20,578,444 during 1965 on capital improvements to its fixed plant and additions to its car and locomotive fleets. The comparable figure in 1964 was $21,690,647. By far the largest part of our capital expenditures, $15,275,895, went for new rolling stock and in improving existing equipment. A total of $4,618,559 was spent on improvements to our roadway and structures, and the remainder — $683,990 — went for other improvements to our properties.

Of the amount spent for new rolling stock and in improving existing equipment, $4,516,902 was paid from the Company's treasury and the remainder financed through a Conditional Sale Agreement and Equipment Trust Certificates.

EQUIPMENT OBLIGATIONS

Equipment obligations outstanding at year-end, including those due in one year, totaled $53,933,861, an increase of $3,503,553, representing additional obligations incurred of $10,758,993, less serial maturities of $7,255,440 paid during 1965.

Equipment debt instalments due in 1966 will amount to $7,265,789; equipment depreciation chargeable to operating expenses will approximate $7,900,000.

NEW EQUIPMENT

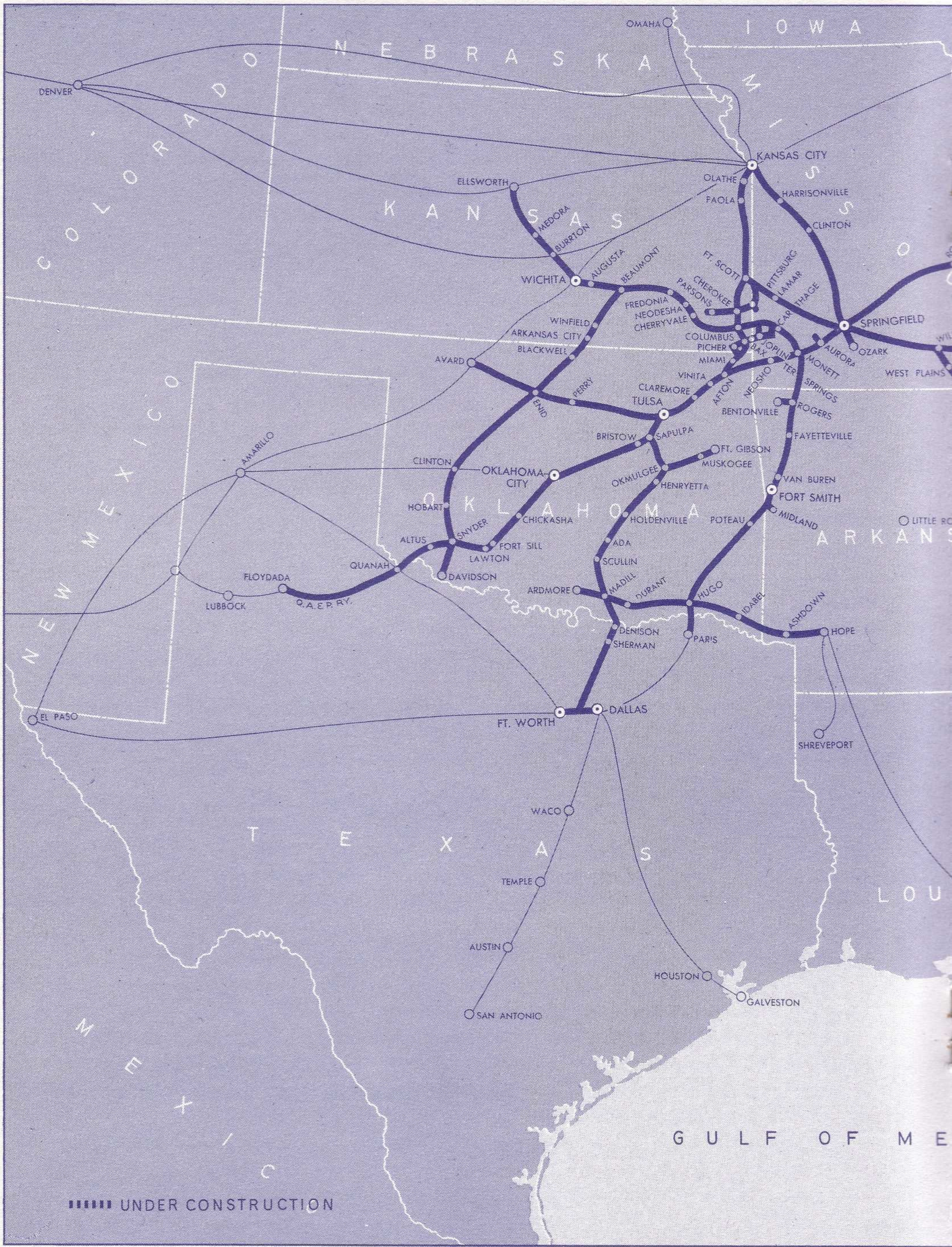
Below may be found a description of the new rolling stock installed during 1965 to modernize the Frisco's car and locomotive fleets. Markedly improved over their counterparts of twenty years ago, today's freight cars are larger, easier to load and unload, fitted with specialized devices to meet the changing requirements of the shipping public, and designed to afford greater protection against lading damage. Locomotives, too, reflect recent engineering advances as more rugged and powerful Diesel-Electric units now make it possible to pull heavier and longer trains at faster speeds with longer intervals between locomotive maintenance and shopping periods.

Built in Company Shops:

- 50 cast steel underframe bulkhead flat cars, with roller bearings, end-cushioning and tie-downs; capacity: 70 tons each.

Purchased New:

- 16 Diesel-Electric locomotives, 2,500 horsepower each.
- 75 Covered hoppers with roller bearings; capacity: 100 tons — 4,427 cubic feet each.
- 100 Open top hoppers with roller bearings; capacity: 100 tons each.
- 150 Insulated box cars with roller bearings, cushion underframes, high-strength floors, movable bulkheads and side fillers; capacity: 70 tons each.
- 100 Non-insulated box cars with roller bearings, cushion underframes, flush doors, high-strength floors and belt rails; capacity: 70 tons each.
- 10 High cubic capacity box cars, 86′ long, with cushion underframes and roller bearings; capacity: 70 tons each.
- 11 Air Slide cars with roller bearings; capacity: 100 tons — 4,180 cubic feet each.
- 10 Air Slide cars with roller bearings; capacity: 70 tons — 2,600 cubic feet each.
- 100 Aluminum covered hopper cars with roller bearings; capacity: 100 tons — 4,750 cubic feet each.


NEBRASKA
IOWA
COLORADO
KANSAS
MISSOURI
NEW MEXICO
OKLAHOMA
ARKANSAS
TEXAS
LOU
MEXICO
GULF OF ME
DENVER
OMAHA
KANSAS CITY
OLATHE
PAOLA
HARRISONVILLE
CLINTON
ELLSWORTH
MEDORA
BURRTON
WICHITA
AUGUSTA
BEAUMONT
FT. SCOTT
PITTSBURG
LAMAR
CARTHAGE
CHEROKEE
PARSONS
FREDONIA
NEODESHA
CHERRYVALE
WINFIELD
ARKANSAS CITY
BLACKWELL
COLUMBUS
PICHER
MIAMI
JOPLIN
SPRINGFIELD
OZARK
AURORA
MONETT
WEST PLAINS
AVARD
ENID
PERRY
VINITA
CLAREMORE
TULSA
AFTON
NEOSHO
BENTONVILLE
ROGERS
FAYETTEVILLE
BRISTOW
SAPULPA
FT. GIBSON
MUSKOGEE
OKMULGEE
HENRYETTA
CLINTON
OKLAHOMA CITY
HOBART
CHICKASHA
HOLDENVILLE
POTEAU
VAN BUREN
FORT SMITH
MIDLAND
LITTLE RO
ALTUS
SNYDER
FORT SILL
LAWTON
ADA
SCULLIN
QUANAH
DAVIDSON
MADILL
DURANT
ARDMORE
HUGO
IDABEL
ASHDOWN
HOPE
DENISON
SHERMAN
PARIS
AMARILLO
FLOYDADA
LUBBOCK
Q.A.& P. RY.
EL PASO
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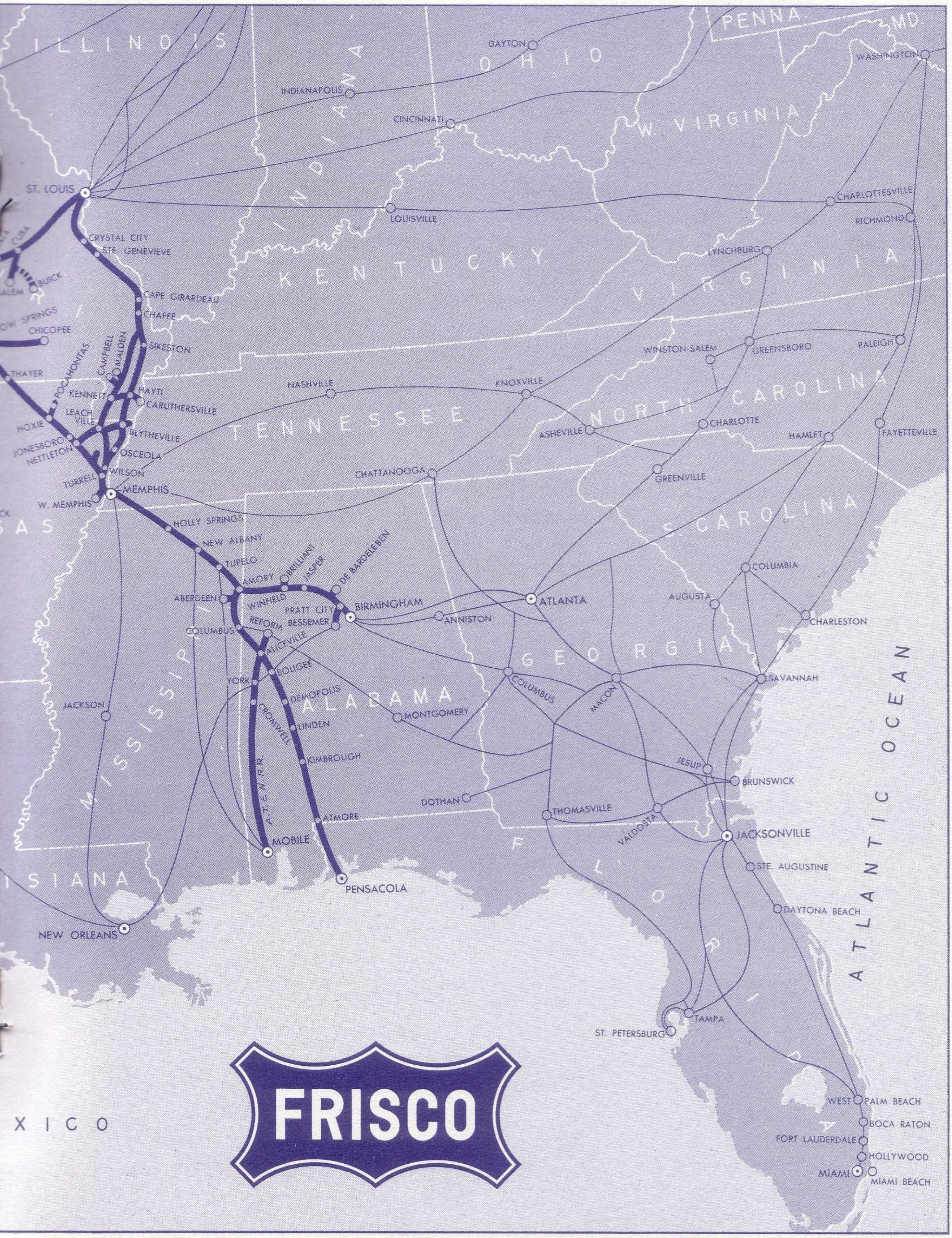
DALLAS
SHREVEPORT
WACO
TEMPLE
AUSTIN
SAN ANTONIO
HOUSTON
GALVESTON
UNDER CONSTRUCTION


ILLINOIS
INDIANA
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ALABAMA
MISSISSIPPI
FLORIDA
ATLANTIC OCEAN
XICO
DAYTON
WASHINGTON
INDIANAPOLIS
CINCINNATI
ST. LOUIS
LOUISVILLE
CHARLOTTESVILLE
RICHMOND
LYNCHBURG
CRYSTAL CITY
STE. GENEVIEVE
CUBA
BUICK
CAPE GIRARDEAU
CHAFFE
CHICOPEE
SIKESTON
CAMPBELL
MALDEN
POCAHONTAS
THAYER
KENNETT
HAYTI
CARUTHERSVILLE
LEACH VILLE
HOXIE
JONESBORO
NETTLETON
BLYTHEVILLE
OSCEOLA
TURRELL
WILSON
MEMPHIS
W. MEMPHIS
WINSTON-SALEM
GREENSBORO
RALEIGH
NASHVILLE
KNOXVILLE
ASHEVILLE
CHARLOTTE
HAMLET
FAYETTEVILLE
CHATTANOOGA
GREENVILLE
HOLLY SPRINGS
NEW ALBANY
TUPELO
AMORY
BRILLIANT
JASPER
DE BARDELEBEN
ABERDEEN
WINFIELD
PRATT CITY
BESSEMER
BIRMINGHAM
REFORM
COLUMBUS
ALICEVILLE
ANNISTON
ATLANTA
AUGUSTA
COLUMBIA
CHARLESTON
YORK
BOLIGEE
DEMOPOLIS
CROMWELL
LINDEN
KIMBROUGH
JACKSON
MONTGOMERY
COLUMBUS
MACON
SAVANNAH
JESUP
BRUNSWICK
AT. & N.R.R.
DOTHAN
ATMORE
THOMASVILLE
VALDOSTA
JACKSONVILLE
MOBILE
PENSACOLA
STE. AUGUSTINE
DAYTONA BEACH
NEW ORLEANS
TAMPA
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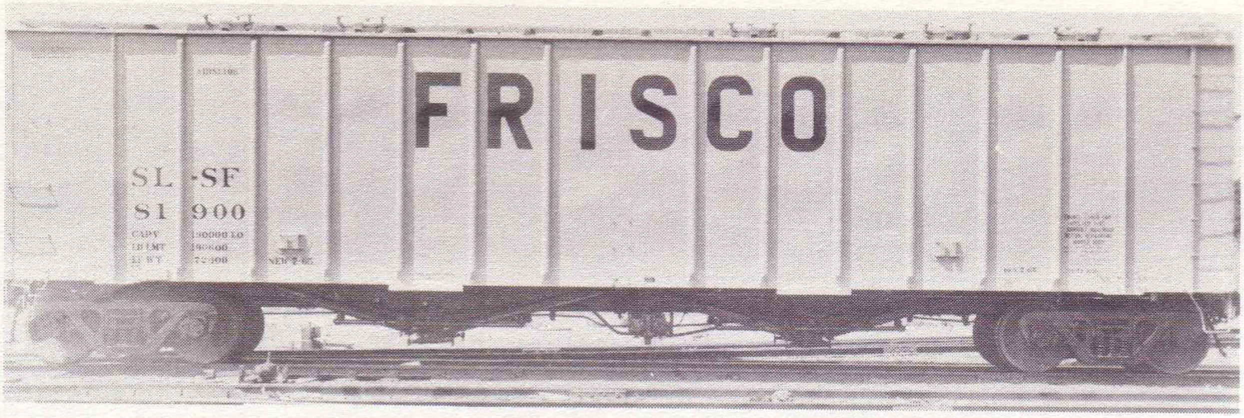
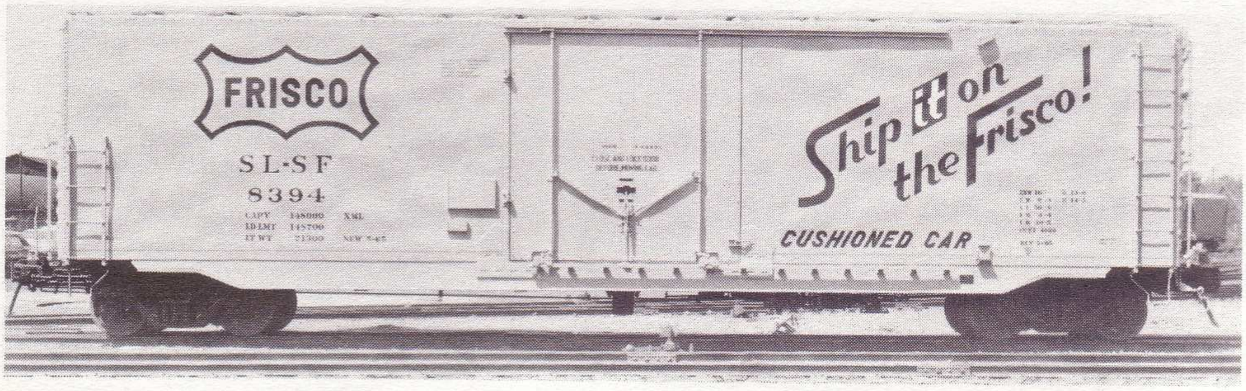
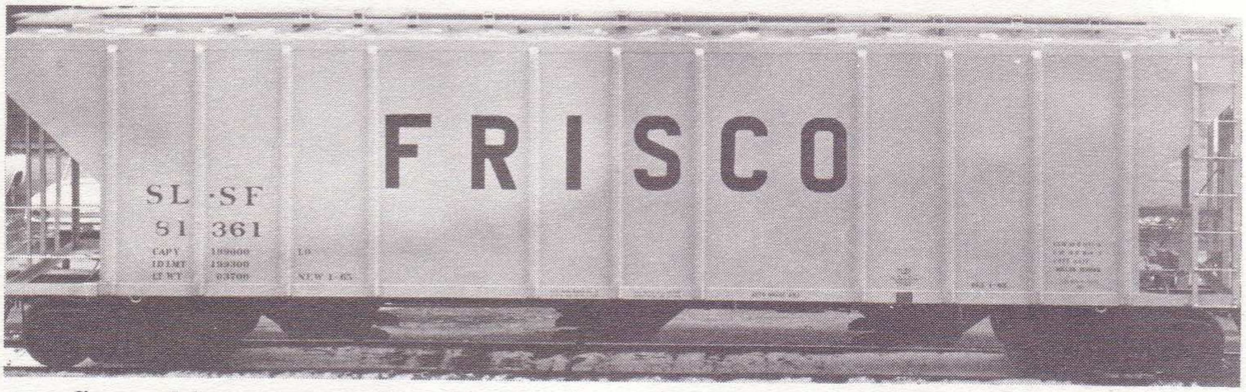
PALM BEACH
BOCA RATON
FORT LAUDERDALE
HOLLYWOOD
MIAMI
MIAMI BEACH
FRISCO



Airslide car with roller bearings. Capacity: 4,180 cubic feet — 100 tons.



Non-insulated box car, with cushion underframe and roller bearings. Capacity: 70 tons.



Covered hopper car with roller bearings. Capacity: 4,427 cubic feet — 100 tons.

Open top hopper car with roller bearings. Capacity: 100 tons.

ROADWAY AND STRUCTURES

In line with its continuing program of strengthening its track structure to accommodate longer, heavier and faster trains, the Frisco laid 70 miles of new rail during the year. Of this total, slightly more than 35 miles consisted of new 132-lb. continuous welded, ribbon rail laid in quarter-mile lengths to reduce the number of joints, while 15 miles of the same weight were laid in conventional lengths of 39 feet to the section. The remainder of the new rail laid in 1965 consisted of 20 miles of 90-lb. conventional length rail laid on our lighter density lines. Crossties renewed totaled 350,350.

To cushion the impact of rising labor costs, the Frisco moved ahead with its mechanization of roadway functions. With each passing year, technology adds newer, more complex, precision machinery to speed work once done with muscle, pick and shovel. As these machines prove themselves in practical everyday application, they help provide our patrons with a finer up-to-date roadway and the Frisco with a means of doing an essential job better, faster and with less expense.

Still under observation is a test installation of concrete ties referred to in previous reports.

COMMUNICATIONS AND SIGNALS

All train dispatching for the system now is centralized in Springfield, Missouri. Moved to that point were all Centralized Traffic Control consoles which—through an elaborate system of electrical wiring, panel lights and keys — remotely control train movements by opening and closing switches and appropriately changing signal indications over hundreds of miles of railroad. To further extend Centralized Traffic Control, an additional 100 miles of railroad were so equipped between Turrell and Baker, Arkansas. About two-thirds of our heavy density mainline mileage now is equipped with CTC.

The application of other electronic advances was continued: The use of two-way radio was expanded and modernized; teletype equipment was installed at additional locations to speed the transmission of data required for the efficient operation of the property; the use of automatic highway-grade crossing signals was extended and we continued to install, at strategic locations, devices which, through heat sensitivity, warn of impending bearing failures on passing freight cars; another device, also electrically activated, is employed in yard operations to detect broken flanges and loose wheels.

LABOR

In 1965, the Frisco operated approximately 68% of its freight and yard crew assignments without firemen under an Arbitration Board Award which was placed in full effect in 1964. This Arbitration Board Award and a subsequent Special Board of Adjustment Award resulted in the operation of approximately 50% of our yard crews and branch line train crews with one fewer yardman or brakeman, respectively.

On November 15, the Firemen's union served a notice which requested the rehiring, with original seniority, of those employes whose jobs were abolished under the above-mentioned Arbitration Board Award. The notice also asked for the employment of firemen on all freight and yard engines except certain daylight and branch line jobs; monetary reimbursement to those "improperly" separated, "deprived" of seniority rights or "forced away" from home to work at other terminals, and a joint training program for firemen.

Carriers' Conference Committees have been created to negotiate Trainmen's and Carriers' notices relating to the number of employes required to man train and yard crews. On January 21, 1966, the Carriers' Conference Committees invoked the services of the National Mediation Board to help in reaching a settlement.

Wage increases provided for by National Agreements in 1964-65 with operating and nonoperating unions increased Frisco's payroll $1.9 million in 1965. Wage increases of approximately 9¢ per hour effective January 1, 1966 to nonoperating employes will increase Frisco's payroll by about $1 million in 1966. For the period February, 1966 through February, 1968, railroads are obligated to pay an additional $3.40 per employe per month to maintain current level of benefits under the National Health and Welfare Plan for nonoperating employes. It is estimated the increase in Company payments under the Plan will add about $200,000 to Company fringe benefit costs in 1966.

On September 25, the Frisco entered into an agreement with the Train Dispatchers' union to consolidate and centralize in Springfield, Missouri, all of the Company's five train dispatching offices. The agreement provides for separation and transfer allowances, away-from-home and moving expenses, and indemnification against loss in the sale of homes. A Union Shop Agreement also was executed with the Train Dispatchers' union effective November 1, 1965; another agreement calls for compulsory retirement at the age of 70 effective October 1, 1966.

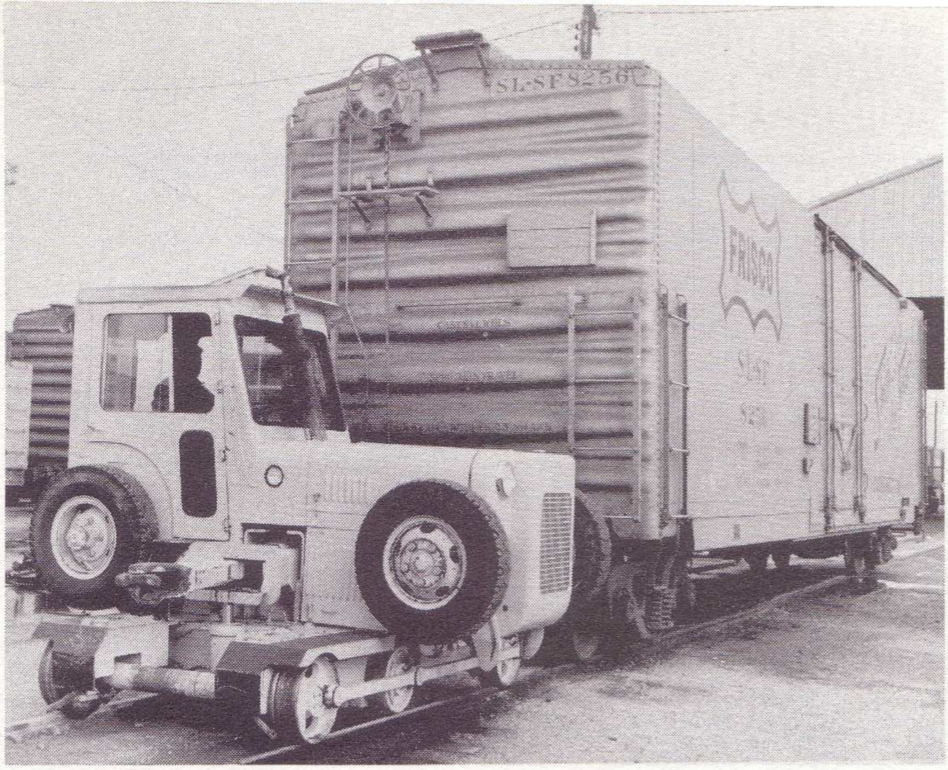
EMPLOYMENT AND WAGES

The average number of employes in 1965 was 8,487 and the total payroll $62,686,127. In 1964, the average number was 8,718 and the total payroll $60,855,630.

FINANCIAL STATEMENTS

Included in this report are the consolidated financial statements of the St. Louis-San Francisco Railway Company and its controlled railroad subsidiaries, together with the opinion thereon of the Company's independent accountants, Price Waterhouse & Co. Among the other enterprises in which your Company has an interest is the New Mexico and Arizona Land Company which issues its own annual report; anyone desiring a copy may obtain one by writing to the New Mexico and Arizona Land Company, 906 Olive Street, Room 903, St. Louis, Missouri 63101.

Prefabricated or panelized track. Track is pre-anchored to ties in standard sections. Sections are then bolted together in place.



Trackmobile, a vehicle adaptable to operation on either rubber tires or flanged wheels. It can be used in lieu of a locomotive to switch freight cars to and from points in the repair shop.

For informational purposes, a condensed income account and balance sheet covering the railroad as well as non-railroad operations of the Company are presented on pages 30 and 31.

SAFETY

Long among the leaders of the railroad safety movement, the Frisco — and its subsidiary, the Quanah, Acme & Pacific Railway — in 1965 became recipients of the highest award for safety, the Harriman Gold Medal.

Recipients of the coveted Gold Medals are selected annually by the American Museum of Safety, through its Harriman Memorial Awards Committee, for the best over-all safety records based on statistics compiled by the Interstate Commerce Commission.

For the twelfth consecutive year, the Frisco was the recipient of the National Safety Council's Public Safety Activity Award, bestowed for "distinguished service to safety" in promoting accident prevention off the job as well as on the job.

MANAGEMENT CHANGES

On October 1, J. E. Gilliland became Chairman of the Board and President of the Company, succeeding L. W. Menk who on that date became President of Burlington Lines. Formerly Vice President in charge of Traffic and Industrial Development, Mr. Gilliland is a veteran railroader whose service with the Frisco system began in 1948 when the parent Company acquired control of the Alabama, Tennessee and Northern Railroad Company of which he then was President. He received his higher education at the College of Commerce, Chicago, Illinois, and is a graduate of the Harvard Business School's Advanced Management Program.

Mr. E. G. Kreyling, Jr., was appointed Vice President, Traffic and Industrial Development, succeeding Mr. Gilliland. Mr. Kreyling graduated from Washington University with a B.S.B.A. degree; later he was awarded a M.B.A. degree by the same University. He began his service with the Frisco in 1955 as a commodity analyst. Before being named to his new post, he served successively as Director of Traffic Research, Assistant General Freight Traffic Manager and General Freight Traffic Manager.

PRICE WATERHOUSE & CO.
14 SOUTH FOURTH STREET
ST. LOUIS

March 7, 1966

To the Board of Directors and Stockholders of
St. Louis-San Francisco Railway Company:

We have examined the balance sheet of the St. Louis-San Francisco Railway Company and railroad subsidiaries consolidated at December 31, 1965 and the statements of income and retained income for the year. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, except that provision has not been made for the possible increase in income taxes of future periods as set forth in Note 2 to the financial statements, the accompanying statements examined by us present fairly the financial position of St. Louis-San Francisco Railway Company and railroad subsidiaries consolidated at December 31, 1965 and the results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse & Co

CONSOLIDATED INCOME STATEMENT

	1965	1964
	(000) omitted	
OPERATING REVENUES:		
Freight	$138,314	$129,041
Other	10,365	11,076
Total operating revenues	148,679	140,117
OPERATING EXPENSES:		
Maintenance of way and structures	19,402	17,959
Maintenance of equipment	21,211	19,756
Transportation	53,789	53,719
Other	15,030	16,143
Total operating expenses (includes depreciation of $10,398,000 and $9,625,000, respectively)	109,432	107,577
Net operating revenue	39,247	32,540
OPERATING CHARGES:		
Taxes (except federal income taxes)	10,743	10,236
Equipment and joint facility rents	7,037	6,925
Total operating charges*	17,780	17,161
Net operating income*	21,467	15,379
OTHER INCOME, net:	1,631	2,006
Balance for fixed and contingent charges*	23,098	17,385
FIXED AND CONTINGENT CHARGES:		
Fixed charges	5,791	5,675
Contingent interest	1,976	2,620
Total fixed and contingent charges	7,767	8,295
Income before federal income taxes	15,331	9,090
ESTIMATED FEDERAL INCOME TAXES: (Note 2, Page 26)	4,300	1,967
NET INCOME (in conformity with I.C.C. principles)	$ 11,031	$ 7,123

*Before Federal income taxes.

CONSOLIDATED BALANCE SHEET

	December 31, 1965	December 31, 1964
	(000) omitted	
ASSETS		
CURRENT ASSETS:		
Cash	$ 2,189	$ 3,576
Temporary cash investments	15,959	25,788
Cash deposits for interest, dividends, etc.	2,022	1,646
Receivables from U. S. Government, individuals, agents and companies	11,728	10,864
Material and supplies, at average cost	5,238	4,744
Other current assets	322	246
Total Current Assets	37,458	46,864
SPECIAL DEPOSITS	1,237	1,187
INVESTMENTS (Page 28):		
Securities of and advances to unconsolidated subsidiaries and affiliates	8,210	8,508
Other	30	30
Total Investments	8,240	8,538
PROPERTIES (Note 4, Page 27):		
Roadway and structures	300,456	300,597
Equipment	205,413	201,606
Non-operating property	4,276	3,894
Accrued depreciation — road	**54,358**	**54,230**
Accrued depreciation — equipment	**103,835**	**105,572**
Accrued depreciation — non-operating property	**263**	**252**
Total Properties	351,689	346,043
OTHER ASSETS:		
Discount on long term debt	2,311	2,303
Miscellaneous	2,255	1,574
Total Other Assets	4,566	3,877
Total Assets	$403,190	$406,509

Bold face type denotes credit.

CONSOLIDATED BALANCE SHEET

	December 31, 1965	December 31, 1964
	(000) omitted	
LIABILITIES		
CURRENT LIABILITIES:		
Audited accounts and wages payable	$ 3,204	$ 2,937
Accrued and miscellaneous accounts payable	11,392	12,678
Interest and dividends payable	3,387	4,458
Estimated federal taxes on income (Note 5, Page 27)	3,772	2,065
Other accrued taxes	2,645	2,693
Other current liabilities	2,446	2,712
Total Current Liabilities (excluding current portion of long term debt)	26,846	27,543
LONG TERM DEBT (Page 29):		
First Mortgage Bonds, 4% Series A — 1997	65,790	66,390
First Mortgage Bonds, 4% Series B — 1980	16,140	16,390
Income Debentures, 5% Series A — 2006	30,064	30,064
Second Mortgage Income Bonds, 4½%—2022 (Note 6b, Page 27)	—	25,099
Equipment obligations	53,934	50,430
Total Long Term Debt ($7,266,000 payable in 1966)	165,928	188,373
OTHER LIABILITIES:		
Estimated casualty and other reserves	1,559	1,267
Miscellaneous, including deferred credits	1,484	1,172
Total Other Liabilities	3,043	2,439
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 6, Page 27):		
Preferred, $100 par value, authorized 1,500,000 shares — Series A 5% issued 287,036 shares, less 39,626 shares in treasury	24,741	24,741
Common, no par value — Authorized 6,000,000 shares, issued 2,213,175 shares, less 50 shares in treasury in 1965 and 1,891,337 shares, less 50 shares in treasury in 1964	94,746	82,349
CAPITAL SURPLUS	17,438	17,438
RETAINED INCOME (Page 26)	70,448	63,626
Total Shareholders' Equity	207,373	188,154
Total Liabilities and Shareholders' Equity	$403,190	$406,509

CONSOLIDATED RETAINED INCOME STATEMENT

	(000) omitted
Balance December 31, 1964	$ 63,626
Add:	
Net income for the year	11,031
Deduct:	
Dividend on Preferred Stock — $5.00 per share	1,237
Dividend on Common Stock — $1.50 per share	2,972
	4,209
Balance December 31, 1965	$ 70,448

NOTES TO FINANCIAL STATEMENTS

1. PRINCIPLES OF CONSOLIDATION: Included in the consolidated financial statements are the accounts of the parent company and railroad subsidiaries: Quanah, Acme & Pacific Railway Company; Alabama, Tennessee and Northern Railroad Company; Birmingham Belt Railroad Company, and Northeast Oklahoma Railroad Company.

2. AMORTIZATION, ACCELERATED AND GUIDELINE DEPRECIATION: The Company and its railroad subsidiaries maintain their books of account, and the accompanying statements have been prepared, in conformity with principles and methods of accounting prescribed or authorized by the Interstate Commerce Commission. These principles and methods do not provide for the income tax effect of the excess of tax amortization and depreciation over recorded depreciation as is necessary to conform with generally accepted accounting principles.

The supplementary income information shown below reflects the adjustments necessary to present net income in conformity with generally accepted accounting principles:

	1965	1964
Net income (in conformity with ICC principles) as set forth in the consolidated income statement	$11,031,000	$7,123,000
Adjustments to generally accepted accounting principles:		
Provision for income tax effect of —		
Amortization of defense facilities	891,000	904,000
Accelerated and guideline depreciation	(2,523,000)	(2,800,000)
Net income (as it would be stated in conformity with generally accepted accounting principles)	$ 9,399,000	$5,227,000

The cumulative reduction in federal income taxes, due to the above-mentioned differences, not reflected in the accompanying balance sheet, amounted to $36,732,000 at December 31, 1965.

3. PENSION PLAN: Unfunded past service costs of the Company's pension plan amounted to approximately $5,761,000 at December 31, 1965. The cost of the plan charged to income in 1965 was $1,386,000, including $832,000 of past service; in 1964 the cost was $1,297,000, including $794,000 past service.

4. PROPERTIES: Gross properties are stated at estimated original cost as determined by the Interstate Commerce Commission for reorganizational purposes as of January 1, 1947, plus additions and betterments at cost and less retirements since that date.

The Company uses depreciation accounting with respect to equipment and depreciable road properties. However, for rails, ties, and other track materials instead of depreciation accounting, it follows an acceptable alternate accounting practice of "replacement" accounting. Under this method, replacements in kind are charged to expenses, and betterments (improvements) are capitalized. The amounts capitalized are not depreciated.

At December 31, 1965, nondepreciable property, including land and land rights, aggregated approximately $195,100,000.

5. FEDERAL INCOME TAXES: Federal taxes on income for 1963, 1964 and 1965 are subject to final determination by the Treasury Department. In the opinion of management, the reserve provided for federal taxes on income is adequate.

6. CAPITAL STOCK: The Preferred Stock is redeemable at par plus accrued dividends. The stock is convertible at the option of the holders at any time on or before 15 days prior to the date as of which such stock shall have been called for redemption, at the rate of two shares of Common for each share of Preferred. On January 25, 1966, the Directors of the Company voted to call 50% of its outstanding Preferred Stock for redemption on March 16, 1966. See page 7 for details.

At December 31, 1965 there were 584,382 shares of authorized Common Stock reserved as follows:

(a) 574,072 shares for conversion of Preferred Stock.

(b) 150 shares for conversion of $6,000 principal amount of Second Mortgage Income Bonds under protect letters issued by the conversion agent. 299,975 shares were issued as a result of conversion in 1965. See page 7 for details.

(c) 10,160 shares for issuance under a restricted stock option plan authorized in 1952 for certain officers and key employes. Options on 21,863 shares were exercised in 1965. No further options may be granted under the plan.

7. CONTINGENT LIABILITIES: The Company is guarantor of principal and interest, individually or jointly with other railroads, of obligations of various affiliated companies. The Company is a participant in a service interruption policy with The Imperial Insurance Company, Limited.

INVESTMENTS IN AFFILIATED AND OTHER COMPANIES

	NUMBER OF SHARES	PER CENT OWNED	PAR VALUE	BOOK VALUE
AFFILIATED COMPANIES				
Stocks:				
Clarkland, Inc.	500	100	$ 50,000	$ 76,010
*Clarkland Royalty, Inc.	100	100	1,000	1,000
*Frisco Transportation Co.	4,500	100	450,000	450,000
Greater Tulsa, Inc. Preferred Stock	630	100	6,300	6,300
Greater Tulsa, Inc. Common Stock.	70	100	700	700
906 Olive Corporation	1,500	100	150,000	150,000
New Mexico and Arizona Land Co.	500,258.48	50.03	500,258	515,469
*Birmingham Terminal Co.	250	16⅔	25,000	25,000
Illinois Terminal Railroad Co.	181.818	9.09	1,818	1,818
*Kansas City Terminal Ry. Co.	1,833⅓	8⅓	183,334	183,334
Pullman Co., The	8,456	1.1562	84,560	253,680
*Railway Express Agency, Inc.	29,064	1.45	29,064	1,400
*Terminal R. R. Association of St. Louis	2,058	6¼	205,800	1
Trailer Train Co.	500	2.44	500	50,000
*Tulsa Union Depot Co.	1,000	100	No Par	1,000
*Union Terminal Co., The—Dallas	60	12½	6,000	6,000
*Wichita Union Terminal Ry. Co.	333⅓	33⅓	33,333	12,502
				$ 1,734,214
Notes:				
Clarkland, Inc.	....	....	....	$ 1,351,265
906 Olive Corporation	....	....	....	175,000
Railway Express Agency, Inc.	....	....	....	404,817
				$ 1,931,082
Investment Advances:				
Clarkland Royalty, Inc.	....	....	....	$ 15,945
906 Olive Corporation	....	....	....	240,214
Birmingham Terminal Co.	....	....	....	286,945
Clarkland, Inc.	....	....	....	1,497,629
Kansas City Terminal Ry. Co.	....	....	....	983,857
Frisco Transportation Co.	....	....	....	543,427
Union Terminal Co., The—Dallas.	....	....	....	214,119
Wichita Union Terminal Ry. Co.	....	....	....	760,607
Wichita Terminal Association	....	....	....	2,000
				$ 4,544,743
Total investments in affiliated companies	....	....	....	$ 8,210,039
OTHER INVESTMENTS	....	....	....	$ 29,626

*Pledged under mortgages.

LONG TERM DEBT

	DATE OF MATURITY	OUTSTANDING DEC. 31, 1965	1966 MATURITIES	INTEREST EXPENSE FOR 1965
FUNDED DEBT UNMATURED—				
First Mortgage Series A 4%	Jan. 1997	$ 65,790,200†	*	$ 2,645,897
First Mortgage Series B 4%	Sep. 1980	16,140,000†	*	649,271
Second Mortgage Income Series A 4½%	Jan. 2022	......		473,223
Income Debentures Series A 5%	Jan. 2006	30,063,500†	*	1,503,175
		$111,993,700		$ 5,271,566
EQUIPMENT OBLIGATIONS—				
Trust Certificates:	Serially to			
Series I 2⅞%	Aug. 1966	$ 339,000	$ 339,000	$ 15,430
Series J 3⅛%	Dec. 1966	315,000	315,000	19,277
Series K 2⅞%	Dec. 1967	374,000	187,000	15,681
Series L 3⅜%	Jun. 1968	1,035,000	345,000	39,781
Series M 3%	Jan. 1969	1,500,000	500,000	60,000
Series N 4¼%	Mar. 1980	4,185,000	279,000	132,902
Series O 4⅜%	May 1980	4,725,000	315,000	123,475
Matured during year	......	......	......	12,666
Conditional Sale Agreements:				
Dated Dec. 1, 1955, No. 1, 3½%	Dec. 1970	5,863,000	1,172,600	232,566
Dated Apr. 1, 1956, No. 2, 3½%	May 1971	385,000	70,000	14,904
Dated Sep. 1, 1956, Nos. 3 & 4, 4¼%	Sep. 1971	931,034	155,172	42,317
Dated Sep. 1, 1956, No. 5, 4¼%	Jun. 1972	823,979	133,333	39,097
Dated Jan. 1, 1957, Nos. 6, 7, 8, 9, 5%	Jul. 1972	7,219,335	1,110,667	402,617
Dated Dec. 15, 1958, No. 10, 4¾%	Feb. 1974	524,167	61,667	25,956
Dated Dec. 1, 1959, No. 11, 5⅝%	Feb. 1975	648,850	68,300	37,778
Dated Mar. 1, 1960, No. 12, 5¾%	Mar. 1975	3,040,000	320,000	182,467
Dated Aug. 1, 1960, No. 13, 5¼%	Aug. 1975	2,074,491	208,000	112,506
Dated May 1, 1961, No. 14, 4¾%	Jun. 1976	1,209,533	117,400	61,170
Dated Jan. 2, 1962, No. 15 & 16, 4¾%	Jan. 1977	1,674,300	152,400	84,958
Dated Nov. 1, 1962, No. 17, 5%	Nov. 1977	1,221,096	101,758	64,027
Dated Jul. 1, 1963, No. 18/22, 4½%	Aug. 1978	4,560,177	350,783	210,470
Dated Jan. 15, 1964, No. 23/27 4¼%	Jan. 1979	8,056,228	596,758	361,722
Dated Mar. 15, 1964, No. 28/29 4.45%	Mar. 1979	1,072,956	79,478	49,368
Dated Aug. 15, 1965, No. 30, 4¾%	Sep. 1975	1,848,993	184,899	15,614
		$ 53,626,139	$ 7,163,215	$ 2,356,749
MISCELLANEOUS OBLIGATIONS—				
Lease Purchase Agreements	Aug. 1968	$ 307,722	$ 102,574	$ 16,544

*Subject to sinking fund provisions under mortgage indentures:

First Mortgage Series A	$ 386,911
First Mortgage Series B	195,000
Income Debentures Series A	165,645

†Excludes bonds held in treasury as follows:

First Mortgage Series A	$1,970,000
First Mortgage Series B	1,247,000
Income Debentures Series A	941,000

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY SYSTEM

CONDENSED INCOME ACCOUNT AS OF DECEMBER 31, 1965

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	SLSF Ry.	NEO R.R.	QA&P Ry.	AT&N R.R.
Operating revenues	$ 140,635	$ 735	$ 3,254	$ 3,668
Operating expenses	105,296	405	1,454	1,942
Net operating revenue	35,339	330	1,800	1,726
Operating charges	15,364	160	531	1,599
Net operating income	19,975	170	1,269	127
Other income, net	7,175	5	2	**12**
Total income	27,150	175	1,271	115
Fixed and contingent charges	7,840	—	186	—
Income before Federal income taxes	19,310	175	1,085	115
Estimated Federal income taxes	3,650	74	466	110
Net income	$ 15,660	$ 101	$ 619	$ 5

CONDENSED BALANCE SHEET AS OF DECEMBER 31, 1965

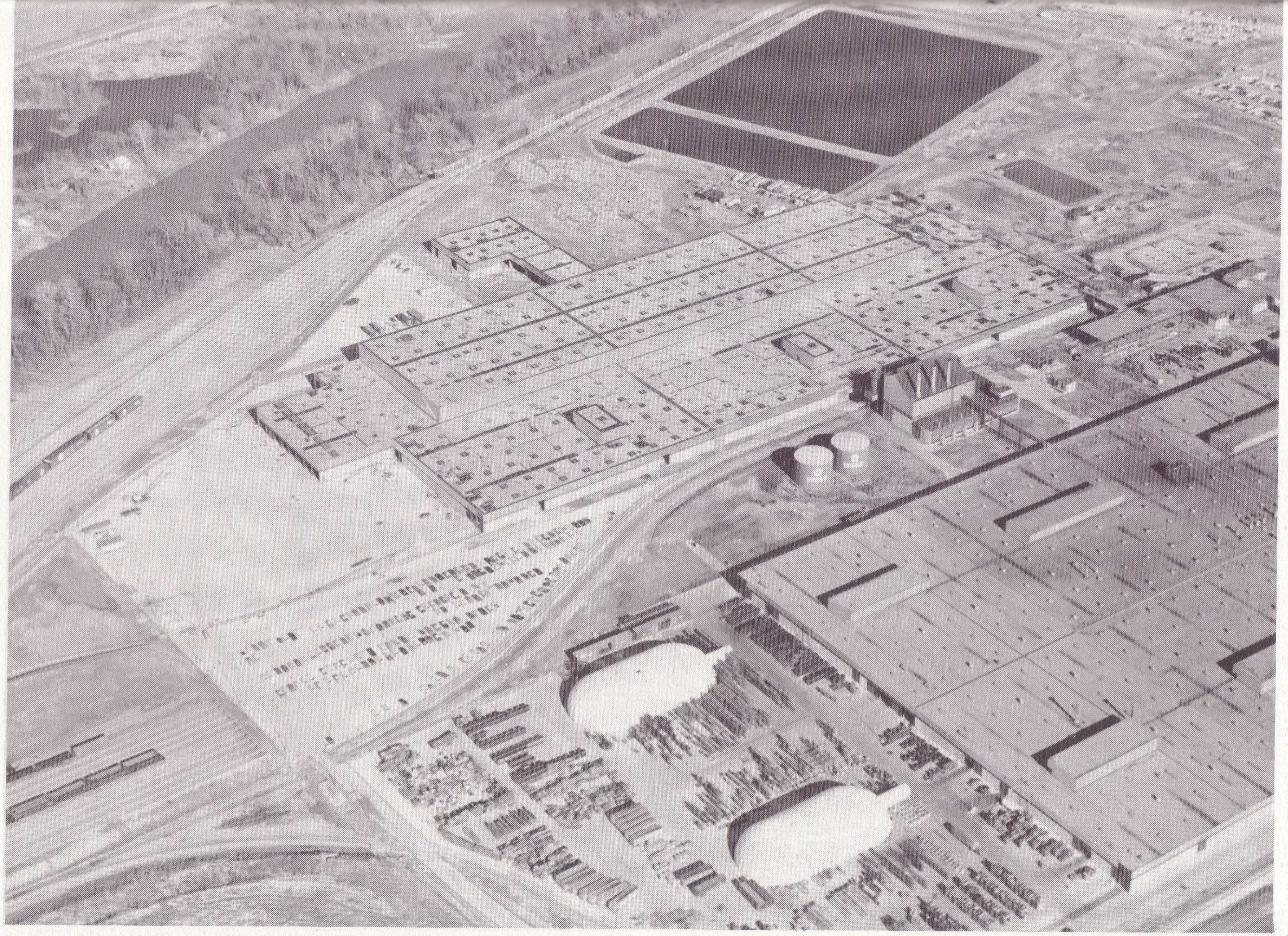
	SLSF Ry.	NEO R.R.	QA&P Ry.	AT&N R.R.
Assets:				
Current assets	$ 35,692	$ 761	$ 1,104	$ 773
Property investment — net	336,843	1,055	4,119	6,823
Investments — other	17,341	—	—	—
Other assets and deferred charges	7,434	3	10	12
Total assets	$ 397,310	$ 1,819	$ 5,233	$,7608
Liabilities:				
Current liabilities	$ 25,596	$ 379	$ 812	$ 1,105
Long term debt due within one year	7,266	—	—	—
Long term debt	158,662	—	—	1,241
Casualty reserves	1,438	—	62	—
Amount payable to affiliate companies	—	—	2,915	1,675
Other liabilities and deferred credits	1,470	9	22	171
Total liabilities	$ 194,432	$ 388	$ 3,811	$ 4,192
Shareholder's equity:				
Preferred Stock	$ 24,741	$ —	$ —	$ —
Common Stock	94,746	388	150	1,246
Capital surplus	14,893	253	—	828
Retained income	68,498	790	1,272	1,342
Total shareholder's equity	$ 202,878	$ 1,431	$ 1,422	$ 3,416
Total liabilities and shareholder's equity	$ 397,310	$ 1,819	$ 5,233	$ 7,608

*After inter-company eliminations.
Bold face type denotes contra.

AND WHOLLY OWNED SUBSIDIARY COMPANIES

omitted)

Birm. Belt R. R.	* Total Railroads	Frisco Transptn. Company	Clarkland Inc.	906 Olive Corp.	Other Co's	* Total All Co's
$ 387	$ 148,679	$ 2,935	$ 458	$ 986	$ 223	$ 152,390
335	109,432	2,900	54	682	221	112,516
52	39,247	35	404	304	2	39,874
126	17,780	169	39	62	4	17,963
74	21,467	**134**	365	242	**2**	21,911
78	1,631	**1**	**1**	—	—	1,647
4	23,098	**135**	364	242	**2**	23,558
101	7,767	—	19	163	—	7,940
97	15,331	**135**	345	79	**2**	15,618
—	4,300	—	140	30	23	4,493
$ **97**	$ 11,031	$ **135**	$ 205	$ 49	$ **25**	$ 11,125
$ 202	$ 37,458	$ 443	$ 134	$ 325	$ 72	$ 38,141
2,926	351,689	277	3,695	3,738	10	359,179
—	8,240	3	175	—	—	3,789
5	5,803	37	95	22	16	5,951
$ 3,133	$ 403,190	$ 760	$ 4,099	$ 4,085	$ 98	$ 407,060
$ 32	$ 26,846	$ 358	$ 157	$ 62	$ 49	$ 27,282
—	7,266	—	72	172	—	7,510
—	158,662	—	313	2,918	—	161,893
—	1,559	—	—	—	—	1,559
3,850	—	543	2,849	415	45	—
4	1,484	—	10	93	—	1,389
$ 3,886	$ 195,817	$ 901	$ 3,401	$ 3,660	$ 94	$ 199,633
$ —	$ 24,741	$ —	$ —	$ —	$ 6	$ 24,741
50	94,746	450	50	150	5	94,746
984	17,438	—	119	—	6	17,296
1,787	70,448	**591**	529	275	**13**	70,644
$ **753**	$ 207,373	$ **141**	$ 698	$ 425	$ 4	$ 207,427
$ 3,133	$ 403,190	$ 760	$ 4,099	$ 4,085	$ 98	$ 407,060



In the center is the new Dodge truck assembly plant at Fenton, Mo. In the right foreground is Chrysler's automobile assembly plant.

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A copy of a supplemental report which includes additional financial and statistical statements will be mailed to any stockholder or interested person upon request.

Write to:

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St. Louis, Missouri 63101