The Papers of Eugene Meyer (mss52019)

120_01_001-	Subject File, Federal Reserve Board, Railroad Financing, 1931-32

EUGENE MEYER

SUBJECT FILE

FEDERAL RESERVE BOARD
RAILROAD FINANCING

1931-32

December 30th, 1931

Mr. Eugene Meyer
1624 Crescent Place
Washington, D. C.

Dear Mr. Meyer:

Enclosed herewith is a memorandum on the financial problems of the railroads, together with a covering letter. You will appreciate that I have not access to any figures on bank loans of individual railroads except such as have been given to me, in a few cases, by Mr. Anderson. The figures on bank loans which I have used throughout the memorandum are those which he gave me in confidence for your use.

With this memorandum out of the way, I am preparing a study for you on the copper industry and one on the oil industry from the standpoint of emergency financial requirements. In a general way, I do not feel that either of these industries present any appreciable financial problems except to the extent that they may come in incidentally through banks. The problems of the operating companies themselves, whether in copper or in oil, are brought on by low prices and consequentldeficiency in earnings rather than by maturiting obligations or new capital requirements.

Sincerely yours,

HGM:MF
ENCLS

December 30th, 1931

Personal

Mr. Eugene Meyer
1624 Crescent Place
Washington, D. C.

Dear Mr. Meyer:

Enclosed herewith is a summary of problems affecting particular railroads during the next two years, based on such data as I have been able to obtain from the Bureau of Railway Economics, Standard Statistics, and a few personal contacts. You will realize that this is prepared along broad general lines so as to get a quick survey of the most important aspects of the railroad problem from a financial standpoint.

In a broad general way, it may be said that the railroads of the United States as a whole will just about show their aggregate fixed charges of $700,000,000 earned in 1931. During the closing months of 1931 business was somewhat worse than for the average of the year, though not as much worse as one might have expected. As an illustration, car loadings are off 26.8% as compared with 1929 during the first six months of 1931, off 33.6% for the five months ending with November, and 28.9% for the year to December 12th. Therefore, it would appear that the showing of the last few months, as compared with 1929, is reflected only by about 5% difference in car loadings as compared with the average of the year. Projecting this ratio forward and allowing for a somewhat greater rate of decline in passenger and express business, the indications are that on the basis of railroad traffic conditions during the last few months, the railroads might fall around $200,000,000 to $250,000,000 short of earning their interest charges.

It is expected that the rate increase granted by the Interstate Commerce Commission would bring in about $120,000,000 annually and a 10% wage cut should reduce operating costs by approximately $200,000,000 annually. Therefore, it appears that the railroads of the United States as a whole might be able to cover their fixed charges on the basis of business conditions as they have been during the latter half of 1931, with the benefit of the rate increase already authorized and the benefit of the expected 10% wage reduction.

The fact that the railroads as a group might show such a result would not mean that every railroad could earn its interest charges, for some will show substantially more than interest earned and others will show substantial deficits, but the picture as a whole is not without definitely encouraging aspects.

There are, of course, certain broad aspects of the railroad problem which require action going far beyond financial relief, such as regulation of truck and waterway competition or adjustment of state and local taxes which now aggregate around $320,000,000 annually, but these problems are part of the more distant rather than of the immediate future.

The situation respecting the immediate financial necessities of the railroads is fairly clear. In 1932 there are bond maturities of approximately $60,000,000. Of these, $20,000,000 represents the Three Year Notes of Nickel Plate which present a special problem discussed in detail in the accompanying memorandum, and $20,000,000 represents a mortgage issue of St. Louis Southwestern, also involving certain problems in connection with the relations of this road to Southern Pacific. The remaining $20,000,000 represents mostly small underlying issues of roads in good condition, and it is to be presumed that the maturities of many of these issues could be extended if such a course were thought advisable.

In 1933 bond maturities total about $181,000,000 and these involve some very large situations such as $68,000,000 Baltimore & Ohio, $14,000,000 Chicago & Northwestern, nearly $42,000,000 Great Northern, and $35,000,000 Missouri Pacific, which represent something much more than possibilities of extension or refinancing of underlying liens.

Equipment obligations mature to the extent of $110,000,000 in 1932 and $107,000,000 in 1933. It is of interest to note that the railroads as a whole in 1930 charged against operation some $230,000,000 for depreciation and retirements and even on a greatly reduced scale of write-offs, the railroads of the United States as a whole, if earning their operating expenses and interest, should be able to meet equipment maturities out of current depreciation accruals. Even aside from this possibility, equipment trust obligations represent the best form of security and therefore the simplest financing problem involved in the whole railroad situation.

Bank loans may aggregate somewhere around $260,000,000 and these, plus construction requirements, may represent the largest items to be dealt with during the year 1932. Apparently the largest single piece of financing which involves both bank loans and imperative construction requirements, will be presented by New York Central, which is said to be desirous of raising $100,000,000 at a comparatively early date, partly to cover $40,000,000 bank loans, partly to cover a few small items of maturities and partly for financing the immense construction program involved in the West Side improvement in New York City.

The railroads have been spending somewhere around $500,000,000 annually on new capital expenditures in recent years. It is difficult to arrive at any figure representing the irreducible minimum of capital expenditures, but Mr. J. H. Parmelee, in a letter to the writer, states that he would place the figure of minimum necessary capital expenditures at not less than $250,000,000 annually, stating that in his judgement this is the figure below which the railroads could not go in any year "without showing signs of such a degree of inanition as would lead to their final decay".

From all of the above it would appear that the railroad financial requirements for 1932, to be taken care of in one way or another might aggregate approximately $680,000,000, made up of $60,000,000 bond maturities, $110,000,000 equipment maturities, $260,000,000 bank loans and $250,000,000 new capital requirements.

Sincerely yours,

HCM:MF
ENCL

MEMORANDUM ON FINANCIAL REQUIREMENTS OF RAILROADS

The following memorandum is based on the financial position of the railroads as far as it can be determined here from the fragmentary information available, which is necessarily not complete or up to date with respect to bank loans or changes in maturity dates as a result of any transactions since December 31st, 1930. The memorandum in most cases deals with figures in round millions, except where the items are too small to warrant such treatment. The list of maturities eliminates certain items which are technical only. For example, the list of maturities prepared by the Bureau of Railway Economics includes for 1932 a $16,834,000 maturity of the Chicago & Alton which mortgage was foreclosed and purchased by the Baltimore & Ohio for around $3,900,000 and the entire amount is therefore omitted from this summary. The same list includes a maturity in 1933 of the Seaboard Air Line aggregating $6,198,000 and since Seaboard is already in the hands of receivers, its maturities are also omitted from this list.

Bank loans are available in rough totals for the principal railroads as a group, with only fragmentary details regarding certain roads, for the purpose of this memorandum. There is nothing available as to probable minimum new capital requirements except a very general estimate that these may total about $250,000,000 annually.

Subject to the above qualifications, the financial requirements of the railroads, without regard to deficits which may accrue during the next two years as a result of deficiencies in earnings in excess of any amounts which can be handled by the Railroad Credit Corporation, are as follows:

		1932	1933
Bond Maturities		$ 60,000,000	$181,000,000
Equipment Obligation Maturities		$110,000,000	$107,000,000
Bank Loans, First of Year	(about)	$260,000,000	(?)
Minimum New Capital Requirements		$250,000,000(?)	$250,000,000(?)

With respect to equipment obligation maturities, these should represent the easiest financing problem of all, first, because in the case of most roads the charges for depreciation and retirements, included in operating expenses, probably cover all or a substantial part of the current equipment trust maturities, and, second, equipment trust obligations stand practically at the base of railroad credit and enjoy a preferred market position as well as a preferred position with regard to safety of the investment, though perhaps with exceptions as to certain types of passenger equipment.

In recent years the railroads have been spending around $500,000,000 annually on new capital requirements, though these expenditures in the future need not be anywhere near as great if the business is to be adjusted only to the maintenance of the status quo with a minimum amount of expansion and improvement. This question, of course, ties in also to matters of State and Government policy, since it involves work such as grade crossings, etc., done under the order of Federal, State or Municipal government.

The following discussion covers in detail the situation with respect to bond maturities of principal roads and bank loans where data is available. It is given in alphabetical order, except that Nickel Plate (New York, Chicago & St. Louis Railroad Company) is discussed first.

NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY

The New York, Chicago & St. Louis Railroad Company faces a maturity on October 1st, 1932, of $20,000,000 Three Year 6% Notes issued in 1929. There is also a maturity of a divisional bond, Lake Erie & Western Railroad 6's, April 26th, 1932, in the amount of $130,000 and there are certain other small maturities in 1932 aggregating an additional $130,000. All of these items are included in the total of maturities in the table earlier in this memorandum. There are no maturities listed for 1933. In addition, there is a bank loan, apparently handled through the Guaranty Trust Company, of $6,000,000 due February 22nd (23rd?), 1932. This is not included in the maturity total above for the reason that it is considered as a short-term bank obligation rather than an item of funded debt. As far as data is available for the purpose of this memorandum, this road is not in the banks to any appreciable extent outside of the foregoing loan.

The $6,000,000 loan maturing next February was raised primarily on account of the shortage of income during 1931, and therefore represents in large part the financing of current deficits after distributions. It is secured by $10,500,000 New York, Chicago & St. Louis 4½% Refunding Mortgage Bonds and Certificates of Deposit for 115,193 shares prior lien stock, 14,800 shares preferred stock and 168,000 common stock of Wheeling & Lake Erie Railway, this being all of the Company's holdings in Wheeling & Lake Erie stock through the medium of a certain deposit agreement growing out of a transactions financed by the $20,000,000 note issue maturing October 1st, 1932. The latter transaction was as follows:

This goes back to a transaction by which the Baltimore & Ohio, the New York Central and the Nickel Plate purchased Wheeling & Lake Erie stock from the Rockefeller interests. This transaction was not approved by the Interstate Commerce Commission and as a result the New York Central and the Baltimore & Ohio turned over their Wheeling & Lake Erie interests to the Allegheny Corporation. Nickel Plate was also ordered to divest itself of Wheeling & Lake Erie interests, but after much negotiation the stock held by Allegheny Corporation was purchased by Nickel Plate and deposited in the hands of E. R. Fancher of the Federal Reserve Bank of Cleveland as Trustee. Nickel Plate issued $20,000,000 notes for the purpose of purchasing the Wheeling & Lake Erie stock from Allegheny Corporation. The notes <u>are not secured by mortgage or collateral</u>. They, therefore, represent the extreme upper limit of the funded debt structure.

Including the above notes, but not including any bank loans, Nickel Plate as of August 1931 had outstanding $148,000,000 funded debt, of which $8,000,000 represented equipment obligations, also $36,000,000 preferred stock and $33,000,000 common stock. In 1929 earnings totalled $13,687,000,000 available for charges aggregating $6,297,000; in 1930, $12,324,000 available for charges totalling $7,927,000; in 1931, the indications are that income will be slightly under fixed charges. It has been calculated that the amount accruing from the proposed rate increase on the basis of 1931 traffic would aggregate

$1,398,000 annually, which would show some margin above interest charges on the basis of 1931 results.

However, it should be noted that the income account includes $2,070,000 dividend income in 1929 and $5,913,000 dividend income in 1930. No figures are available for 1931 but there are indications that dividend income received in this year will have been very substantial and perhaps almost equal to that of 1930.

A very large, if not by far the greater, part of this dividend income must be considered as non-recurring, for it represents dividends received from the Pere Marquette Corporation, which latter made profits by the sale of Pere Marquette stock to Chesapeake & Ohio and distributed part of the profits as dividends in 1930 and part in 1931. There may also have been dividend receipts from another subsidiary, the Nickel Plate Development Company. Also, dividends may have been received from Wheeling & Lake Erie stock in 1931 since a distribution on the prior lien stock was made in that year. It is of interest to note that without the credits for dividends received this road would have had available for fixed charges only $10,500,000 in 1928, $11,600,000 in 1929, $6,400,000 in 1930 and, perhaps, only around $3,000,000 in 1931 available for fixed charges aggregating at the present rate around $8,000,000 annually.

It is evident that the problems of Nickel Plate are of a very special nature and relate to the whole scheme of railroad consolidation in the Eastern Territory. The road finds itself facing on October 1st, 1932 the maturity of an unsecured obligation, probably not held to any extent by savings banks, insurance companies or trust funds, which obligation was assumed for the purpose of buying Wheeling & Lake Erie stock from Allegheny Corporation. A substantial part of the income of the road has come from dividends arising out of security transactions, and perhaps out of other transactions of a non-recurring nature, and because of the outside investment position the fixed charges are high in proportion to the normal past earning power of the railroad itself. It is for these reasons that so extended a discussion is given in this memorandum.

BALTIMORE & OHIO — No bond maturities for 1932, but $63,000,000 maturing March 1st, 1933 and $5,000,000 maturing October 1st, 1933. No data as to bank loans. Company is expected to earn 1.20 times fixed charges in 1931.

BOSTON & MAINE — Bond Maturities $2,563,000 in 1932, $5,228,000 in 1933. These maturities represent general mortgage bonds or underlying issues to be refinanced through general mortgage. The first maturity of importance is $2,400,000 General Mortgage 5's, Series HH, March 1st, 1932, next important issues being $3,828,000 January 1st, 1933 and $1,000,000 February 1st, 1933. No data available regarding bank loans.

This road is in pretty good condition, for the six years ending 1930 rate of earnings was nearly twice present rate of fixed charges and the year 1931 will probably show earnings of $7,500,000 to $8,000,000 available for $6,333,000 interest. Truck and passenger automobile competition is already extensive and has been effective for some years past. It should be possible to find a very simple and satisfactory basis for financing these maturities.

CHICAGO & ALTON — The $16,000,000 issue noted in maturity lists represents a mortgage which has been foreclosed, consequently this item is omitted from this discussion as noted earlier herein.

CHICATO & NORTH-WESTERN RAILWAY — Chicago & Northwestern has no maturities in 1932, but will face a maturity of $6,500,000 May 1st, 1933 and $7,700,000 October 1st, 1933. No data on bank loans. Will earn only around $10,000,000 in 1931 available for fixed charges totalling $16,000,000. Past record of road good, but business seriously affected by combinations of industrial and agricultural depressions. Is particularly affected by falling off in the movement of iron ore.

ERIE RAILROAD — Erie has no maturities in 1932, but faces a maturity of $4,616,000 New York & Erie Railroad extended mortgage 4½'s on March 1st, 1933. Is said to owe banks about $2,500,000 now and will have to increase its bank indebtedness on account of deficiancy in earnings. Apparently earnings for 1931 will be about 90% of fixed charges (which aggregate $16,000,000 annually). Was earning fixed charges with comfortable margin from 1922 to end of 1930.

The maturity of March 1st, 1933 represents a small underlying issue which has already been extended once. It is secured on an essential part of the Erie system, though by a third lien, and covers 446 miles subject to underlying mortgages of around $4,600,000.

LONG ISLAND RAILROAD — Long Island Railroad has a maturity of $332,000 on June 1st, 1932 and one of $1,262,000 on October 1st, 1932. Both of these represent underlying bond issues.

Long Island has been earning about three times its interest requirements, with earnings for 1931 being almost up to those of 1930. No data is available as to bank loans or immediate future requirements for new capital.

MISSOURI PACIFIC RAILROAD

Missouri Pacific has no maturities of any particular importance in 1932 but there is one of $34,500,000 (St. Louis, Iron Mountain & Southern First Mortgage 4's) on May 1st, 1933. It is said that the Company is in fair condition financially and does not owe money to banks, having financed a maturity of $43,000,000 in 1931, and also its more pressing and immediate needs, by the sale of $61,000,000 First and Refunding 5's in February 1931.

This Company had a large construction program involving the double tracking of its main line for 126 miles west from St. Louis, which was carried on without interruption from 1925 on at a total cost of $25,000,000, and the work was practically completed in 1931.

This railroad has been put in very good condition in recent years and its earnings have shown substantial improvement. It has been fortunate in being the principal outlet, through its subsidiary, International-Great Northern, for the new oil fields in East Texas. The Company's capital structure is marked by very heavy funded indebtedness in proportion to stock, there being outstanding $410,000,000 funded debt, $71,000,000 preferred stock and $82,000,000 common stock.

Indications are that for the year 1931 earnings will be about 12% in excess of fixed charges, consequently the Company is not as yet faced with the accrual of deficits. Fixed charges are now at the rate of around $19,000,000 annually. It is expected that the proposed rate increase, based on 1931 traffic, would increase revenues by $2,860,000 annually.

This road seems to offer no immediate problem and it seems to present the possibilities of a sound basis for financing the large maturity of May, 1933.

NEW YORK CENTRAL RAILROAD COMPANY On the list of the maturities furnished by the Bureau of Railway Economics, New York Central shows only a nominal amount of $250,000 for 1932. However, there is a maturing obligation of a subsidiary, the Pine Creek Railway First Mortgage 6's due December 1st, 1932 in the amount of $3,500,000. This mortgage has been assumed by the New York Central Railroad Company and is therefore part of its obligations. There are also some other smaller items involving bonds of various leased or controlled companies including the P. McK. & Y. First 6's, which mature July 1st, 1932 in the amount of $2,250,000. Consequently, New York Central has to make provision on account of its subsidiaries for at least $5,750,000 in refunding obligations in 1932, representing amounts not listed in the tabulation furnished by the Bureau of Railway Economics. These figures are taken into account in arriving at the total shown in the earlier part of this memorandum.

However, the maturities form an exceedingly small part of the New York Central's problem. They are said to owe approximately $40,000,000 to banks, and to have ahead of them very large expenditures over the next few years for the West Side improvement in New York and for other large construction programs. It is estimated that they will need to raise at an early date approximately $100,000,000 to cover maturities, bank loans and construction programs.

During 1931 New York Central's net income from railway operations has been almost exactly cut in half. Assuming no change in dividend income the outlook is that they will just cover their fixed charges in 1931. It is estimated that the proposed rate increase will bring them in an additional $10,150,000 annually on the basis of 1931 traffic, which amount is approximately one-sixth of their Present annual rate of fixed charges.

It should be noted that New York Central is very largely dependent on outside income. For the year 1930 total operating income was $57,000,000 and income from outside sources was $39,000,000. Fixed charges totalled $58,000,000 and taxes and other deductions totalled slightly over $2,000,000. The outside income included $14,000,000 in dividends, $6,000,000 interest from funded securities, $4,000,000 interest from unsecured securities and $5,000,000 from rents, also several other large items of income from outside sources. Without full supporting details on the outside income, it is impossible to form any estimate as to its probable variation in the near future.

New York Central has very large real estate interests in the vicinity of Grand Central Station. They appear to have an investment of some $14,000,000 in New York Central Building and nearly $3,000,000 in the Hotel Biltmore. They also have an investment of $5,000,000 in the Waldorf Astoria Hotel, in which latter building the New Haven also has an investment of $5,000,000. It is said that the securities held by the New York Central and the New Haven in connection with their advances to the Waldorf Astoria are fairly close to the property in order of lien and that a large part of the investment in that building was financed with a junior position. It is also said that most of New

York Central's interest in property in the Grand Central area is now on a basis of ground rents and that where it does have any interest in buildings, through advances made to stimulate construction, the interest is comparatively small and well protected. However, there may be a situation here calling for further investigation if a large financing operation is considered in connection with New York Central, for the reason that this company's interests in the real estate situation in New York may have an important bearing on its earning power in the immediate future.

NEW YORK, NEW HAVEN & HARTFORD R. R. CO. The Bureau of Railway Economics tabulation shows no maturities for New Haven in 1932 or 1933, but a leased road, the Old Colony railroad, has a maturity of $1,000,000 3½% Bonds due July 1st, 1932. This amount is included in the tabulation at the beginning of this memorandum. This is a well secured underlying lien. The maturity is a small item, but New Haven has bank loans of around $10,000,000 to $15,000,000. They have been paying off several small bond issues during recent years and have been making some advances on real estate development in the Grand Central area including an investment of $5,000,000 in the Waldorf Astoria Hotel, as noted above. They have no earnings deficit as yet and are expected to earn about $3 per share in 1931.

NORFOLK & WESTERN RAILWAY Norfolk & Western has maturities aggregating $2,326,000 in 1932. The road is in splendid condition financially and for the first eleven months of 1931 showed earnings equivalent to $13 per share on the common stock as against $20 per share for the corresponding period of 1930. This is one of the soundest railroad situations in the United States and the handling of these small maturities should be quite simple.

NORTH PACIFIC RAILWAY — This road faces no financial problem as yet and has no maturities in the next two years, but will be faced by the fact that Burlington, on which it has been depending so heavily for dividends, will fall short of earning its dividends by at least $3,500,000 this year and will either have to reduce its dividend or borrow money in 1932. This is a problem which may come up for later consideration.

OREGON SHORT LINE RAILROAD COMPANY — Oregon Short Line has no immediate problems but on August 1st, 1933, will have to meet a $4,991,000 maturity, Utah & North Railway First 4's. These are very high-grade bonds secured by first mortgage on 484 miles of line extending from Ogden, Utah to Butte, Montana.

PERE MARQUETTE RAILWAY A — Pere Marquette faces a maturity of $3,000,000 on July 1st, 1932, the Lake Erie & Detroit River Divisional 4½'s, a high-grade bond not disturbed in the last reorganization. The Company does not owe anything to banks and has enough cash to take care of its deficits up to the end of 1931, but it is accumulating a very serious deficiency of earnings on account of the falling off of the automobile business on which it is so largely dependent.

Pere Marquette has fixed charges aggregating around $3,000,000 annually, and is dependent for these principally on operating income, its outside income being quite small. For 1931, the indications are that Pere Marquette will not earn much more than one-third of its fixed charges. The proposed rate increase, based on 1931 traffic, is expected to add only about $1,000,000 additional, so that even with this rate increase the road will earn only about two-thirds of its fixed charges. Therefore, the indications are that Pere Marquette may need as much as $6,000,000, in 1932, $3,000,000 for maturities and $3,000,000 for operating deficits and various corporate purposes.

<u>READING COMPANY</u> It will be recalled that Reading Company was formerly a holding company carrying on railroad operations through the Philadelphia & Reading Railroad Company, and coal mining operations through the Philadelphia & Reading Coal & Iron Company. In recent years the capital structure has been changed, stock of the Philadelphia & Reading Coal & Iron Company has been distributed and the railroad operations have been consolidated and are now carried on under the name of the Reading Company. Reading also owns about 53% of the capital stock of Central Railroad of New Jersey.

This company does not face any maturities until October 1st, 1933, when the Philadelphia & Reading prior lien extended 5's mature in the amount of $2,643,000. No data is available as to bank loans. Indications are that for the year 1931 the Company will earn 1.4 times its fixed charges, which latter item is at the rate of approximately $8,600,000 annually. However, the Company's outside income is substantial, aggregating nearly $5,000,000 annually, made up principally of $2,000,000 in dividends and $2,400,000 miscellaneous. Dividends from Central Railroad of New Jersey have been aggregating around $1,750,000 annually. As Central Railroad of New Jersey has now passed its dividend, Reading Company will lack this source of income in the immediate future. The 1931 income, without the dividends from Central Railroad of New Jersey, would have been equivalent to approximately 1.2 times fixed charges.

ST. LOUIS SOUTHWESTERN RAILWAY

On June 1st, 1932, this road faces the maturity of $20,720,000 First Consolidated Mortgage 4's. This road has a total funded debt of $52,000,000 bonds, $3,000,000 equipment obligations, and has guaranteed nearly $5,000,000 bonds of subsidiaries and has a liability of $5,000,000 as its proportion of other bond guarantees. The bonds maturing on June 1st, 1932 are secured mostly by a third lien and may be considered as representing the top 40% of the bonded debt structure.

There is no data available, for the purposes of this memorandum, regarding the Company's bank loans, except a statement quoted from a letter of the Southern Pacific Company to a stockholders' committee on June 18, 1931, to the effect that floating debt approximated $9,000,000.

St. Louis Southwestern is now a part of the problems of Southern Pacific, since the latter company has already acquired a substantial part of the outstanding stock and has made an offer for additional stock, it being reported that Southern Pacific owns, holds under option, or has agreements for exchange with, St. Louis Southwestern stock up to a total of 85% of the outstanding preferred and common.

It is estimated that for the year 1931 St. Louis Southwestern will show earnings of approximately 90% of fixed charges, which latter are at the rate of around $2,800,000 annually, including income* bond interest. It is estimated that the proposed rate increase, based on 1931 traffic, would add $630,000 annually to earnings available for interest.

The maturity of this bond issue on June 1st next, apparently will necessitate a final settlement of the whole question of Southern Pacific control of St. Louis Southwestern, and, if Southern Pacific controls and the road is to be taken into the Southern Pacific system through the acceptance, by the remaining stockholders representing a 15% minority interest, of the offer of Southern Pacific of three shares of the latter company for each five shares of St. Louis Southwestern preferred and one share for each three shares of St. Louis Southwestern common, then Southern Pacific will become the interested party in the refunding operation, and the whole problem of collateral, terms, etc., will be very different from the one which will be presented if St. Louis Southwestern is to be assisted solely on the basis of its own performances.

<u>SOUTHERN RAILWAY</u> Except for equipment trust maturities aggregating $4,000,000 annually, Southern Railway has no maturity problems over the next four years. The Company does not owe any money to banks and has been able to carry itself so far in spite of the fact that for the year ending December 31st, 1931, its earnings apparently will be at the rate of only 73% of fixed charges, which latter aggregate approximately $17,000,000 annually. In 1930 earnings available for dividends were only $9,000,000 and dividends were paid to the extent of $13,000,000, leaving a deficit of $4,000,000. In spite of this strain, the Company had $12,000,000 cash and $17,000,000 U. S. Treasury notes on December 31, 1930. During 1931 to date $6 per share was paid on the common and $5 on the preferred, or a total of $10,800,000 in dividend disbursements. Taking into account the deficit in earnings as compared to fixed charges, the indications are that Southern Railway

during 1931 will have used up at least $16,000,000 of the $29,000,000 cash and Treasury Notes available at the end of 1930.

Apparently Southern Railway can carry itself for some time as far as deficits are concerned, particularly since the proposed freight rate increase would add $2,745,000 annually on the basis of 1931 traffic. However, the Company faces the necessity of dragging Mobile & Ohio, which in turn presents certain special problems, though they are small in their effect on Southern Railway in proportion to the great volume of business handled by the latter, and earnings accruing therefrom, under normal business conditions.

Southern Railway guarantees $5,650,000 Mobile & Ohio Stock Trust Certificates, calling for dividends at the rate of 4% annually. Through the guarantee, these apparently are a definite obligation of Southern Railway Company both as to principal and interest. Mobile & Ohio failed to earn fixed charges by $930,000 in 1930 and in 1931 will not even earn operating expenses. The situation of Mobile & Ohio is said to have been rendered especially critical by the competition of Government operated barges on the Mississippi River and the Warrior River. Southern Railway will soon be faced with the problem of either supporting Mobile & Ohio to the extent of its entire fixed charges, which aggregate approximately $1,700,000 annually, or losing the road and still being saddled with the burden of the stock trust certificates.

Southern Railway is also contesting a suit brought by certain Mobile & Ohio minority stockholders claiming that $9,000,000 in dividends paid by Mobile & Ohio to Southern Railway should have gone to Mobile & Ohio stockholders.

Thus it appears that while Southern Railway is a fundamentally sound situation, which should come back quickly with the return of normal business conditions in its territory, and while Southern Railway in itself has no pressing financial problems, there are collateral problems with relation to its interests in Mobile & Ohio which may call for special consideration.

WESTERN PACIFIC RAILROAD — This road has no maturities, but it owes around $3,000,000 to $4,000,000 to banks and in addition will need about $4,000,000 during the first half of 1932 to take care of accruing deficiencies. This company has kept to the policy of putting the road in good shape and it has been extending its lines northward to connect with the Great Northern extension southward from Klamath Falls, Oregon and open up a new lumber producing area, which latter step is rather unfortunate in the light of the present condition of the lumber market. The indications are that for 1931 Western Pacific will earn only about one-quarter of its fixed charges, which aggregate around $3,500,000 annually. This road presents a rather complicated system of holding and subsidiary companies and has a good deal of construction work under consideration or under way and no doubt will require a great deal of special investigation to determine what type of security may be available for financial transactions.

MISCELLANEOUS — In addition to the above, there are one or two other situations which will need further consideration later on. As an illustration, Great Northern has nothing pressing at the moment but has a maturity of nearly $42,000,000 in August, 1933 and as the problem of refunding this arises, presumably in the early part of 1933, the matter of deficiencies in Burlington earnings will also require consideration. Furthermore, Denver & Rio Grande may present some problems at a later date on account of an order from the Interstate Commerce Commission to go through with its contract to purchase Denver & Salt Lake for $3,000,000, and as Denver & Rio Grande, while facing no maturities, owes about $1,500,000 to $2,500,000 to banks and has a deficiency in earnings, the whole question of financing this purchase in combination with existing bank loans and accruing deficiencies will require special consideration.

EGM:MF
12/30/31

January 30, 1932

Hon. Eugene Meyer
1624 Crescent Place
Washington, D. C.

Dear Mr. Meyer:

Enclosed herewith is a memorandum covering certain broad features of the railroad financing problem, based on what I have been able to see in it to date. It seems to me that there are certain broad problems calling for fery early consideration, so that a policy can be adopted in connected with the applications as they come in. As an illustration, it might be thought desirable to call a conference of banking interests and get some understanding as to the attitude of banks in connection with their loans. I believe that the Interstate Commerce Commission will defer action, without prejudice, in connection with applications for the repayment of bank loans and make recommendations regarding other purposes in the thought that some general policy as to bank loans can be developed before the specific question of any one loan is passed upon by them.

I am of the opinion that we will be able to make some kind of very satisfactory arrangements with or through Coverdale & Colpitts for assistance in the investigation of railroad applications, and this, I feel, will be a very happy solution, for they are generally considered outstanding authorities in such matters and have a nationwide reputation.

Sincerely yours,

HGM:MF
ENCL

MEMORANDUM ON PROBABILITY OF IMMEDIATE RAILROAD REQUIREMENTS

From the applications being presented, it seems clear that many railroads will ask assistance for about the same general type of purposes. Many applications will cover all of these purposes and some will cover only a few, but it seems important to get a grasp of the problem as a whole so that some common policy may be developed.

Aside from special problems involved in new construction, completion of large construction programs, or special cases of small roads, the purposes covered by the applications will be as follows:

1. To pay up accumulated audited vouchers.
2. To meet maturities of equipment trust obligations.
3. To cover earning deficits.
4. To cover additions and betterments.
5. For the retirement of bank loans.
6. To meet maturities other than equipment obligations.

1. TO PAY UP ACCUMULATED AUDITED VOUCHERS. This situation is presented already in the application of the Wabash and in the application of the Erie. Wabash asks $5,000,000 for this purpose and Erie $2,000,000. The Wabash situation represents the accrual of unpaid audited vouchers up to the date of receivership and Erie represents accruals in excess of normal. The point made by the applicants is that they are behind on payments, that they are being pressed by creditors, that the creditors need the money badly for their own purposes and have

often assigned their bills to banks, deposited their accounts with banks as collateral and in various ways become frozen themselves or assisted in freezing the banking situation generally throughout the country. It is stated that many of the large roads are in good shape in this respect and not behind on their bills, but that many other roads such as the Van Sweringen lines in general, the Frisco, Rock Island, Mobile & Ohio and Wabash, are pretty well behind on payment of bills. The names of these roads are given without authority except that of discussion among informed circles, representing comment coming through from supply men. It is reported that the amount of money involved in this situation may be somewhere around $25,000,000 to $30,000,000. In other words, it is thought that the railroads as a whole are behind on their payments on audited vouchers to this amount in excess of normal, and that they are freezing industry, and indirectly, banks, to this extent. It is possible that this proposition may involve as a collateral an undue pulling down of cash deposits on the part of a number of railroads, thus making them sail very close to the wind from their own standpoints and also affecting the deposits of the multitudinous banks in which their accounts are carried all over the country. It is obvious that creditors of this type become in receivership, to a considerable extent at least, potential holders of liens underlying the bond issues, yet from a practical standpoint it does not appear that it will be possible to finance them except on liens junior to loans still paying interest, or at least liens pari passu with those of most junior securities still paying interest.

2. TO MEET MATURITIES OF EQUIPMENT TRUST OBLIGATIONS. This problem involves in the case of Wabash, and in the case of Seaboard, if an application should be presented, a comparatively small amount of maturing equipment obligations already in default. The total amount of equipment obligations maturing during 1932 for all of the Class 1 railroads, is estimated at $110,000,000. A large part of these no doubt represent the obligations of strong roads which can meet such payments out of depreciation reserves, or whose credit is still good enough to permit financing them through existing channels. However, accruals from depreciation charges are of no use unless the cash is available for the purpose of meeting the maturity, and a very large number of roads may apply for assistance in meeting these maturities. The applications will be made on the theory that equipment is vital to the roads and also on the theory that the maintenance of the integrity of equipment trusts is vital to railroad finance.

The question of making advances for the purpose of meeting such maturities will present some specific problems as to security, for equipment obligations are, to a certain extent at least, to be considered as a practical underlying lien, on the theory that the equipment is necessary for the operation of the roads. However, there will be certain difficulties presented in attempting to continue the lien on the equipment if money is advanced for the purpose of meeting a certain maturing obligation. If the maturity is paid and cancelled, it would seem that in many cases the remaining equity in the equipment, subject to later maturities, would pass under various mortgages through the operation of after-acquired property clauses. If the maturing part of the obligation is kept alive, either through purchase by the railroad or by assignment to the loaning agency, it may be that a lien on the equity can still be kept, but that this lien will be subordinated to the liens of all later maturities. The question of the desirability and the practicability of trying to keep a lien on the equipment will require a determination of policy since it will be a problem common to every application for this purpose.

3. TO COVER EARNING DEFICITS. It is the theory of the Railroad Credit Corporation that impounded monies resulting from Ex Parte 103, the order authorizing the freight surcharges, will be available as loans for the purpose of meeting operating deficits and interest requirements. This application is not available for roads already in the hands of receivers, the funds may not be available to some roads at a sufficiently early date, and the increase in revenues resulting from these surcharges may not come up to expectations,--consequently there may well be many roads which will ask assistance for this purpose either before, or coincidental with, applications to the Railroad Credit Corporation. While each case will present special problems, there may be a problem common to all and warranting discussion as to general policy.

4. TO COVER ADDITIONAL AND BETTERMENTS. Aside from large special problems of improvement or new construction, every railroad has a normal program of small additions and betterments, and these are normally met out of surplus income. It is therefore probable that each

road making an applications for an advance, these no doubt being principally roads having a threatened deficiency of income, will request assistance for the purpose of carrying on these ordinary minor programs. It would appear that such requirements cannot be financed through the Railroad Credit Corporation, though this point may require further investigation. At any rate, the problem will be a common one presented frequently.

5. FOR THE RETIREMENT OF BANK LOANS. This problem is being presented in the applications first coming to hand and it is a very large and fundamental one. It involves the question of whether or not the banks, which generally speaking are about the same group of large banks, are going to continue in their present financial position with respect to the railroads or whether they are to be repaid. In a few cases, where receiverships are involved, the maturity of the bank loans has been accelerated by legal action such as receivership. In most cases, however, these are short-term loans not yet matured but perhaps maturing at a comparatively early dates. It would seem that this problem must necessarily be met in principle as a whole, and not piece-meal, though specific problems will be presented in individual cases. No exact data is available as to the amount of such loans except a general statement that they may total somewhere around $260,000,000 for all Class 1 railroads.

6. TO MEET MATURITIES OTHER THAN EQUIPMENT OBLIGATIONS. This presents the simplest problem of all since the amounts maturing in 1932 aggregate only $60,000,000 and for 1933 $181,000,000. Each case is a separate

and distinct one, involving questions of earning power, value of physical property, character of security available, such as the possibility of extending the mortgages securing the maturing obligations, possible marketability of the obligations created and such specific questions of a nature peculiar to each case. These maturities do not seem to present the general common problems involved in connection with advances for unpaid audited vouchers, maturing equipment obligations, or bank loans.

HGM:MF
1/30/32