



CONTINUOUS RAIL

Alaska Railroad 2010 Annual Report



A message from the Chairman

John Binkley



In 1995, former Governor Bill Sheffield and I joined recently-appointed Jack Burton as members of the Alaska Railroad Corporation (ARRC) Board of Directors. The railroad had just closed the books on 1994 and the outlook was grim for the fledgling state enterprise. ARRC was operating in the red with a net loss of \$3.2 million on gross revenues of \$54.8 million. The debt-to-equity ratio was shaky, the capital budget was a meager \$8.8 million and the asset value stood at \$113 million.

While the state had paid only \$22 million for the entire railroad, the federal government had neglected the asset. If the Alaska Railroad was to survive, a substantial capital investment was required to get the line back into shape.

Fast forward to the end of 2010...ARRC showed a net income of \$13.4 million on gross revenues of \$167.1 million.

The average annual capital budget over the last five years has been \$86.5 million and ARRC's balance sheet is solid with nearly \$1 billion in assets.

Over the last 15 years, Governor Sheffield, Jack and I have remained a constant in the railroad's governance, working with fellow Board members to build a strong foundation with a focused and sustained effort. Assisted by Senator Ted Stevens and Alaska's congressional delegation, members of the board and management spent years making the case for federal investment in the railroad's infrastructure. With hard-fought capital dollars and a new operating plan, ARRC made the transition from shaky to solid ground.

The ARRC Board remains active and continues to guide necessary change. Today, ARRC is a leaner organization capable of modest gains in a difficult economy. We continue to make smart, calculated investments to enhance safety, better serve our customers and to ensure profitability.



With continued focus on efficiency and infrastructure in 2010, the railroad was prepared to meet changes in leadership and the economy. President and CEO Patrick Gamble retired in April after nine years of excellent leadership. We owe a debt to Chief Financial Officer Bill O'Leary, who stepped in as interim CEO while the Board conducted an exhaustive search for the railroad's next leader. In September, we welcomed new President and CEO Christopher Aadnesen, whose 37 years of railroading experience will be vital in a challenging environment. The Board also saw change with the departures of former commissioners Leo von Scheben and Emil Notti. We thank them for their service. In turn, we welcomed two new members: Department of Commerce, Community & Economic Development Commissioner Susan Bell and Department of Transportation and Public Facilities Commissioner Marc Luiken. Transition on the ARRC Board continued into early 2011, when I asked board member Linda Leary to step up as the new chair. I have every confidence in her ability to lead your Alaska Railroad forward. The change in leadership will be smooth and beneficial.

As I look back at a decade and a half of service, I take heart in the remarkable success story that is your Alaska Railroad. ARRC's unique business structure allows the railroad to remain self-reliant and flexible enough to prevail through challenge and change.

On behalf of the Board of Directors and our many dedicated Alaska Railroad employees, I am pleased to present the 2010 annual report.

John Binkley, 2010 Chairman



Governor Sean Parnell appointed Linda Leary to the ARRC Board of Directors in October 2009. She is president and a co-owner of Carlile Transportation Systems, and has

worked for Carlile for more than 25 years. Ms. Leary is an active member of Alaska's business community, serving on the boards of the Resource Development Council of Alaska, Alaska State Chamber and Associated General Contractors. She is equally involved in important charitable organizations, serving on the United Way Executive Cabinet, and on the board of the Breast Cancer Focus, Inc. and Rasmuson Foundation. She earned her master's degree in logistics management from the University of Alaska Anchorage. The ARRC Board of Directors unanimously elected her to serve as chair on February 16, 2011.

A message from the President & CEO

Chris Aadnesen



Continuously welded rail, or CWR, is a railroad term for the practice of welding sections of rail into longer segments to improve strength and durability while offering a smoother, faster ride.

It's an appropriate metaphor for 2010 at the Alaska Railroad. Continuity of effort is what helped the railroad through a difficult year, despite personnel changes and cutbacks made in 2009 that meant we had to do more with substantially less. Our executive team, in particular, lent the strength and stability that kept the organization on track and ahead of financial projections. I am pleased to be joining a team with such strong leadership – not to mention a deep bench.

When I started in September, one of my first tasks was to look throughout the organization to assess strengths and weaknesses and to identify opportunities. I've met one-on-one with dozens of employees, and not just at the top level. What they've told me and what I've observed has left me with plenty of confidence in the future of this organization.

I base that confidence on my nearly four decades of railroading experience in the United States and abroad. The Alaska Railroad has benefited from smart, strategic leadership that invested in all the right places. The core infrastructure of the Alaska Railroad – the rails, ties, ballast and bridges – is in excellent shape. As a result, we are poised to take advantage of opportunities that can generate an even stronger performance in 2011 and beyond.

Confidence cannot translate to complacency. We remain in a continuously challenging fiscal position despite the stronger-than-expected performance this year. Revenue estimates for the next five years hinge on petroleum and export coal forecasts that project these businesses will continue on an upswing, but diversifying revenue sources is part of our vision for the corporation's future. We will work closely with members of the Alaska Legislature and our Governor to ensure the foundation of the railroad remains strong and offers a baseline of success as we explore new opportunities.

I look forward to strengthening relationships with railbelt communities and businesses as our future together continues to unfold.

Best regards,

Chris Aadnesen





New rail on its way to Healy to be made into Continuously Welded Rail.



ARRC shipped more export coal in 2010 than ever before – more than 950,000 metric tonnes.

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CONTINUOUSLY WELDED RAIL isn't just an arcane railroading term; it also provides an apt metaphor for the Alaska Railroad's overall operations in 2010. The decades of accumulated railroad experience and collective wisdom of the Alaska Railroad team provided the continuity that made the corporation stronger and more efficient in 2010. Thanks to their commitment and energy, the corporation ended 2010 with \$13.4 million in net earnings – well above the projected \$8.4 million.

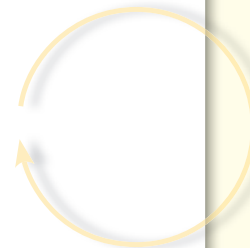
This profitability turnaround came from difficult decisions made in 2009 and persistent efforts to reduce expenses. Substantial cost-saving initiatives, along with an educated read of the market, enabled the Alaska Railroad to do more with less and emerge profitable in what was expected to be a very difficult year from an earnings perspective.

A perfect example of this more-with-less approach is the “singling” of Grandview. In 2010, the railroad developed a new approach to running coal trains to Seward that not

only saved labor costs and wear on rail and train equipment, it was also safer and faster. In the past, heavy, 67-car coal trains stopped at the base of Grandview Pass to divide into two segments that could make it over the relatively steep 3 percent grade with the power of three locomotives. Using distributed power technology, the railroad now employs seven locomotives, some inserted in the middle and end of the train, to tackle the pass in just one run. The trip is made in fewer than 12 hours now, saving crew costs while reducing the potential for accidents and injuries and boosting the profitability of each coal train. This innovation came at a particularly opportune time, as global market forces drove the price of coal up. The Alaska Railroad shipped more coal for export in 2010 than ever before – just short of one million metric tons. As a result, export coal revenue has grown markedly during the past two years, up more than 150 percent from 2008.



Using distributed power technology, ARRC now tackles Grandview Pass in just one run.



Another more-with-less example comes from Passenger Services, which completed the year approximately \$2.5 million ahead of projections, thanks to increased proceeds from rail services and tours. The Passenger Services and Passenger Operations departments accomplished these earnings with fewer people, a brand-new passenger reservations system and a difficult economic climate. The coordinated effort required



alternate work schedules, early mornings and less time at the desk, earning those responsible a 2010 Railroad President's Award. Despite the challenges, goals were met and exceeded.

Several financial and legal actions resulted in major improvements to the railroad's finances. Extension of a tax relief bill by Congress allowed the railroad to execute a tax-credit transaction that added \$2.1 million to the bottom line for both 2010 and 2011. The railroad also transitioned to a new health care plan administrator for an expected savings of \$300,000-400,000 per year. During 2010, the railroad recovered \$4.2 million, following a settlement with the federal government to recoup some of the cost of investigating environmental contamination that occurred during federal ownership of the railroad and also received \$4 million from a settlement with a contractor for defective rail welding.

Infrastructure improvements made possible by federal stimulus funds received in 2009 included a major rehabilitation of the Anchorage Historic Depot and improvements at the Fairbanks, Seward and Talkeetna depots. Approximately \$12 million in stimulus funds were spent in 2010, including the installation of a wheel impact load detector to improve the safety of rail operations. Safety on the rails was also improved by approval of a permit to use herbicides to control weed growth along the tracks on the south end (Seward area). This has the potential to help save the railroad from fines and other penalties imposed by the Federal Railroad Administration, while improving safety. It was the first time since the early 1980s

that the railroad has been able to use chemical vegetation control along the tracks, and plans for 2011 include herbicide use on the north end.

Real Estate inked leases with tenants to occupy most of the space in the Historic Freight Shed in Ship Creek. In 2010, the railroad completed an extensive and environmentally-friendly renovation that makes the building the state's first and only historic building to meet the standards established by the national Leadership in Energy and Environmental Design (LEED) program. The Alaska Humanities Forum and the U.S. Forest Service have signed lease agreements for the building, and its LEED profile played a major role in tenant interest. This capital project was bankrolled entirely with internally generated or leveraged funds, without the use of government-backed grants or bonds.

2010 proved to be a year of financial challenge and cost-driven innovation. Through it all, the Alaska Railroad workforce provided the foundation that kept the corporation moving forward, continuing to provide critical transportation services for communities and businesses across the state. While 2010 presented significant change at many levels of the railroad, decades of experience and depth of knowledge provided the continuity in service that the railroad's neighbors, communities and businesses have relied upon for nearly a century.



Trailer on Flatcar (TOFC) business was also a strong performer in 2010, driven by increased consumer demand in Fairbanks and the ability of the Freight Marketing and Logistics teams to anticipate and respond to customer needs. Revenues increased 19 percent over 2008, helping to offset petroleum volume reductions from the North Pole refinery.

continuous

The Alaska Railroad Corporation has not received any bona-fide offers of a sale arrangement within the calendar year of 2010, nor is the Corporation aware of any potential sales that require analysis under AS 42.40.260.

FINANCIAL HIGHLIGHTS

Earnings (in thousands):	2010	2009
Operating Revenue:		
Freight	\$ 84,328	\$ 84,939
Passenger	20,783	21,455
Other	772	704
Grant	40,225	36,515
Total Operating Revenue	<u>146,108</u>	<u>143,613</u>
Operating Expenses	<u>140,556</u>	<u>137,993</u>
Operating Income	5,552	5,620
Non-operating Revenue (Expenses):		
Net Real Estate Income	9,378	9,365
Gain (Loss) on Sale of Capital Assets	—	517
Investment Income	78	115
Interest Expense, Net of Grant Revenue	(1,561)	(1,715)
Net Income	<u>13,447</u>	<u>13,902</u>
Balance Sheet (in thousands):		
Assets:		
Current Assets	\$ 97,910	\$ 73,928
Non-current Assets	761,002	741,154
Restricted Assets	27,087	46,155
Other Assets	18	18
Total Assets	<u>886,017</u>	<u>861,255</u>
Liabilities:		
Current Liabilities	43,863	40,768
Non-current Liabilities	609,525	606,714
Total Liabilities	<u>653,388</u>	<u>647,482</u>
Fund Equity	<u>232,629</u>	<u>213,773</u>
Total Liabilities & Fund Equity	<u>886,017</u>	<u>861,255</u>
Operating Ratio	0.96	0.96

[Click here for full financial report.](#)



BOARD OF DIRECTORS (L to R)

Jack Burton, Track Inspector,
Alaska Railroad Corporation

Susan Bell, Commissioner,
Department of Commerce, Community
and Economic Development

John Binkley, (2010 Chair) President,
Alaska Cruise Association

Mark Luiken, Commissioner,
Department of Transportation and
Public Facilities

Linda Leary, (2011 Chair) President,
Carlisle Transportation Systems

Jon Cook, Chief Financial Officer,
Airport Equipment Rentals, Inc., Fairbanks

Governor Bill Sheffield (Vice-Chairman), Port Director,
Municipality of Anchorage



The 2011 Alaska Railroad commemorative print, "Northbound Over the Matanuska Bridge" by Douglas Girard, depicts a passenger train moving north into the Matanuska Valley.



