Chairman of the Board

CHAIRMAN'S MESSAGE

These are exciting times for the Alaska Railroad Corporation. In 1998, with the support of Alaska's Congressional delegation and Gov. Tony Knowles, we were able to put into motion the most ambitious capital improvement plans the Railroad has seen since construction began 85 years ago.

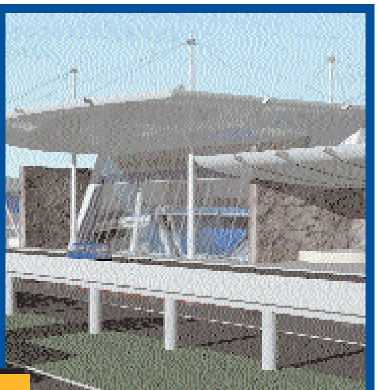
Within the next few years, the Alaska Railroad will be serving its customers with new, safer, more efficient port facilities at Seward and Whittier; a comfortable, full-service depot at Denali National Park; a new depot and public transit center in Fairbanks; and a central rail station at Alaska's gateway, Anchorage International Airport. And by 2005, we hope to be carrying commuters from the Matanuska-Susitna Valley and Girdwood into Anchorage with safe, cost-effective, environmentally friendly rail transit.

Who would have thought in 1923, when the Railroad was completed, that by the end of the century we would be going from a twisting, wilderness rail link to a 21st century, full-service transit and transportation system?

It's a bold vision and a lot of work, but our capital program is founded on solid ground. What you'll be seeing in the Alaska Railroad's capital program is basic investment in Alaska's major transportation hubs – our ports and major cities – and investment in the links that make the Railroad work seamlessly with air, water and road transportation.

This is not a case of "build it and they will come." They're already here. In Seward and Whittier, the visitor industry is clamoring to keep up with rapid growth, and the Railroad enhances that growth. At Denali Park, with the National Park Service phasing out its old hotel facility (the Alaska Railroad was the original owner), the Railroad is playing a more prominent role in

IN TOUCH



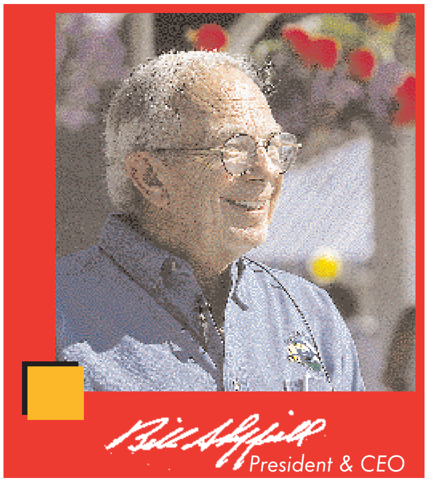
Anchorage International Airport will receive a facelift as one of many improvement projects.

filling the needs of the tens of thousands of visitors we bring to America's premier tourist attraction.

In Fairbanks, the heart of Alaska's Interior, the growth of the region demands a practical approach to providing integrated transit services. In Anchorage, we have the chance to do now what cities all over the world are trying to do after the fact – build a proper rail link into their gateway airport. And with commuter service, we will only be catching up to a need that's been there for a decade as the outlying areas of Anchorage grow exponentially.

With the vision and direction of our elected leaders – Gov. Knowles, Sen. Ted Stevens, Sen. Frank Murkowski, Rep. Don Young and the Alaska Legislature – this public corporation's Board of Directors has been able to chart a course for growth that meets Alaska's needs. Our goal is to serve you better through the next century as well.

Concept of future commuter service trains.



PRESIDENT'S MESSAGE

We are an interesting company. We're a door-to-door freight shipper and we handle barge traffic on a 1,500-mile haul from the south. We are one of Alaska's prime tourist attractions, but we are also the lifeline for rural Alaskans off the road system. We move jet fuel refined from Alaska crude oil to help keep the state's air cargo business in the air. We move Alaska coal to Korea to help keep the lights burning in Seoul.

And we're owned by the public. We make a living by doing business the way every good company does business – safety, customer service, reinvestment in the asset – but we also have at our core a public mission to be a catalyst for growth and the backbone of Alaska's surface transportation system.

That's where our earnings go – to that public mission. Every nickel this Railroad earns goes right back into the asset. There are no dividends for shareholders or stock options for management. What we earn each year goes back into ties, ballast, equipment, fuel, facilities, improvements and our employees. We want to continue to improve on the asset and make our earnings more secure for the years to come.

In this annual report, we list the name of every employee who works here to re-enforce the fact that what you see in the color photos and the graphs and the financial statements is a reflection of the work of all those folks.

In 1998, that good work – and the loyalty of our good customers – helped the Alaska Railroad Corporation to another year of near-record earnings. In 1999, those earnings will be put to work as match for federal grant funds, payment on the purchase of our new SD70MAC locomotives and other improvements that will allow the Railroad to grow its business.

Our focus in 1999 is to keep the Alaska Railroad self-sustaining, safe and service-driven. Our thanks go to our employees, our customers and our shareholders – the people of Alaska.

1998 *YEAR IN REVIEW*

The Alaska Railroad Corporation once again enjoyed a banner year, posting near-record profit in 1998. It compiled net earnings of $9.93 million – second-most in the Railroad's 14 years under State ownership.

The Railroad registered near-record returns in all phases of operation. Net operating revenue totaled $5 million, better than in any year but 1997. Net revenue from real estate amounted to $4.4 million, up from last year's $4 million total. The Corporation's assets are now worth $168.51 million, an increase of 25.2 percent from 1997.

Having celebrated its 75th anniversary over the summer, the Railroad heads into the next millennium with several improvement projects in the works and financial stability ensured for years to come.

In 1998, the Railroad was as active as ever. It completed a variety of renovation projects, laid down thousands of feet of track, installed nearly 100,000 new crossties and transported a record number of passengers.

The Railroad had its best showing hauling freight, although numbers were down in some areas. More than 6.4 million tons of freight were hauled by the Railroad in 1998, an increase of 3.9 percent from 1997.

The demand for gravel was greater than in the past, as 3.3 million tons of it were transported by the Railroad, marking a 12.1 percent increase from 1997. Construction and road projects made 1998 a near-record year for the transportation of gravel.

Gravel wasn't the only freight to be hauled more frequently in 1998. Every kind of freight the Railroad carried increased in tonnage, with the exception of export coal. Due to decreased demand, export coal shipments ended three months early, in September 1998.

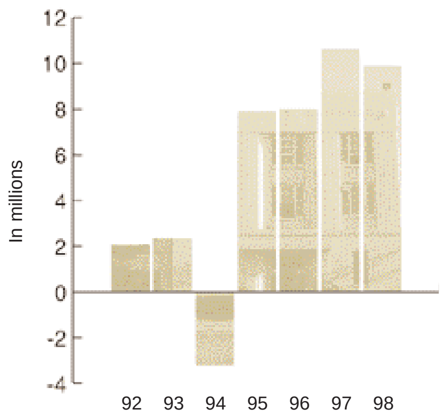
The Railroad also had a superior year on the passenger front. It carried a record number of passengers: 614,236. But the growth of passengers riding the train has tapered off. After a whopping 20 percent increase in 1997, there was an increase of less than 1 percent in 1998 – or about 1,800 more passengers.

In 1998, the Alaska Railroad reduced FRA reportable injuries by 23 percent when compared to 1997. The Railroad spent $445,000 on claims in 1998, down 11 percent from the $511,000 total of 1997. However, the goal of the Railroad to reduce its FRA reportable injuries to one injury per 200,000 hours worked will require outside assistance and the Railroad plans to hire a safety consultant in 1999.

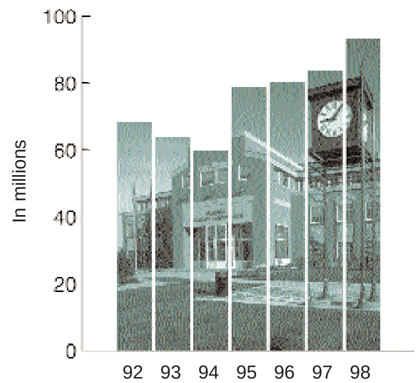
Planning continued for the arrival of new SD70MAC locomotives due for delivery in late 1999. These locomotives will change the complexion of the Alaska Railroad forever. It will mean fewer locomotives with more power, more efficiency with less impact on the environment.

The Alaska Railroad will enter a new era in 1999. Projects are being developed for a new, expanded Denali Depot, Seward Dock, Whittier Pedestrian Overpass, Fairbanks Intermodal Facility and for a rail station at Anchorage International Airport.

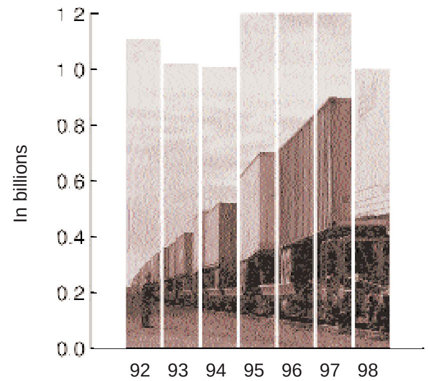
Net Income



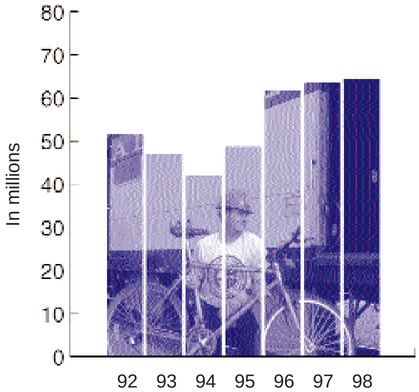
Revenue



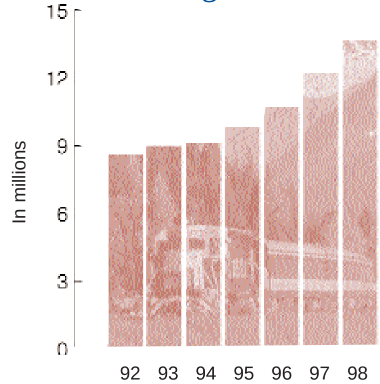
Revenue Ton Miles



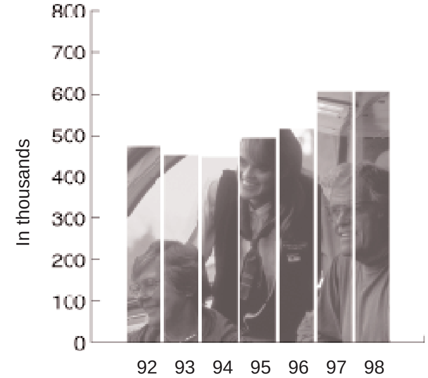
Freight Revenue



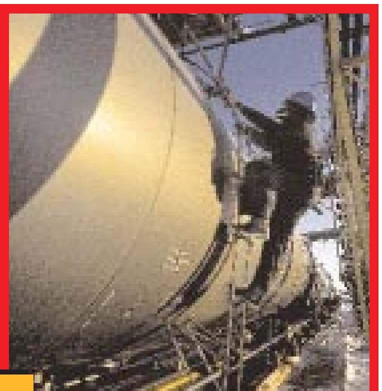
Passenger Revenue



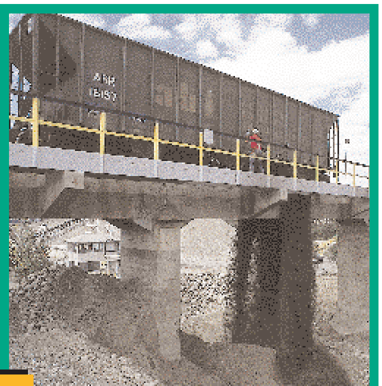
Passenger Ridership



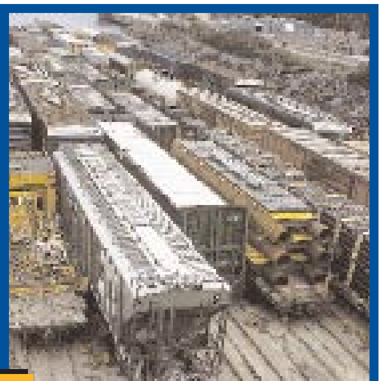
1998 COMMODITIES



Petroleum freight grew overall by 4.6 percent in 1998, with a 25 percent increase in December.



The Railroad carried 3.3 million more tons of gravel than last year.



The Railroad's barge component helped create a record-breaking year in hauling freight.

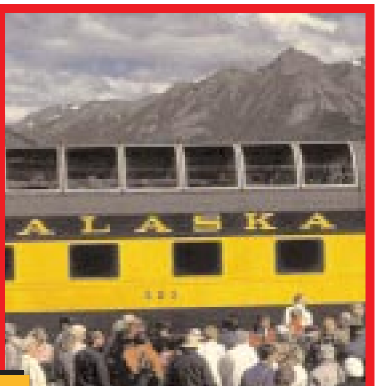
RAILFREIGHT

The Alaska Railroad hauled more freight than in any previous year, even though oil prices fell in 1998. Every aspect of the Railroad's freight operations – from local coal to gravel to petroleum – grew from last year. Freight accounted for $65 million of gross revenue, up 1 percent from last year's total of $64 million. The only exception was export coal tonnage, which dropped 46.7 percent in large part because shipments were halted between September and December. The recent downturn in the Asian economy produced cheap coal in the spot market, lowering the overall demand for coal.

Construction and road projects fueled a 12.1 percent increase in gravel tons shipped over the year. The Railroad transported more than 3.3 million tons of gravel – nearly a half-million tons more than last year. The Railroad has not hauled that much gravel since Alaska's construction boom 15 years ago. The Railroad's biggest jump occurred in its interline barge breakbulk operations, totaling a 39.7 percent increase from 1997. In addition, there were increases in interline tonnage of 4.7 percent. Interline freight as a whole accounted for $23.1 million gross revenue, 35.9 percent of freight's total gross revenue. Interline connections did decline in southbound revenue.

Intermodal units shipped grew by 3.4 percent over the previous year. Intermodal transport has room to grow, but has been slow due to low fuel prices and a surplus of truckers poised to haul oilfield supplies from Fairbanks to Prudhoe Bay. Local railcar business, encompassing the transportation of logs, pipes and other miscellaneous articles, posted an improvement of 18.7 percent in revenue from 1997. The shipment of pipes and logs in and out of Seward is expected to drop in 1999, but other small lines of business are expected to pick up due to increasing construction projects. Local coal tonnage increased by 11 percent, primarily due to the rebuilding of Fort Wainwright's stockpile. The outlook for local coal shipments in 1999 is stable.

The transportation of petroleum is expected to improve in 1999. With the completion of the Williams Company refinery expansion at the end of 1998, December figures were up by 25 percent compared to those in 1997. The shipment of petroleum was once again a significant contributor to the Railroad's bottom line. It produced $22.5 million of gross revenue, 35 percent of freight's total.



More than 614,000 people traveled through Alaska by rail during 1998.

PASSENGERSERVICES

The Alaska Railroad marked its second straight year of record ridership in 1998, as a total of 614,236 passengers rode the rails. It was another first-rate year for passenger services, although the growth rate was slight at .3 percent from 1997.

While the total number of passengers stayed about the same as last year, there was a great deal of difference in how and where the passengers traveled in 1998.

Charters and specials, led by a Christmas train to Seward that sold out, showed a 25.1 percent increase. But a handful of other routes recorded declining numbers. The most significant was a 16.7 percent decline in the Denali-to-Fairbanks route on the "Denali Star," producing an overall decline of 2.6 percent on the entire Anchorage-to-Fairbanks "Denali Star" route.

While the number of tourists visiting Alaska continued to increase, the growth rate has reached a plateau, which was reflected in smaller growth for the Railroad. Nearly all of the

Service remains an important factor in the continued increase in Alaska Railroad passengers.

The Alaska Railroad Corporation headquarters overlooks Ship Creek, near downtown Anchorage.

Railroad's passenger services noted changes of less than 2 percent. In fact, the Portage-to-Whittier shuttle reported nearly the exact figures from last year: 170,679 passengers in 1997; 170,639 in 1998.

LANDMANAGEMENT

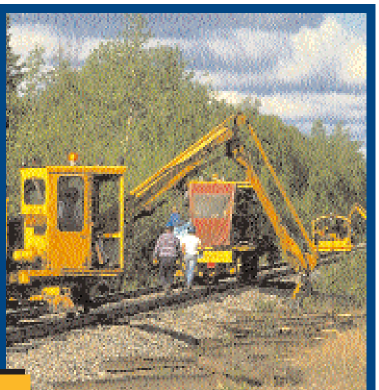
Real estate once again played a significant role in the Alaska Railroad's portfolio, accounting for nearly half of the Corporation's total net revenue. The Real Estate Department began to more aggressively market its portfolio in 1998.

Real estate contributed $4.4 million to the Railroad's $9.94 million total net revenue, or 44.3 percent of the total. Fair-market-value leases within Railroad reserves along the railbelt provided the bulk of the real estate revenue. Additional revenue is generated by the Whittier and Seward docks, and various permits. One hundred and ten cruise ships used Railroad docks and accounted for $1.2 million in revenue.

The Railroad signed a lease with the City of Whittier in 1998 in preparation for the completion of the tunnel road in May of 2000. The lease covers non-operational Railroad land and gives the city the flexibility to lease the land to customers they feel will best enhance the city’s master plan.

Real estate net income was up 8.6 percent from last year's $4.1 million total. Gross revenue was up, climbing a million dollars to $7.9 million. This increase came despite increased expenses, most of them coming from first-time environmental expenditures such as tests and remediation. Also, prior year financial statements were reclassified to consistently reflect a change in accounting methods relating to allocation of corporate overhead.

The Ship Creek Master Plan neared completion, mapping out future development in the area. The plan gathered ideas from a wide group of users and considers business, recreation and environmental concerns.



100,000 new ties were installed, many of them replacing ties originally installed just after WWII.

RAILMANTENANCE

The Alaska Railroad had an industrious 1998 keeping the tracks maintained, installing new rail and ties, rebuilding engines and much more.

The Railroad was most active making improvements to the track itself. More than 19,000 feet of new rail was laid, while another 17,000 feet of track was transposed to equalize wear.

Nearly 100,000 ties were installed, replacing the nearly 50-year-old ties that were originally installed just after World War II. Replacing the old ties is an ongoing project. The benefits of new ties and ballast are making a difference marked by fewer problems, especially on the north end. The Railroad also built more than 14,000 feet of new track in places such as Bear Valley, Fairbanks and Girdwood.

Accomplishments by the Mechanical Department included four locomotive power assembly changes, 10 truck rebuilds, extensive locomotive cab improvements to better insulate against cold weather, the refurbishment of passenger dome car #502 and the conversion of roller bearings in passenger cars.

The Alaska Railroad entered a new era in 1998, thanks in large part to Alaska's Congressional delegation, Senators Ted Stevens and Frank Murkowski and Representative Don Young, and the Knowles Administration. Through their efforts, the Railroad will receive considerable federal grant funding for capital improvements through 1999.

Many of the projects have already started, although they are still in preliminary stages. The following is a run-down of each project:

1998 PROJECT REPORT

Anchorage International Airport

What It Is: A $28 million project to develop a state-of-the-art rail station at the Anchorage International Airport. The station will be the centerpiece of all passenger services development at the Railroad, connecting Seward, Whittier and Girdwood, making commuter services to Wasilla and Palmer a more viable option.

1998 Update: A number of studies have been initiated, including a market identification study and operational and equipment analysis. The architectural firm of McCool, Carlson and Green is working on schematic design *(see below)*.

Military Base Line Changes/Anchorage-Wasilla Track Upgrade

What It Is: A safety enhancement to eliminate or reduce curves on the rail line between Anchorage and Wasilla. It will increase track speed and the viability of commuter service to Wasilla and Palmer.

1998 Update: The Railroad is working on both military installations and between Eagle River and Wasilla. Negotiations continue for land acquisitions between Eagle River and Wasilla and will involve a land trade with Eklutna Native Corporation. An environmental assessment has begun. Construction is expected to begin in the summer of 1999, starting in the Chugiak area.

Denali Depot

What It Is: A project to build a new and expanded passenger depot in Denali National Park. The large facility will handle the increase of people due to the future closure of the park hotel. The Railroad is working with the Park Service, which is also planning construction.

1998 Update: Selection of an architectural firm continued at the close of 1998. Construction is expected to begin in the fall of 2000, after the tourist season ends at Denali.

Seward Dock

What It Is: An $11.14 million project consisting of multiple facets, including the construction of a new freight dock and the conversion of the existing dock into a passenger services-only dock.

1998 Update: An environmental analysis has been started. Construction of the freight dock is expected to be finished in April 2000. The passenger dock should be ready by November 2001.

Whittier Pedestrian Overpass

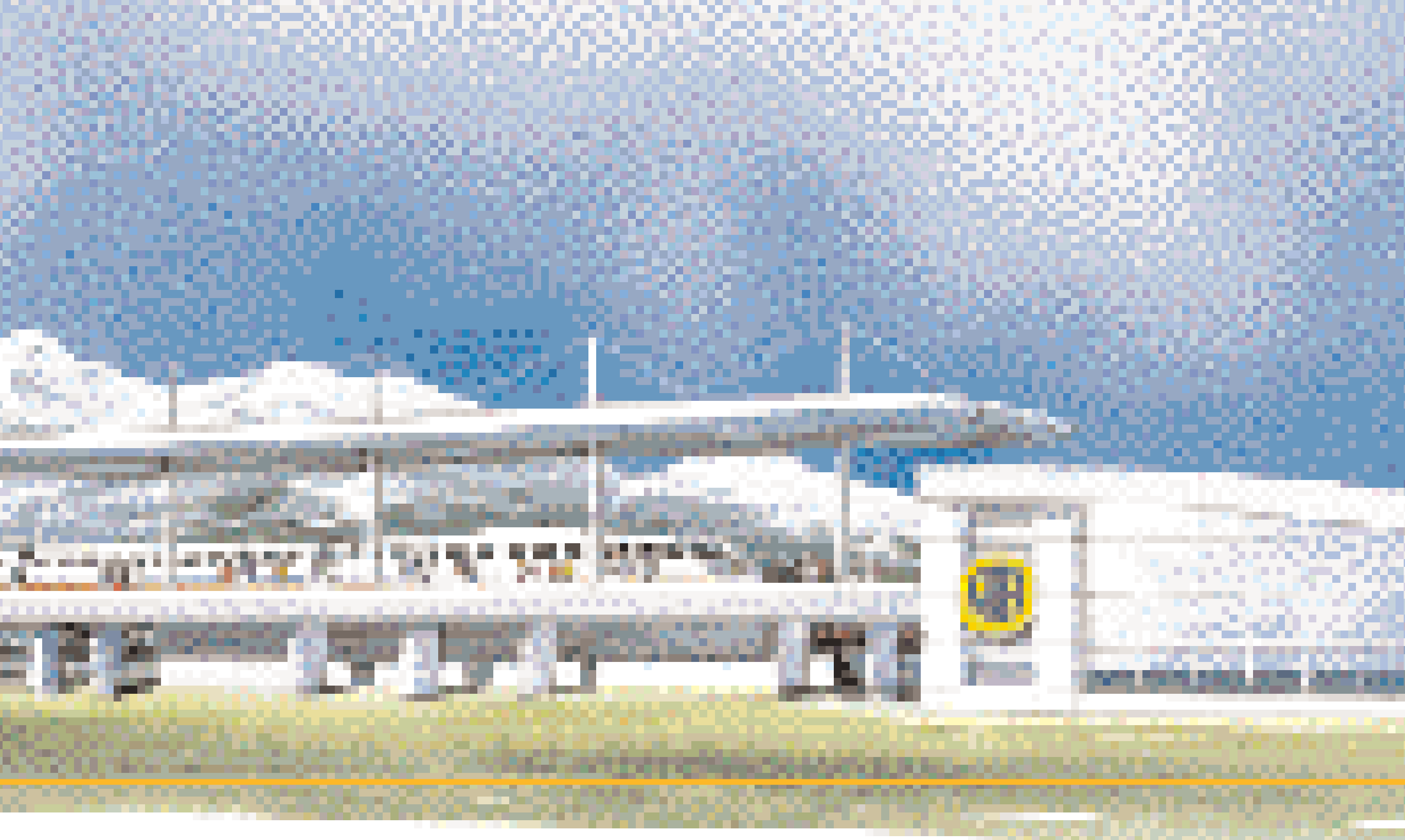
What It Is: A $2.1 million safety enhancement project to construct a pedestrian overpass over the rail yard in Whittier. This will give pedestrians safe passage over the railyard, which lies between the town and the dock.

1998 Update: A total of $700,000 has been appropriated for the project, with additional funding still being sought. The overpass is expected to be completed in the spring of 2001.

Fairbanks Intermodal Facility

What It Is: The construction of a new intermodal facility to accommodate rail, bus and truck traffic will allow trains to park, unload and pull up for maintenance at the same facility. The construction of the new facility will prevent the hour-long stoppage of rush-hour traffic that occurs daily in downtown Fairbanks during the summer.

1998 Update: Once an environmental analysis is completed and a design is finalized, construction is expected to begin in 2001.



Girdwood Transportation Study

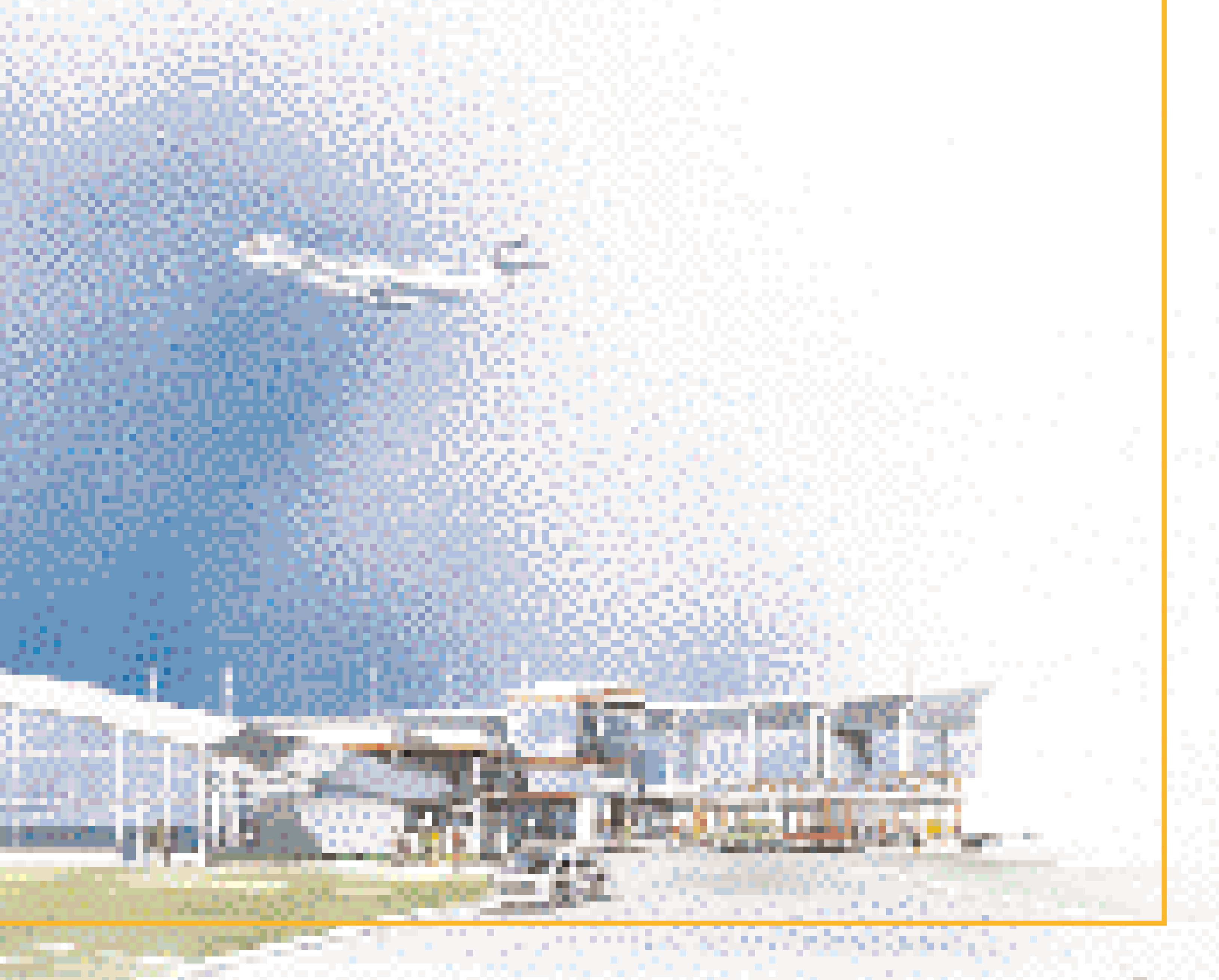
What It Is: A $25,000 contribution to a study of transportation options within the Girdwood bowl. Since rail is a potential service provider in Girdwood, the Alaska Railroad was asked to participate in the funding of the rail portion of this Municipality of Anchorage study.

1998 Update: Members of the Railroad staff helped select a firm to conduct the study. However, the Anchorage Assembly has final approval on the selection of the firm.

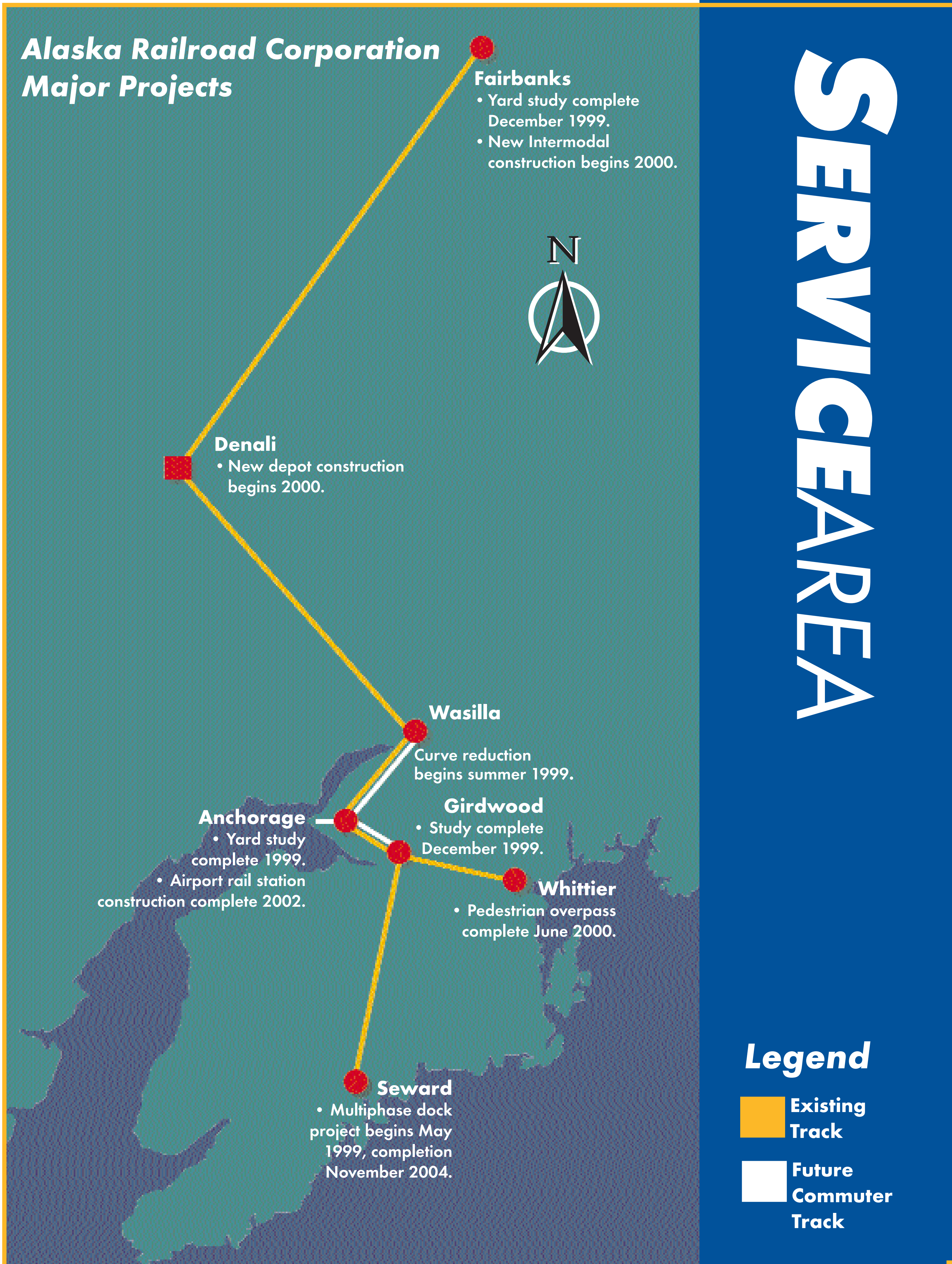
Anchorage/Fairbanks Yard Study

What It Is: A $400,000 study to determine the future needs of the Alaska Railroad's customers. The study will develop a Railroad traffic estimate looking out 30 years, plus study track length, location and needs for double track. It will also include railyard designs for Anchorage and Fairbanks, looking at needs for capacity up to 30 years.

1998 Update: A contractor has been selected to conduct the study, which began in May 1999.



SERVICE AREA



THOMAS ADAMS • JAMES ADAMS • D. KATHERINE ADAMS • JAMES AHIERS • TROY ALBIN • KEVIN ALESHIRE • EDWARD ALFORD • JAMES ALLEN • STACY AMMERMAN • JEROME ANDERSON • CHRISTINE ANDERSON • ANTHONY ARAGON • W. ARMSTRONG • ANTONELLI ARON • TED ASHBRIDGE • MICHAEL AULT • BILL BAILEY • WARRON BAINBRIDGE • DAVID BANG • SCOTT BANKS • JOHN BARBER • DONALD BARKER • SAM BARNES • KENNETH BARTLETT • DIANA BAUMAN • JERRY BEA • MARK BEAR • J. GARY BEITINGER • JAMES BELL • JOHN BERG • KEVIN BERGSRUD • ALFREDO BERNAL • DONALD BICKERS • DIANE BICKERS • GLEN BIEGEL • WILLIAM BIVINS • JULIE BLACK • LOUISE BLACKMUR • JIM BLAKLEY • JAMES BLASINGAME • KAYLE BOND • MICHAEL BOODRY • JIM BOSCH • DENNIS BOUWENS • BRYANT BOWLES SR. • TOMMY BOYCE • MATTHEW BRADY • RAYMOND BRADY • W. 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JEFF FOWLER • DUANE FRANK • RODNEY FRANK • MICHAEL FRAZAR • IAN FRAZIER • HOWARD FREESE • DONALD FREESTONE • DANIEL FRERICH • MICHAEL FRETWELL • ALBERT FYFE JR. • RASCHAD GALIMBA • ERIC GAMBLE • JERRY GAMBLE • CLIFFORD GAMBLE • PAUL GANGSTAD • KENTON GASS • JOHN GAULE • JOSEPH GELINAS • GRANT GERHART • CINDY GILDER • CLIFFORD GILES • LISA GILLESPIE • VERN GILLIS • VERNON GLEICH • STEVEN GLESSING • TIMOTHY GOBBI • IONE GOBBI • JUSTEN GOBBI • JOHN GODBEY • DANA GODFREY • LARRY GOLDING • ROBERT GONZALEZ • BRUCE GOUGH • REBECCA GRADY • BRYAN GRAHAM • DAVID GRAHAM • CLINTON GRAY • PAUL GREEN • KENNETH GREENE • DALE GRETH • KENNETH GRIFFIN • WILLIAM GRIFFITH • MICHAEL GRUEBER • GUNNAR GUNDERSON • DAVID HAAG • PETER HACKENBERGER • JASON HACKER • STEPHEN HAGEDORN • WILLIAM HAGGART • JOSEPH HALL • ROBERT HALPIN • DAVID HAMRE • HOWARD HANSEN • DONALD HARPOLE • MICHAEL HARRIS • THOMAS HARRIS • DWIGHT HARRIS • DAVID HARRIS • JOHN HARSTAD • RODNEY HARVEY • DAVID HASTINGS • STEVEN HAYES • LAMBERT HAZELAAR • CAROLINE HEATER • JOHN HEATER • WILLIAM HEDGE • CHRIS HELKENN • OWEN HELLMAN • STEVE HENKEL • LAURA HERMAN • PAULA HERZNER • LEE HIGBIE • KENNETH HIGHTOWER • WILLIAM HIGHTOWER • DONALD HILL • MICHAEL HILL • DARRELL HILL • AUSTIN HILL • EDWARD HILLS • ROBIN HINDMARCH • ELENA HINDS • TERRY HINMAN • EVERETT HINTON • DENNIS HOADLEY • NATHANIEL HOCKER • JAY HOLE • JOHN HOLLAND • RICHARD HOLZAPFEL • WAYNE HORINE • ALAN HORNBERGER • WILLIAM HORSTMANN • ROBERT HOUSTON • CLIFFORD HOWARD • JOHN HOWE • KRAIG HUGHES • GEORGE HULING • MICHAEL HULS • R. HUNT • WILLIAM HUPPRICH • KENT IHDE • SEAN JANES • RAYMOND JARAMILLO • BRAD JENKS • GRANT JOHNSON • JEFF JOHNSON • PHYLLIS JOHNSON • TIMOTHY JOHNSON • DOUGLAS JOHNSON • DOUGLAS JOHNSON • VIRGINIA JOHNSON • SAMUEL JOHNSON • PHILIP JOHNSTON • FORREST JOHNSTON • MICHAEL JOHNSTON • CHARLES JONES • DONALD JUBB • DAVID KAMPSEN • DUANE KAUKE • DONALD KEEFE • DANIEL KEIM • HERFF KEITH • SAMUEL KELLEY • TIMOTHY KELLY • THOMAS KENDALL • WILLIAM KENNEDY • JOHN KENNEDY • CONNOR KEOGH • STEPHAN KESTER • JOSEPH KETZLER • SUSAN KIGER • MELVIN KILGORE • ROBERT KILLOUGH • STEVE KIM • JOHN KINCAID • BENJAMIN KING • KRIS KINNEY • BYRON KLOCKNER • HEATHER KNIEFEL • PEGGY KNOLL • CHRISTOPHER KNOX • DENNIS KNUTH • GERALD KNUTSON • W. DAVID KOCHER • DIANE KOHLER • DARYL KOLLANDER • ROBERT KOOREN • PATRICIA KOSLOVICH • ROBERT KOSUSNIK • DAVID KROMPACKY • JAMES KUBITZ • DAWN LAAKSO • DONALD LAFAVER • BRIAN LAFORGE • ROBERT LALONDE • SHELLEY LANDERS • SAMUEL LANE • THAD LANGFORD • GORDON LARSON • WILLIAM LATHAM • SHELLY LEGGETT • RICKY LEGGETT • JIMMY LEMKE • STEVEN LERWICK • MURIEL LEWIS • GENE LEWIS • JOHN LEWIS • KATHLEEN LEWIS • MICHAEL LINDBERG • DAVID LINDQUIST • DALE LOFSTEDT • THEODORE LOMBARD • CHARLES LORITZ • MICHAEL LOVE • STEVEN LOVE • PATRICK LOWE • GARY LUND • THOMAS LUZACK • JOHN MACDONALD • MICHELLE MADDOX • LYLE MADSEN • MICHAEL MAILLET • DANIEL MALONEY • JOHN MAPES • STEVEN MARASCOLA • DOUGLAS MARKS • RUSSELL MARTIN • KATRINA MARTOLANO • WAYNE MARTSOLF • TRAVIS MATLOCK • ALBERT MAURO • JAMES MAW • GARY MCALPIN • BRADLEY MCALPINE • FOREST MCCAHON • JOHN MCDONALD • JOHN MCDOWELL • CLYDE MCMAHON • PAMELA MEANS • KEVIN MEIER • NACOLE MERRELL • LANDON MESSELHEISER • KERI MESZAROS • PAUL MILLER • RONALD MILLER • F. SUE MILLER • CHRISTOPHER MOORE • BRYAN MORRIS • KAREN MORRISSEY • HEATHER MOSBY • RICK MOSHER • ELDRIDGE MOSS III • JAMES MURPHY • CLAY MURPHY • ROCKY MURRILL • ROBERT MURTON • TIMOTHY NAGY • GEORGE NASER • CARL NEELY • JEFFREY NELSON • GORDON NELSON • CHRISTOPHER NIESSINK • ROBERT NIESSINK • GEORGE NOLAN • CHARLES NORRIS • STEVEN O'CONNOR • FRANKLIN O'MEARA • MICHAEL O'NEIL • ROBERT O'NEILL • GARY ODENS • MICHAEL OLSON • LOUIS OWENS • EUGENE OWENS • WILLIAM PAASCH • JAMES PAGE • REGINA PALMER • JERRY PARKS • SIDNEY PARRIS • AARON PASCAR • THOMAS PAYNE • JESS PELZEL • STEVE PERKINS • MICHAEL PERYAM • SCOTT PETERSEN • WILLOW PEYTON • WILLIAM PHELPS • GARY PHILLIPS • BENJAMIN PICCIONI • PAUL PIERCE • ERNEST PIPER • THOMAS PLATTENBERGER • EUGENE PLESCIA • MEILI POLEO • RONALD POLK • FRANKLIN PRICE • WADE PROCTOR • CLIFFORD PROETZ • ED PRUSAK • PAULA PSIK • JOHN PUCKETT • CAROL PULIS • JAMES PYPE • LUCAS PYRAH • DON RABIDEAU • FRANCIS RABIDEAU • RICK RAPUZZI • JAMES RASMUSSEN • JAMES RECKERS • JAMES REDA • WARREN REDFEARN • ELLEN REEDY • NICOLE REESE • DAVY REGISTE • EILEEN REILLY • LYNN REITZ • WENDY RICHERSON • LORRAINE RISCH • EDWARD RIVERA • LISA RIVERA • JONATHAN ROBERTS • DAVID ROBERTS • WANDA ROBINSON • MARY ROCK • BARBARA ROGERS • REX ROGERS • WESLEY ROGERS • JEFF ROGNES • ANTHONY ROSARIO • MARK ROSEVEAR • HARRY ROSS • MICHAEL ROSSO • KIRBY ROUNTREE • JAY RUCKMAN • CURT RUDD • DARREN RUPE • GARY RUSSELL • DAVE RUTKOWSKI • CHRISTIAN RYLL • STANLEY SANDERFORD • JOANNE SANDMAN • EARL SANDMAN • JENNIFER SANDVIK • ANTONIO SANSONE • BRYAN SAUL • CHERYL SAUTEL • DANIEL SAVAGE • DOUGLAS SCHILLING • CHARLES SCHMIDT • BENJAMIN SCHMIDT • SUSAN SCHRADER • LAVERL SCHULENBERG • MICHAEL SCHULTZE • EDWARD SCHULZ • RODNEY SCHUMACHER • KATHLEEN SCHWALBE • BRIAN SCHWULST • TROY SCOTT • RAYMOND SECHSER • JAMES SEEBERGER • TROY SESSIONS • GARY SETTEN • ADRIE SETTEN • DAVID SHAFER • PATRICK SHAKE • WILLIAM SHEFFIELD • MICHAEL SHEPLER • FRANK SHEPPARD • GEORGE SHERMAN • JONATHAN SHERWOOD • PHILIP SHIBE • DAVID SHOEMAKER • GREGORY SHOEMAKER • CYNTHIA SHOLLY • ANDY SIEBERT • SCOTT SIEGMANN • STEVEN SILVERSTEIN • RICHARD SIMMONS • DOUGLAS SIMONDS • RONALD SIMS • RICHARD SINGSAAS • KENNETH SMITH • JAY SMITH • ROBERT SMITH • JOHN SMITH • TIMOTHY SNAPP • JEFFREY SNYDER • STEVEN SOMMER • RANDY SPRINGSTEED • STEWART STACKHOUSE • SEAN STAEHLI • BRIAN STAFFORD • LOREN STATZ • JEFFREY STERBENZ • WARNER STEWART • CRAIG STOSKOPF • ROBERT STOUT • JOHN STOVER • TROY STRASS • JOHN STREET • LAWRENCE SULLIVAN • GLENN SULLIVAN • DONALD SUMMERS • TERRY SURLS • GARY SUTCH • TIMOTHY SUTHERLAND • JANET SWANSON • ERIK SWANSON • BRUCE TASKY • RICHARD TEEPLES • CHARLES TENNEY • RICHARD TESCHER • PATRICIA THIBODEAUX • ROY THOMAS • DAVID THOMPSEN • RANDY THOMPSON • LLOYD THOMPSON • EDWARD THOMPSON • RONALD THOMPSON • ANGELA THOMPSON • LANCE THOMPSON • MARK TIMBLIN • NANCY TJADEN • ERIC TOMSHA • ALLAN TOWNSEND • MICHAEL TRITZ • CHERYL TROJOVSKY • GLEN TROMBLEY • JAMES TRUEBLOOD • PAUL TURNER • E. CHRISTINE TURNER • GERALD VALINSKE • SALLY VAN DER STARRE • LAWRENCE VAN KLEECK • JON VERLEY • EUGENE VICERE • TONY VIRNIG • PATRICK VOGEL • DUANE VOSSEN • DAVID WADE • SANDRA WANNER • JAMAR WASHINGTON • SCOTT WATKINS • LEE WATNE • MICHAEL WEATHERELL • MARTIN WEATHERELL • GALE WEATHERELL • KEITH WEBSTER • STEVE WELSH • DWIGHT WEST • ED WESTWOOD • ANDREW WHITE • KEITH WHITE • JASON WHITE • ROBERT WHITEHEAD • LARRY WICK • MICHAEL WIESKAMP • MARY WILLIAMS • TIFFANY WILSON • GARY WING • HERDER WINKELMAN • FRANK WITHEY • KEVIN WOOD • DONALD WRIGHT • GREGORY WYATT • JEFFREY WYATT • ROBERT YOST • DARRELL ZABLE • HENRY ZAWADZKI • TIMOTHY ZIMBRICH

1998 FINANCIALS

Management Statement: Alaska Railroad Corporation

The management of the Alaska Railroad Corporation is responsible for the fair statement of the accompanying financial statements and all other information contained in the annual report. The financial statements were prepared in conformity with generally accepted accounting principles and prevailing railroad industry practices and reflect Management's judgments and estimates concerning effects of events and transactions that are accounted for or disclosed. The financial information contained elsewhere in the annual report is consistent with that in financial statements.

The Alaska Railroad Corporation maintains accounting systems that are supported by internal accounting controls. These systems and controls provide reasonable assurance that assets are safeguarded and that transactions are executed in accordance with Management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control should not exceed the related benefits. Management believes the company's system provides this appropriate balance in all material respects.

The financial statements have been audited by KPMG Peat Marwick LLP, independent certified public accountants, who are appointed by the Board of Directors. Their audit is conducted in accordance with generally accepted auditing standards which include an objective, outside review of operating results, financial condition, and the Corporation's system of internal controls. The opinion of the independent auditors is contained in this annual report.

The audit committee of the board of directors, composed solely of outside directors, meets with independent auditors and management periodically to discuss audit findings and other accounting and financial matters. The committee reviews the scope and results of the audit effort with the independent auditors as well as the annual financial statements and recommends their approval by the board of directors.

Jerry Anderson

Vice President, Finance and Administration

The Board of Directors Alaska Railroad Corporation:

We have audited the accompanying balance sheets of the Alaska Railroad Corporation as of December 31, 1998 and 1997, and the related statements of income, equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Railroad Corporation as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

February 19, 1999

KPMG LLP

BALANCESHEETS

ALASKA RAILROAD CORPORATION
December 31, 1998 and 1997
(In Thousands)

Assets		**1998**	**1997**
Current assets:			
Cash and cash equivalents	$	5,209	5,918
Accounts receivable, net of allowance for doubtful accounts of $638 in 1998 and $524 in 1997		10,992	11,536
Materials and supplies		3,839	3,180
Prepaid expenses and other current assets		353	967
Total current assets		20,393	21,601
Operating property and equipment			
Road and roadway structures		99,226	83,549
Equipment		47,475	43,921
Road materials and supplies		2,216	1,357
Construction in progress		8,502	5,276
Accumulated depreciation and amortization		(59,544)	(52,433)
Total operating property and equipment, net		97,875	81,670
Land (note 10)		13,850	13,850
Board designated assets (note 3)		9,166	3,210
Restricted assets (note 4)		26,750	13,857
Other assets (note 5)		474	367
	$	168,508	134,555
Liabilities and Equity			
Current liabilities:			
Current portion of long-term debt (note 6)	$	1,096	1,954
Accounts payable and accrued liabilities		4,765	4,073
Payroll liabilities		5,321	6,759
Unearned revenues		1,678	2,250
Total current liabilities		12,860	15,036
Long-term debt, less current portion (note 6)		4,069	37
Accrued postretirement and pension benefits (note 7)		8,037	6,881
Deferred grant revenue (note 8)		34,741	14,704
Deferred revenue (note 4)		14,673	13,857
Total liabilities		74,380	50,515
Equity:			
Investment by the State of Alaska		34,174	34,174
Retained earnings		59,802	49,866
Accumulated other comprehensive income - net unrealized gain on securities available for sale		152	—
Total equity		94,128	84,040
Commitments and contingencies (notes 6, 7, 11, 12 and 13)			
	$	168,508	134,555

INCOME STATEMENTS

ALASKA RAILROAD CORPORATION
Years ended December 31, 1998 and 1997
(In Thousands)

		1998	1997
Operating revenue:			
Freight (note 9)	$	64,987	64,029
Passenger		13,491	12,119
Other		296	238
		78,774	76,386
Grant revenue (note 8)		1,607	1,230
		80,381	77,616
Operating expense:			
Transportation		37,376	37,076
Engineering (note 8)		20,118	17,852
Mechanical		9,918	10,158
General and administrative		7,947	6,078
		75,359	71,164
Income from operations		5,022	6,452
Other income (expense):			
Real estate income, less direct expenses of $3,560,000 in 1998 and $2,880,000 in 1997 (note 10)		4,402	4,054
Interest income		602	352
Interest expense		(90)	(268)
		4,914	4,138
Net income	$	9,936	10,590

EQUITY STATEMENTS AND COMPREHENSIVE INCOME

		Investment by the State of Alaska	Retained Earnings	Accumulated other Comprehensive Income	Total Equity
Balance at December 31, 1996	$	34,174	39,276	—	73,450
Comprehensive income -					
Net income		—	10,590	—	10,590
Balance at December 31, 1997		34,174	49,866	—	84,040
Comprehensive income:					
Net income		—	9,936	—	9,936
Change in unrealized holding gain on securities available for sale		—	—	152	152
Total comprehensive income					10,088
Balance at December 31, 1998	$	34,174	59,802	152	94,128

CASHFLOWS

ALASKA RAILROAD CORPORATION
Years ended December 31, 1998 and 1997
(In Thousands)

	1998	1997
Operating activities:		
Net income	$ 9,936	10,590
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,567	6,758
Gain on disposal of assets	(150)	—
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable, net of allowance for doubtful accounts	544	(376)
(Increase) decrease in materials and supplies	(659)	166
(Increase) decrease in prepaid expenses and other assets	507	(766)
Increase (decrease) in accounts payable and accrued liabilities	692	(1,427)
Increase (decrease) in payroll liabilities	(1,438)	1,236
Increase (decrease) in unearned revenues	(572)	795
Increase in accrued postretirement and pension benefits	1,156	884
Increase in deferred revenue	816	791
Net cash provided by operating activities	18,399	18,651
Investing activities:		
Purchases of operating property and equipment	(23,772)	(15,310)
Proceeds from sales of operating property and equipment	150	—
Increase in board designated assets, net of unrealized gain on available-for-sale securities	(5,804)	(3,210)
Increase in restricted assets	(12,893)	(791)
Increase in deferred grant revenue	20,037	6,885
Net cash used in investing activities	(22,282)	(12,426)
Financing activities:		
Payments on long-term debt	(2,186)	(5,121)
Proceeds from long-term debt	5,360	—
Net cash provided by (used in) financing activities	3,174	(5,121)
Net increase (decrease) in cash and cash equivalents	(709)	1,104
Cash and cash equivalents at beginning of year	5,918	4,814
Cash and cash equivalents at end of year	$ 5,209	5,918
Supplemental disclosure of cash activity:		
Interest paid	$ 92	277

(1) Organization and Operations

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

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

(2) Summary of Significant Accounting Policies

In preparing the financial statements in accordance with generally accepted accounting principles management is required to make a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and revenue and expenses for the reporting period. Actual results could differ from these estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below.

(a) Basis of Accounting

The ARRC is subject to the jurisdiction of the Surface Transportation Board (STB). Accordingly, the ARRC has prepared the accompanying financial statements in accordance with the STB rules and regulations (US CFR Title 49), which are generally consistent with generally accepted accounting principles as promulgated by the Financial Accounting Standards Board.

(b) Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include time deposits, money market accounts and repurchase agreements with original maturities of three months or less.

(c) Materials and Supplies

Materials and supplies inventories are carried at the lower of average cost or market. Road materials and supplies include rail, ties, ballast, and other track materials. These items will generally be capitalized when placed into service, and accordingly are included in operating property and equipment.

(d) Operating Property and Equipment

Operating property and equipment are stated at cost. Depreciation and amortization is computed on the straight-line basis over the estimated useful lives of the related assets, ranging from 5 to 32 years.

(e) Board Designated Assets

Board designated assets represent investment securities held by the ARRC in anticipation of funding future postretirement benefits and locomotive and equipment purchases. Management has both the ability and intent to hold the investment securities designated for locomotive and equipment purchases to maturity, and accordingly, has elected to account for them at amortized cost under Statement of Financial Accounting Standards (SFAS) No.115, *Accounting for Certain Investments in Debt and Equity Securities.* Investment securities designated for postretirement benefits are invested in equity mutual funds and are accounted for as available for sale securities under SFAS No.115. Available for sale securities are stated at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of other comprehensive income.

(f) Restricted Assets

Restricted assets represent investment securities held by the ARRC in anticipation of the approval of future capital projects. Management has both the ability and intent to hold the investment securities to maturity, and accordingly has elected to account for them at amortized cost under SFAS No.115. Funds received but not yet expended are recorded as deferred revenue.

(g) Grants

Grant revenue is recorded in the same period as expenses related to the grant. Grant funds received but not yet expensed are recorded as deferred grant revenue.

(h) Income Taxes

As a corporation owned by the State of Alaska, the ARRC is exempt from Federal and State income taxes.

(i) Environmental Remediation Costs

The Corporation accrues for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Costs of future expenditures for environmental remediation liabilities are not discounted to their present value.

(j) Fair Value of Financial Instruments

Fair values of financial instruments, as defined under SFAS No.107, *Disclosures About Fair Value of Financial Instruments,* are estimated by the ARRC's management. Fair values of restricted assets and related deferred revenue are based on quoted market prices, when available, and quoted market prices of comparable instruments, when not available. Fair values for accounts receivable are estimated using cash flows in comparison to assets with similar estimated average lives but bearing current market interest rates. Fair values of long-term debt are based on the discounted value of contractual cash flows and interest rates being offered for similar debt. ARRC has determined the fair values of financial instruments do not differ significantly from their carrying amounts with the exception of investments which are discussed in notes 3 and 4.

(k) Reclassifications

Certain reclassifications have been made to the prior year balances in order to conform to the current year presentation.

(l) Comprehensive Income

On January 1, 1998, the ARRC adopted SFAS No. 130, *Reporting Comprehensive Income*. SFAS No.130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. Comprehensive income consists of net income and net unrealized gains and losses on securities and is presented in the statement of equity and comprehensive income. The statement requires only additional disclosures in the financial statements; it does not affect the ARRC's financial position or results of operations.

(3) Board Designated Assets

Through December 31, 1998, the ARRC Board of Directors has designated investments for the purchase of locomotives (note 13), for vehicles and equipment, and for postretirement benefits (note 7) as follows (in thousands):

Description of Security		Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value
1998:					
Available for Sale					
Equity mutual fund	$	706	152	—	858
Held to Maturity					
Money market accounts		5,755	—	—	5,755
U.S. Agency notes (maturing within one year)		2,553	1	—	2,554
	$	8,308	1	—	8,309
1997:					
Held to Maturity					
U.S. Agency notes (maturing within one year)	$	3,210	—	—	3,210

(4) Restricted Assets

The ARRC received $9,000,000 from the State of Alaska in 1990 for the purchase of locomotives and coal hopper cars for the Wishbone Hill Coal project. Any remaining funds, along with interest earned on the $9,000,000 while in the possession of the ARRC, may be used to purchase other equipment and improvements related to the project. This contribution from the State of Alaska is accounted for as deferred revenue, which will be amortized over the life of the project. According to the agreement, the ARRC is to refund the $9,000,000 plus interest earned less administrative fees during the holding period if the Wishbone Hill Coal Project is canceled. At December 31, 1998, these restricted assets totaled $14,434,000.

Also included in restricted assets is $239,000 received in 1990 from the Department of Natural Resources. These funds are being managed by the ARRC in anticipation of future capital projects. If no capital projects are undertaken, the funds, including accrued interest, would be returned to the Department of Natural Resources.

As part of the 1997 Taxpayer Relief Act passed by the U.S. Congress, states without Amtrak service are due a benefit to be spent on passenger service improvements in lieu of the tax benefits received through Amtrak subsidies over the years. Alaska's share of this benefit is $23,230,000, $11,615,000 of which was received by ARRC in 1998, with the remaining $11,615,000 to be received in 1999. The unspent portion of the amount received, along with investment income thereon, is reported as deferred grant revenue (note 8). At December 31, 1998, these restricted assets totaled $12,077,000.

Securities considered Held to Maturity at December 31, 1998 and 1997 consisted of the following (in thousands):

Description of Security		Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value
1998:					
Money market accounts	$	1,605	—	—	1,605
U.S. Agency notes (maturing within one year)		2,022	3	—	2,025
U.S. Agency notes (maturing in 1-5 years)		18,234	22	(35)	18,221
Corporate notes (maturing in 1-5 years)		4,889	33	(4)	4,918
Total	$	26,750	58	(39)	26,769
1997:					
Money market accounts	$	351	—	—	351
U.S. Treasury strips (maturing within one year)		2,912	—	(1)	2,911
U.S. Agency notes (maturing within one year)		1,629	2	—	1,631
U.S. Agency notes (maturing in 1-5 years)		7,129	22	(11)	7,140
Corporate notes (maturing within one year)		1,033	—	—	1,033
Corporate notes (maturing in 1-5 years)		803	2	—	805
Total	$	13,857	26	(12)	13,871

(5) Investment in Partnership

During 1992, the ARRC entered into a general partnership agreement to develop and operate a hotel complex in the Ship Creek area. The ARRC entered into a 35-year lease with the partnership for the land on which the hotel is located for $1 per year. In return, the ARRC received a 40% interest in the partnership, which is accounted for using the equity method. The ARRC has no cash investment in the partnership. The ARRC's equity in the earnings of the partnership totaled $63,000 and $191,000 at December 31, 1998 and 1997, respectively.

(6) Long-Term Debt and Notes Payable

Long-term debt at December 31, 1998 and 1997 consists of the following (in thousands):

		1998	1997
Note payable, secured by equipment, due in monthly payments of $74,173, including interest at 4.28%, matures September 2003.	$	3,819	—
Note payable, secured by equipment, due in monthly payments of $30,603, including interest at 4.28%, matures October 2003.		1,309	—
Note payable, secured by equipment, due in monthly payments of $18,616 including interest at 4.44%, matures February 1999.		37	254
Note payable, secured by equipment, due in monthly payments of $132,699 including interest at 4.6%, matured August 1998.		—	521
Note payable, secured by equipment, due in monthly payments of $82,066 including interest at 4.50%, matured October 1998.		—	804
Note payable, secured by equipment, due in monthly payments of $88,066 including interest at 5.8125%, matured May 1998.		—	412
		5,165	1,991
Less current portion		1,096	1,954
	$	4,069	37

ARRC has met all debt covenants at December 31, 1998.

Long-term debt maturities are as follows at December 31, 1998 (in thousands):

Year ending December 31		
1999	$	1,096
2000		1,104
2001		1,124
2002		1,026
2003		815
	$	5,165

The ARRC has arrangements for short-term unsecured lines of credit of up to $10,000,000 each with two banks. The general purpose line of credit allows borrowing up to $10,000,000 at a rate of 56% of the prime rate of a major bank. The self-insurance line of credit allows borrowing up to $10,000,000 at a rate of 65% of the prime rate of a major bank. ARRC has met the debt covenants of both lines of credit, which have due dates of August 1, 1999. The ARRC believes these lines will be renewed when they mature or additional commitments will be obtained on similar terms.

(7) Employee Benefits

On January 1, 1998, the ARRC adopted SFAS No. 132, *Employers' Disclosures about Pension and Other Postretirement Benefits.* SFAS No. 132 revises employers' disclosures about pension and other postretirement benefit plans. SFAS No. 132 does not change the method of accounting for such plans.

(a) Defined Benefit Plan

The ARRC has a defined benefit pension plan (Plan) covering all regular represented and nonrepresented employees who are not covered by the Civil Service Retirement System. Benefits under this Plan are based upon the employee's years of service and final average compensation. The ARRC's funding policy is to contribute each year an amount equal to the net periodic pension cost. In 1998 and 1997, the ARRC contributed an amount for the periodic pension cost which was net of a prepaid pension amount. Employees contribute an amount equal to 9% of compensation. Contributions are made continuously throughout the year. Plan assets are comprised of fixed income securities and common stocks.

The following table sets forth the Plan’s funded status at December 31, 1998 and 1997 (in thousands):

		1998	1997
Change in benefit obligation:			
Benefit obligation at beginning of year	$	20,349	15,944
Service cost		865	698
Interest cost		1,516	1,215
Participant contributions		1,453	1,279
Actuarial loss		512	1,640
Benefits paid		(472)	(427)
Benefit obligation at end of year		24,223	20,349
Change in plan assets:			
Fair value of plan assets at beginning of year		22,332	18,882
Actual return on plan assets		3,713	2,598
Participant contributions		1,453	1,279
Benefits paid		(472)	(427)
Fair value of plan assets at end of year		27,026	22,332
Funded status		2,803	1,983
Unrecognized net actuarial gain		(5,088)	(3,701)
Unrecognized prior service cost		1,027	1,100
Unrecognized transition asset		182	243
Accrued benefit cost	$	(1,076)	(375)

The following table sets forth the Plan's weighted average assumptions used in determining the actuarial present value of the projected benefit obligation at December 31, 1998 and 1997:

	1998	1997
Discount rate	6.75%	7.25%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	4.00%	4.75%

Components of 1998 and 1997 net pension costs are as follows (in thousands):

		1998	1997
Service cost	$	865	698
Interest cost		1,516	1,215
Expected return on plan assets		(1,814)	(1,550)
Amortization of prior service costs		73	73
Amortization of unrecognized transition obligation		61	61
Recognized net actuarial gain		—	(78)
Net periodic benefit cost	$	701	419

(b) Defined Contribution Plan

Federal employees who transferred to the ARRC continue to participate in the Civil Service Retirement System (CSRS). ARRC is required to contribute 8.5% of the transferred employees' base pay. Pension expense related to CSRS was $815,000 and $687,000 for the years ended December 31, 1998 and 1997, respectively.

(c) Postretirement Benefits Other Than Pension

The ARRC sponsors a defined benefit health care plan (Plan) that provides postretirement medical benefits to employees receiving retirement under the corporate retirement plan and retired CSRS employees who do not qualify for the federal medical insurance. The Plan is contributory, with retiree contributions adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance. The accounting for the Plan anticipates future cost-sharing changes to the written plan that are consistent with ARRC's expressed intent to increase the retiree contribution rate by the amount of that year's premium increase. ARRC's policy is to fund the cost of medical benefits in amounts determined at the discretion of management. At December 31, 1998, the ARRC has designated assets with a market value of $858,000 for the funding of these benefits (note 3).

The ARRC accounts for postretirement health care by accruing these benefits over the period in which active employees become eligible for such postretirement benefits. The following table sets forth the Plan's funded status, at December 31, 1998 and 1997 (in thousands):

		1998	1997
Change in benefit obligation:			
Benefit obligation at beginning of year	$	5,271	7,437
Service cost		432	417
Interest cost		314	317
Actuarial gain		(10)	(2,700)
Benefits paid		(200)	(200)
Benefit obligation at end of year		5,807	5,271
Funded status		(5,807)	(5,271)
Unamortized prior service costs		(298)	(325)
Unrecognized net actuarial gain		(856)	(910)
Accrued benefit cost	$	(6,961)	(6,506)

The components of 1998 and 1997 net periodic cost for these postretirement benefits are as follows (in thousands):

		1998	1997
Service costs	$	432	417
Interest costs		314	317
Recognized prior service costs		(27)	(27)
Recognized net actuarial gains		(64)	(42)
Net periodic cost	$	655	665

For measuring the 1998 expected postretirement benefit obligation, a 9% annual rate of increase in the per capita claims cost was utilized. This rate was assumed to decrease over a four–year period to an ultimate rate of 5.25% in 2002.

For measuring the 1997 expected postretirement benefit obligation, a 10% annual rate of increase in the per capita claims cost was utilized for all participants. This rate was assumed to decrease over a five–year period to an ultimate rate of 5.25% in 2002.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one–percentage–point change in assumed health care cost trend rates would have the following effects (in thousands):

		1998		1997
		One percentage point increase	**One percentage point decrease**	**One percentage point increase**
Effect on total service and interest cost components	$	239	(178)	382
Effect on postretirement benefit obligation	$	1,479	(1,124)	1,556

The effect of a one-percentage-point decrease in assumed health care cost trend rates was not available for 1997.

(8) Federal Grants

The ARRC received $10,000,000 grants in 1998, 1997 and 1996 from the Federal Railroad Administration (FRA) for capital rehabilitation and improvements benefiting passenger operations. FRA grant expenditures totaled $9,844,000 and $9,201,000 for the years ended December 31, 1998 and 1997.

Spending on road and roadway structures, which have a 15 to 25 year life, has totaled $21,333,000 through December 31, 1998, and spending on a positive train control system, which has a 10 to 15 year life, totaled $3,490,000. The ARRC will recognize grant revenue equal to depreciation on these assets each year.

In 1998, the ARRC received $11,615,000 of the $23,230,000 benefit due from the 1997 Taxpayer Relief Act (note 4). Expenditures under this grant totaled $25,000 for the year ended December 31, 1998.

The ARRC recognized the following grant revenues during years ended December 31:

		1998	**1997**
FRA Grant:			
Depreciation on assets constructed	$	725	432
Grant funded engineering expense		857	798
Taypayer Relief Act -			
Grant funded project planning expense		25	—
	$	1,607	1,230

Deferred revenue as of December 31 represents the following (in thousands):

		1998	**1997**
FRA Grant:			
Net book value of assets constructed	$	23,494	15,230
Amount receivable from grantor		(830)	(526)
Taypayer Relief Act -			
Grant funding received in advance		11,590	—
Investment earnings on funding		487	—
	$	34,741	14,704

(9) Major Customers

One ARRC customer accounted for 34% of freight revenue in both 1998 and 1997.

(10) Land

The ARRC leases a significant portion of its land to various parties under long-term agreements. Rental income on these leases, which is included in Real Estate income, was $6,385,000 and $5,460,000 in 1998 and 1997, respectively.

The following table summarizes future minimum lease payments receivable as of December 31, 1998 (in thousands):

Year ending December 31		
1998	$	6,277
1999		6,550
2000		6,886
2001		6,810
2002		6,681
Thereafter		138,026
	$	171,230

The ARRC has $1,291,000 in rent credits outstanding on these leases at December 31, 1998.

(11) Operating Leases and Agreements

The ARRC leases its headquarters, certain operating equipment, and barge services under operating leases and agreements. Payments under the leases and agreements totaled $15,707,000 and $13,630,000 in 1998 and 1997, respectively. Future minimum lease payments as of December 31, 1998 are summarized as follows (in thousands):

Year ending December 31		
1999	$	15,014
2000		13,563
2001		3,247
2002		945
2003		818
Thereafter		6,933
Amounts to be received under non-cancellable sub-leases		(3,968)
	$	36,552

(12) Insurance

The ARRC is self-insured to certain limits for employee health benefits, personal injury, property and casualty damage claims which are funded by a line of credit (note 6). The ARRC is also self-insured against workers' compensation claims. The ARRC carries commercial insurance policies limiting its exposure for health benefits to $2.5 million, for casualty/liability to $5 million and for property to $10 million at December 31, 1998.

(13) Commitments and Contingencies

During 1997, and as amended in 1998, the ARRC entered into an agreement to purchase 16 locomotives for approximately $32,200,000. The locomotives are scheduled to begin delivery in the last month of 1999. The Board of Directors has designated assets with a carrying value of $3,936,000 toward the purchase of these locomotives (note 5).

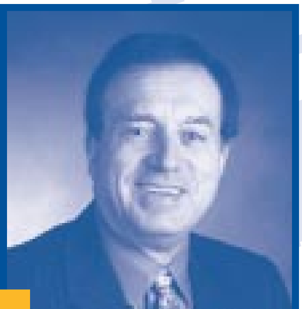
During 1992, the EPA filed a complaint seeking to fine the ARRC for alleged violations of the Resource Conservation and Recovery Act in relation to storing hazardous wastes at the Anchorage rail yard. A consent agreement was executed during 1994 settling the alleged violations. The accrual included in the financial statements does not reflect any costs to clean up any contamination in the area covered by the settlement. No contamination has been discovered, but the ARRC believes most, if not all, contamination in this area would have occurred prior to the transfer of the ARRC from the federal government to the State of Alaska. That liability for contamination will be ultimately imposed on the federal government under the transfer act and a 1990 agreement between the federal government and the ARRC.

Several of the ARRC unions have filed a grievance relating to the gain sharing provisions in their respective contracts. No reserves have been established for this claim as the ultimate amount of claim to be paid, if any, is uncertain. Although the eventual disposition of this claim cannot be predicted with certainty, it is the opinion of ARRC's management that the ultimate outcome will not have a material adverse impact on the ARRC's financial position, but may have a significant impact on the statement of income in a given year.

The ARRC is a defendant in various legal proceedings related to the conduct of its business. Provision has been made in the financial statements for probable losses, if any, from such litigation. In the opinion of management, the outcome of the litigation will not have a material effect on the financial position of the ARRC.

THEBOARD

Johne Binkley
Chairman
Chairman & CEO
Alaska Riverways, Inc.



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