



SPECIAL REPORT TO THE STATE OF ALASKA LEGISLATURE AND ADMINISTRATION



FEBRUARY 2006

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INTRODUCTION

Up until the mid 1990s, the Alaska Railroad could have been considered a respectable “1960s” railroad. It served the state year after year by hauling freight and passengers over miles of aging track and bridges, using aging equipment. Much of the route was without signals and out of radio coverage. Older less powerful locomotives were teamed to pull trains slowly through a serpentine track system that was routinely subject to floods, rock falls and snow slides. Understandably, tightly scheduled regular operations had not even advanced to the wishful thinking stage.

All that has changed. Now, 4,000 horsepower diesel locomotives, new equipment and facilities, state-of-the-art communications and signal technology, and a stronger, straighter, faster, safer track embody the railroad's contemporary modern status.

Modernization efforts over the last ten years have enabled us to make another overall strong showing in 2005. Present indications are that 2005 will join the two previous years as the railroad's three most profitable years ever. Passenger services experienced its most successful year ever....again. Freight totals turned in a solid performance.

Outstanding safety results once more highlighted employee performance for the third year in a row. We had fewer and less severe injuries, despite the highly challenging working conditions. We turned in similar improvements for equipment derailments and damage. As a result of beating our “best ever” safety record, I believe we have established a new company standard in safety. By raising the bar for 2006, our goals will appear formidable. We are up to the challenge.

How has modernization contributed to such repeated operational and financial strength? New technology is adding speed and capacity while increasing reliability. Concrete ties, with a 100-year life expectancy, compared to 40 years for wood ties, are being installed throughout the line. When you notice the lack of wheel "clickety-clack," it's because we are welding the track joints, which greatly reduces maintenance costs, increases safety, and leads to quieter, happier neighborhoods along the railbelt. Investment in new equipment is contributing to higher margin business. Quality and reliability are watchwords in shop maintenance, backed by better machinery and data systems. Facility upgrades and renovation are assuming a much higher priority than in years past in order to improve the workplace environment.

In short, a balanced, robust investment in capital improvements has, and will continue to modernize the Alaska Railroad. The question becomes where should we focus specific investment expenditure in the next five years? The Alaska Railroad capital program first addresses this question by listing in this document three guiding priorities. In order they are:

- 1** Safety improvements: rail, ties, signals, bridges, maintenance and communications are the blocking and tackling fundamentals of safe railroad operations and must therefore continue receiving our undivided investment attention.
- 2** A better, safer quality of life on the job: employees must be well equipped, educated and trained. This plan invests significant dollars toward improving the work place and personal skills of our employees.

As a result of beating ‘best ever’ safety record, I believe we have established a new company standard in safety. By raising the bar for 2006, our goals will look formidable. We are up to the challenge.

3 Increased capacity for future business: to remain financially successful we must increase net earnings, which is a function of attracting and retaining more high margin business while simultaneously reducing expenses. This plan invests in new locomotives, track equipment, railcars, technology and other programs that provide good return on investment, which will keep us moving steadily towards our ambitious business goals.

As we assess the future, it's clear that the Alaska Railroad must increase load capacity in order to simultaneously support the gas pipeline project, new passenger business, increased coal and gravel production, and growth in refined petroleum movement. We must also cultivate win-win strategic relationships with the state, railbelt communities and the military if we are to succeed at new eco-

nomics development opportunities such as the rail line extension to Fort Greely/ Delta Junction.

This long range capital improvement and program plan will be used to guide the Alaska Railroad. It will point us in a direction that insures Alaska a safe, reliable, expedient railroad with which the communities and rail customers can partner to meet today's requirements while we jointly plan with confidence for tomorrow. The Alaska Railroad is continuing its' journey on the way to being a world-class 21st century railroad.

Respectfully,



Patrick K. Gamble
President & CEO



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ARRC TODAY

ALASKA RAILROAD “QUICK FACTS”

Purchase Price (Jan. 5, 1985)

Paid to federal government	\$22.3 m
Start-up costs & contributed capital	\$11.9 m
Total Investment-State of Alaska	\$34.2 m

Organization (following State purchase)

- Independent corporation owned by State
- Managed by a seven-member board of directors appointed by the Governor
- Mandated to be self-sustaining, responsible for all financial and legal obligations

Operating Data

Miles of main line	466
Miles of branch line	59
Miles of yards and sidings	86
Total miles of track	611
Freight cars (owned & leased)	1,643
Passenger cars	48
Locomotives	61

Operating Statistics (Jan. 1-Dec. 31, 2005)

Passenger ridership	471,348 passengers
Freight tonnage	8,156,643 tons

Financial Statistics

Preliminary/unaudited: Jan.1-Dec 31, 2005	
Total Assets	\$ 573.7 m
Total 2005 revenues	\$ 126.0 m
Total 2005 expenses	\$ 113.8 m
2005 net income	\$ 12.2 m
Budgeted 2005 net income	\$ 11.1 m

Employees (December 31, 2005)

Number of year-round employees	754
Average years of service	10.8
Average age	43.8
Male	624
Female	130

Unions

A majority of ARRC employees are members of five unions, including:

United Transportation Union	138
Transportation Communication Union	47
International Association of Machinists	62
American Federation of Govt Employees	295
American Train Dispatchers Department	10

Vision

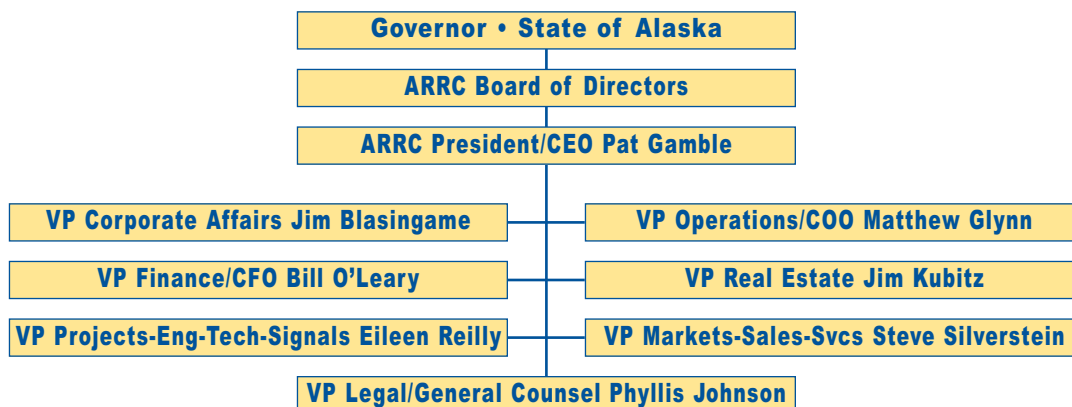
Building a Great Railroad across the Great Land

Mission

1 Be profitable while delivering safe, high quality service to our freight, passenger, and real estate customers.

2 Foster the development of Alaska’s economy by integrating Railroad and railbelt community development plans.

Alaska Railroad Organizational Chart



Finances

With total revenues of \$126 million and total expenses of \$113.8 million, the Alaska Railroad netted \$12.2* million in 2005. Transportation of petroleum products, gravel, coal, oilfield and mining supplies, chemicals and consumer goods account for 75% of ARRC's gross revenues. ARRC serves almost a half million passengers each year, accounting for approximately 15.5% of gross revenues.

ARRC owns approximately 36,000 acres of land. Of that, 14,000 acres are right-of-way and 4,500 acres are

used in operations. The remaining land can be leased or permitted to help generate revenue for ARRC. Real estate and other miscellaneous revenues generally account for about 9.5% of the corporation's gross revenues.

The Railroad invests all cash flow generated by annual net earnings and depreciation on capital improvements to its 611 miles of track, 169 bridges, 79 crossing signals, train signals, the roadbed, equipment, and other asset enhancements.

Additionally, significant operating



dollars are spent on maintenance of rail cars, locomotives, employee training, technology improvements, safety, security, and environmental initiatives. A well-balanced capital investment program is absolutely essential to corporate vitality and growth, and the President/CEO personally oversees the balancing process.

* unaudited

More about how ARRC relates to State government

The Alaska Railroad Corporation Act of 1984 established an independent state-owned corporation. Railroad employees are technically not state employees in that they receive pay, benefits, and retirement all from the ARRC, not the state. Unlike other independent Alaska state corporations (such as the Alaska Housing Finance Corporation and the Alaska Industrial Development and Export Authority), ARRC's federal enabling statute specifically requires that all revenue earned by the Railroad shall be retained by the corporation for railroad purposes. The intent was to ensure the Railroad had control of all the funds it needed to meet basic maintenance needs, improve the asset for increased safety and profitability, and could avoid having to rely on the state general fund. The Railroad's annual net earnings are all invested back into the corporation. Although ARRC is not covered under the State's Executive Budget Act, the state government ensures oversight of ARRC's operation and management practices through the following:

- The ARRC Board of Directors is responsible for initiating both a financial and performance audit each year. As required by statute, the financial audit is performed by an independent certified public accountant. A recognized railroad management expert conducts the annual performance audit to ensure ARRC is managed and

operated effectively and efficiently. Copies are provided to the Governor and the Legislature

- ARRC must file an oversight report with the Legislature and Governor before it undertakes certain expansion, reduction, or diversification of train services.
- Legislative approval is required for certain corporate actions, such as disposing of the Railroad's entire interest in land, or leasing land for longer than 55 years, or selling tax free bonds.
- The Legislative Budget and Audit Committee regularly reviews ARRC's operation and management practices.
- ARRC's procurement procedures are required to be substantially equivalent to state procurement requirements.
- ARRC employees and directors are subject to the Executive Branch Code of Ethics, but not the Sarbanes/Oxley Act.
- The Commissioners of the Alaska Dept. of Transportation and Public Facilities and Dept. of Commerce, Community and Economic Development both serve on ARRC's board of directors.
- ARRC's spill prevention and response plans are filed and regulated by the State; ARRC is required by state law to show sufficient financial responsibility to respond to spills.

MILESTONES

Five-Year Plan — Operating Budget

<i>(in millions)</i>	2006 Budget	2007 Plan	2008 Plan	2009 Plan	2010 Plan
Operating Revenues	\$ 110.63	\$ 118.85	\$ 122.37	\$ 125.43	\$ 128.93
Operating Expenses	(102.08)	(103.85)	(104.96)	(106.10)	(107.17)
Net Income — Operations	8.55	15.00	17.41	19.33	21.76
Net Income — Real Estate	7.40	7.81	8.24	8.70	9.17
Other Income	0.45	0.47	0.49	0.52	0.54
Net Income (before depreciation and interest)	16.40	23.28	26.14	28.55	31.47
Depreciation	(14.12)	(15.50)	(17.28)	(18.62)	(20.48)
Interest Expense	(1.08)	(1.10)	(1.08)	(1.08)	(1.07)
Net Income (earned without Preventive Maintenance)	1.20	6.68	7.78	8.85	9.92
Preventive Maintenance Reimbursement	6.20	6.35	6.51	6.67	6.84
Net Income	\$ 7.40	\$ 13.03	\$ 14.29	\$ 15.52	\$ 16.76



Five-Year Forecast — Capital Budget

<i>(in millions)</i>	2006 Budget	2007 Forecast	2008 Forecast	2009 Forecast	2010 Forecast	TOTAL
ARRC Internally Generated	\$ 14.9	\$ 20.3	\$ 23.2	\$ 25.7	\$ 28.8	\$ 112.9
Federal Railroad Administration	9.9	10.0	10.0	10.0	—	\$ 39.9
Federal Transit Administration	35.7	38.4	43.5	47.6	47.6	\$ 212.8
Federal Highway Administration	4.3	2.2	2.2	2.2	—	\$ 10.9
Department of Defense	18.9	10.0	10.0	10.0	—	\$ 48.9
Total	\$ 83.7	\$ 80.9	\$ 88.9	\$ 95.5	\$ 76.4	\$ 425.4

