FINANCE DOCKET No. 12240

DELAWARE, LACKAWANNA & WESTERN RAILROAD COMPANY RECONSTRUCTION LOAN

Submitted November 21, 1938. Decided November 28, 1938

1. The Delaware, Lackawanna & Western Railroad Company, on the basis of present and prospective earnings, found reasonably to be expected to meet its fixed charges without a reduction thereof through judicial reorganization.
2. Upon application, a loan of not exceeding $2,000,000 to the Delaware, Lackawanna & Western Railroad Company by the Reconstruction Finance Corporation approved conditionally.

John M. Davis, *William S. Jenny*, *John G. Enderlin*, *Philip D. Jonas*, and *J. L. Seager* for applicant.

REPORT OF THE COMMISSION

DIVISION 4, COMMISSIONERS MEYER, PORTER, AND MAHAFFIE

BY DIVISION 4:

The Delaware, Lackawanna and Western Railroad Company on November 16, 1938, filed an application with the Reconstruction Finance Corporation, hereinafter called the Finance Corporation, for a loan under the provisions of section 5 of the Reconstruction Finance Corporation Act, approved January 22, 1932, and acts amendatory thereof and supplemental thereto. Under the provisions of such acts the Finance Corporation may, with our approval, make loans upon full and adequate security, to aid in the financing of railroads when, in the opinion of the Finance Corporation, funds are not available on reasonable terms through private channels, provided that in the case of loans not made for maintenance or purchase of equipment, to railroads not in receivership or trusteeship, we certify, in connection with our approval thereof, that the borrower, on the basis of present and prospective earnings, may reasonably be expected to meet its fixed charges, without reduction thereof through judicial reorganization. We have made the required investigation.

The application.—The applicant requests a loan of $2,000,000 for a period of five years, to be secured by its promissory note or notes, bearing interest at 4 percent per annum, with the privilege of prior repayment on 30 days' written notice at any time after the first year, at a price of 102 during the second year, 101 during the third year, and

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100½ after the third year. The proceeds of the loan would be used for the purpose of meeting tax accruals on December 1, 1938, including $1,968,594.27 taxes which the State of New Jersey has levied against the property of the applicant and its leased subsidiaries in the State of New Jersey, and $31,406 of a tax of $197,755 levied against the applicant by the city of Buffalo, N. Y. The applicant is obligated under such leases to pay the taxes levied against the property of such subsidiaries, and unless the taxes are paid on or before December 1, 1938, a penalty for nonpayment at the rate of 1 percent a month or fraction thereof during which payment is in default will be incurred.

The applicant states that no agreement has been or will be made to pay any person, association, firm, or corporation, either directly or indirectly, any commission or fee for the loan applied for, and that no such payments have been or will be made.

The applicant further states that it is unable to obtain additional bank credits at this time on acceptable terms, and it believes that it cannot secure additional funds by the sale of its bonds to the public without unwarranted sacrifice.

Transportation properties and operations.—The applicant's main lines extend from its western terminus in Buffalo, N. Y., through the States of New York, Pennsylvania, and New Jersey, to its eastern terminus at Hoboken and Jersey City, N. J., and New York City, N. Y., with branch lines in each of these States. The system embraces 244 miles of owned main line and 986 miles of operated main line. Its equipment consists of 469 locomotives, 19,297 freight-train cars, 813 passenger-train cars, 577 company-service cars, and 268 units of floating equipment. Of the total gross freight revenue during 1937, nearly 29 percent was from traffic in anthracite, and 43.5 percent was from manufactures and miscellaneous. Other important items of traffic are bituminous coal, iron and steel, cement, and railway car wheels, axles, and trucks.

The final value for rate-making purposes of the owned and used carrier properties composing the applicant's system found by the Commission, division 1, as of June 30, 1918, was $244,162,696, including $5,700,000 for working capital. Between valuation date and December 31, 1937, the net additions and betterments reported amounted to $92,489,938. The sum of the foregoing amounts is $336,652,634.

Necessities of applicant.—The applicant's cash on hand on October 31, 1938, amounted to $3,287,191, as compared with $2,037,299 on January 1, 1938. In a forecast for the last two months of 1938 and for the year 1939, furnished by the applicant, cash of $2,556,191 is shown for December 31, 1938, and $3,569,671 for December 31, 1939. This forecast contemplates that the requested loan shall be made and

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includes payment of interest thereon. The applicant estimates that its normal cash working capital should approximate $3,000,000, although it could drop to $2,000,000 before vouchers would have to be deferred.

The general basis of the applicant's cash forecast is its forecast of operations for the year 1939, which, it estimates, will show an increase of 15 percent in freight receipts over the year 1938. Giving consideration to a small increase in passenger revenues, and an increase of 5 percent in other revenues, the applicant forecasts total operating revenues 12 percent in excess of those realized in 1938.

Security.—As security for the loan the applicant offers to pledge with the Finance Corporation Morris & Essex Railroad Company construction-mortgage 4½-percent bonds, series C, maturing November 1, 1975, in such amount as shall be required. The bonds are secured by the applicant's construction mortgage of November 1, 1925, to the Farmers Loan & Trust Company (now City Bank Farmers Trust Company) trustee, covering all the railroad, property, and franchises of the Morris & Essex Railroad Company. Each of the bonds bears the guaranty of the applicant, endorsed thereon, of the payment of both principal and interest. The mortgage is a closed one, and was given to secure a total issue of $35,000,000, principal amount, of bonds, all of which have been issued. Of the total issue, $10,000,000 of 5-percent series-A bonds, maturing November 1, 1955, and $15,000,000 of 4½-percent series-B bonds, maturing November 1, 1955, are outstanding in the hands of the public, while $10,000,000 of series-C bonds are in the applicant's treasury. There is no priority or preference of any bond secured by the mortgage over any other bond so secured. The construction mortgage of 1925 securing the bonds is a second-mortgage lien upon the property therein described, and junior in lien only to the Morris & Essex first and refunding gold mortgage of December 1, 1900, also a closed mortgage, securing a prior issue of $35,000,000, principal amount, of 3½-percent bonds maturing December 1, 2000, all outstanding in the hands of the public.

The Morris & Essex Railroad extends from tidewater at Hoboken, N. J., through Bergen Hill, just west of Hoboken, by two double-track tunnels and then almost immediately separates into two lines of main track. The most southerly of these, known as the Morristown line, extends in a general westerly direction by way of Newark to Morristown and from Dover to Port Morris, thence southwesterly through Hackettstown to Washington, and to Phillipsburg on the Delaware River. The other and more northerly line, known as the Boonton line, extends from a point near the west end of Bergen Hill tunnel northwestedly by way of Passaic, Paterson, and Boonton to a

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connection with the Morristown line at Denville near Dover. With the exception of the road between Washington and Phillipsburg, both of these lines are double tracked throughout. The total railroad mileage is 125.99. In addition, the railroad of the Morris & Essex Railroad Company comprises three lines leased to it and operated and maintained by the applicant in connection with the main line of the Morris & Essex Railroad. The leased lines are the Chester Railroad, Morris & Essex Extension Railroad, and the Newark & Bloomfield Railroad. The total mileage of the leased lines is 6.16 miles. The railroad and property of the Morris & Essex is leased in perpetuity to the applicant.

The Morris & Essex balance sheet as of September 30, 1938, shows total investments of $84,104,541, total current assets $906,537, and total deferred assets $5,372,853, a grand total of $90,383,931. The liabilities consist of capital stock $15,000,000, total long-term debt $70,000,000, total current liabilities $907,194, and total deferred liabilities $5,185,-389. There was a corporate deficit of $708,652.

The series-C bonds offered for pledge are not listed upon the New York Stock Exchange. These bonds, however, are the same as the series-B bonds, except as to date of maturity. The latter bonds are listed, and ranged from a high of 55½ to a low of 34½ during the current year, and closed at 51½ in the week ended November 19, 1938. The applicant estimates that a price of 45 for the series-C bonds would be reasonable.

Among other securities in the applicant's treasury and available as collateral for the requested loan is $964,100, par value, of Lehigh & Hudson River Railroad Company capital stock. The balance sheet of the Lehigh & Hudson River as of September 30, 1938, shows total investment of $7,048,483, current assets $435,962, deferred assets $37,669, and unadjusted debits $61,342, a total of $7,583,456. Liabilities comprise capital stock $4,707,000, current liabilities $127,248, unadjusted credits $978,420 including $96,227 tax liability, and corporate surplus $1,770,790. Total railway operating revenues for the first nine months of 1938 were $1,040,480, and net income was $75,749. This stock is not listed on the New York Stock Exchange.

The applicant's total railway operating revenues ranged from a maximum of $81,743,222 in 1929, to a minimum of $43,339,279 in 1933. They increased to $44,592,530 in 1934, $44,722,233 in 1935, $49,728,116 in 1936, and $50,175,004 in 1937, declining to $44,136,882 in 1938, with the last two months estimated. Such revenues are estimated at $49,-542,721 in 1939. Sizable surpluses in net income were enjoyed in the years 1928 to 1931, inclusive, but deficits were incurred in each year thereafter, being $2,542,447 in 1932, $2,993,862 in 1933, $1,972,613 in

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1934, $2,932,305 in 1935, $132,847 in 1936, $936,772 in 1937, and $3,609,-061 in 1938. The applicant forecasts net income of $463,200 in 1939. During the period 1932 to 1937, inclusive, income available for fixed charges averaged $6,047,120 and fixed charges, $7,965,611. It estimates fixed charges at $7,679,910 in 1938 and income available therefor at $4,070,849. Total maintenance expenses declined from $16,961,-009 in 1931 to $13,065,925 in 1937, and are estimated at $11,236,571 in 1938. The applicant states that maintenance expenses in 1939 should not exceed those of 1938. The charges to operating expenses for depreciation were $2,552,991 in 1932, $2,696,701 in 1935, and are estimated by the applicant at $2,445,915 for the current year.

The applicant's balance sheet shows as of September 30, 1938, total investment in road and equipment $137,118,967, and total of all investments $206,500,701. This is an increase of $25,798,866 in road and equipment and of $6,403,046 in all investments over figures for those items shown at the close of 1928. As of September 30, 1938, current assets were $7,012,565, including cash $3,153,039, traffic and car-service balances receivable $721,585, net balances receivable from agents and conductors, $560,718, miscellaneous accounts receivable $822,256, material and supplies $1,740,627, and other current assets $14,340. Total current liabilities as of the same date were $7,031,767, comprising loans and bills payable $950,000, traffic and car-service balances payable $740,913, audited accounts and wages payable $2,435,394, miscellaneous accounts payable $283,321, dividends matured unpaid $26,-510, unmatured interest accrued $91,653, unmatured rents accrued $2,402,067 and other current liabilities $137,909. The applicant's total capital stock was $84,511,920, including premium on capital stock, and total long-term debt was $4,457,283. Tax liability was shown as $4,922,285. Total corporate surplus was $56,366,620. In addition to the applicant's liability for its own long-term debt of $4,457,283, it is the guarantor of $70,000,000, principal amount, of Morris & Essex Railroad Company bonds, of which $25,000,000 mature in 1955, $10,-000,000 in 1975, and the remainder in 2000; $1,394,000, principal amount, of Warren Railroad Company bonds, maturing in the year 2000; and $23,639,000, principal amount, of New York, Lackawanna & Western Railway Company bonds, maturing in 1973.

The applicant has been assessed New Jersey State property taxes of approximately $2,700,000 in excess of the tax-liability shown on the balance sheet. The matter of its tax liability is now in litigation.

For many years prior to 1932, the applicant experienced no difficulty in meeting its fixed charges after depreciation. Although its earnings suffered a serious decline in the following years, so that it has since failed to earn its charges in any year, it failed to earn its charges

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before depreciation only in 1933, 1935, and in the current year. Its total depreciation charges exceeded its total deficits by approximately $2,900,000 during this 7-year period. It showed marked response to the improved business conditions in 1935 and 1936, suffering deficits of only $132,847, and $936,772 in these two years, respectively, after depreciation charges of $2,655,514 and $2,507,474, respectively. While we view the applicant's estimate of net results to be expected from 1939 operations as somewhat too optimistic, we are convinced that a material improvement may be expected in the immediate future over the results of recent operations, and that under such circumstances the applicant may reasonably be expected to meet its fixed charges.

Conclusions.—We conclude:

1. That the applicant may reasonably be expected, on the basis of present and prospective earnings, to meet its fixed charges without reduction thereof through judicial reorganization.

2. That we should approve a loan of not to exceed $2,000,000 to the applicant by the Finance Corporation, for a period not exceeding five years, for the purpose stated in the application and in this report.

3. That the applicant should deliver to the Finance Corporation, as collateral security for the loan $7,000,000 of Morris & Essex Railroad Company 4½-percent construction-mortgage bonds, series C, maturing November 1, 1975, and $964,100 of Lehigh & Hudson River capital stock.

4. That the applicant should agree with the Finance Corporation to apply the proceeds of the loan herein approved solely for the purpose and in the manner designated in the report.

5. That the collateral herein required to be pledged will constitute full and adequate security for the loan.

6. That the applicant should agree that it will, within 30 days from the making of the loan, report to us and to the Finance Corporation, in writing, the disposition made of the proceeds thereof.

An appropriate certificate of approval will be issued.

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