STB FD 32760 11-30-95 A 1648V26 2/7

$12.4 million, respectively, for environmental matters relating to properties held for sale. Costs associated with environmental remediation of properties held for sale may be deferred to the extent such costs, together with estimated future costs and the existing cost basis of the property do not exceed, in the aggregate, the amount expected to be realized upon sale.

The Company owns or previously owned two properties and has a partial interest in four properties that are on the national priorities list ("NPL") under CERCLA, the federal "superfund" statute. The Company has been informed that it is or may be a PRP, together with multiple other PRPs, with respect to the remediation of eight other properties on such list. Certain other Company properties are included on lists of sites maintained under similar state laws. Inclusion of a site on such lists would allow federal or state "superfund" monies to be spent on clean-up at the sites if PRPs do not perform the cleanup. The law governing "superfund" sites provides that PRPs may be jointly and severally liable for the total costs of remediation. In some instances, liability may be allocated through litigation or negotiation among the PRPs based on equitable factors, including volume contribution. Of its properties, including the NPL and PRP properties described above, the Company has only three sites that individually involved future cost estimates for environmental matters as of December 31, 1994 in excess of $5 million.

The Company's total costs for its environmental matters cannot be predicted with certainty; however, the Company has accrued reserves for environmental matters with respect to operating and non-operating properties not held for sale, as well as certain properties previously sold, based on the costs estimated to be incurred when such estimated amounts (or at least a minimum amount) can be reasonably determined based on information available. At December 31, 1994 and 1993, the Company had accrued reserves for environmental contingencies of $65.0 million and $61.7 million, respectively. Based on the Company's reserves, management does not believe that disposition of environmental matters known to the Company will have a material adverse effect on the Company's financial condition. However, there can be no assurance that material liabilities or costs related to environmental matters will not be incurred in the future.

ITEM 3. LEGAL PROCEEDINGS

Union Pacific-Missouri Pacific Trackage Rights Compensation. As a condition to its approval of the consolidation of Union Pacific, Missouri Pacific Railroad Company ("MP") and Western Pacific Railroad Company in 1982, the ICC awarded SSW trackage rights to operate over the MP lines between Kansas City and St. Louis. The ICC's initial decision did not fix the compensation SSW would pay for the trackage rights, which commenced in January 1983. After a series of hearings, the ICC set forth new principles to govern the computation of charges. Union Pacific has asserted a claim for additional amounts due against the Company of approximately $63 million (including interest) as of December 31, 1994, and filed a collection action in Federal District Court. In early 1995, the court issued an order finding that the Company owes Union Pacific the amount of $60.99 million as of January 31, 1995 plus additional accrued amounts occurring since that date, but allowing the Company to pursue a counterclaim for losses due to alleged discrimination against the Company's trains using the joint facility. The Company and Union Pacific have agreed in principle concerning settlement of the litigation. Whether or not final agreement to settle on the proposed terms is reached, the Company's payment to Union Pacific will be substantial. Management has made adequate provision for this matter in current liabilities in its financial statements.

1991 Dunsmuir Derailment. In July 1991, a derailment near Dunsmuir, California resulted in the escape from a tank car of metam sodium (a soil fumigant) into the Sacramento River. The derailment allegedly resulted in environmental damage, particularly the loss of fish, plants and other organisms in approximately 38 miles of the Sacramento River.

Approximately 46 lawsuits were filed against SPT by private plaintiffs alleging costs and damages for personal injuries, property damage, business losses and other losses. Most of these were consolidated, and classes consisting of approximately 3,350 claimants were certified. In June 1993, SPT and the class action plaintiffs agreed to settle and that settlement was given final approval by the court in January 1995. Through the settlement, the class action plaintiffs will receive a total of $14 million from SPT and the other defendants. Thirteen class action plaintiffs filed appeals from the preliminary approval of the settlement. Those appeals have not been dismissed. The only remaining civil cases on the derailment involve four personal injury-only claims and one business loss-only claim brought by plaintiffs who opted out of the class action.

In addition, the State of California and the United States each filed suits against SPT and others in the United States District Court in Sacramento, California. These cases sought natural resource damages, costs, injunctive relief and civil penalties. Litigation instituted earlier by Southern Pacific in the U. S. District Court for Los Angeles was transferred to the Sacramento federal court. Several angling advocacy groups and an environmental group intervened in the Sacramento federal action. All of the parties except the intervenors reached a settlement which is incorporated in two consent decrees lodged with the court in March 1994. The consent decree involving SPT provides that the Company will pay $30 million and the other defendants collectively will pay $8 million in settlement of all government claims. The settlement was subject to the conditions that the intervenors' claims be dismissed with prejudice and that the court approved the consent decrees after public comment. On December 19, 1994, the court ruled that it would grant SPT's motion to dismiss the intervenors' claims and indicated it would approve the two consent decrees upon completion of the public comment process. On February 3, 1995, the governments responded to public comments and requested entry of the consent decrees. The intervenors prematurely filed notices of appeal from the decision to dismiss their claims.

On March 14, 1995, the court entered two orders. In one the court found that the consent decrees complied with law, were fair, reasonable and made in good faith, and entered them as final orders as of that date. By the other order, the court clarified that its December 19, 1994 decision was not a final order of dismissal of the intervenor's claims, but that its March 14, 1995 actions did constitute final dismissal. The entry of the decrees and dismissal of the intervenor's claims terminates the litigation except for any properly brought appeals.

The California Public Utilities Commission ("PUC") also instituted an investigation into causes of the derailment. The PUC recently issued a decision imposing fines of $488,000 and certain operational requirements. SPT is challenging the decision in all respects.

SPT is insured against most types of damages and related costs involved in the Dunsmuir derailment to the extent they exceed $10.0 million. As of December 31, 1994, SPT had paid approximately $46.8 million related to the Dunsmuir derailment, of which $12 million was charged to expense primarily to cover the $10 million deductible. The balance has been or is in the process of being collected from insurance carriers. As of December 31, 1994, approximately $31.9 million has been recovered by SPT from insurers. SPT expects to recover substantially all additional damages and costs under its insurance policies (including amounts payable pursuant to the settlement of private suits described above, as well as amounts payable pursuant to settlement of the federal court action described above, except for $750,000 which constitutes penalties and the potential penalty of $488,000 under the PUC decision). As a result, disposition of these matters is not expected to have a material adverse effect on the Company's financial condition.

Houston-Metro. In 1992, SPT received $45 million from the sale of property to the Metropolitan Transit Authority (Metro) in Houston, Texas. SPT believes that the contract of sale in 1992 also requires Metro to acquire an additional $30 million of SPT right-of-way properties. Metro, on the other hand, has indicated that it believes an adjustment or credit should be made with respect to the purchase price for the property it already purchased. Negotiations between SPT and Metro to resolve the matter have been unsuccessful. On March 29, 1994, SPT filed a lawsuit in the U.S. District Court in Houston, Texas seeking damages and/or specific performance in connection with Metro's decision not to purchase the additional $30 million of SPT right-of-way properties and further seeking a declaratory judgment that SPT is not required to refund any amounts to Metro under the 1992 sales contract. On the same day, Metro filed a lawsuit in the U.S. District Court in Houston, Texas seeking a refund from SPT of $19.7 million under the 1992 sales contact between SPT and Metro.

General. SPT is involved in certain income tax cases relating to prior periods, but pursuant to an agreement with SPT's former parent as part of the Company's acquisition of SPT, the former parent has assumed the liability for any adjustments to taxes due or reportable on or before October 13, 1988, the date of acquisition. Accordingly, the Consolidated Financial Statements of the Company do not make provision for any taxes and interest of SPT that may have been due or reportable relating to periods ending on or before October 13, 1988.

Although the Company has purchased insurance, the Company has retained certain risks (consisting principally of a substantial deductible per occurrence) with respect to losses for third-party liability and property claims. In addition, various claims, lawsuits and contingent liabilities are pending against the Company. Management has made provisions for these matters which it believes to be adequate. As a result, the ultimate disposition of these matters is not expected to have any material adverse effect on the Company's financial condition.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

All issued and outstanding Common Stock of the Company is owned by SPRC.

No dividends were declared or paid in 1994, 1993 or 1992. As of December 31, 1994, there were certain restrictions on the payment of dividends by the Company and net worth covenants. See Notes 5 and 7 to the Consolidated Financial Statements.

The advances to SPRC of $719.1 million at December 31, 1994 are not interest bearing. It is anticipated that the Company will make dividend payments or advances in the future to SPRC in order for SPRC to meet its debt service obligation.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in connection with the Consolidated Financial Statements and related Notes.

Results of Operations

SPRC transferred ownership of D&RGW to SPT effective October 1, 1994 by a contribution to capital. The consolidated financial statements have been restated to reflect the combined financial position and results of operations and cash flows of the companies for all periods presented.

Year Ended December 31, 1994 Compared to Year Ended December 31, 1993

The Company had net income of $204.5 million for 1994 (including a $6.0 million charge for the cumulative effect of a change in accounting for post-employment benefits under Statement of Financial Accounting Standards ("FAS") No. 112 adopted by the Company effective January 1, 1994) compared to a net loss of $193.0 million for 1993 (including a $104.2 million charge for the cumulative effect of a change in accounting for post-retirement benefits other than pensions under FAS No. 106 adopted by the Company effective January 1, 1993). The Company had operating income of $231.6 million for 1994 compared to an operating loss of $20.8 million for 1993. Operating results for 1993 were adversely affected by severe weather and flooding in certain western and midwestern states during the year, a significant decline in automotive shipments, a shortage of power due to a temporary reduction in the number of locomotives leased by the Company and a slower than anticipated recovery in certain segments of the economy. Operating income for 1994 showed the effects of substantial increases in traffic volume due to improvements in the economy and to Company programs to increase productivity.

Operating Revenues. In 1994, railroad operating revenues increased $218.7 million compared to 1993. Railroad freight operating revenues increased $206.8 million. Shipments of all commodities increased, with the most significant percentage increases occurring in intermodal, coal, construction materials and minerals, and automobiles. Other railroad revenues increased $11.9 million due primarily to increases in switching and demurrage revenue associated with increased traffic volume. For 1994, carloads increased 9.4% and revenue ton-miles increased 12.5% compared to 1993. The average net freight revenue per ton-mile for 1994 declined by 4.5% compared to 1993 due principally to an increase in traffic volume for commodities that generated lower revenue per ton-mile (e.g., coal and intermodal traffic), as well as to increases in revenue deductions and allowances that resulted in lower net freight revenue per ton-mile and carload.

The following table compares traffic volume (in carloads), gross freight revenue (before contract allowances and adjustments) and gross freight revenue per carload by commodity group for 1994 compared to 1993

Carload and Gross Freight Revenue Comparison
Years Ended December 31, 1994 and 1993

	Carloads			Gross Freight Revenue			Gross Freight Revenue Per Carload		
	1994	1993	% Change	1994	1993	% Change	1994	1993	% Change
	(in thousands)			(dollars in millions)			(dollars)		
Intermodal	728.1	607.6	19.8%	$851.9	$731.9	16.4%	$1,170	$1,205	(2.9)%
Chemical and petroleum products	342.7	344.2	(0.4)	614.9	589.2	4.4	1,794	1,712	4.8
Coal	303.2	263.4	15.1	299.3	245.6	21.9	987	932	5.9
Food and agricultural products	247.0	249.0	(0.8)	414.7	392.9	5.5	1,679	1,578	6.4
Forest products	226.2	221.4	2.2	432.0	398.4	8.4	1,910	1,799	6.2
Metals and ores	181.5	173.5	4.6	275.3	259.9	5.9	1,517	1,498	1.3
Construction materials and minerals	171.5	153.6	11.7	172.0	151.2	13.8	1,003	984	1.9
Automotive	73.4	65.1	12.7	188.7	166.6	13.3	2,571	2,562	0.4
Total	2,273.6	2,077.8	9.4%	$3,248.8	$2,935.7	10.7%	$1,429	$1,413	1.1%

- Intermodal carloads and revenue for 1994 increased over 1993 due to increased container-on-flatcar ("COFC") business with major steamship accounts, as well as the inclusion of additional revenue-empty car movements in the carload figures for 1994. The decline in revenue per carload was due primarily to the lower revenue per car associated with revenue-empty car movements.

- Chemical and petroleum products carloads remained relatively flat for 1994 compared to 1993, while revenue increased for 1994 compared to 1993. The revenue growth was due to increased shipments of environmental wastes, fertilizer, chlorine and caustic soda and organic chemicals, which yield a higher revenue per carload, partially offset by the change in the classification of certain plastics traffic.

- Coal carloads and revenue increased for 1994 due to continued demand for the low-sulfur high-BTU content coal produced by Company-served mines. This demand was from both existing utility customers and new utility customers and was enhanced by the customers' ability to blend the low sulfur coal with higher sulfur coal in order to satisfy requirements of the Clean Air Act. The increase in revenue per carload was due primarily to increases in length of haul.

- Food and agricultural products revenue increased in 1994 compared to 1993 on declining carload volumes. Carloads declined in 1994 compared to 1993 due to the shutdown of a sugar beet processor in California and to reductions in grain traffic during the first half of 1994 caused by a smaller than usual crop harvest that resulted from the severe midwest flooding during 1993. The increases in revenue and revenue per carload were the result of increased length of haul and changes in the commodity mix.

- Carload volume for forest products increased in 1994 compared to 1993 due to increased traffic in lumber stock and particle board that was driven by increased construction activity and by increased wood chip and scrap paper traffic. Revenue per carload increases were due primarily to price increases in lumber products where strong demand in the California, Arizona and transcontinental markets helped support price increases as well as increased length of haul for particle board, wood chips and scrap paper.

- Carloads and revenue for metals and ores traffic increased for 1994 compared to 1993 due primarily to the startup of iron ore traffic between Minnesota and Utah in August 1994 and to increased ferrous metals shipments generated by a strong pipe market during the first half of 1994

- Construction materials and minerals carloads and revenue increased for 1994 compared to 1993 due to increased traffic in sand and gravel, cement and miscellaneous building materials that resulted from increases in highway and building construction as well as increases in mineral traffic.

- Automotive carloads and revenue increased for 1994 compared to 1993 due to strong demand for trucks and automobiles associated with general economic growth.

Operating Expenses. Railroad operating expenses for 1994 decreased $32.2 million, or 1.1%, compared to 1993. The following table sets forth a comparison of the Company's railroad operating expenses during the year ended December 31, 1994 and 1993

Railroad Operating Expense Comparison
Years Ended December 31, 1994 and 1993

	1994	1993	% Change
Labor and fringe benefits	$1,085.1	$1,132.5	(4.2)%
Fuel	251.3	252.4	(0.4)
Materials and supplies	187.3	217.6	(13.9)
Equipment rental	330.7	341.0	(3.0)
Depreciation and amortization	249.9	250.1	(0.1)
Other	723.5	666.4	8.6
Total	$2,827.8	$2,860.0	(1.1)%

- Labor and fringe benefit costs decreased $47.4 million, or 4.2%, for 1994 compared to 1993. The Company reduced rail employment by approximately 5% during the year. The employment decline included a reduction of approximately 460 employees in the Company's operating departments, as well as a reduction of 275 employees due to the January 1, 1994 implementation of an outsourcing agreement for management information services functions. In addition, fringe benefit expenses in 1994 were reduced compared to 1993 by the elimination of an unemployment payroll tax in July 1993. Additional traffic volume during 1994 resulted in a 4.1% increase in train crew starts which reduced the impact of the employment decline. Expressed as a percentage of operating revenue, labor and fringe benefit expenses declined to 34.8% for 1994 compared to 39.1% for 1993.

- Fuel expenses decreased $1.1 million, or 0.4%, for 1994 compared to 1993. The decrease is a result of reduced cost per gallon (which includes handling and fuel hedging costs) from $.62 per gallon during 1993 to $.58 during 1994, partially offset by an increase in fuel consumption attributable to the increase in traffic volume. Included in the 1994 fuel expense is $14.0 million related to fuel hedging contracts compared to $9.6 million for 1993.

- Materials and supplies expense decreased $30.3 million, or 13.9%, for 1994 compared to 1993. The decrease was due to a combination of reduced maintenance of way and equipment repair expenses. The reduced maintenance of way expenses were due primarily to a $17.0 million reduction attributable to an increase in and a change in classification of the capitalization of indirect costs. In 1993, these capitalized costs were classified as a reduction in other expenses. Equipment related materials and supplies expenses decreased due to the 186 locomotive rebuilds capitalized (as a result of more extensive work performed) in 1994 compared to 61 in 1993, while 41 locomotive overhauls were expensed in 1994 compared to 158 in 1993.

- Equipment rental costs decreased $10.3 million, or 3.0%, for 1994 compared to 1993. The decrease included an $8.0 million decrease in car hire and a $2.3 million decrease in locomotive and other lease costs. Included in the 1993 amount were increased rental costs associated with the midwest flooding. Partially offsetting the decreased expense were additional equipment rental costs during 1994 associated with increased traffic volume.

- Depreciation expense decreased $0.2 million, or 0.1%, for 1994 compared to 1993.

- Other expenses increased $57.1 million, or 8.6%, for 1994 compared to 1993. This category of expense includes outside repairs and services, joint facility rent and maintenance costs, casualty costs and property and other taxes. Expenses in this category which increased significantly over the prior year were information system outsourcing costs, property taxes, excise taxes and joint facility rent expense and the capitalized costs referred to above. Expenses in this category which decreased significantly from the prior year included costs associated with the midwest flooding in 1993 and other professional services costs. Expenses for management information system outsourcing, implemented on January 1, 1994, were $41.6 million for 1994 (partially offset by decreased labor costs as discussed above). Property taxes in 1994 showed a $15.1 million increase over 1993 because the 1993 amount was reduced by the favorable settlement of disputed property taxes in California. Excise taxes increased $11.9 million over the prior year due to the enactment of an increase in the federal excise tax on fuel in October 1993. Joint facility rent expense increased $4.5 million in 1994 over 1993 because the 1993 amount was reduced by the favorable settlement of joint facility agreements with another railroad. Joint facility maintenance costs and detour costs showed a decrease in 1994 due to costs incurred in 1993 associated with the midwest flooding. In addition, professional services expenses deceased $7.7 million in 1994 from 1993.

Other Income and Interest Expense. Other income was $236.6 million for 1994 compared to $11.1 million for 1993, an increase in income of $225.5 million. The increase was due primarily to increased gains on sales of property of $250.6 million, most of which resulted from the December 1994 sale of a transit corridor and other related properties located between downtown Los Angeles and the ports of Los Angeles and Long Beach (the "Alameda Corridor") for proceeds of $235 million. Real estate rental income, net, increased $5.2 million due primarily to reduced expenses associated with real estate activities. Interest income increased $1.8 million due to the higher average cash balance outstanding during 1994. The remaining portion of other income was an expense of $77.2 million in 1994 compared to an expense of $45.1 million in 1993, an increased expense of $32.1 million. Included in the 1994 amount is an increase in expense of $12.0 million associated with the sale of accounts receivable. In December 1994, the Company recorded expenses of $15.2 million for the write-off of deferred loan costs and for redemption premiums attributable to the repayment of $290 million principal amount Senior Secured Notes. During 1993, the Company recorded expenses of $12.3 million for the write-off of deferred loan costs. In addition, in November 1993, the Company received $27.1 million in cash from Southern Pacific Telecommunications Company ("SP Telecom") in full redemption of the SP Telecom preferred stock owned by the Company plus accrued dividends on the preferred stock, resulting in other income of $14.9 million.

Interest expense was $118.2 million for 1994 compared to $104.4 million for 1993, an increase of $13.8 million. The increase was due primarily to increased expense on capitalized lease obligations in 1994 as well as to $5.2 million charge attributable to the Company's interest rate swap agreements.

Other

In prior years, the Company has experienced increased costs due to the effect of inflation on the cost of compensation and benefits, and in the replacement of or additions to property and equipment. A portion of the increased labor costs directly affects expenses through increased operating costs. Fuel costs have fluctuated with market conditions and have directly affected operating results. Operating efficiencies have, however, partially offset this impact. Competition and other market factors may continue to restrict the Company's ability to recover all increases in costs through increases in the price of services. Certain of the wage agreements obtained in 1991, 1992 and 1993 have reduced the effects of inflation on operating costs but provide for cost of living increases beginning in 1995. A substantial portion of those agreements expire and are subject to renegotiation in 1995 (1988 with respect to the agreement covering the Western Lines).

To ensure stability of its fuel costs, the Company has entered into fuel hedging agreements covering approximately 95% of its estimated 1995 fuel needs at an average purchase price of $.49 per gallon (excluding handling costs). However, in the event that fuel prices decline below the average purchase price under the hedging agreements the Company will not receive any benefit from these fuel hedging agreements and may in fact pay more for fuel than it would have paid in the absence of such agreements.

The Company's Consolidated Financial Statements are prepared on the historical accounting basis. SPRC reports its financial position and results of operations on the purchase accounting basis. As a result, the Company reflects more depreciation expense than its parent, as well as larger gains on sales of property.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements, including supplementary data and accompanying report of independent auditors are listed in the Index to Consolidated Financial Statements and Consolidated Financial Statement Schedules filed as part of this annual report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH AUDITORS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART IV

ITEM 14. EXHIBITS. FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

A. Documents filed as part of this report:

1. The financial statements, financial statement schedules and accompanying report of independent auditors are listed in the Index to Financial Statements and Financial Statement Schedules filed as part of this Annual Report.

2. Exhibits:

Document Number	Document Description
3.1	Southern Pacific Transportation Company Composite Certificate of Incorporation (incorporated by reference to Exhibit 3A to the Company's Annual Report on Form 10-K for the year ended December 31, 1980).
3.2	Certificate of Amendment of Certificate of Incorporation of the Company dated April 1, 1989 (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989).
3.3	Certificate of Amendment of Certificate of Incorporation of the Company dated August 9, 1993 (incorporated by reference to Exhibit 3.3 to the Company's Annual Report on From 10-K for the year ended December 31, 1993).
3.4	By-laws of the Company, as adopted October 13, 1988 (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988).
4.2	Debt Instruments: The Company is not filing any instruments evidencing indebtedness because the total amount of securities authorized under any single such instrument does not exceed 10% of the Company's total assets. The registrant agrees to provide the Commission upon request copies of instruments defining the rights of holders of long-term debt of the registrant and its subsidiaries for which consolidated financial statements are required to be filed with the Commission.
10.1	Receivables Purchase Agreement between the Company and Rio Grande Receivables, Inc. dated as of November 1, 1989 (incorporated by reference to Exhibit 10.2 of the Company's Annual Report on Form 10-K for the year ended December 31, 1989).
10.2	Receivables Purchase Agreement between St. Louis Southwestern Railway Company and Rio Grande Receivables, Inc. dated as of November 1, 1989 (incorporated by reference to Exhibit 10.2 of the Company's Annual Report on Form 10-K for the year ended December 31, 1989).
10.3	Receivables Purchase Agreement between The Denver and Rio Grande Western Railroad Company and Rio Grande Receivables, Inc. dated as of November 1, 1989 (incorporated by reference to Exhibit 10.3 to SPRC's Annual Report on Form 10-K for the year ended December 31, 1994).
10.4	Southern Pacific Rail Corporation Employment Agreement with E. L. Moyers dated July 16, 1993 (incorporated by reference to Exhibit 10.14 to SPRC's Registration Statement on Form S-1 that was initially filed on May 12, 1993 (File No. 33-62608)); Southern Pacific Rail Corporation Agreement dated March 3, 1994 (accepted March 7, 1994) with E. L. Moyers (incorporated by reference to Exhibit 10.17 to SPRC's Annual Report on Form 10-K for the year ended December 31, 1993); and Agreement with E. L. Moyers dated February 14, 1995 (incorporated by reference to Exhibit 10.4 to SPRC's Annual Report on Form 10-K for the year ended December 31, 1994).*

Document Number	Document Description
10.5	Form of Registration Rights Agreement (incorporated by reference to Exhibit 10.19 to SPRC's Registration Statement on Form S-1 that was initially filed on May 12, 1993 (File No. 33-62608)).
10.6	Form of Corporate Matters Agreement (incorporated by reference to Exhibit 10.20 to SPRC's Registration Statement on Form S-1 that was initially filed on May 12, 1993 (File No. 33-62608)).
10.7	Form of 1993 Equity Incentive Plan (incorporated by reference to Exhibit 10.21 to SPRC'S Registration Statement on Form S-1 that was initially filed on May 12, 1993 (File No. 33-62608)).
10.8	Employment Agreement with Cannon Y. Harvey dated June 1, 1993 (incorporated by reference to Exhibit 10.15 to SPRC's Registration Statement on Form S-1 that was initially filed on December 17, 1993 (File No. 33-73116)); and Amendment to such Agreement dated December 1, 1994 (accepted December 7, 1994) (incorporated by reference to Exhibit 10.8 to SPRC's Annual Report on Form 10-K for the period ending December 31, 1994).*
10.9	Employment Agreement with Thomas J. Matthews dated August 1, 1993 (incorporated by reference to Exhibit 10.16 to SPRC's Registration Statement on Form S-1 that was initially filed on December 17, 1993 (File No. 33-73116)); and Amendment to such Agreement dated January 1, 1995 (incorporated by reference to Exhibit 10.9 to SPRC's Annual Report on Form 10-K for the period ending December 31, 1994).*
10.10	Employment Agreement with Robert F. Starzel dated October 26, 1994 (incorporated by reference to Exhibit 10.10 to SPRC's Annual Report on Form 10-K for the period ending December 31, 1994).*
10.11	Employment Agreement with Donald C. Orris dated February 21, 1995 (incorporated by reference to Exhibit 10.11 to SPRC's Annual Report on Form 10-K for the period ending December 31, 1994).*
10.12	Employment Agreement with Jerry R. Davis dated February 20, 1995 (incorporated by reference to Exhibit 10.12 to SPRC's Annual Report on Form 10-K for the period ending December 31, 1994).*
21.1	Subsidiaries of the Company

The Registrant will furnish to a requesting security holder any Exhibit requested upon payment of the Registrant's reasonable copying charges and expenses in furnishing the Exhibit.

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* Management contract or compensatory plan, contract or arrangement required to be filed as an Exhibit pursuant to Item 14(c).

B. Reports on Form 8-K.

The Company did not file any reports on Form 8-K during the three months ended December 31, 1994.

C. Other Exhibits:

No exhibits in addition to those previously filed or listed in Item 14(a)(3) are filed herein.

D. Other Financial Statement Schedules:

No additional financial statement schedules are required.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOUTHERN PACIFIC TRANSPORTATION COMPANY

By: s/ B. C. Kane
B. C. Kane
Controller
(Principal Accounting Officer)
Date: March 23, 1995

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Date: March 23, 1995

By: /s/ Jerry R. Davis
Jerry R. Davis
Chairman, and Chief Executive Officer and Director (Principal Executive Officer)

Date: March 23, 1995

By: /s/ Robert F. Starzel
Robert F. Starzel
Vice Chairman and Director

Date: March 23, 1995

By: s/ Donald C. Orris
Donald C. Orris
President and Chief Operating Officer and Director

Date: March 23, 1995

By: s/ Thomas J. Matthews
Thomas J. Matthews
Senior Vice President--Administration and Director

Date: March 23, 1995

By: /s/ Lawrence C. Yarberry
Lawrence C. Yarberry
Vice President--Finance
(Principal Financial Officer)

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULE

All other schedules are omitted because they are not applicable or because the required information is shown in the financial statements or the notes thereto. Columns omitted from schedules filed have been omitted because the information is not applicable.

Financial statements and summarized financial information of companies accounted for by the equity method have been omitted because considered in the aggregate, or individually, they would not constitute a significant subsidiary.

Independent Auditors Report

The Board of Directors
Southern Pacific Transportation Company:

We have audited the accompanying consolidated balance sheets of Southern Pacific Transportation Company and Subsidiary Companies (a wholly-owned subsidiary of Southern Pacific Rail Corporation) as of December 31, 1994 and 1993, and the related consolidated statements of operations, stockholder's equity, and cash flows for each of the years in the three-year period ended December 31, 1994. In connection with our audits of the consolidated financial statements, we also have audited financial statement schedule VIII as of and for each of the years in the three-year period ended December 31, 1994. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards required that we plan and perform an 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Pacific Transportation Company and Subsidiary Companies as of December 31, 1994 and 1993, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1994 in conformity with generally accepted accounting principles. Also in our opinion, the related financial statement schedule VIII, as of and for each of the years in the three-year period ended December 31, 1994, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company changed its methods of accounting for income taxes and post-retirement benefits other than pensions effective January 1, 1993.

As discussed in Note 1 to the consolidated financial statements, Southern Pacific Rail Corporation transferred ownership of the Denver and Rio Grande Western Railroad Company to the Company effective October 1, 1994 by a contribution to capital. The accompanying consolidated financial statements have been restated to reflect the combined financial position and results of operations and cash flows of the companies for all periods presented.

KPMG Peat Marwick LLP

KPMG PEAT MARWICK LLP

San Francisco, California
February 24, 1995

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

	December 31, 1994	December 31, 1993
	(in millions)	*(restated)*
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 54.4	$ 51.7
Accounts receivable, net of allowance for doubtful accounts of $7.7 in 1994 and $7.0 in 1993 (Note 2)	176.6	122.1
Notes receivable from Rio Grande Receivables, Inc. (Note 2)	96.1	54.6
Other notes receivable	7.2	2.8
Materials and supplies, at cost	71.1	56.9
Other current assets	62.6	43.0
Total current assets	468.0	331.1
PROPERTY, at cost (Notes 3, 5, 9 and 12)		
Roadway and structures	5,800.6	5,893.1
Railroad equipment	1,871.5	1,711.3
Other property	239.1	225.1
Total property	7,911.2	7,829.5
Less accumulated depreciation	2,779.2	2,960.4
Property, net	5,132.0	4,869.1
OTHER ASSETS AND DEFERRED CHARGES		
Investments in affiliated companies	17.3	17.0
Notes receivable and other investments	78.0	50.7
Notes receivable from Rio Grande Receivables, Inc. (Note 2)	30.0	30.0
Other	64.1	90.7
Total other assets	189.4	188.4
TOTAL	$5,789.4	$5,388.6

(Continued)

See accompanying notes to consolidated financial statements.

SOUTHERN PACIFIC TRANSPORTATION COMPANY AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS (Continued)

	December 31, 1994	December 31, 1993
	(in millions)	(restated)
LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES		
Accounts and wages payable	$ 151.0	$ 123.5
Accrued payables		
Taxes	34.7	47.7
Interest	36.7	26.5
Vacation pay	65.7	66.9
Current portion of long-term debt (Note 5)	59.5	66.7
Redeemable preference shares of a subsidiary (Note 7)	1.9	1.8
Other current liabilities (Note 4)	629.3	568.1
Total current liabilities	978.8	901.2
LONG-TERM DEBT (Note 5)	725.3	929.9
DEFERRED INCOME TAXES (Note 6)	1,038.4	951.4
OTHER LIABILITIES (Notes 4 and 10)	720.5	688.0
REDEEMABLE PREFERENCE SHARES OF A SUBSIDIARY (Note 7)	42.3	44.2
COMMITMENTS AND CONTINGENCIES (Notes 6, 9, 10 and 12)		
STOCKHOLDER'S EQUITY		
Common stock, without par value: authorized 2,000 shares, issued and outstanding 1,350 shares in 1994 and 1,200 shares in 1993	424.9	424.9
Additional paid-in capital (Note 8)	1,090.1	795.7
Retained income (Note 7)	1,488.2	1,337.5
Advances to parent	(719.1)	(684.2)
Total stockholder's equity	2,284.1	1,873.9
TOTAL	$5,789.4	$5,388.6

See accompanying notes to consolidated financial statements.

SOUTHERN PACIFIC TRANSPORTATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions)

	Year Ended December 31, 1994	1993 (restated)	1992 (restated)
OPERATING REVENUES			
Railroad	$3,056.4	$2,837.7	$2,810.3
Other	63.9	61.0	48.9
Total	3,120.3	2,898.7	2,859.2
OPERATING EXPENSES			
Railroad			
Labor and fringe benefits (Note 10)	1,085.1	1,132.5	1,167.0
Fuel	251.3	252.4	236.9
Materials and supplies	187.3	217.6	244.7
Equipment rental	330.7	341.0	300.5
Depreciation and amortization (Note 3)	249.9	250.1	250.4
Other	723.5	666.4	624.3
Total railroad	2,827.8	2,860.0	2,823.8
Other	60.9	59.5	45.0
Total	2,888.7	2,919.5	2,868.8
OPERATING INCOME (LOSS)	231.6	(20.8)	(9.6)
OTHER INCOME			
Gains from sales of property and real estate (Note 3)	281.3	30.7	303.0
Real estate and other rentals, net	25.5	20.3	16.7
Interest income	7.0	5.2	5.9
Other income (expense), net (Note 2)	(77.2)	(45.1)	(36.5)
Total	236.6	11.1	289.1
INTEREST EXPENSE (Note 5)	118.2	104.4	94.0
INCOME (LOSS) BEFORE INCOME TAXES	350.0	(114.1)	185.5
INCOME TAXES (BENEFIT) (Note 6)			
Current	51.3	34.8	21.8
Deferred	88.2	(60.1)	51.7
Total	139.5	(25.3)	73.5
NET INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING	210.5	(88.8)	112.0
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING FOR POST-EMPLOYMENT BENEFITS IN 1994 AND POST-RETIREMENT BENEFITS OTHER THAN PENSIONS IN 1993 (Net of income tax benefits of $3.8 and $64.3, respectively) (Note 10)	(6.0)	(104.2)	-
NET INCOME (LOSS)	$ 204.5	$ (193.0)	$ 112.0

See accompanying notes to consolidated financial statements.

SOUTHERN PACIFIC TRANSPORTATION COMPANY AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY

Years ended December 31, 1994, 1993 and 1992
(in millions)

	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Retained Income	Advances to Parent	Total Stockholder's Equity
Balances at December 31, 1991 (restated)	1,000	$424.9	$ 330.2	$1,465.2	$(620.8)	**$1,599.5**
Net income	-	-	-	112.0	-	**112.0**
Advances to parent	-	-	-	-	(33.3)	**(33.3)**
Balances at December 31, 1992 (restated)	1,000	424.9	330.2	1,577.2	(654.1)	**1,678.2**
Net loss	-	-	-	(193.0)	-	**(193.0)**
Dividend to Rio Grande Holding, Inc.	-	-	-	(46.7)	-	**(46.7)**
Advances to parent	-	-	-	-	(30.1)	**(30.1)**
Common stock issued (Note 8)	200	-	445.5	-	-	**445.5**
Contribution of capital	-	-	20.0	-	-	**20.0**
Balances at December 31, 1993 (restated)	1,200	424.9	795.7	1,337.5	(684.2)	**1,873.9**
Net income	-	-	-	204.5	-	**204.5**
Dividend to Rio Grande Holding, Inc.	-	-	-	(53.8)	-	**(53.8)**
Advances to parent	-	-	-	-	(34.9)	**(34.9)**
Common stock issued (Note 8)	150	-	294.4	-	-	**294.4**
Balances at December 31, 1994	1,350	$424.9	$1,090.1	$1,488.2	$(719.1)	**$2,284.1**

See accompanying notes to consolidated financial statements.

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	Year Ended December 31,		
	1994	1993 (restated)	1992 (restated)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$204.5	$(193.0)	$ 112.0
Adjustments to net income (loss)			
Depreciation and amortization	249.9	250.1	250.4
Deferred income taxes	84.4	(124.4)	51.8
Gains from sales of property	(281.3)	(30.7)	(303.0)
Cumulative effect of change in accounting for post-employment benefits in 1984 and post-retirement benefits in 1993	9.8	168.5	-
Changes in:			
Receivables, net	(95.7)	(9.1)	44.3
Materials and supplies	(14.2)	(3.1)	1.2
Other current and non-current assets	7.0	5.3	9.7
Other current and non-current liabilities	41.2	(164.7)	(19.5)
Total adjustments	1.1	91.9	34.9
Net cash provided by (used for) operating activities	205.6	(101.1)	146.9
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(270.1)	(313.1)	(335.8)
Property sold and retired	343.4	35.7	359.7
Change in notes receivable and other investments, net	(11.1)	(6.1)	(26.3)
Net cash provided by (used for) investing activities	62.2	(283.5)	(2.4)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of debt, net of costs	55.6	430.3	510.7
Debt and revolver drawdown (repayment), net	(524.5)	(433.0)	(596.6)
Advances to parent	(34.9)	(30.1)	(33.3)
Dividends paid (Note 8)	(53.8)	(46.7)	-
Proceeds from issuance of common stock, net of costs	294.4	445.5	-
Contribution of capital	-	20.0	-
Redeemable preference shares repayment	(1.9)	(2.1)	(2.1)
Net cash provided by (used for) financing activities	(265.1)	383.9	(121.3)
NET CHANGE IN CASH AND CASH EQUIVALENTS	2.7	(0.7)	23.2
CASH AND CASH EQUIVALENTS-BEGINNING OF THE YEAR	51.7	52.4	29.2
CASH AND CASH EQUIVALENTS-END OF THE YEAR	$ 54.4	$ 51.7	$ 52.4

See accompanying notes to consolidated financial statements.

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Ownership, Principles of Consolidation and Basis of Presentation - Southern Pacific Transportation Company ("SPT") is a wholly-owned subsidiary of Southern Pacific Rail Corporation ("SPRC"); therefore, per share data are not shown in the accompanying consolidated financial statements. As used in this document, the Company refers to SPT together with its subsidiaries. The consolidated financial statements are prepared on the historical cost basis of accounting and include the accounts of SPT and all significant subsidiary companies, including St. Louis Southwestern Railway Company ("SSW"), the Denver and Rio Grande Western Railroad Company ("D&RGW") and SPCSL Corp. ("SPCSL"), on a consolidated basis. All significant intercompany balances and transactions have been eliminated in consolidation. SPRC transferred ownership of D&RGW to SPT effective October 1, 1994 by a contribution to capital. The consolidated financial statements have been restated to reflect the combined financial position and results of operations and cash flows of the companies for all periods presented.

Cash and Cash Equivalents - For statement of cash flows purposes, the Company considers commercial paper, municipal securities and certificates of deposit with original maturities when purchased of three months or less to be cash equivalents.

Investments - Investments in affiliated companies (those in which the Company has a 20 percent to 50 percent ownership interest) are accounted for by the equity method. Other investments are stated at cost which does not exceed market.

Property - Property accounting procedures followed by the Company and its railroad subsidiaries are prescribed by the Interstate Commerce Commission ("ICC"). In accordance with the Company's definition of unit of property, all costs associated with the installation of rail, ties, ballast and other track improvements are capitalized. Other costs are capitalized to the extent they increase asset values or extend useful lives. Retirements are generally recorded using a system-wide first-in, first-out basis. The cost of property and equipment (including removal and restoration costs) is depreciated on the straight line composite group method, generally based on estimated service lives. Pursuant to ICC regulation, periodic depreciation and cost studies are required and changes in service life estimates are subject to the review and approval of the ICC. Gains or losses from disposition of depreciable railroad operating property are credited or charged to accumulated depreciation except for significant disposal of property. Certain railroad properties that are not essential to transportation operations may be sold or held for sale. Gains or losses resulting from sales of real estate no longer required for railroad operations are recognized as other income in the consolidated statement of operations.

Revenues - Freight revenues from rail transportation operations are recognized based on the percentage of completed service method. Other railroad revenues and other revenues are recognized as earned.

Retiree Welfare Benefits - Prior to January 1, 1993, the Company expensed retiree welfare benefits when paid. Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions" and recorded the estimate of its liability under Statement No. 106 of $168.5 million, which net of income taxes resulted in a charge to earnings of $104.2 million (see Note 10). Statement of Financial Accounting Standards No. 106 requires that all employers sponsoring a retiree welfare plan use a single actuarial cost method as is required for pension plan accounting and that they disclose specific information about their plan in their financial statements.

Post-employment Benefits - In November 1992, the Financial Accounting Standards Board ("FAS") issued Statement of Financial Accounting Standards No. 112 "Employers' Accounting for Post-employment Benefits". FAS 112 requires employers to recognize the obligation to provide benefits to former or inactive employees after employment but before retirement, if certain conditions are met. Effective January 1, 1994, the Company adopted FAS 112 and recorded a $9.8 million pre-tax charge ($6.0 million after tax). The Company's policy continues to be to fund the cost of post-employment benefits as the benefits are payable.

Income Taxes - The Company records income taxes using the liability method prescribed by Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities.

A change in the tax laws or rates results in adjustment to the deferred tax liabilities and assets. The effect of such adjustments are included in income in the period in which the tax laws or rates are changed.

2. SALE OF RECEIVABLES

Beginning in 1989, the Company began selling certain net receivables (including interline accounts), without recourse, to Rio Grande Receivables, Inc. ("RGR"), a subsidiary of SPRC. Also in 1989, RGR began selling the receivables purchased from the Company, with certain limited recourse provisions, to ABS Commercial Paper, Inc. ("ABS"), an unaffiliated third party, on a continuing basis for a period of up to five years subject to certain terms and conditions. The Company has agreed to service the receivables sold and is paid a fee for such services. The sale price for the receivables sold is based upon the face amount of the receivables and is reduced by discounts for expected defaults, servicing costs and anticipated collection periods. The Company retains a residual interest in the receivables should actual collections exceed the projected collections upon which the default discounts are calculated.

ABS finances its purchases by the sale of its commercial paper, secured by the receivables it purchases, up to a maximum aggregate principal amount of $300.0 million at any time outstanding. The ability of ABS to sell commercial paper is supported by certain banks which have agreed to provide liquidity to ABS on an as-needed basis. The liquidity banks must maintain a P-1 rating or there would need to be one or more replacement banks or a reduction in the maximum amount of commercial paper which ABS could issue.

As of December 31, 1994, 1993 and 1992, the Company had sold $454.3 million, $391.7 million and $366.5 million of net outstanding receivables, respectively, and had notes receivable from RGR for receivables sold of $126.1 million, $84.6 million and $65.7 million, of which $ 30.0 million were interest bearing at December 31, 1994, and 1993, respectively, and are included in other assets. Included in other income (expense), net, is approximately $(54.0) million in 1994, $(42.0) million in 1993 and $(31.1) million in 1992 of discounts and other expenses associated with the sales of accounts receivable. The initial term of the agreements expires on October 31, 1995. The Company is currently in the process of replacing the facility with another facility prior to the expiration date.

3. PROPERTY

The average depreciation rates for the Company's property and equipment ranged from 1 to 5 percent for roadway and structures, 4 to 7 percent for locomotives and 3 to 6 percent for freight cars for 1994.

The Company received cash proceeds from sales and retirements of real estate and property of $343.4 million,

$35.7 million and $359.7 million in 1994, 1993 and 1992, respectively. The 1994 amount includes proceeds of $235.0 million for the sale of a transit corridor to the ports of Los Angeles and Long Beach (the "Alameda Corridor"). The 1992 amount includes $124.0 million from sales to the Peninsula Corridor Joint Powers Board ("JPB"), $45.0 million from sales to Metro Transit of Houston, Texas, $83.0 million from sales to the Los Angeles County Transportation Commission ("LACTC") and $36.5 million from the sale/leaseback of locomotives and freight cars in June 1992. The Company recorded expenditures of $13 million in 1994, $12 million in 1993 and $18 million in 1992 in costs relating to environmental conditions on properties held for sale.

The Company has granted the JPB options to purchase additional rights-of-way and land within five years after the closing of the sale of the Peninsula Main Line for $110 million of which approximately $79 million has not lapsed, been exercised or extinguished. The Company will retain exclusive freight rights on the sold properties.

4. OTHER CURRENT LIABILITIES AND OTHER LIABILITIES

Other current liabilities include the following amounts:

	December 31, 1994	December 31, 1993
	(in millions)	
Reserves for casualty, freight-related claims and other (current portion)	$225.4	$165.3
Accrued repairs, equipment rentals and other payables	375.2	357.2
Post-retirement and post-employment benefit obligations	17.2	20.6
Reserve for employee separation and relocation (current portion)	11.5	25.0
Total	$629.3	$568.1

Included in other non-current liabilities are $322.0 million and $329.0 million for casualty and freight-related claims and $-0-million and $35.3 million for employee separation and relocation at December 31, 1994 and 1993, respectively, in addition to $157.5 million and $148.8 million for post-retirement and post-employment benefits other than pensions at December 31, 1994 and 1993, respectively.

5. LONG-TERM DEBT

Long-term debt is summarized as follows (in millions):

	December 31, 1994	December 31, 1993
Equipment obligations (9.125-14.25%; due 1995 to 2007)	$324.5	$380.4
Mortgage bonds (8.2%; due 1995 to 2001)	34.7	39.6
Credit agreement (various; due 1996)	-	125.0
Senior secured notes (10.5%; due 1999)	-	290.0
Other debt (4.0-6.0%; due 1995 to 2018)	93.0	88.1
Capitalized lease obligations (Note 8)	332.6	73.5
Total	784.8	996.6
Less current portion	(59.5)	(66.7)
Total long-term	$725.3	$929.9

On March 2, 1994, SPRC closed an offering of 25,000,000 shares of common stock for net proceeds of $503.6 million. In connection with the foregoing transaction, the Company issued 150 shares of common stock to SPRC for total consideration of $294.4 million from its parent. Proceeds from this transaction were used for repayment of the $175 million outstanding under the SPT Credit agreement (including interest thereon) and for general corporate purposes.

In November 1994, the Company entered into a new $300 million three-year revolving credit agreement to replace its existing $200 million credit agreement. This agreement contains quarterly financial covenants including minimum tangible net worth, a maximum funded debt to net worth ratio and a minimum fixed charge coverage ratio. No borrowings have been made under the new facility.

In December 1994, the Company entered into a bank agreement permitting the Company to borrow up to $150 million as a term loan maturing in 1999. The agreement contains quarterly financial covenants identical to those contained in the revolving credit agreement. Any borrowing under the facility must be made by December 27, 1995. No borrowings have been made under this facility.

In December 1994, using proceeds from the sale of the Alameda Corridor of $235 million, together with other funds on hand, the Company retired the $290 million outstanding under the Senior Secured Notes. The repayment was accomplished by placing approximately $297 million of government securities in a defeasance trust in December 1994. In connection with the retirement of the Senior Secured Notes, the Company wrote-off in other expenses $9.4 million of unamortized debt issuance costs and paid a prepayment premium of $5.8 million and expensed in interest expense $5.2 million attributable to the Company's interest rate swap agreement.

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Contractual maturities of long-term debt (including capital lease obligations) during each of the five years subsequent to 1994 and thereafter are as follows (in millions):

1995	$ 59.5
1996	53.0
1997	53.0
1998	45.6
1999	54.4
Thereafter	519.3

Management estimates the fair value of the Company's debt at December 31, 1994 and 1993 was approximately $783 million and $1,085 million, respectively, based on interest rates for similar issues and financings.

At December 31, 1994, the Company was a party to interest rate swap agreements for which it pays a variable rate on an aggregate notional amount of $100 million, which is used to hedge its fixed interest rate exposure on certain debt and is accounted for as an adjustment of interest expense over the life of the debt. The approximate expense to terminate the swap at December 31, 1994 was $4 million.

A significant portion of railroad equipment and certain railroad property is subject to liens securing the mortgage bonds, equipment obligations or other debt.

6. INCOME TAXES

The following summarizes income tax expense (benefit) for the years indicated:

	Year Ended December 31,		
	1994	1993 (in millions)	1992
Current			
Federal	$ 43.5	$ 30.7	$ 19.1
State	7.8	4.1	2.7
Total	51.3	34.8	21.8
Deferred			
Federal	74.6	(48.4)	43.1
State	13.6	(11.7)	8.6
Total	88.2	(60.1)	51.7
Deferred taxes on cumulative effect of change in accounting for post-employment benefits in 1994 and post-retirement benefits other than pensions in 1993			
Federal	(3.3)	(54.6)	-
State	(.5)	(9.7)	-
Total deferred taxes on cumulative effect	(3.8)	(64.3)	-
Total income tax expense (benefit)	$135.7	$(89.6)	$ 73.5

Deferred tax expense in 1993 includes $21.2 million related to the change in the federal tax rate. Total income tax expense (benefit) from continuing operations differed from the amounts computed by applying the statutory Federal income tax rate to income before income taxes as a result of the following:

	Year Ended December 31,		
	1994	1993	1992
Statutory rate	35.0%	(35.0)%	34.0%
State income taxes (net of federal income tax benefit)	4.7	(4.3)	4.0
Cumulative effect of federal tax rate change (from 34% to 35%)	-	18.6	-
Other, net	0.2	(1.5)	1.6
Effective rate	39.9%	(22.2)%	39.6%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below (in millions):

	December 31, 1994	December 31, 1993
Deferred tax assets:		
Accruals and reserves not deducted for tax purposes until paid	$ 386.6	$ 361.9
Net operating loss carryforwards	501.9	546.7
Capital lease obligation	135.7	36.2
Other	110.1	109.0
Total gross deferred tax assets	1,134.3	1,053.8
Deferred tax liabilities:		
Differences in depreciation and cost capitalization methods (including deferred gains on property)	(2,171.6)	(1,994.7)
Other	(1.1)	(10.5)
Total gross deferred tax liabilities	(2,172.7)	(2,005.2)
Net deferred tax liability	$(1,038.4)	$ (951.4)

The Company has analyzed the sources and expected reversal periods of its deferred tax assets and liabilities. The Company believes that the tax benefits attributable to deductible temporary differences and operating loss carryforwards will be realized by the recognition of future taxable amounts related to taxable temporary differences for which deferred tax liabilities have been recorded. Accordingly, the Company believes a valuation allowance for its deferred tax assets is not necessary.

SOUTHERN PACIFIC TRANSPORTATION COMPANY AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The former parent of the Company has agreed to indemnify SPRC, SPT and its subsidiaries against any federal income tax liability that may be imposed on the Company or its 80%-owned subsidiaries for tax periods ending on or prior to October 13, 1988 ("the Acquisition Date"). Years prior to 1984 are closed. SPRC agreed to pay or cause SPT and its subsidiaries to pay to the former parent any refund of federal income taxes attributable to the 80%-owned subsidiaries received by SPRC, SPT or its subsidiaries after the Acquisition Date for any tax period ending on or prior to the Acquisition Date. Further, the former parent also agreed to indemnify SPRC, SPT and its subsidiaries, at least in part, for state, local and other taxes in respect of periods to and including the Acquisition Date, but only to the extent that such taxes are due or reportable for periods prior to the Acquisition Date.

The intercompany tax allocation agreement between the Company and SPRC, which became effective following the closing of the Acquisition, was amended effective January 1, 1992, to provide that SPT and its subsidiaries will pay to SPRC the lesser of either the amount equal to that which the Company would have paid (or received) had the Company filed a separate consolidated tax return or which SPRC would pay as current taxes.

SPRC's consolidated federal income tax returns, in which the Company is included, for the period October 14, 1988 through 1990, have been examined and are currently being considered by the Appeals Office of the Internal Revenue Service ("IRS") regarding various unagreed issues. SPRC's consolidated Federal income tax returns are currently being examined for the tax years 1991 through 1993. Management believes adequate provision has been made for any potential adverse result.

The IRS's audit of RGH's returns, in which D&RGW is included, for 1983 and the period ended October 31, 1984, led to the issuance of a Notice of Deficiency in October 1992 for 1980, 1983 and the period ended October 31, 1984. The audit of the Anschutz Corporation ("TAC"), of which RGH and D&RGW were members from November 1, 1984, through October 13, 1988, also led to the issuance of a Notice of Deficiency for the 1979 and 1982 years as the result of the disallowance of net operating loss ("NOL") and investment tax credit carrybacks from the July 31, 1985 through July 31, 1987 periods. Both notices have been petitioned to the United State Tax Court. RGH does not expect a resolution of these cases in 1995. RGH's taxable periods from July 1, 1987 through October 13, 1988, included in the consolidated returns of TAC are currently under IRS audit as part of the TAC audit. However, management believes adequate reserves have been provided to cover any anticipated deficiencies for these tax years.

As of December 31, 1994, the Company had approximately \$1.2 billion of NOLs that will expire in 2003 through 2008. The NOLs are subject to review and possible disallowance, in whole or in part, by the IRS upon audit of the Federal income tax returns of the Company.

Section 382 of the Internal Revenue Code of 1986, as amended, limits a corporation's utilization of its NOLs when certain changes in the ownership of the corporation's stock occur within a three-year period. Such a change has occurred with respect to SPRC and therefore the Company will be permitted to deduct a limited amount of its NOLs in each taxable year, commencing with the year ending December 31, 1994. The Company currently does not expect, however, that the limitation imposed under Section 382 will have a material adverse impact on the Company's ability to utilize its NOLs prior to their expiration. Nevertheless, the limitation could under certain circumstances delay the Company's utilization of its NOLs and thereby increase the current portion of the Company's Federal income taxes. Further, the limitation under certain circumstances could also cause a portion of the Company's NOLs to expire unutilized.

7 REDEEMABLE PREFERENCE SHARES OF A SUBSIDIARY

SSW, a 99.9%-owned subsidiary of SPT, originally issued $53.5 million ($48.5 million Series A and $5.0 million Series B) of SSW's non-voting redeemable preference shares. The current carrying amount on the balance sheets at December 31, 1994 and 1993 reflects the outstanding balances of the redeemable preference shares of $44.2 million and $46.0 million, respectively.

The Series A shares are subject to mandatory redemption at face value over a 20-year period commencing in 1991, at which time mandatory dividends shall be declared and paid over the same period. The overall effective interest rate since the date of issue is approximately 2.0%. The Series B shares are subject to mandatory redemption at face value over a 15-year period commencing in 1989. Mandatory dividends shall be declared and paid over a 10-year period commencing in 1994. The overall effective interest rate since the date of issue is approximately 4.9%.

Mandatory redemptions and mandatory dividends of Series A and Series B shares scheduled for payment during each of the five years subsequent to 1994 are $4.2 million per year.

The Series A and Series B shares restrict certain dividend payments by SSW to its common and preferred shareholders. Under these provisions, at December 31, 1994, $53.2 million of SSW's historical cost basis retained income was not restricted. No estimate of the fair value of the preference shares was made by the Company.

8. CAPITAL AND DEBT TRANSACTIONS

In August 1993 and March 1994 SPRC closed the offering and sale of 30,783,750 shares and 25,000,000 shares of common stock, respectively. In connection with these offerings, the Company issued 200 shares of common stock in 1993 and 150 shares of common stock in 1994 for consideration of $445.5 million and $294.4 million from SPRC, respectively. Proceeds from these transactions were used to repay debt, purchase equipment operated pursuant to operating leases and for general corporate purposes.

In 1993 and 1994, D&RGW paid dividends of $46.7 million and $53.8 million to RGH, respectively.

9. LEASES

The Company leases certain freight cars, locomotives, data processing equipment and other property. Future minimum lease payments under noncancellable leases as of December 31, 1994 are summarized as follows (in millions):

	Capital Leases	Operating Leases
Year ended December 31,		
1995	$ 24.3	$152.7
1996	44.5	140.2
1997	40.9	130.3
1998	39.8	121.8
1999	46.7	106.5
Thereafter	503.9	349.4
Total minimum payments	700.1	$1,000.9
Less amount representing interest (at rates ranging from 7.2% to 13.1%)	(367.5)	
Present value of minimum lease payments	$332.6	

Rental expense for noncancellable operating leases with terms over one year was $168.7 million, $156.5 million and $117.6 million for the years ended December 31, 1994, 1993 and 1992, respectively. Contingent rentals and sublease rentals were not significant.

In late 1993 and 1994, as part of a program to upgrade its locomotive fleet, the Company acquired 150 new locomotives, 17 of which were delivered in the last quarter of 1993 with the balance delivered in 1994. Additionally, the Company acquired 133 remanufactured locomotives of which 115 were delivered in 1994 and the balance in early 1995. These locomotives were financed by capital leases (for which the total capitalized lease obligation in 1994 was approximately $221 million). The Company acquired through capital lease financing approximately 1,400 freight cars (700 newly manufactured and 700 remanufactured) for which the total capitalized lease obligation in 1994 was approximately $56 million. The Company also received approximately 1,600 additional reconditioned freight cars in 1994 on which it expects to complete capital lease financing in 1995. In addition, the Company acquired 350 used freight cars in 1994 under operating leases.

The Company has ordered an additional 206 AC powered locomotives to be financed by capitalized lease financing that are scheduled to be delivered during the second and third quarters of 1995. In addition, the Company has ordered 920 new hopper cars and expects to receive approximately 1,500 reconditioned freight cars in 1995. The Company expects to finance these acquisitions though capitalized lease financing. The total expected capitalized lease obligation to be incurred in 1995, including the 1,600 reconditioned freight cars received in 1994 for which financing is scheduled to be arranged in 1995, is approximately $400 million.

In 1984, the Company entered into a long-term lease agreement with the ports of Los Angeles and Long Beach relating to the Company's Intermodal Container Transfer Facility (the "Facility"). Under the terms of the lease, the Company is obligated to make certain future minimum lease payments and is subject to additional contingent rentals which are based on the annual volume of container movement at the Facility. The minimum lease payments, ranging from approximately $3.9 million to $4.5 million for 1995 and 1996, respectively, are included in the table above. However, for each five-year period from 1987 through 2036, the amount of the annual minimum lease payments and contingent rentals will be determined by the ports based on independent appraisals of the fair rental value of the property and, therefore, no amounts are included in the above table for such years. The 1994 expense was $7.6 million.

The Company leases operating rights on track owned by other railroads and shares costs of transportation facilities and operations with other railroads. These include rights on Union Pacific lines between Kansas City and St. Louis and on Burlington Northern Railroad Company lines between Kansas City and Chicago. The Company has the right to terminate its usage with certain notice periods. Net rent expense for trackage rights was $6.4 million in 1994, $1.9 million in 1993 and $13.0 million in 1992. The 1993 amount includes the benefit of the negotiated settlement of a joint facility case of approximately $10 million.

The Company pays for the use of transportation equipment owned by others and receives income from others for the use of its equipment. It also shares the cost of other transportation facilities with other railroads. Rental expense and income from equipment and the operation of joint facilities are included in operating expenses on a net basis. Total net equipment lease, rent and car hire expense was $331 million, $341 million and $301 million for 1994, 1993 and 1992, respectively.

10. EMPLOYEE BENEFIT AND COMPENSATION PLANS

Pension Plan. The Company is a participating employer under the SPRC Pension Plan (the "SPRC Pension Plan"). The SPRC Pension Plan is a defined benefit noncontributory pension plan covering primarily employees not covered by a collective bargaining agreement. The SPRC Pension Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). Pension benefits for normal retirement are calculated under a formula which utilizes average compensation, years of benefit service and Railroad Retirement and Social Security pay levels. The Company's funding policy is to contribute each year an amount not less than the minimum required contribution under ERISA nor greater than the maximum tax deductible contribution. The assets of the SPRC Pension Plan consist of a variety of investments including U.S. Government and agency securities, corporate stocks and bonds and money market funds.

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following summarizes the components the Company's net periodic pension cost under the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (in millions):

	Year Ended December 31,		
	1994	1993	1992
Service costs - benefits covered during the year	$ 5.1	$ 5.5	$ 4.9
Interest cost on projected benefit obligation	29.9	31.2	31.5
Actual (return)/loss on plan assets	0.7	(40.1)	(17.6)
Net amortization and deferral	(32.0)	7.5	(16.1)
Net periodic pension cost	$ 3.7	$ 4.1	$ 2.7

The following summarizes the funded status and amounts recognized in the Company's consolidated balance sheets for the SPRC Pension Plan (in millions):

	December 31,	
	1994	1993
Actuarial present value of benefit obligations		
Vested benefits	$335.1	$366.0
Non-vested benefits	6.0	7.8
Accumulated benefit obligation	$341.1	$373.8
Projected benefit obligation	$376.9	$420.8
Fair value of assets in plan	328.3	363.2
Projected benefit obligation in excess of plan assets	(48.6)	(57.6)
Unrecognized transition amount	(3.9)	(4.6)
Unrecognized gain or loss	7.8	20.7
Unrecognized prior service cost	4.3	4.8
Net pension liability included in the balance sheet	$(40.4)	$(36.7)

The following summarizes the significant assumptions used in accounting for the SPRC Pension Plan:

	December 31,		
	1994	1993	1992
Weighted average discount rate	8.5%	7.25%	8.0%
Expected rate of increase in future compensation levels	6.0%	6.0%	6.0%
Weighted average expected long-term rate of return on plan assets	9.0%	9.0%	9.0%

Thrift Plan. SPRC has established a defined contribution plan (the "SPRC Thrift Plan") as an individual account savings and investment plan primarily for employees of SPRC who are not subject to a collective bargaining agreement. Eligible participants may contribute a percentage of their compensation and the Company also contributes using a formula based on participant contributions.

Post-retirement Benefits Other Than Pensions. The Company sponsors several plans which provide health care and life insurance benefits to retirees who have met age and service requirements. The contribution rates that are paid by retirees are adjusted annually to offset increases in health care costs, if any, and fix the amounts payable by the Company. The life insurance plans provide life insurance benefits for certain retirees. The amount of life insurance is dependent upon length of service, employment dates and several other factors and increases in coverage beyond certain minimum levels are borne by the employee. Prior to January 1, 1993, the Company's policy was to expense and fund the cost of all retiree welfare benefits only as the benefits were payable.

The Company adopted FAS No. 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions", effective January 1, 1993. The effect of adopting FAS No. 106 on net income and the net periodic benefit cost (expense) for 1993 was a charge to earnings of $168.5 million (less income taxes of $64.3 million). The Company's policy continues to be to fund the cost of all retiree welfare benefits only as the benefits are payable. Accordingly, there are no plan assets.

The following table summarizes the plan's accumulated post-retirement benefit obligation (in millions):

	December 31,					
	1994			1993		
	Health Care	Life Insurance	Total	Health Care	Life Insurance	Total
Retirees	$41.1	$92.0	$133.1	$47.2	$107.7	$154.9
Fully eligible plan participants	8.6	5.4	14.0	10.9	7.7	18.6
Accumulated post-retirement benefit obligation	$49.7	$97.4	$147.1	$58.1	$115.4	$173.5
Unrecognized net gain (loss)			13.7			(8.4)
Plan amendment			4.1			4.3
Accrued post-retirement benefit cost included in other liabilities			$164.9			$169.4

As of December 31, 1994 and 1993, the current portion of accrued post-retirement benefit cost was approximately $16.3 million and $20.6 million, respectively, and the long-term portion was approximately $148.6 million and $148.8 million, respectively.

The net periodic post-retirement benefit costs include the following components (in millions):

	1994	1993
Service cost	$ 0.8	$ 0.7
Interest cost	12.0	12.7
Amortization of plan amendment	(0.2)	-
Net periodic post-retirement benefit cost	$12.6	$13.4

For measurement purposes, the Company has not assumed an annual rate of increase in the per capita cost of covered benefits for future years since the Company has limited its future contributions to current levels. The weighted average discount rate used in determining the benefit obligation was 8.5 percent.

Post-employment Benefits. In November 1992, the FAS issued Statement No. 112 "Employers' Accounting for Post-employment Benefits" FAS 112 requires employers to recognize the obligation to provide benefits to former or inactive employees after employment but before retirement, if certain conditions are met. Effective January 1, 1994, the Company adopted FAS 112 and recorded a $9.8 million pre-tax charge ($6.0 million after tax). The Company's policy continues to be to fund the cost of post-employment benefits as the benefits are payable.

1990-1994 Long-Term Earnings Growth Incentive Plan and Annual Incentive Compensation Plans. Certain officers of the Company were covered by the 1990-1994 Long-Term Earnings Growth Incentive Plan of the Company. The 1992 and 1993 Annual Incentive Compensation Plans covered all exempt employees of the Company. Based on the provisions of these plans, no amounts were paid or charged to expense in 1994, 1993 or 1992.

Equity Incentive Plan. The SPRC Compensation Committee has authorized a grant of stock bonuses under SPRC's Equity Incentive Plan covering up to 1,555,000 shares of SPRC Common Stock, in the aggregate, to 28 key executive employees of the Company, contingent upon the attainment of certain pre-established corporate financial and individual performance objectives. A portion of each stock bonus grant is subject to the achievement of an operating ratio for SPRC of 89.5 for 1994, 88.0 for 1995, 85.0 for 1996, or 83.0 for 1997, as well as individual performance objectives during those same years. If the required SPRC operating ratio for any year is not achieved, or if the required individual performance objectives are not achieved, the SPRC Compensation Committee of the Board of Directors may in its discretion award a portion of such shares. In 1994, the Company charged to expense approximately $7.5 million representing the value of approximately 413,000 shares which were awarded in January 1995 pursuant to the Equity Incentive Plan.

11. RELATED PARTIES

The Company has maintained separate accountability for the operating activities of its principal railroad subsidiaries as to the sharing of freight revenues and charges for use of railroad equipment and joint facilities. Interline accounts receivable and payable continue to be settled through the traditional clearing process between railroads. The railroads are coordinating and, where appropriate, consolidating the marketing, administration, transportation and maintenance operations of the railroads.

The Company paid $1.3 million, $6.8 million and $4.2 million in 1994, 1993, 1992, respectively, to SP Environmental Systems, Inc. ("SPES"), a wholly-owned subsidiary of SPRC, for professional services regarding environmental matters, excluding services provided by third parties billed through SPES.

Subsidiaries of Anschutz Company perform specific services for the Company, primarily relating to the purchase and administration of locomotive fuel and fuel futures contracts and fiber optic telecommunications. The amount paid by the Company in 1994 for these transactions was $7.9 million. The Company believes that the terms of the transactions are comparable to those that could be obtained from unaffiliated parties.

12. COMMITMENTS AND CONTINGENCIES

The Company is dependent upon its rail operations and real estate activities to meet its debt obligations, to make payments to buy-out surplus employees, to make capital expenditures and to pay dividends or make advances to SPRC in order for SPRC to make principal and interest payments relating to the $375 million 9-3/8% Senior Notes due 2005. The various debt agreements of the Company contain restrictions as to payment of dividends to SPRC. The Company is permitted to make advances or dividends to its parent in order for certain specified interest to be paid by its parent.

On November 4, 1993, the Company and Integrated Systems Solutions Corporation ("ISSC"), a subsidiary of IBM, entered into a ten-year agreement under which ISSC will handle all of the Company's management information services ("MIS") functions. These include systems operations, application development and implementation of a disaster recovery plan. Pursuant to the agreement, the Company is obligated to pay annual base charges of between $45 million and $50 million (which covers, among other things, payments for MIS equipment and personnel) over a ten-year period subject to adjustments for cost of living increases and variations in the levels of service provided under the agreement.

Inherent in the operations of the transportation and real estate business is the possibility that there may exist environmental conditions as a result of current and past operations which might be in violation of various federal and state laws relating to the protection of the environment. In certain instances, the Company has received notices of asserted violation of such laws and regulations and has taken or plans to take steps to address the problems cited or to contest the allegations of violation. The Company has recorded reserves to provide for environmental costs on certain operating and non-operating properties. Environmental costs include site remediation and restoration on a site-by-site basis, as well as costs for initial site surveys and environmental studies of potentially contaminated sites. The Company has made and will continue to make substantial expenditures relating to environmental conditions on its properties, including properties held for sale. In assessing its potential environmental liabilities, the Company typically causes on-going examinations of newly identified sites and evaluations of existing clean-up efforts to be performed by environmental engineers. These assessments which usually consider a combination of factors such as the engineering reports, site visits, area investigations and other steps, are reviewed periodically by counsel. Due to uncertainties as to various issues such as the required level of remediation and the extent of participation in clean-up efforts by others, the Company's total clean-up costs for environmental matters cannot be predicted with certainty. The Company has accrued reserves for environmental matters with respect to operating and non-operating properties not held for sale, as well as certain properties previously sold, based on the costs estimated to be incurred when such estimated amounts (or at least a minimum amount) can be reasonably determined based on information available. During the years ended December 31, 1994, 1993 and 1992, the Company recognized expenses of $15.4 million, $11.8 million and $8.0 million, respectively, related to environmental matters. At December 31, 1994 and 1993 the Company had accrued reserves for environmental contingencies of $65.0 million and $61.7 million, respectively, which includes $13.2 million and $16.5 million, respectively, in current liabilities. These reserves relate to estimated liabilities for operating and non-operating properties not held for sale and certain properties previously sold and were exclusive of any significant future recoveries from insurance carriers. Based on the Company's assessments described above, other available information and the amounts of the Company's established reserves, management does not believe that disposition of environmental matters known to the Company will have a material adverse effect on the Company's financial position. However, there can be no assurance that material liabilities or costs related to environmental matters will not be incurred in the future.

A substantial portion of the Company's railroad employees are covered by collective bargaining agreements with national railway labor organizations that are organized along craft lines. These agreements are generally negotiated on a multi-employer basis with the railroad industry represented by a bargaining committee. The culmination of various Presidential and legislative events in 1992 resulted in the Company negotiating most of its labor agreements separately. Certain of the wage agreements obtained in 1991, 1992 and 1993 have reduced the effects of inflation on operating costs but provide for cost of living increases beginning in 1995. A substantial number of the labor agreements expire and are subject to renegotiation in 1995.

To ensure stability of its fuel costs, the Company has entered into fuel hedging agreements covering approximately 95% of its 1995 estimated fuel needs at an average purchase price of $.49 per gallon (excluding handling costs). However, in the event that fuel prices decline below the average purchase price under the hedging agreements, the Company will not receive any benefit from these fuel hedging agreements and may in fact pay more for fuel than it would have paid in the absence of such agreements.

As a condition to its approval of the consolidation of Union Pacific, Missouri Pacific Railroad Company ("MP") and Western Pacific Railroad Company in 1982, the ICC awarded SSW trackage rights to operate over the MP lines between Kansas City and St. Louis. The ICC's initial decision did not fix the compensation SSW would pay for the trackage rights, which commenced in January 1983. After a series of hearings, the ICC set forth new principles to govern the computation of charges. Union Pacific has asserted a claim for additional amounts due against the Company of approximately $63 million (including interest) as of December 31, 1994 and filed a collection action in Federal District Court. In early 1995, the court issued an order finding that the Company owes Union Pacific the amount of $60.99 million as of January 31, 1995 plus additional accrued amounts occurring since that date, but allowing the Company to pursue a counterclaim for losses due to alleged discrimination against the Company's trains using the joint facility. The Company and Union Pacific have agreed in principle concerning settlement of the litigation. Whether or not final agreement to settle on the proposed terms is reached, the Company's payment to Union Pacific will be substantial. Management has made adequate provision for this matter in current liabilities in its financial statements.

In July 1991, a derailment occurred near Dunsmuir, California. While certain aspects of the matter have not been resolved and the total amount of damages and related costs cannot be determined at this time, SPT is insured against most types of damages and related costs involved with the Dunsmuir derailment to the extent that they exceed $10 million. As of December 31, 1994, SPT has paid approximately $46.8 million related to the Dunsmuir derailment, of which $12 million was charged to expense primarily to cover the $10 million deductible. The balance has been or is in the process of being collected from insurance carriers. As of December 31, 1994, approximately $31.9 million has been recovered by SPT from insurers. SPT expects to recover substantially all additional damages and costs under its insurance policies. As a result, disposition of these matters is not expected to have a material adverse effect on the Company's financial condition.

Although the Company has purchased insurance, the Company has retained certain risks with respect to losses for third-party liability and property claims. In addition, various claims, lawsuits and contingent liabilities are pending against the Company. Management has made provisions for these matters which it believes to be adequate. As a result, the ultimate disposition of these matters is not expected to have a material adverse effect on the Company's consolidated financial position.

13. SUPPLEMENTAL CASH FLOW INFORMATION

	December 31,		
	1994	1993	1992
		(in millions)	
Cash payments (refunds):			
Interest	$ 93.2	$72.7	$78.2
Income taxes	61.6	60.6	9.3
Non-cash transactions:			
Sales of real estate for notes receivable	27.9	-	-
Capital lease obligations for railroad equipment	265.2	57.0	-

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. RESTATED QUARTERLY DATA (UNAUDITED)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
		(in millions)		
1994				
Operating revenues	$ 742.1	$801.7	$801.5	$775.0
Operating income	34.5	75.5	65.9	55.7
Other income (expense)	2.9	9.9	(3.2)	227.0[c]
Net income (loss)[a]	(45.9)	50.2	30.0	170.2[c]
1993				
Operating revenues	$671.9	$740.9	$748.5	$737.4
Operating income (loss)	(11.9)	27.2	(32.1)	(4.0)
Other income (expense)	6.2	(0.4)	(17.9)	23.2
Net income (loss)[b]	(119.6)	(2.1)	(69.0)	(2.3)

(a) First quarter 1994 data includes an extraordinary charge of $6.0 million (net of taxes) for the change in accounting for post-employment benefits (FAS 112).

(b) First quarter 1993 data includes an extraordinary charge of $104.2 million (net of taxes) for the change in accounting for post-retirement benefits other than pensions (FAS 106).

(c) Fourth quarter 1994 data includes a pre-tax gain of approximately $227 million on the sale of the Alameda Corridor.

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. HISTORICAL STATEMENTS OF OPERATIONS

Effective October 1, 1994, the stock of D&RGW was contributed to the Company. The historical results of operations of SPT and its subsidiaries including D&RGW commencing October 1, 1994 are as follows for the years ended December 31, 1994, 1993, and 1992:

	1994	1993 (in millions)	1992
Operating Revenues	$2,825.0	$2,550.7	$2,523.8
Operating Expense	2,644.4	2,604.6	2,548.5
Operating Income (Loss)	180.6	(53.9)	(24.7)
Other Income	239.0	8.6	292.1
Interest Expense	115.9	101.5	89.2
Income (Loss) Before Income Taxes	303.7	(146.8)	178.2
Income Tax (Benefit)	120.9	(40.9)	68.7
Net Income (Loss) Before Cumulative Effect of Change in Accounting	182.8	(105.9)	109.5
Cumulative Effect of Change in Accounting	(4.0)	(98.9)	-
Net Income (Loss)	$ 178.8	$ (204.8)	$ 109.5

SOUTHERN PACIFIC TRANSPORTATION COMPANY
AND SUBSIDIARY COMPANIES

SCHEDULE VIII. VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

	Balance at Beginning of Year	Charged to Expense	Deductions	Balance at End of Year
		(in millions)		
Year Ended December 31, 1994				
Casualty and other claims	$448.4	$146.8	$102.8	$492.4
Post-retirement and post-employment benefit obligations	169.4	23.2	17.9	174.7
Employee separation and relocation and other	60.3	-	48.8	11.5
Total	$678.1	$170.0	$169.5	$678.6
Year Ended December 31, 1993 (restated)				
Casualty and other claims	$467.6	$157.7	$176.9	$448.4
Post-retirement benefit obligation	-	181.9	12.5	169.4
Employee separation and relocation and other	113.2	2.5	55.4	60.3
Total	$580.8	$342.1	$244.8	$678.1
Year Ended December 31, 1992 (restated)				
Casualty and other claims	$481.0	$147.7	$161.1	$467.6
Employee separation and relocation and other	195.9	-	82.7	113.2
Total	$676.9	$147.7	$243.8	$580.8

EXHIBIT 21.1

EXHIBIT 21.1

SOUTHERN PACIFIC TRANSPORTATION COMPANY SUBSIDIARIES

Arkansas & Memphis Railway Bridge and Terminal Company
The Denver and Rio Grande Western Railroad Company
Pacific Motor Transport Company
St. Louis Southwestern Railway Company
Southern Pacific Asset Management Company
Southern Pacific Equipment Company
Southern Pacific International, Inc.
Southern Pacific Marine Transport, Inc.
Southern Pacific Mexico, S. A. de C. V.
Southern Pacific Motor Trucking Company
Southern Pacific Warehouse Company
SPCSL Corp.

SOUTHERN PACIFIC LINES

Southern Pacific Rail Corporation

Southern Pacific Building • One Market Plaza • San Francisco, California 94105

August 9, 1995

Dear Stockholder:

I am very pleased to inform you that on August 3, 1995 Southern Pacific Rail Corporation ("Southern Pacific"), Union Pacific Corporation ("Union Pacific"), Union Pacific Railroad Company ("UPRR"), an indirect wholly owned subsidiary of Union Pacific, and UP Acquisition Corporation (the "Purchaser"), a wholly owned subsidiary of UPRR, entered into an Agreement and Plan of Merger (the "Merger Agreement") providing for the merger of Southern Pacific with UPRR (the "Merger"). As a first step in the transaction, the Purchaser will commence a tender offer (the "Offer") to purchase up to 39,034,471 shares of Southern Pacific's common stock (the "SP Shares") (constituting 25% of the outstanding SP Shares) at a price of $25.00 per share in cash ("Offer Price"). After stockholder approval and the receipt of a favorable decision by the Interstate Commerce Commission ("ICC") granting approval, exemption or other authority therefor, Southern Pacific will be merged into UPRR.

As a result of the merger, each SP Share will be converted into the right to receive, in accordance with an election to be filed by each stockholder, either (i) the right to receive $25.00 per share in cash or (ii) .4065 shares of Union Pacific common stock, par value $2.50 per share (the "UP Stock" and together with such cash received pursuant to the Merger, "Merger Consideration"), or a combination thereof. As explained in the enclosed Offer to Purchase, the Merger Agreement imposes a limit on the total number of SP Shares that can be converted into the right to receive cash or UP Stock pursuant to the Merger. Specifically, regardless of the number of stockholders who elect to receive cash or UP Stock, as the case may be, the number of SP Shares converted into the right to receive cash in the Merger (together with the number of SP Shares purchased in the Offer) and UP Stock will equal as nearly as practicable 40% and 60%, respectively, of all outstanding SP Shares. Accordingly, in the case of any particular stockholder, depending upon the number of SP Shares for which such holder has elected to receive cash or UP Stock, as the case may be, such stockholder may not necessarily receive in respect of his or her SP Shares, the amount of cash, UP Stock or the combination thereof that such stockholder requested in his or her election. The Offer to Purchase describes the procedures under the Merger Agreement that will be used in the event proration with respect to either form of Merger Consideration becomes necessary. Stockholders are encouraged to read the Offer to Purchase carefully and in its entirety.

As more fully described in the enclosed Schedule 14D-9, your Board of Directors has unanimously approved the Offer and the Merger Agreement and recommends that those stockholders who desire to receive cash in connection with the transactions contemplated by the Merger Agreement (the "Transactions") accept the Offer and tender their SP Shares.

In deciding whether to tender SP Shares in the Offer, your Board believes that you should take the following factors into account:

(i) Stockholders who tender their SP Shares will have an opportunity to receive a premium over the price at which the SP Shares were trading on the NYSE prior to the announcement of the Transactions for 25% or more of their SP Shares prior to action on the Merger by the ICC. Because the ICC is not expected to make a ruling with respect to the Merger until sometime in 1996, stockholders who tender their SP Shares will be able to receive the Offer Price substantially sooner then they will receive the Merger Consideration. In addition, although Southern Pacific believes that the ICC will approve the Merger, no assurances can be given that such approval will be obtained, and stockholders who do not tender their SP Shares in the Offer will bear the risk relating to ICC approval with respect to all of their SP Shares rather than availing themselves of the opportunity to eliminate that risk with respect to at least 25% of their SP Shares.

(ii) Stockholders who tender their SP Shares in the Offer may receive less UP Stock than they would if they were not to tender their SP Shares, and as a result they may have a lesser ownership interest in the combined company. However, because UP Stock will constitute no more than 60% of the overall consideration, stockholders who decide not to tender SP Shares in the Offer because they wish to receive a greater number of shares of UP Stock for their SP Shares nevertheless may be required to receive some cash pursuant to the Merger.

(iii) As more fully described in the enclosed Offer to Purchase, the sale of SP Shares in the Offer, as well as the receipt of cash, will be subject to current federal income tax, while the receipt of UP Stock will not be subject to current federal income tax. Stockholders should take this difference in U.S. federal income tax treatment into account in deciding whether to tender their SP Shares.

Morgan Stanley & Co. Incorporated ("Morgan Stanley"), financial advisor to Southern Pacific in connection with the Offer and the Merger, has rendered to the Board an opinion that the consideration to be received by the stockholders pursuant to the Offer and the Merger, taken together, is fair from a financial point of view to the stockholders. A copy of the Morgan Stanley Fairness Opinion is attached to the Schedule 14D-9 as Exhibit 8. **Stockholders are urged to read the Fairness Opinion carefully and in its entirety.**

The enclosed Offer to Purchase sets forth all of the terms of the Offer. Additionally, the enclosed Schedule 14D-9 sets forth certain additional information regarding the Transactions relevant to making an informed decision as well as the recommendation of your Board recommending participation in the Offer for those stockholders who desire to receive cash in connection with the Transactions. Please read both documents carefully and in their entirety.

Very truly yours,

Jerry R. Davis

JERRY R. DAVIS
President and Chief
Executive Officer

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14D-9
Solicitation/Recommendation Statement Pursuant to Section 14(d)(4) of the Securities Exchange Act of 1934

SOUTHERN PACIFIC RAIL CORPORATION
(Name of Subject Company)

Southern Pacific Rail Corporation
(Name of Person(s) Filing Statement)

Common Stock, par value $.001 per share
(Title of Class of Securities)

843584
(CUSIP Number of Class of Securities)

Southern Pacific Rail Corporation
One Market Plaza
San Francisco, CA 94105
Attention: Cannon Y. Harvey, Esq.
(415) 541-1000
(Name, Address and Telephone Number of Person Authorized to
Receive Notices and Communications on Behalf of
the Person(s) Filing Statement)

With copies to

Joseph W. Morrisey, Jr., Esq.
Holme Roberts & Owen LLC
1700 Lincoln—Suite 4100
Denver, Colorado 80203

Peter D. Lyons, Esq.
Shearman & Sterling
599 Lexington Avenue
New York, NY 10022

Item 1. ***Security and Subject Company***

The name of the subject company is Southern Pacific Rail Corporation, a Delaware corporation (the "Company"). The address of the principal executive offices of the Company is One Market Plaza, San Francisco, CA 94105. The title of the class of equity securities to which this Statement relates is the common stock, par value $.001 per share, of the Company (the "Shares").

Item 2. ***Tender Offer of the Bidder***

The Statement relates to a tender offer by UP Acquisition Corporation, a Delaware corporation (the "Purchaser") and an indirect wholly owned subsidiary of Union Pacific Corporation, a Utah corporation ("Union Pacific"), disclosed in a Tender Offer Statement on Schedule 14D-1 dated August 9, 1995 (the "Schedule 14D-1") with respect to an offer to purchase up to 39,034,471 Shares (constituting 25% of the outstanding Shares) at a price of $25.00 per Share (such price, or such higher price per Share as may be paid in the Offer (as defined below), being the "Offer Price"), net to the seller in cash, upon the terms and subject to the conditions set forth in the Offer to Purchase dated August 9, 1995 (the "Offer to Purchase") and the related Letter of Transmittal (which, as amended from time to time, together constitute the "Offer"). The Offer to Purchase and the related Letter of Transmittal are filed herewith as Exhibits 1 and 2, respectively, to this Schedule 14D-9 and incorporated herein by reference. Capitalized terms not otherwise defined herein shall have the meanings set forth in the Offer to Purchase.

The Offer is conditioned upon, among other things, (a) the Purchaser receiving, prior to the expiration of the Offer, an informal written opinion in form and substance satisfactory to Purchaser from the staff of the Interstate Commerce Commission (or its successor, if any) (the "ICC"), without the imposition of any conditions unacceptable to the Purchaser, that the use of a voting trust (the "Voting Trust") is consistent with the policies of the ICC against unauthorized acquisitions of control of a regulated carrier, and (b) the Purchaser receiving, prior to the expiration of the Offer, an informal statement from the premerger notification office of the Federal Trade Commission (the "FTC") that either (i) no review of the Offer, the Merger and the transactions contemplated by the Ancillary Agreements (as defined in the Offer to Purchase) will be undertaken pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), or (ii) the transactions contemplated by the Offer and the Merger (the "Transactions") and the transactions contemplated by the Ancillary Agreements are not subject to the HSR Act, or in the absence of the receipt of such informal statement referred to in clause (i) or (ii) above, any applicable waiting period under the HSR Act shall have expired or been terminated prior to the expiration of the Offer (such condition being the "HSR Condition"). Counsel for Union Pacific has been orally advised by the premerger notification office of the FTC that the Offer and the Merger are exempt from the HSR Act and Union Pacific has advised the Company that it currently expects the HSR Condition will be satisfied. See Section 15 of the Offer to Purchase under the caption "The Offer—Conditions of the Offer" which is incorporated herein by reference.

The Offer is being made pursuant to the Agreement and Plan of Merger dated as of August 3, 1995 (the "Merger Agreement") among Union Pacific, the Purchaser, Union Pacific Railroad Company, a Utah corporation and an indirect wholly owned subsidiary of Parent ("UPRR") and the Company. The Merger Agreement is incorporated herein by reference. The Merger Agreement provides, among other things, for the making of the Offer by the Purchaser and further provides that, after consummation of the Offer, Purchaser will be merged with and into UPRR (the "Sub Merger"), with UPRR being the surviving corporation. Upon receipt of a favorable decision of the ICC granting approval, exemption or other authority therefor, the Company will be merged with and into the UPRR (the "Merger" and together with the Sub Merger, the "Mergers"), with UPRR continuing as the surviving corporation (the "Surviving Corporation"). Pursuant to the Merger Agreement, each of the Company's stockholders (the "Stockholders") has the right to submit a request (an "Election") specifying the number of Shares that such Stockholder desires to have converted into 0.4065 shares of common stock, par value $2.50 per share ("Union Pacific Shares"), of Union Pacific (the "Stock Merger Consideration") and the number of Shares that such Stockholder desires to have converted into the right to receive $25.00 per Share in cash, without interest (the "Cash Merger Consideration" and, together with the Offer Price and the Stock Merger Consideration, the "Consideration").

The Merger Agreement provides that the aggregate number of Shares to be converted into Stock Merger Consideration shall be equal as nearly as practicable to 60% of all Shares outstanding immediately prior to the date on which the Merger becomes effective (the "Outstanding Shares") and that the number of Shares to be converted into the Cash Merger Consideration, together with Shares tendered in the Offer, shall be equal as nearly as practicable to 40% of all Outstanding Shares. In the event that Stockholders make Elections to receive either Cash Merger Consideration or Stock Merger Consideration in excess of such proportions, Consideration will be prorated so that the Consideration will be issued in such proportions. The procedures for such proration are described in Section 13 of the Offer to Purchase under the caption "The Offer—Merger Agreement; Shareholders Agreements; Registration Rights Agreements; Other Agreements—Conversion of Shares" and such portion of the Offer to Purchase are hereby incorporated herein by reference. The Merger Agreement is incorporated herein by reference.

According to the Offer to Purchase, the principal executive offices of the Union Pacific and the Purchaser are located at Martin Tower, Eighth and Eaton Avenues, Bethlehem, PA 18018 and the principal executive offices of UPRR are located at 1416 Dodge Street, Omaha, Nebraska 68179.

Item 3. ***Identity and Background***

(a) The name and address of the Company, which is the person filing this Statement, are set forth in Item 1 above.

(b) Except as described below or incorporated by reference herein, to the knowledge of the Company, as of the date hereof, there exists no material contract, agreement, arrangement or understanding and no actual or potential conflict of interest between the Company or its affiliates and (i) the Company, its executive officers, directors or affiliates or (ii) the Purchaser or its executive officers, directors or affiliates.

Employee Matters

Existing Employment Agreements. The Company maintains employment agreements with a number of executives, including Messrs. Davis, Starzel, Orris, Harvey, Matthews, Parsons and Galardi. These agreements provide, among other things, for the payment of certain severance and other benefits upon certain qualifying terminations of the employment of such officers. If Mr. Davis' employment is terminated other than for cause, or if Mr. Davis' title or duties have substantially changed and he resigns prior to March 1, 1998, the Company will be obligated to make certain payments to him, including an amount equal to the greater of $1,000,000 or 75% of the base pay he would have received had he remained employed for the full period. If the employment of any of Messrs. Starzel, Orris, Harvey and Matthews is terminated by the Company other than for cause, or if any of them should resign following certain changes in their employment status (such as a change in their title or duties or a reduction in their salary, or both), the Company will be obligated to make certain payments, including an amount equal to two times the respective annual base salaries in effect on the date of employment termination. If the employment of Mr. Parsons is terminated by the Company other than for cause, the Company will be obligated to make certain payments to him, including an amount equal to his base salary between the date of termination of employment and June 1, 1998. If the employment of Mr. Galardi is terminated by the Company other than for cause, the Company will be obligated to make certain payments to him, including an amount equal to one year's base salary. The base salary for 1995 for Mr. Davis and Mr. Orris is $600,000 and $450,000, respectively, and $350,000 for each of Messrs. Starzel, Harvey, Matthews and Parsons.

The existing employment agreements with Messrs. Davis, Starzel, Matthews and Parsons provide for certain home purchase loans that are interest free during employment. If the employment of Messrs. Davis, Starzel and Matthews is terminated by the Company other than for cause, the remaining balance of the loan will be forgiven.

The employment agreements and certain supplemental retirement agreements with Messrs. Starzel, Orris, Harvey and Matthews provide each of them with supplemental retirement benefits commencing on specified dates (or prior thereto with appropriate actuarial reduction) and in specified monthly amounts (subject to certain adjustments to reflect increases in the cost of living), which payments would continue until the later of their death or the death of their respective spouses; provided, that the specified monthly amount for Mr. Orris will be offset by his retirement benefits under the Southern Pacific Rail Corporation Pension Plan. The supplemental retirement benefit for each of Messrs. Starzel, Orris and Harvey is $10,000 per month upon reaching age 62. Mr. Matthews may elect to receive $8,500 per month beginning on September 1, 2005 or $7,500 per month beginning at any time after September 1, 2000 but before September 1, 2005 unless Mr. Matthews voluntarily resigns his employment prior to September 1, 2005. The employment agreement with Mr. Parsons provides for crediting certain additional years of service pursuant to a supplemental retirement arrangement such that he will be treated as having accrued 27 years of benefit service with the Company.

Merger Agreement. The following is a summary of certain portions of the Merger Agreement which relate to arrangements among the Company and Union Pacific and/or its affiliates and the Company's executive officers and directors. Capitalized terms not otherwise defined below shall have the meanings set forth in the Merger Agreement.

Existing Employment and Benefit Arrangements. The Merger Agreement provides that Union Pacific shall cause the Surviving Corporation and its Subsidiaries to honor and assume the existing employment agreements, supplemental executive retirement agreements and stock bonus agreements, including those described above for the named executive officers. Union Pacific shall also cause the Surviving Corporation and its subsidiaries to honor and assume the Company's other employee benefit plans and employee programs; *provided, however*, that the other employee benefit plans and employee programs may be amended or terminated at any time in accordance with applicable law (except to the extent benefits have already vested thereunder). The Merger Agreement further provides that the existing severance plan for employees of the Company and its Subsidiaries who are terminated other than for cause shall be continued in effect for at least one year following the Effective Time.

Management Continuity Plan. The Merger Agreement provides that the Company and its subsidiaries shall establish a "Management Continuity Plan (the 'MCP')" that will provide certain payments to certain non-agreement employees of the Company or its Subsidiaries based upon their continued employment and performance during the period from the date of the Merger Agreement (or date of hire or promotion, if later) to the date of the payment (or, in the case of the first payment, a date which shortly preceded the date of payment). In order to be eligible to participate in the MCP, an employee must generally waive his or her right, if any, to receive a payment from any other incentive plan maintained by the Company or its subsidiaries or the Surviving Corporation (or its Subsidiaries), including, without limitation, the stock bonus arrangements described in the Company's Notice of Annual Meeting and Proxy Statement dated March 27, 1995 (the "1995 Proxy Statement"), other than the right of Messrs. Starzel and Harvey under separate agreements to receive 16,666 Shares each on each of January 1, 1996 and January 1, 1997 if they have not voluntarily resigned. Under the MCP, payment of awards will be made in two parts, with either 50% or 60% of the award payable prior to December 31, 1995 (depending on the classification of the employee), and the remaining portion payable at the earlier of the 60th day following the Effective Time or any earlier date of the employee's termination of employment. In order to be entitled to the second portion of the award under the MCP, the employee must be employed by the Company or its Subsidiaries at the Effective Time and must remain in employment for at least 60 days immediately following the Effective Time, unless such employment is earlier terminated at the request of the Surviving Corporation or its Subsidiaries. The Merger Agreement provides that the Company may make MCP awards in an aggregate amount up to $15,700,000, and the Merger Agreement also provides that the maximum amount payable under an award to Mr. Davis and Mr. Orris will not exceed $1,400,000 and $900,000, respectively, and $700,000 for each of Messrs. Starzel, Harvey, Matthews and Parsons.

Equity Incentive Plan. The Merger Agreement provides that prior to the purchase of Shares pursuant to the Offer, the Board of Directors (or, if appropriate, any committee administering the Equity Incentive Plan) will adopt resolutions or take other actions as necessary to assure that no holder of an outstanding Award with respect to which Shares might otherwise be issued at or after the Effective Time will have any right to receive equity securities of the Company, the Surviving Corporation or any Subsidiary at or after the Effective Time. Parent and Surviving Corporation have agreed to cause the committee under the Equity Incentive Plan to make adequate provision for the adjustment of outstanding Awards under the Stock Bonus Agreements issued pursuant to and in accordance with the terms of the Equity Incentive Plan. The Company will also ensure that, following the Effective Time, no participant in any other stock based plan, agreement, program or arrangement (including, without limitation, the Employee Stock Purchase Plan) will have any right thereunder to acquire equity securities of the Company, the Surviving Corporation or any Subsidiary).

Severance Arrangements. In addition to the severance arrangements provided under the individual employment agreements, and the Company's existing severance plan, the Merger Agreement provides that the Company and its Subsidiaries shall, promptly after the completion of the purchase of Shares pursuant to the Offer, establish an enhanced severance program (the "Enhanced Severance Program") to provide certain additional severance amounts to certain terminated, non-agreement employees who become entitled to severance at or after the Effective Time pursuant to the existing severance plan, the substantially identical plans to be established for certain Subsidiaries which do not currently have a severance plan, or the individual employment agreements which provide severance benefits. The Merger Agreement provides that the Enhanced Severance Program plus all severance otherwise payable may provide aggregate benefits not in excess of $22,000,000 to all employees covered by the Program, and also provides that the total amount of severance benefits that may be paid to Messrs. Davis, Orris, Starzel, Harvey, Matthews and Parsons (excluding certain miscellaneous items) will not exceed $1,600,000, $1,350,000, $1,050,000, $1,050,000, $1,050,000 and $1,020,833, respectively. For purposes of the Enhanced Severance Program, participants will be divided into three categories, and the severance amount payable will range from an additional one year's base salary for certain employees (in addition to the severance otherwise payable) to the incremental amount necessary to provide an aggregate of 18 months or one year of severance for other employees.

Certain additional information with respect to executive compensation and related employee benefits and other information concerning the Company's executive officers or directors, as modified by the foregoing discussion set forth in this Item 3(b), is set forth in the 1995 Proxy Statement, under the sections entitled "Board of Directors," "Executive Compensation," "Employment Agreements," "Pension Plan" "Report of the Compensation Committee of Southern Pacific Rail Corporation" (only to the extent that the Report contains information with respect to Messrs. Davis, Starzel, Orris, Harvey and Matthews), "Beneficial Ownership of Stock," and "Certain Relationships and Related Transactions," and is incorporated herein by reference. A copy of the pertinent sections of the 1995 Proxy Statement is filed as an exhibit to this Schedule 14D-9. Because Mr. Parsons and Mr. Galardi were not employed with the Company in 1994, the 1995 Proxy Statement does not contain information about their compensation arrangements. Those agreements are filed as Exhibits 24 and 25 to this Schedule 14D-9 and are incorporated herein by reference.

Certain Other Matters

Certain information with respect to certain contracts, agreements, arrangements and understandings between the Company and certain of its executive officers, directors or affiliates (including TAC or one of its affiliates) is set forth in the 1995 Proxy Statement, under the section entitled "Compensation Committee Interlocks and Insider Participation," and is incorporated herein by reference. A copy of the pertinent section of the 1995 Proxy Statement is filed as Exhibit 18 to this Schedule 14D-9. The Company plans to continue its activities under these agreements, as disclosed to Union Pacific pursuant to the Merger Agreement. The Company also is considering, and has so disclosed to Union Pacific pursuant to the Merger Agreement, certain other proposed transactions with TAC or one of TAC's affiliates involving (i) the purchase by an affiliate of TAC of certain tracts of land, (ii) amendments to the pipeline easement described in the 1995 Proxy Statement and (iii) the grant of additional fiber optic easements to an affiliate of TAC. Completion of these proposed transactions are subject to approval by independent directors of the Company after receipt of an appraisal from an independent appraiser that the terms are fair to the Company and comparable to an arms-length transaction with an unaffiliated party.

Certain substantial Stockholders have entered into agreements with Union Pacific in connection with the Merger Agreement. MSLEF II, which beneficially owns approximately 8.5% of the Outstanding Shares, has entered into the MSLEF Shareholder Agreement (as defined in the Offer to Purchase) pursuant to which MSLEF II agreed, among other things, to vote all Shares beneficially owned by it (i) in favor of the Merger and (ii) subject to certain conditions, against mergers or other business combinations (other than the Merger). That agreement will remain in effect until the earlier of (x) the consummation of the Merger, (y) six months following the termination of the Merger Agreement by the Company's Board of Directors pursuant to the Board's fiduciary duties and (z) upon the termination of the Merger Agreement in accordance with the other termination provisions of the Merger Agreement.

Mr. Philip F. Anschutz ("Mr. Anschutz"), The Anschutz Corporation ("TAC") and the Anschutz Foundation (the "Foundation" and, together with Mr. Anschutz and TAC, the "Anschutz Shareholders"), which beneficially own an aggregate of approximately 31.8% of the Outstanding Shares, have entered into the Anschutz Shareholders Agreement (as defined in the Offer to Purchase), which contains voting provisions substantially similar to those contained in the MSLEF Shareholder Agreement. The Anschutz Shareholders Agreement also provides for certain "standstill" and other restrictions and limitations with respect to the Union Pacific Shares to be acquired by the Anschutz Shareholders in the Merger. In addition, the Anschutz Shareholders Agreement provides that the Board of Directors of Union Pacific will elect Mr. Anschutz, or another designee reasonably acceptable to Union Pacific, as a director of Union Pacific's Board of Directors and will appoint Mr. Anschutz (but not any other designee) as Vice Chairman of the Board of Directors.

The Anschutz Shareholders and Union Pacific have also entered into The Anschutz/Resources Shareholders Agreement (as defined in the Offer to Purchase), which provides for substantially similar "standstill" and other restrictions with respect to the Anschutz Shareholders as those contained in the Anschutz Shareholders Agreement. In addition, the Anschutz/Resources Shareholders Agreement provides that the Board of Directors of Resources will elect a designee of TAC (other than persons affiliated with the Anschutz Shareholders or their affiliates), reasonably acceptable to the Board of Directors of Resources, as a director of Resources.

The Anschutz Shareholders also have been granted, subject to certain conditions, registration rights in respect of Union Pacific Shares and Resources Shares that will be acquired. In addition, the Purchaser has been granted, subject to certain conditions, registration rights in respect of the Shares to be purchased pursuant to the Offer.

The agreements summarized above between one or more of the Company and certain substantial Stockholders and Union Pacific or the Purchaser made in connection with the Merger Agreement are described more fully in Section 13 of the Offer to Purchase under the caption "The Offer—Merger Agreement; Shareholders Agreements; Registration Rights Agreements; Other Agreements" and such portions of the Offer to Purchase are hereby incorporated herein by reference. Such portions of the Offer to Purchase contain summaries of these and certain other agreements. Such summaries and the summaries above do not purport to be complete and are qualified in their entirety by reference to the full text of the appropriate agreements which are attached hereto as Exhibits 11 through 17 to this Schedule 14D-9, each of which is hereby incorporated herein by reference.

In addition, the existing corporate matters agreement (including registration rights in favor of TAC and MSLEF II granted thereunder) and the existing stockholder agreement to which TAC and MSLEF II are parties, which are described in the Company's 1995 Proxy Statement under the caption "Beneficial Ownership of Stock" will terminate as of the Effective Time as a result of the Merger. In connection with execution of the Merger Agreement, the Company, TAC and MSLEF II amended the corporate matters agreement to provide for such termination as of the Effective Time and to modify the existing registration rights to account for the registration rights granted by the Company to Purchaser under the Purchaser/Company RRA (as defined in the Offer to Purchase). A copy of the amendment to the corporate matters agreement is filed as Exhibit 27 to this Schedule 14D-9 and is incorporated by reference herein.

Additionally, the Offer to Purchase describes certain operating relationships between the Company or its affiliates and UPRR under the caption "The Offer—Certain Information Concerning The Company—Certain Operating Relationships" and such portions of the Offer to Purchase are hereby incorporated herein by reference. Such summaries do not purport to be complete and are qualified in their entirety by reference to the Offer to Purchase, which is attached hereto as Exhibit 1 to this Schedule 14D-9 and incorporated herein by reference.

The Morgan Stanley Leveraged Equity Fund II, L.P. ("MSLEF II") is a substantial Stockholder of the Company. The sole general partner of MSLEF II is Morgan Stanley Leveraged Equity Fund II, Inc. ("MSLEF II, Inc."), a wholly owned subsidiary of Morgan Stanley Group Inc. Each of MSLEF II, Inc. and Morgan Stanley Group Inc. may be deemed to have shared voting and dispositive power with respect to the Shares held by MSLEF II. As of August 3, 1995, MSLEF II was the record and beneficial owner of, and had the right to vote and to dispose of, an aggregate of 13,341,580 Shares, representing approximately 8.5% of the then outstanding Shares. Mr. Frank V. Sica, a member of the Board of Directors of the Company (the "Board") since October 1989, is a Managing Director of Morgan Stanley & Co. Incorporated ("Morgan Stanley") and a Vice Chairman and Director of MSLEF II, Inc. Morgan Stanley has acted as financial advisor to the Company in connection with the Offer and the Merger and has rendered to the Board an opinion that the Consideration to be received by the Stockholders pursuant to the Offer and the Merger, taken together, is fair from a financial point of view to the Stockholders. See Item 4 "The Solicitation or Recommendation—Opinion of Financial Advisor" and Item 5 "Persons Retained, Employed or to be Compensated." In addition, Richard B. Cheney, former Secretary of Defense, is a director of both Union Pacific and Morgan Stanley Group Inc.

The Company and Union Pacific entered into a Confidentiality Agreement dated as of September 8, 1994. A copy of such Confidentiality Agreement is attached hereto as Exhibit 10 to this Schedule 14D-9 and is incorporated herein by reference.

Indemnification under Delaware Law, the Company's Charter, By-laws and the Merger Agreement

The Company is a Delaware corporation. Section 145 of the Delaware General Corporation Law (the "Delaware Law"), provides that a corporation may indemnify any person who was or is, or is threatened to be made, a party to any threatened, pending or completed legal action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of such corporation), by reason of the fact that such person is or was an officer, director, employee or agent of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise (an "Indemnified Party"). The indemnity may include expenses (including attorney's fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the indemnified person in connection with such action, suit or proceeding, provided such officer, director, employee or agent acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation's best interest and, for criminal proceedings, had no reasonable cause to believe that his or her conduct was unlawful. A Delaware corporation may indemnify officers and directors in an action by or in the right of the corporation under the same conditions, except that no indemnification is permitted without judicial approval if the officer or director is adjudged to be liable to the corporation. Where an officer or director is successful on the merits or otherwise in the defense of any action referred to above, the corporation must indemnify him or her against the expenses that such officer or director actually and reasonably incurred.

Reference is also made to Section 102(b)(7) of the Delaware Law, which enables a corporation in its original certificate of incorporation or an amendment thereto to eliminate or limit the personal liability of a director to the corporation or its stockholders for violations of the director's fiduciary duty, except (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) pursuant to Section 174 of the Delaware Law (providing for liability of directors for unlawful payment of dividends or unlawful stock purchases or redemptions) or (iv) for any transaction from which a director derived an improper personal benefit.

Article Seventh of the Amended and Restated Certificate of Incorporation of the Company provides that the officers, directors and employees and the former officers, directors and employees of the Company and the legal representatives of any such persons shall be indemnified by the Company, in accordance with the procedures established in the By-laws of the Company to the fullest extent permitted by Delaware Law.

Article Eighth of the Amended and Restated Certificate of Incorporation of the Company provides that to the fullest extent permitted by the Delaware Law, a director of the Company shall not be liable to the Company or its stockholders for monetary damages for breach of fiduciary duty as a director. Any repeal or modification of Article Eighth by the stockholders of the Company shall be prospective only and shall not adversely affect any right or protection of a director of the Company existing at the time of such repeal or modification.

Article VI of the By-laws of the Company generally mirrors Delaware Law, and provides that to the extent that any Indemnified Party has been successful on the merits or otherwise in defense of any Third Party Action or Derivative Action, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith without the necessity of any determination that he has met the applicable standards of conduct.

Article VI of the By-laws of the Company also provides that the Company shall have the right to impose as conditions to any indemnification, such reasonable reimbursements and conditions as to the board of directors or stockholders may appear appropriate in each specific case and circumstances.

Further, if Article VI of the By-Laws of the Company or any provision thereof shall be invalidated by any court on any ground, then the Company shall nevertheless indemnify each party otherwise entitled to indemnification thereunder to the fullest extent permitted by law or any applicable provision of Article VI that shall not have been invalidated.

Pursuant to the terms of the Merger Agreement, Union Pacific has agreed that at all times after the date on which the Merger becomes effective ("Effective Time"), it shall indemnify, or shall cause the Surviving Corporation and its subsidiaries to indemnify, each Indemnified Party to the same extent and in the same manner as is now provided in the respective charters or by-laws of the Company and such subsidiaries or otherwise in effect on the date of the Merger Agreement, with respect to any claim, liability, loss, damage, cost or expense (whenever asserted or claimed) ("Indemnified Liability") based in whole or in part on, or arising in whole or in part out of, any matter existing or occurring at or prior to the Effective Time. Union Pacific shall, and shall cause the Surviving Corporation to, maintain in effect for not less than six years after consummation of the Merger the current policies of directors' and officers' liability insurance maintained by the Company and its subsidiaries on the date hereof or at least the same coverage. Without limiting the foregoing, in the event any Indemnified Party becomes involved in any capacity in any action, proceeding or investigation based in whole or in part on any matter, including the transactions contemplated by the Merger Agreement, existing on occurring at or prior to the Effective Time, then to the extent permitted by law, Union Pacific shall, or shall cause the Surviving Corporation to, periodically advance to Indemnified Party its legal and other expenses, subject to the provision by such Indemnified Party of an undertaking to reimburse the amounts so advanced in the event of a final determination by a court of competent jurisdiction that such Indemnified Party is not entitled thereto.

Item 4. ***The Solicitation or Recommendation***

(a) Recommendation of the Board of Directors. At a special meeting held on August 3, 1995, the Board unanimously (i) determined that the terms of the Offer and the Merger are fair to and in the best interests of the Company and the Stockholders and (ii) approved the Merger Agreement, the Ancillary Agreements and the Transactions. The Board recommends that the Stockholders who desire to receive cash in connection with the Transactions tender their Shares pursuant to the Offer.

In deciding whether to tender Shares in the Offer, the Board believes that Stockholders should take the following factors into account:

(i) Stockholders who tender their Shares will have an opportunity to receive a premium over the price at which the Shares were trading on the NYSE prior to the announcement of the Transactions for 25% or more of their Shares (depending on the aggregate number of Shares tendered and the resulting proration factor, if any), prior to action on the Merger by the ICC. Because the ICC is not expected to make a ruling with respect to the Merger until sometime in 1996, stockholders who tender their Shares will be able to receive the Offer Price substantially sooner then they will receive either the Cash Merger Consideration or the Stock Merger Consideration. In addition, although the Company believes that the ICC will approve the

Merger, no assurances can be given that such approval will be obtained, and stockholders who do not tender their Shares in the Offer will bear the risk relating to ICC approval with respect to all of their Shares rather than availing themselves of the opportunity to eliminate that risk with respect to at least 25% of their Shares.

(ii) Stockholders who tender their Shares in the Offer may receive less Stock Merger Consideration than they would if they were not to tender their Shares, and as a result they may have a lesser ownership interest in the combined company. However, because the Stock Merger Consideration will constitute no more than 60% of the overall Consideration, Stockholders who decide not to tender Shares in the Offer because they wish to receive a greater portion of Stock Merger Consideration for their Shares nevertheless may be required to receive some Cash Merger Consideration.

(iii) Generally speaking, Stockholders who exchange their Shares for cash in the Offer or the Merger will be subject to federal income tax, while Stockholders will be able to exchange their Shares for the Stock Merger Consideration on a tax-free basis, in each case as more fully described in Section 5 of the Offer to Purchase under the caption "Certain Federal Income Tax Consequences." Stockholders should take this difference in U.S. federal income tax treatment into account in deciding whether to tender their Shares.

A form of letter to Stockholders communicating the Board's recommendation and the press releases announcing the Merger Agreement and the Transactions are attached hereto as Exhibits 3, 5 and 6, respectively, to this Schedule 14D-9, each of which is hereby incorporated herein by reference.

(b)(1) Background of the Offer; Contacts with the Company. In the ordinary course of Union Pacific's long-term strategic review process, Union Pacific and UPRR routinely analyze potential combinations with various railroad companies. Beginning in mid-1994, certain senior officers of Union Pacific and the Company had occasional, informal discussions regarding the possibility and desirability of an acquisition of the Company by Union Pacific and other possible transactions. On September 8, 1994, Union Pacific and the Company entered into a Confidentiality Agreement in connection with these discussions, but the discussions terminated later in September 1994.

In late February, 1995 and continuing through mid-April, 1995, certain senior officers and directors of Union Pacific and the Company had a number of meetings and telephone conversations to discuss on a preliminary basis a possible acquisition of the Company by Union Pacific. In connection with such preliminary discussions, on April 8, 1995, Union Pacific's legal counsel provided to the Company and its legal counsel a draft merger agreement. No negotiations were ever conducted concerning such draft agreement. In mid-April, 1995, Union Pacific and the Company discontinued discussions concerning a possible transaction due to an inability to reach agreement on the structure and terms thereof.

Discussions and meetings concerning a possible transaction resumed in late June, 1995 among certain senior officers of Union Pacific and the Company. At a meeting on July 17, 1995, senior officers of Union Pacific and the Company established a preliminary basis for continuing discussions to seek to reach an agreement concerning a transaction and for proceeding with a due diligence review. Such officers of Union Pacific and the Company determined to continue discussions on the basis of the following tentative terms, among others: Union Pacific would acquire up to 25% of the Outstanding Shares in a cash tender offer at $25.00 per Share and, following receipt of ICC approval and the satisfaction of other conditions, would acquire the remaining Shares in a "cash election" merger in which Stockholders would receive, at their election, for each Share, cash consideration of $25.00, or a fraction of a share of Union Pacific Shares determined by dividing $25.00 by the average closing price of Union Pacific Shares prior to the Merger (subject to a pricing "collar" mechanism which would result in not more than 0.4464 shares of Union Pacific Shares nor less than 0.4065 shares being issued per Share). In such transactions, 60% of the Shares would be converted into Union Pacific Shares and the remaining 40% into cash, including the Shares to be acquired in the tender offer.

At the July 17, 1995 meeting, Union Pacific indicated to Mr. Anschutz that its willingness to continue discussions was conditioned upon, among other things, the willingness of the Anschutz Shareholders and MSLEF II to consider agreeing to vote their Shares, representing approximately 31.8% and 8.5%, respectively, of the Outstanding Shares, in favor of the Merger. Mr. Anschutz indicated that the Anschutz Shareholders would be willing to consider such an agreement if the Company and Union Pacific could negotiate satisfactory terms for a transaction, and provided that satisfactory terms concerning an agreement between the Anschutz Shareholders and Union Pacific could be negotiated. Subsequently, Union Pacific was advised that MSLEF II also would be willing to consider an agreement to vote its Shares in favor of the Merger if the Company and Union Pacific could negotiate satisfactory terms for a transaction, and subject to MSLEF II's negotiation of satisfactory terms of an agreement with Union Pacific.

Management of Union Pacific and the Company each conditioned their willingness to continue discussions concerning a possible transaction upon, among other things, the negotiation of satisfactory terms and the negotiation and execution of definitive transaction agreements, a satisfactory due diligence review, and the approval of their respective Boards of Directors. The Company also indicated to Union Pacific that its willingness to continue discussions was conditioned upon the willingness of Union Pacific to enter into an appropriate agreement restricting voting, additional acquisitions and dispositions of Shares to be purchased by Union Pacific in the Offer.

Following the July 17, 1995 meeting, extensive due diligence was conducted by the Company, Union Pacific and their respective legal, financial and accounting advisors. In addition, senior officers of the Company and Union Pacific and their respective counsel met and talked regularly to negotiate the terms of the transaction and the definitive agreements providing for the transaction, and senior officers of Union Pacific and its counsel negotiated with the Anschutz Shareholders and MSLEF II and their counsel the terms of their transactions and the definitive agreements therefor.

On July 27, 1995, at a regularly scheduled meeting, the Board of Directors of Union Pacific analyzed and reviewed, with Union Pacific's management and financial and legal advisors, among other things, various strategic, financial and legal considerations concerning a possible transaction with the Company, the potential terms of a transaction and the status of negotiations. (At several earlier meetings, Union Pacific's Board of Directors had reviewed the strategic considerations and other issues, as well as the status of any discussions then being conducted, regarding such an acquisition.) At the July 27 meeting, Union Pacific's management and financial and legal advisors made presentations to the Union Pacific Board concerning various aspects of the possible transaction. No decision was reached by the Union Pacific Board at the meeting, but it was the consensus of directors that management and Union Pacific's advisors should continue to negotiate with the Company and report back to the Union Pacific Board once management was prepared to make a recommendation. At its July 27, 1995 meeting, the Board of Directors of Union Pacific approved the IPO and the Spin-off (each as defined in the Offer to Purchase). Following the meeting, Union Pacific issued a press release announcing the IPO.

On July 27, 1995, at a regularly scheduled meeting, the Board of Directors of the Company analyzed and reviewed, with the Company's management and financial and legal advisors, among other things, various strategic, financial and legal considerations concerning a possible transaction with the Company, the potential terms of a transaction and the status of negotiations. At the July 27 meeting, the Company's management and financial and legal advisors made presentations to the Board concerning various aspects of the possible transaction. No decision was reached by the Board of the Company at the meeting, but it was the consensus of directors that management and the Company's advisors should continue to negotiate with Union Pacific and report back to the Board of the Company once the Company's management was prepared to make a recommendation.

On August 2, 1995, senior officers of Union Pacific and the Company met and had various telephone conversations to discuss the progress of the negotiations to date, certain issues between the parties that had not been resolved, and the results of due diligence. With respect to the proposed pricing for the transaction, the parties agreed to a fixed exchange ratio of .4065 shares of Union Pacific Shares per Share for the stock portion of the purchase price, in place of the previously discussed "floating" exchange ratio with a pricing "collar".

On August 3, 1995, the Board of Directors of Union Pacific held a special telephonic meeting to review, with the advice and assistance of the Board's financial and legal advisors, the proposed Merger Agreement and Ancillary Agreements and the Transactions. At such meeting, Union Pacific's management and financial and legal advisors made presentations to the Board concerning the transaction, and Union Pacific's financial advisor, CS First Boston Corporation ("CS First Boston"), rendered to Union Pacific's Board an oral opinion (which was subsequently confirmed in writing) to the effect that, as of such date, the consideration to be paid by Union Pacific in the Offer and the Merger, taken together, was fair to Union Pacific from a financial point of view. Following the Board's review of the Transactions, the Board unanimously approved (with three directors absent, and one director abstaining because of an affiliation with Morgan Stanley, the financial advisor to the Company in connection with the Transactions and an affiliate of MSLEF II, a party to an Ancillary Agreement in its capacity as a Stockholder) the proposed Merger Agreement and Ancillary Agreements and the Transactions, and authorized, subject to completion of negotiation of a limited number of remaining issues, the execution and delivery of such Agreements.

Also on August 3, 1995, the Board of Directors of the Company held a special meeting to review, with the advice and assistance of the Board's financial and legal advisors, the proposed Merger Agreement and Ancillary Agreements and the Transactions, including the Offer and Merger. At such meeting, the Company's management and financial and legal advisors made presentations to the Board concerning the Transactions and the Company's financial advisor, Morgan Stanley, provided an oral opinion (which was subsequently confirmed in writing) that on the date of the Merger Agreement the consideration to be received by Stockholders pursuant to the Offer and the Merger, taken together, is fair from a financial point of view to such Stockholders. Following the Board's review of the Transactions, the Board unanimously approved the proposed Merger Agreement and Ancillary Agreements and the transactions contemplated thereby, authorized (subject to completion of negotiation of a limited number of remaining issues) the execution and delivery of such Agreements, determined that the Offer and the Merger are fair to and in the best interests of the Stockholders, recommended that Stockholders who desire to receive cash for their Shares accept the Offer and tender their Shares pursuant to the Offer, and recommended that Stockholders approve and adopt the Merger Agreement. The Board's approval of the Merger Agreement and the Ancillary Agreements and the Transactions constituted approval for purposes of Section 203 of the DGCL such that the provisions of the statute are not applicable to such Agreements or the Transactions contemplated thereby (see the Offer to Purchase under the caption, "Certain Legal Matters; Regulatory Approvals—State Takeover Statutes").

Following the August 3, 1995 Board meetings described above, the following joint press release was issued:

BETHLEHEM, PA., Aug. 3—Union Pacific Corporation (NYSE: UNP) and Southern Pacific Rail Corporation (NYSE: RSP) announced today that they have reached an agreement providing for the merger of Southern Pacific with Union Pacific. The $5.4 billion transaction would form North America's largest railroad, a 34,000-mile network operating in 25 states and serving both Mexico and Canada. The two railroad companies had combined 1994 operating revenues of $9.54 billion.

The agreement, approved today by the Boards of Directors of Union Pacific and Southern Pacific, is subject to execution of a definitive merger agreement, which is expected to be signed very shortly. Under terms of the agreement, Union Pacific would make a first-step cash tender offer of $25.00 a share for up to 25 percent of the Common Stock of Southern Pacific. The tender offer would commence next week. The shares purchased in the tender offer will be held in a voting trust. Following completion of the offer, and the satisfaction of other conditions, including approval by the Interstate Commerce Commission (ICC), Southern Pacific will be merged with Union Pacific Corporation. Upon completing the transaction, each share of Southern Pacific stock will be converted, at the holder's election (subject to proration), into the right to receive $25.00 in cash or 0.4065 shares of Union Pacific Common Stock. As a result of the transaction, 60 percent of Southern Pacific shares will be converted into Union Pacific stock and the remaining 40 percent into cash, including the shares acquired in the original tender offer. The two companies expect to file an application with the ICC no later than December 1.

Union Pacific also stated that the previously announced spin-off of Union Pacific Resources would be consummated after completion of the transaction. The initial public offering of shares of Union Pacific Resources will proceed as scheduled.

In connection with the merger, Philip Anschutz, a major shareholder of Southern Pacific, will be appointed non-executive Vice Chairman of the Board of Directors of Union Pacific following completion of the transaction and will enter into a customary seven-year standstill agreement. In addition, Mr. Anschutz, who owns 31 percent of Southern Pacific, and the Morgan Stanley Leveraged Equity Fund, which owns seven percent of Southern Pacific, have agreed to vote their shares in favor of the transaction.

"When completed, this transaction will deliver major benefits for customers," said Drew Lewis, Union Pacific's Chairman and Chief Executive Officer. "The combined system will be able to offer new services that neither Union Pacific nor Southern Pacific can offer on its own. The new system will yield extensive new single-line service, faster schedules, more frequent and reliable service, shorter routes and improved equipment utilization. Benefits from operating efficiencies, facility consolidations, cost savings and increased traffic are estimated to be in excess of $500 million per year."

During the afternoon and evening of August 3, 1995, senior officers of the Company and Union Pacific, Mr. Anschutz and MSLEF II and their respective counsel resolved all remaining issues to the mutual satisfaction of the parties, and the Merger Agreement and Ancillary Agreements were executed and delivered by all parties thereto.

Prior to the commencement of trading on the morning of August 4, 1995, Union Pacific issued the following press release:

BETHLEHEM, PA., Aug. 4—Union Pacific Corporation (NYSE: UNP) announced today that it has executed a definitive merger agreement for the previously announced merger with Southern Pacific Rail Corporation (NYSE: RSP). Under the terms of the agreement, Union Pacific will make a first-step cash tender offer of $25.00 per share for up to 25 percent of the Common Stock of Southern Pacific. Following completion of the transaction, each share of Southern Pacific stock will be converted, subject to proration, into the right to receive $25.00 in cash or 0.4065 shares of Union Pacific Common Stock. As a result of the transaction, 60 percent of Southern Pacific's shares will be converted into Union Pacific stock and the remaining 40 percent, including the shares acquired in the original tender offer, will be converted into cash.

The merger is subject to receipt of Interstate Commerce Commission (ICC) approval and other customary conditions.

On August 9, 1995, Union Pacific and the Purchaser commenced the Offer.

(b)(2) Reasons for the Recommendation. The Board and the Company's senior management continually review the current and future state of the Company's strategic position, short-term and long-term prospects, including alternatives to remaining an independent company. Early in 1995, following Union Pacific's announcement that it would not pursue a business combination involving Santa Fe, the Company's management concluded that the proposed merger of Burlington Northern and Santa Fe was likely to be consummated in 1995. In light of this development, the Company's management again reviewed the Company's business and prospects and the Company's expected future competitive situation. In connection with that review, the Company's management considered possible business combinations with Union Pacific and other entities in the transportation industry. Following that review, the Company's management concluded that a business combination with Union Pacific was likely to be more advantageous to the Company and its Stockholders than any other business combination.

In light of, among other things, the review described in the immediately preceding paragraph, the Board determined that it would be in the best interest of the Company and its Stockholders to approve the Merger Agreement and the Transactions. In approving the Merger Agreement and the Transactions and recommending that Stockholders who wish to receive cash in connection with the Transactions tender their Shares pursuant to the Offer, the Board considered a number of factors, including, but not limited to, the following:

(i) the terms and conditions of the Merger Agreement;

(ii) the presentations by management of the Company (at Board meetings on July 27, and August 3, 1995 and at previous board meetings) regarding the financial condition, results of operations, business and prospects of the Company, including the prospects of the Company if it remains independent;

(iii) the trading price of the Shares over the last three years and that the $25.00 per share to be paid in the Offer and as the Cash Consideration in the Merger represents a premium of approximately 33.7% over the $18.70 average closing sale price for the Shares on the New York Stock Exchange ("NYSE") for the 20 business days prior to the announcement of the Transactions;

(iv) the expected future trading values of the Shares in light of, among other things, the historical trading multiples of other U.S. railroad companies;

(v) the oral and written presentations by Morgan Stanley at the July 27, and August 3, 1995 Board meetings and the written opinion of Morgan Stanley dated August 3, 1995 to the effect that, as of the date of the opinion, the Consideration to be received by the Stockholders pursuant to the Offer and the Merger, taken together, is fair from a financial point of view to the Stockholders. A copy of the opinion of Morgan Stanley, which sets forth the procedures followed, the factors considered and the assumptions made by Morgan Stanley, is described herein under the caption "Opinion of Financial Advisor", attached hereto as Exhibit 9 to this Schedule 14D-9 and incorporated in its entirety herein by reference. **Stockholders are urged to read the opinion of Morgan Stanley carefully and in its entirety;**

(vi) the Merger offers the opportunity for substantial synergies and the transaction structure allows the Stockholders who receive Stock Merger Consideration to participate in those synergies through continued ownership of the combined company;

(vii) the Merger provides the opportunity to participate in the potential benefits of the proposed spin-off of Union Pacific's oil and gas exploration and production operations;

(viii) the views expressed by management and Morgan Stanley that there did not appear to be any other party with which the Company would be as good a strategic fit as Union Pacific, and that it was unlikely that any other party would propose a transaction that, taken as a whole, was more favorable to the Company and its Stockholders;

(ix) the Merger Agreement permits the Board, in the exercise of its fiduciary duties, to engage in negotiations with or to furnish information to third parties in response to unsolicited, written alternative acquisition proposals after the date of the Merger Agreement;

(x) the Merger Agreement permits the Board at any time prior to the purchase of at least 15% of the Outstanding Shares pursuant to the Offer, in the exercise of its fiduciary duties, to terminate the Merger Agreement in favor of a superior alternative acquisition proposal, without any payments or other liability to Union Pacific;

(xi) although the Voting Agreements provide that the Shareholders parties thereto will not vote in favor of any other acquisition transaction for six months following the termination of the Merger Agreement by the Company pursuant to the Board's exercise of its fiduciary duties, the Board believes that, in light of the lengthy time period required for the ICC approval of an acquisition of control of the Company, this agreement between the Shareholders and Union Pacific will not prevent the consummation of an alternative transaction; and

(xii) Stockholders who tender their Shares pursuant to the Offer will have the opportunity to receive a premium for at least 25% of their Shares prior to the receipt of ICC approval of the Transactions and will receive the premium even if ICC approval is not ultimately obtained.

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

SOUTHERN PACIFIC RAIL CORPORATION

By: /s/ THOMAS J. MATTHEWS
Name: Thomas J. Matthews
Title: Senior Vice President—Administration

Dated: August 9, 1995

MORGAN STANLEY

MORGAN STANLEY & CO.
INCORPORATED
1251 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10020
(212) 703-4000

August 3, 1995

Board of Directors
Southern Pacific Rail Corporation
Southern Pacific Building
One Market Plaza
San Francisco, CA 94105

Gentlemen:

We understand that Southern Pacific Rail Corporation (the "Company"), Union Pacific Corporation (the "Buyer"), Union Pacific Railroad Company, an indirect wholly owned subsidiary of the Buyer, and UP Acquisition Corporation, also an indirect wholly owned subsidiary of the Buyer ("Acquisition Sub") have entered into an Agreement and Plan of Merger, dated as of August 3, 1995 (the "Merger Agreement"), which provides, among other things, for (i) the commencement by Acquisition Sub of a tender offer (the "Offer") for up to 39,034,471 shares of the issued and outstanding shares of common stock, par value $.001 per share (the "Company Common Stock"), of the Company for $25.00 per share net to the seller in cash (the "Offer Consideration"), and (ii) upon receipt of certain U.S. regulatory approvals, the subsequent merger (the "Merger") of the Company with and into Acquisition Sub. Pursuant to the Merger, the Company will become a wholly owned subsidiary of the Buyer and each outstanding share of the Company Common Stock, other than shares held in treasury or held by the Buyer and its affiliates, will be converted into the right to receive, at the holder's election, either (i) $25.00 in cash (the "Cash Consideration") or (ii) 0.4065 shares of common stock, par value $2.50 per share (the "Buyer Common Stock"), of the Buyer (the "Stock Consideration," and together with the Cash Consideration and the Offer Consideration, the "Consideration"), subject to adjustment in either case in certain circumstances. The terms and conditions of the Offer and the Merger are more fully set forth in the Merger Agreement.

You have asked for our opinion as to whether the Consideration to be received by the holders of shares of Company Common Stock pursuant to the Offer and the Merger, taken together, is fair from a financial point of view to such holders.

For purposes of the opinion set forth herein, we have:

(i) analyzed certain publicly available financial statements and other information of the Company and the Buyer, respectively;

(ii) reviewed certain internal financial statements and other financial and operating data concerning the Company and the Buyer prepared by the managements of the Company and the Buyer, respectively;

(iii) reviewed certain financial projections for the Buyer prepared by the management of the Buyer;

(iv) reviewed certain financial projections for the Company, including estimates of certain potential benefits of the proposed business combination, prepared by the management of the Company;

(v) discussed on a limited basis the past and current operations and financial condition and the prospects of the Company and the Buyer with senior executives of the Company and the Buyer, respectively;

(vi) reviewed the reported prices and trading activity for the Company Common Stock and the Buyer Common Stock;

(vii) compared the financial performance of the Company and the prices and trading activity of the Company Common Stock with that of certain other comparable publicly-traded companies and their securities;

(viii) reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;

(ix) discussed certain issues relating to the proposed spin-off of the Buyer's oil and gas exploration and production operations with senior executives of the Buyer;

(x) participated in discussions among representatives of the Company, the Buyer and their financial and legal advisors;

(xi) reviewed the Merger Agreement and certain related documents; and

(xii) performed such other analyses as we have deemed appropriate.

We have assumed and relied upon, without independent verification, the accuracy and completeness of the information reviewed by us for the purposes of this opinion. With respect to the financial projections, including the estimates of the Company of certain potential benefits of the proposed business combination, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the future financial performance of the Company and the Buyer, respectively. We have not made any independent valuation or appraisal of the assets or liabilities of the Company or the Buyer, nor have we been furnished with any such appraisals. Our opinion is necessarily based on economic, market and other conditions as in effect on, and the information made available to us as of, the date hereof.

In arriving at our opinion, we were not authorized to solicit, and did not solicit, interest from any party with respect to the acquisition of the Company or any of its assets.

We express no opinion and make no recommendations as to whether the holders of Company Common Stock should elect to receive either the Offer Consideration, the Cash Consideration or the Stock Consideration.

We have acted as financial advisor to the Board of Directors of the Company in connection with this transaction and will receive a fee for our services. In the past, Morgan Stanley & Co. Incorporated ("Morgan Stanley") and its affiliates have provided financial advisory and financing services for the Company and the Buyer and have received fees for the rendering of these services. In addition, the Morgan Stanley Leveraged Equity Fund II, L.P., an affiliate of Morgan Stanley, owns approximately 8.5% of the outstanding shares of Company Common Stock as of the date hereof and Mr. Frank V. Sica, a Managing Director of Morgan Stanley, is a member of the Board of Directors of the Company.

It is understood that this letter is for the information of the Board of Directors of the Company and may not be used for any other purpose without our prior written consent. We consent, however, to the inclusion of this opinion as an exhibit to any Schedule 14D-9, proxy or registration statement distributed in connection with the Offer or the Merger.

Based on the foregoing, we are of the opinion on the date hereof that the Consideration to be received by the holders of shares of Company Common Stock pursuant to the Offer and the Merger, taken together, is fair from a financial point of view to such holders.

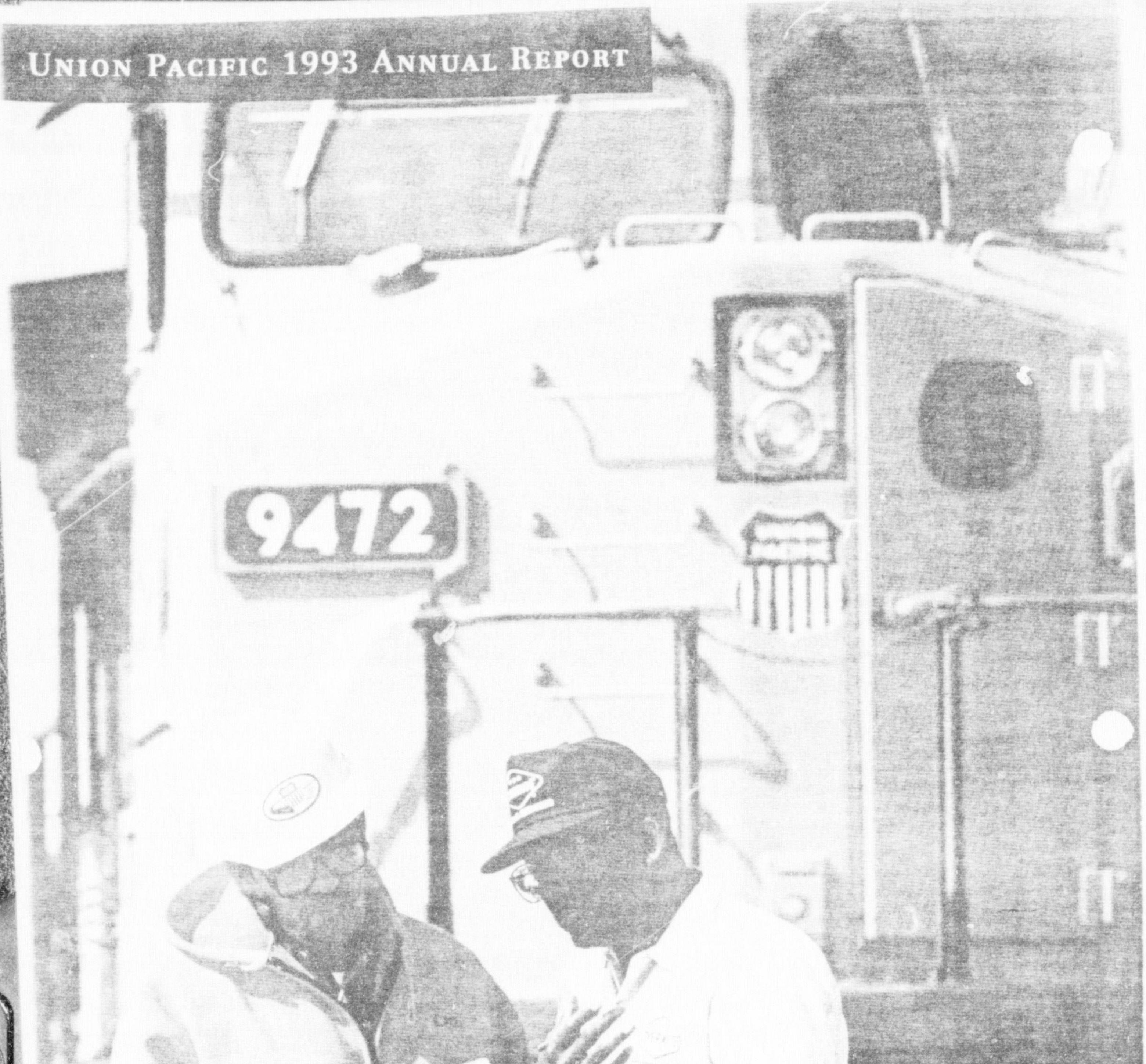
Very truly yours,

MORGAN STANLEY & CO. INCORPORATED

By: ______________________

Mahmoud A. Mamdani
Principal

Union Pacific 1993 Annual Report



Seamless Service

FINANCIAL HIGHLIGHTS

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars, Except Ratios and Per Share Amounts	1993[a]	1992	1991[b]
For the Year	Operating revenues	**$7,561**	$7,294	$7,029
	Operating income	**1,489**	1,405	461
	Income before cumulative effect of accounting changes	**705**	728	64
	Cumulative effect of accounting changes	**(175)**	–	–
	Net income	**530**	728	64
	Cash from operations	**1,563**	1,660	1,392
	Capital investments	**1,574**	1,567	1,231
At Year-End	Total debt	**$4,184**	$4,099	$4,050
	Common stockholders' equity	**4,885**	4,639	4,163
Measurements	Earnings per share:			
	Income before cumulative effect of accounting changes	**$ 3.43**	$ 3.57	$ 0.31
	Cumulative effect of accounting changes	**(0.85)**	–	–
	Net income	**2.58**	3.57	0.31
	Dividends declared per share	**1.54**	1.42	1.305
	Debt to total capital employed	**35.6%**	36.9%	39.2%
	Return on average common stockholders' equity	**11.1%**	16.5%	1.5%

[a] 1993 results include a net after-tax charge of $175 million for the adoption of changes in accounting methods and a $61 million charge for the deferred tax effect of the Omnibus Budget Reconciliation Act of 1993 (see Notes 2 and 7 to the Financial Statements, respectively). Excluding these accounting adjustments, net income would have been $766 million ($3.73 net income per share) with a return on average common stockholders' equity of 15.7%.

[b] 1991 operating income and net income include an $870 million ($575 million after-tax) special charge (see Note 3 to the Financial Statements). 1991 operating income and net income, excluding the special charge, would have been $1,331 million and $639 million, respectively ($3.16 net income per share), with a return on average common stockholders' equity of 14.2%.

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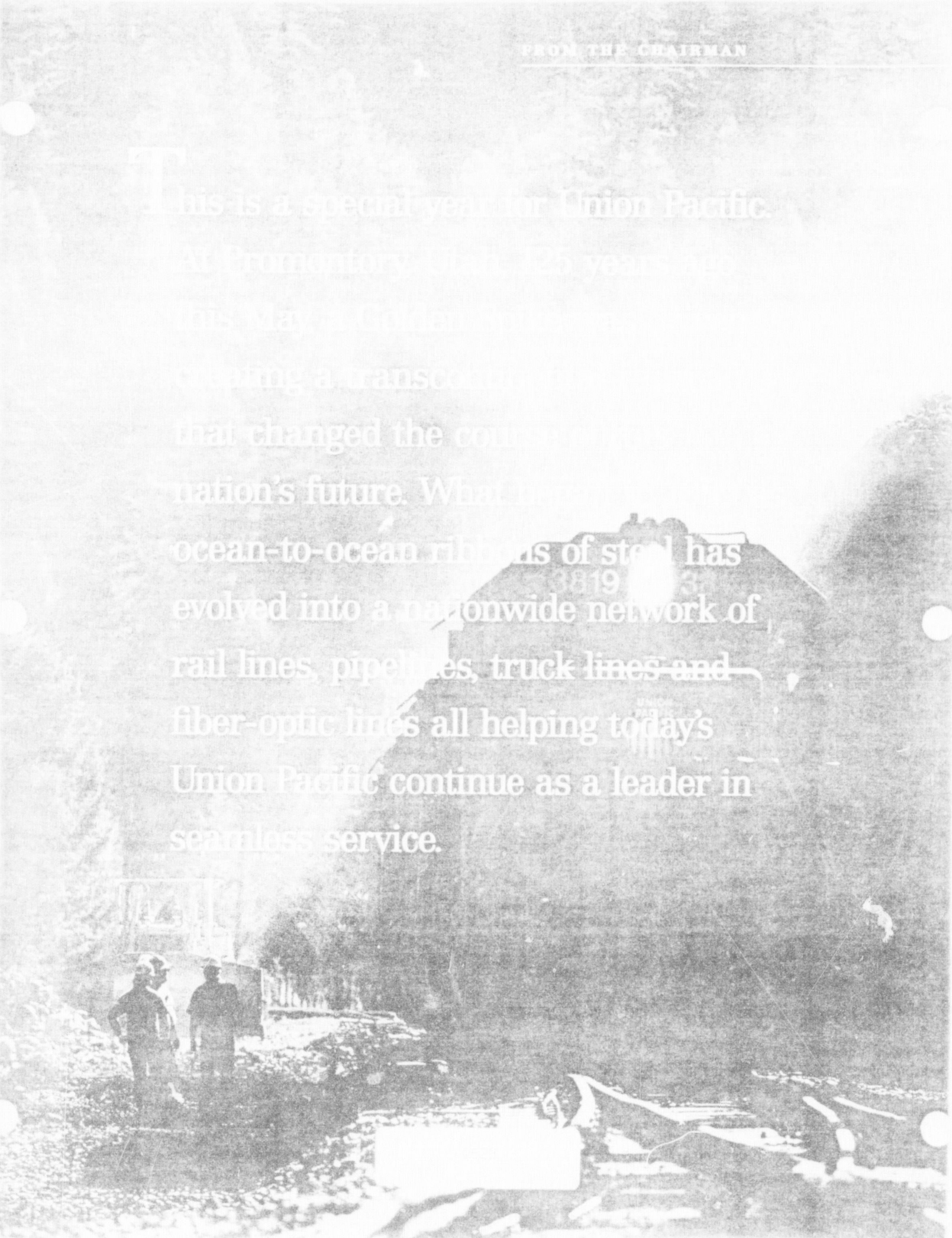

This is a special year for Union Pacific. At Promontory, [illegible] 125 years [illegible] this May [illegible] [illegible] a transco[illegible] that changed the cou[illegible] nation's future. Wha[illegible] ocean-to-ocean rib[illegible] of ste[illegible] has evolved into a nationwide network of rail lines, pipelines, truck lines and fiber-optic lines all helping today's Union Pacific continue as a leader in seamless service.

The famous Golden-Spike picture behind me shows the excitement the builders and bankrollers felt as they celebrated their back-breaking accomplishment – a seamless national linkage. Whether it's moving freight from ship to store, natural gas from well bottom to burner tip, industrial waste from discharger to disposal site or technology from mainframes to Main Street, Union Pacific is doing it and doing it well.

On the cover, for example, Overnite carries auto parts from Detroit to Chicago, where they are loaded onto a Union Pacific train bound for a Mexico City plant. Seamless. All Union Pacific. As you read this report, you'll see other examples of why seamless service is here to stay. Consumers benefit, customers benefit and shareholders benefit.

Union Pacific had a highly successful year in 1993, despite several one-time items. The corporation earned $530 million, compared to $728 million in 1992. Included in 1993's results were a $175 million after-tax charge largely reflecting changes in accounting rules for income taxes and retiree benefits, and a $61 million adjustment for the effect of the increase in the corporate Federal income tax rate on deferred taxes. Excluding these accounting adjustments, earnings would have improved to $766 million.

Despite our difficulties with Mother Nature – including floods that dampened earnings by $34 million – 1993 was a year we are all very proud of.

Union Pacific Railroad: Overcoming Nature

Union Pacific Railroad's greatest foe in 1993 was not the economy or competition – but weather. The Railroad was battered by record snowstorms in the Sierra Nevadas and devastated by the record midwestern flood. It was only with the herculean efforts of our people working around the clock that we surmounted these problems. Despite these obstacles, the Railroad actually increased carloadings 4 percent and, excluding the accounting adjustments, would have earned $669 million, compared to $667 million in 1992.

Turning to 1994, the Railroad has many things going for it. The North American Free Trade Agreement should help build its traffic with Mexico. We have direct access to this expanding market and much of the Mexican Railway is linked to our electronic transportation tracking system.

Union Pacific – with two other carriers – launched the largest coal-hauling program east of the Mississippi when it began shipping coal from Wyoming's Powder River Basin to Georgia Power. Seamless partnerships with major trucking companies – including Overnite – have generated exciting prospects for intermodal shipping.

To make sure coal, intermodal and other traffic will not be hampered by capacity constraints, the Railroad is eliminating bottlenecks by expanding its busy Nebraska corridor and the Oregon Blue Mountain route to the Northwest. It is also increasing intermodal capacity at Memphis, Stockton and Seattle.

The Railroad continues to improve efficiency and customer service. By year-end nearly all through-freight trains were down to two-person crews, and key marketing and operations people were teamed by commodity in seamless business units to further improve customer satisfaction.

Resources: Another Banner Year

Union Pacific Resources achieved another banner year. Earnings would have been $309 million excluding the accounting adjustments, up from $272 million in 1992, while reserves increased and production reached record levels.

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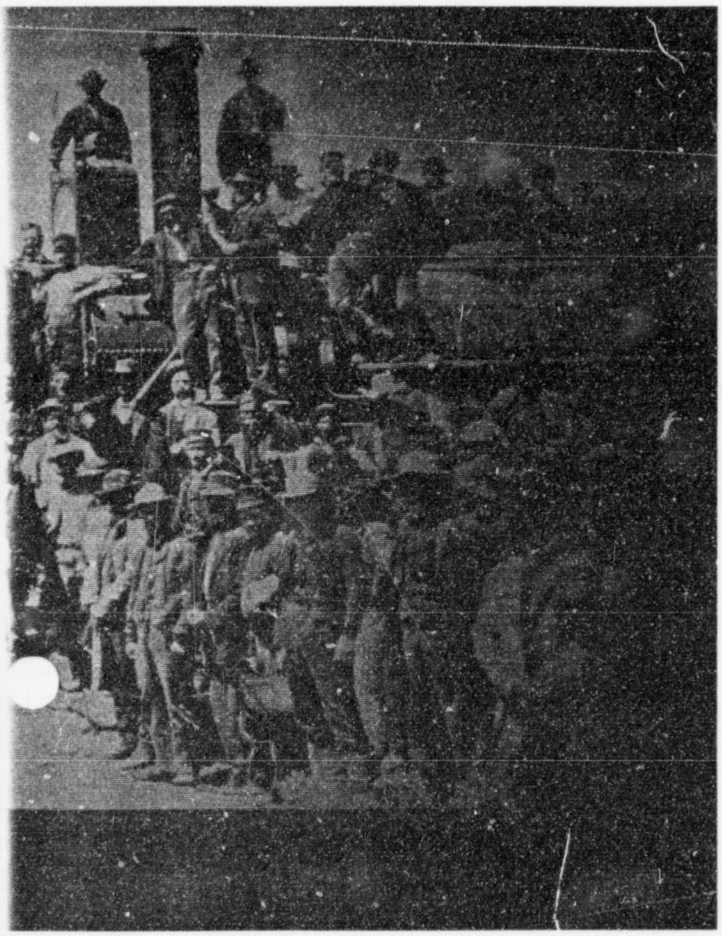

Resources remained the most active driller in the United States. Austin Chalk production rose 13 percent to 66,600 equivalent barrels a day, as Resources extended its drilling effort into Louisiana. In East Texas, it increased its interest in a major gas processing plant to 88 percent. In Wyoming, Resources is completing its Wahsatch Gathering System, adding 55 million cubic feet a day of natural gas to its Green River output.

Resources' late 1992 reorganization into integrated profit centers has streamlined it for the tough, cyclical environment of the Nineties.

New Records at Overnite

Overnite had a terrific year – the best in its 60-year history – in a highly competitive industry. Excluding the accounting adjustments, the company would have achieved record earnings of $65 million before goodwill, reaching a new high in less-than-truckload tonnage.

Business accelerated for Overnite in the second half – with double-digit growth over 1992 – highlighted by expanded operations in the Northeast. More important, Overnite centralized its customer service and billing operations in Richmond to improve its dealings with its customers. Overnite will begin installing electronic systems that will vastly increase its ability to track shipments, equipment and personnel, thus greatly improving the overall management of the company's business.

USPCI and the Recession

USPCI struggled to break even before goodwill due to the lingering recession and policy uncertainties in Washington. Non-hazardous operations in North Dakota and Utah grew, but startup of the incinerator at Clive, Utah, was delayed until later in 1994. The corporation has engaged a management consulting firm to assist in the evaluation of the company, its strategic options and its prospects.

Skyway: The Newcomer

This report welcomes Skyway Freight Systems into the Union Pacific family. We completed our purchase of this multimodal logistics and transportation company in May. It will contribute to our profitability and supply innovative logistics support to our other transportation companies.

At the top of this letter, I told you about Union Pacific's dedication to enhancing the seamless transportation network begun 125 years ago. That commitment to building on our hardscrabble heritage would not be possible without a dedicated, determined workforce being called on every day to do more with less.

If a photograph were taken depicting a modern-day linkage of transportation sources, it most likely would show an employee and a customer connected through lap-top computers rather than scores of people and two steam engines connected by a Golden Spike. That's progress. I think our forefathers would be as proud of us as we are of them. That's the best linkage of all.

Drew Lewis

Drew Lewis
Chief Executive Officer
Bethlehem, Pennsylvania
February 24, 1994

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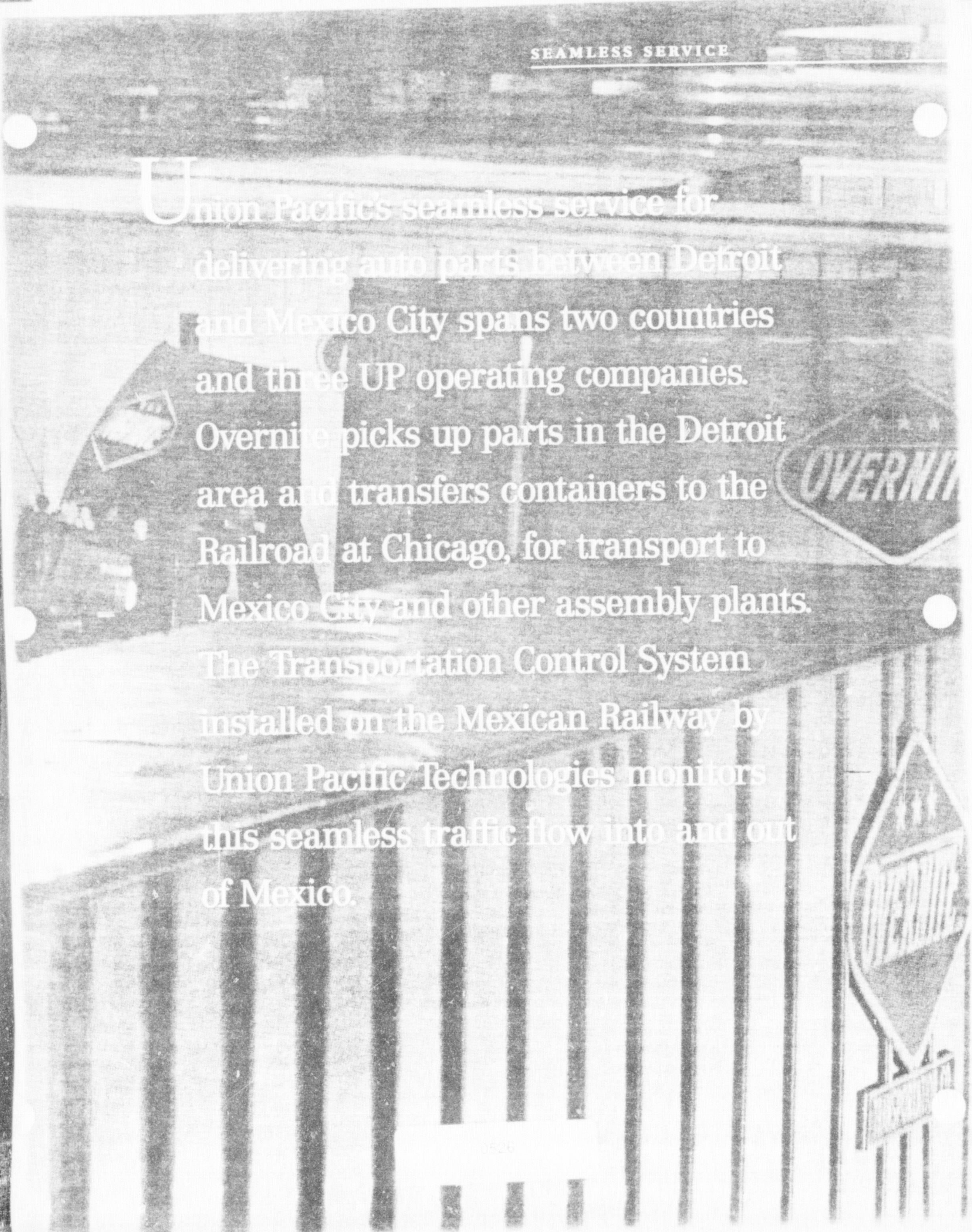
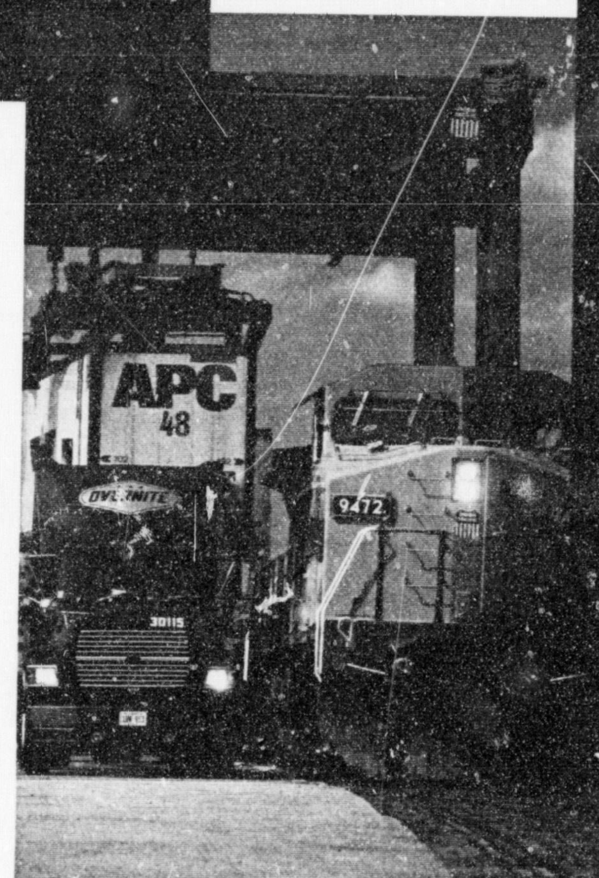


Union Pacific's seamless service for delivering auto parts between Detroit and Mexico City spans two countries and three UP operating companies. Overnite picks up parts in the Detroit area and transfers containers to the Railroad at Chicago, for transport to Mexico City and other assembly plants. The Transportation Control System installed on the Mexican Railway by Union Pacific Technologies monitors this seamless traffic flow into and out of Mexico.

Overnite picks up axles from Ford's Sterling plant in Detroit, the first step in key seamless service that spans much of North America.



Overnite hauls containers with axles to Chicago, where they are loaded onto a Union Pacific flatcar bound for Mexico City.

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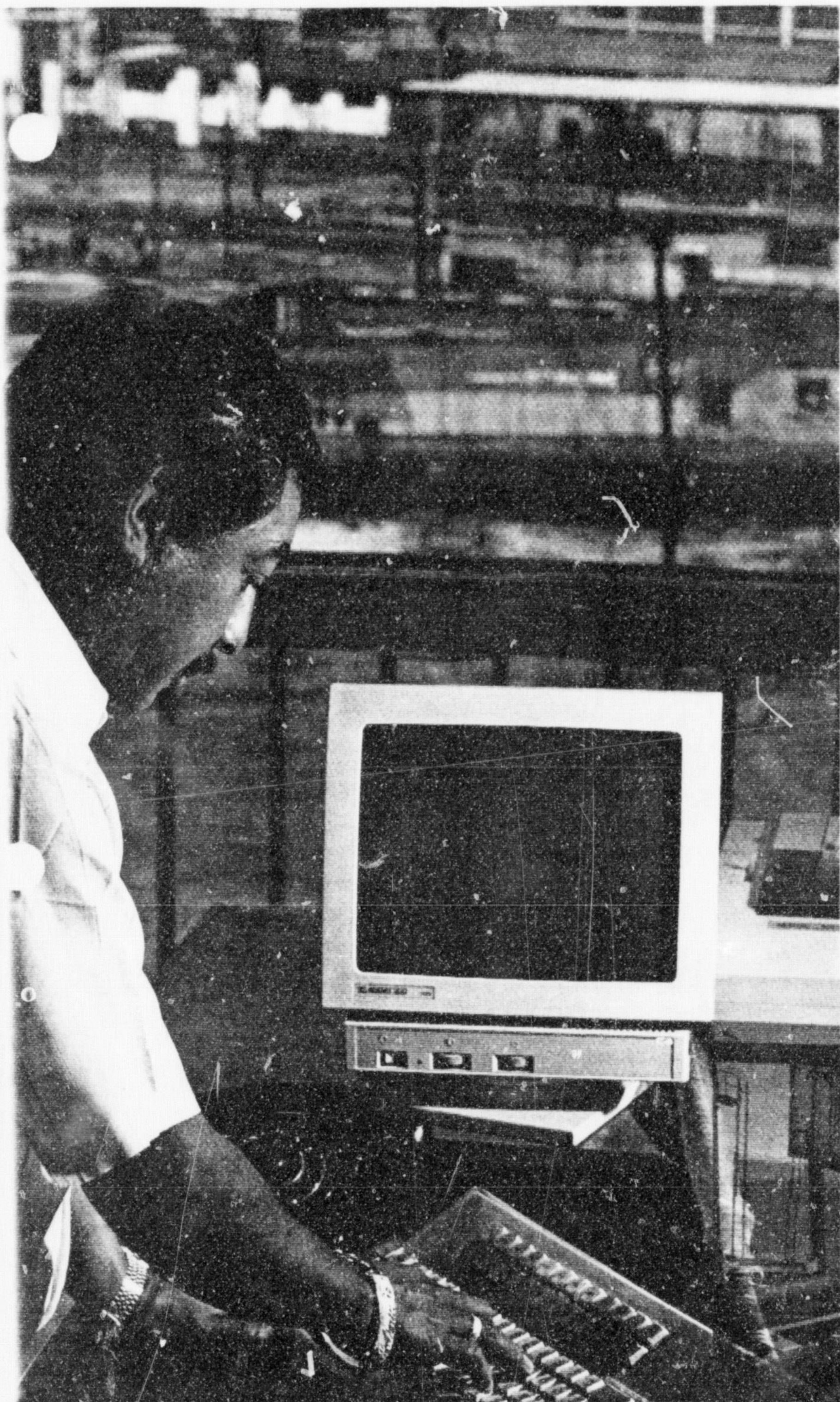
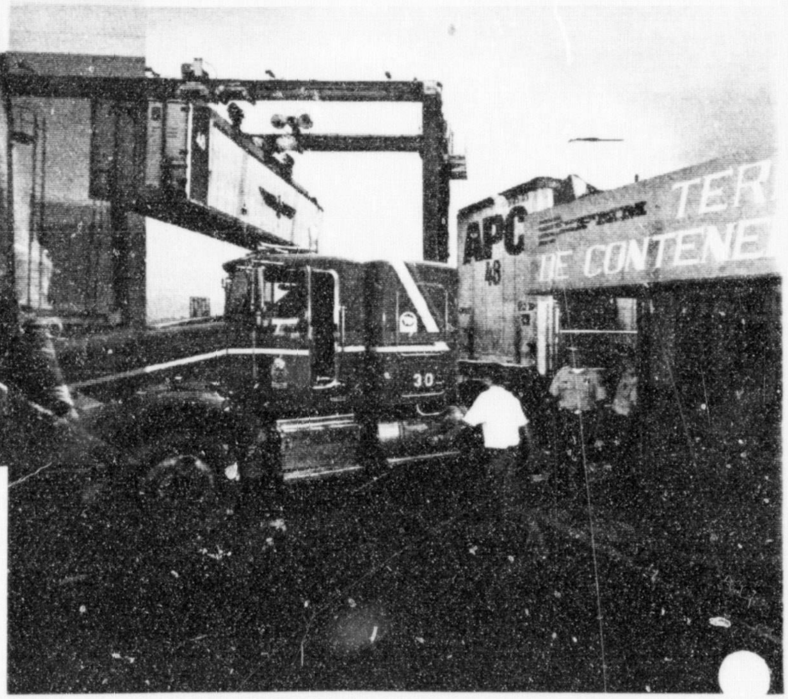


The container train is tracked by the Transportation Control System installed by Union Pacific Technologies in Mexico City's main control tower.

Containers are loaded onto tractors at one of the city's largest intermodal yards.



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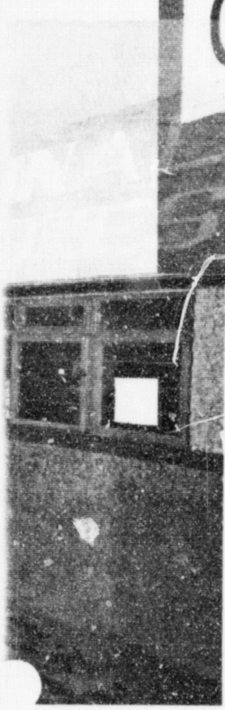
End of the 2,400-mile journey: the axles are delivered to the Cuautitlán plant outside Mexico City.



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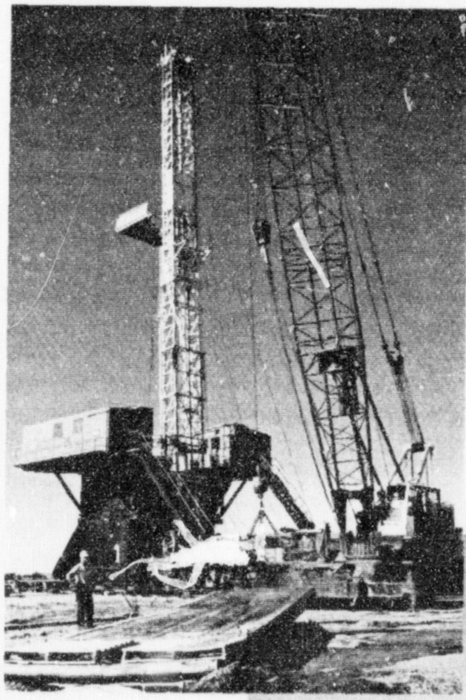
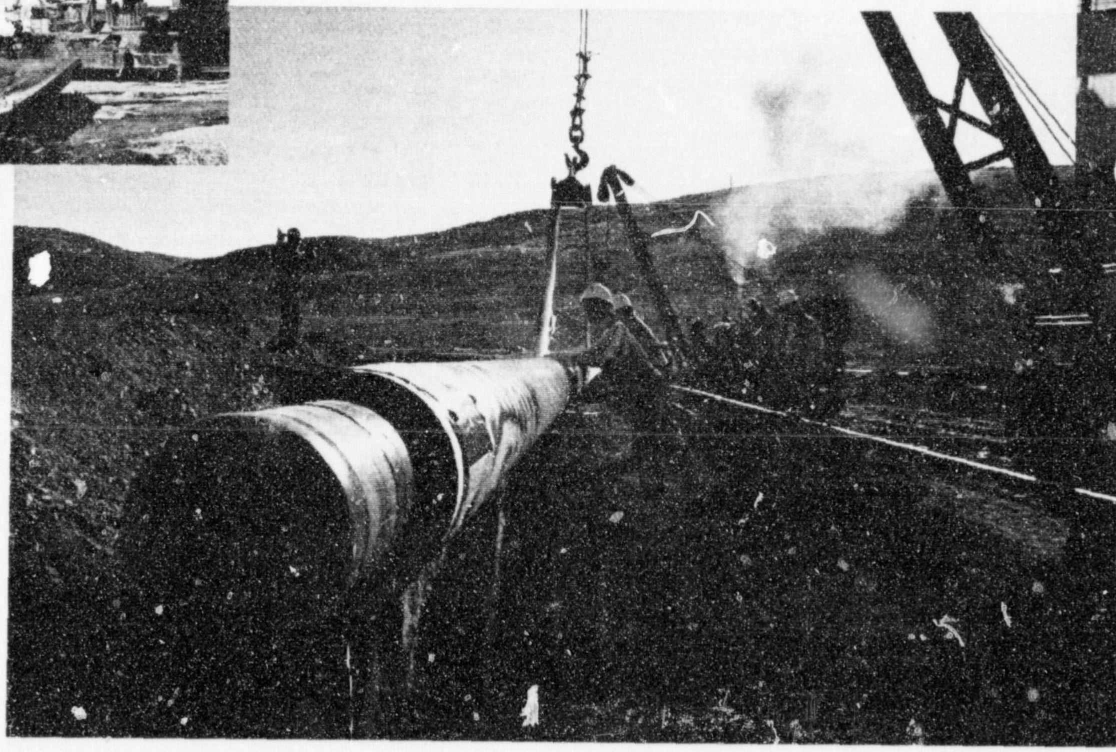
Union Pacific Resources is building seamless service into key parts of its production and sales operations. In western Wyoming and Utah, it is constructing the 41-mile Wahsatch Gathering System that will connect gas wells in the Green River Basin to the Whitney Canyon gas processing plant. From there the gas is transported to the Kern River Pipeline, a 762-mile long artery that serves customers in southern California.



Resources has begun shipping gas from the Greater Green River Basin to California.



The 41-mile Wahsatch Gathering System in western Wyoming will allow Resources to access gas wells that were previously beyond its reach.

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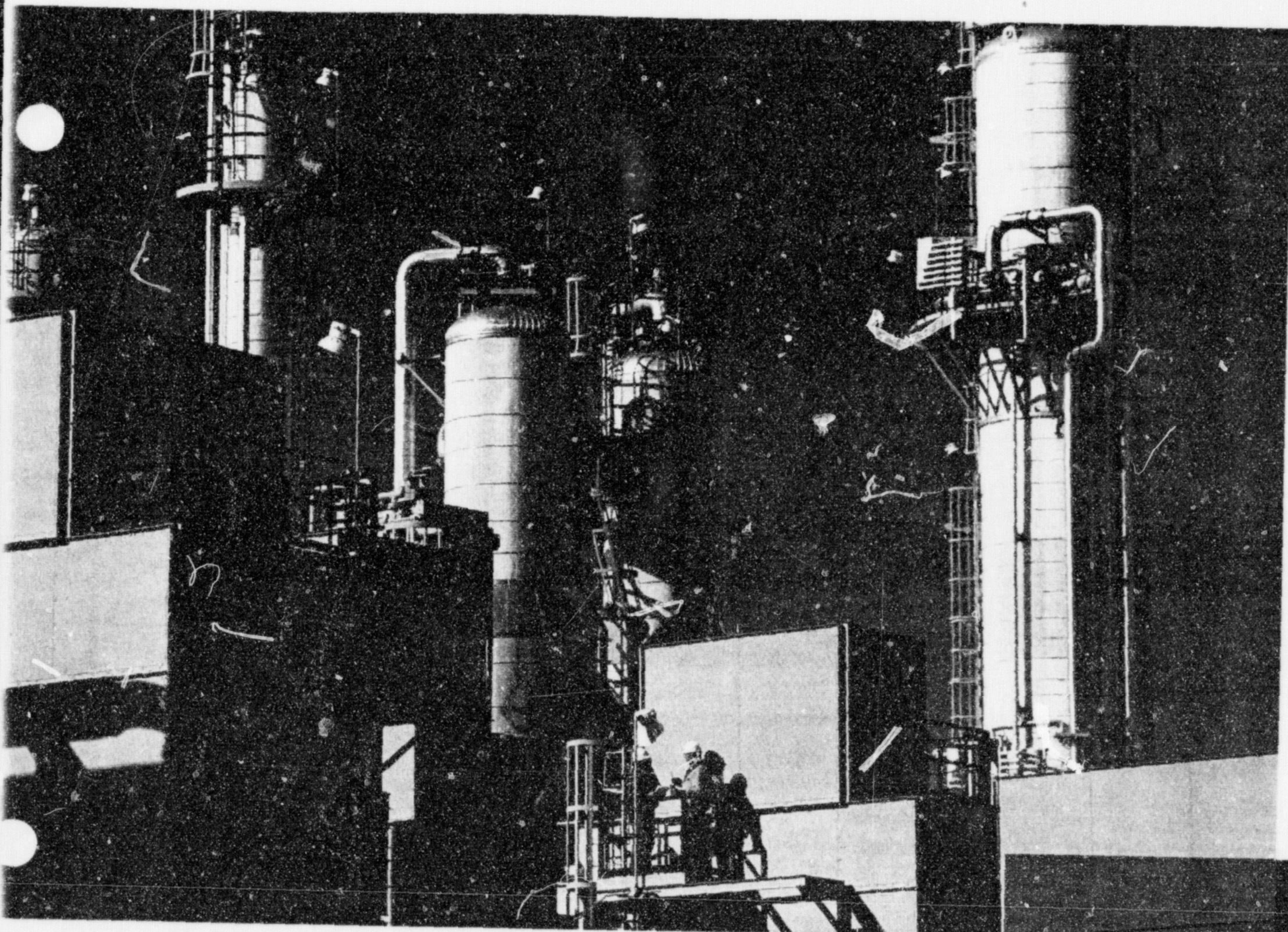
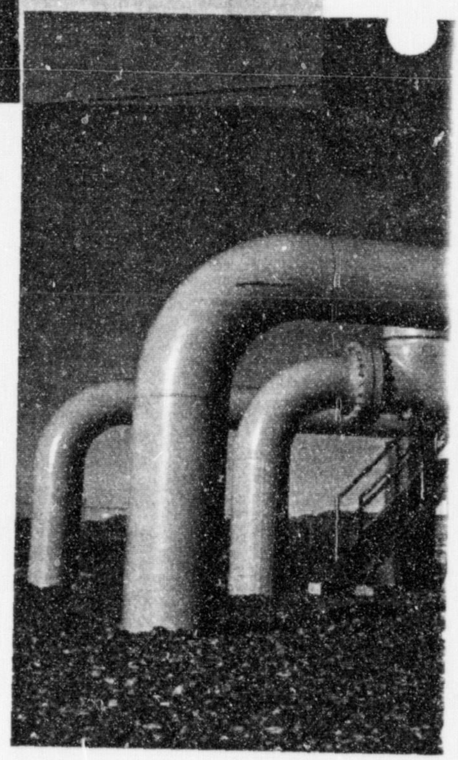


The Whitney Canyon Gas plant in western Wyoming removes impurities from gas produced in the Greater Green River Basin.



The 762-mile Kern River Pipeline carries gas from western Wyoming to southern California.

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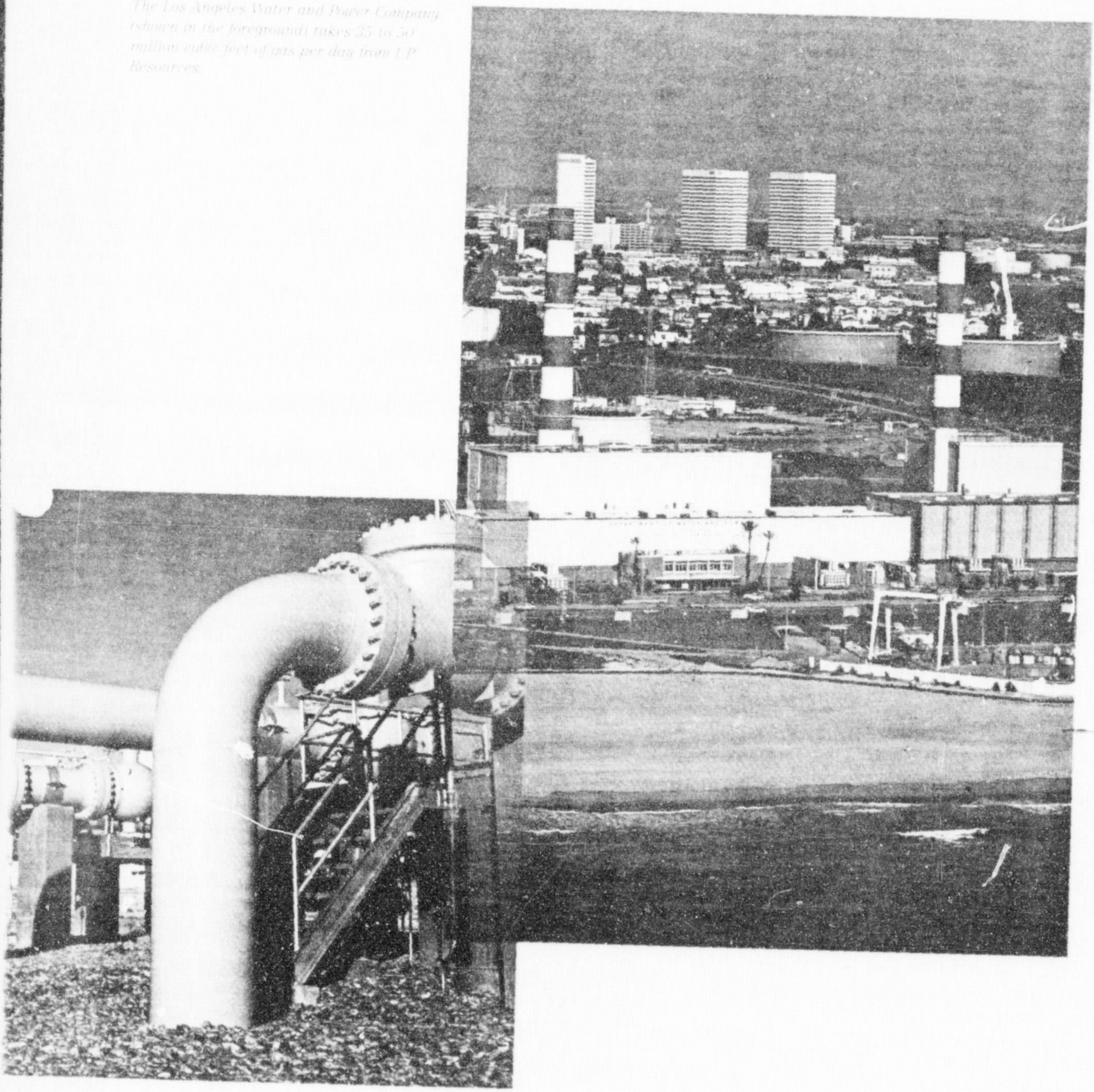
The Los Angeles Water and Power Company (shown in the foreground) takes 35 to 50 million cubic feet of gas per day from UP Resources.



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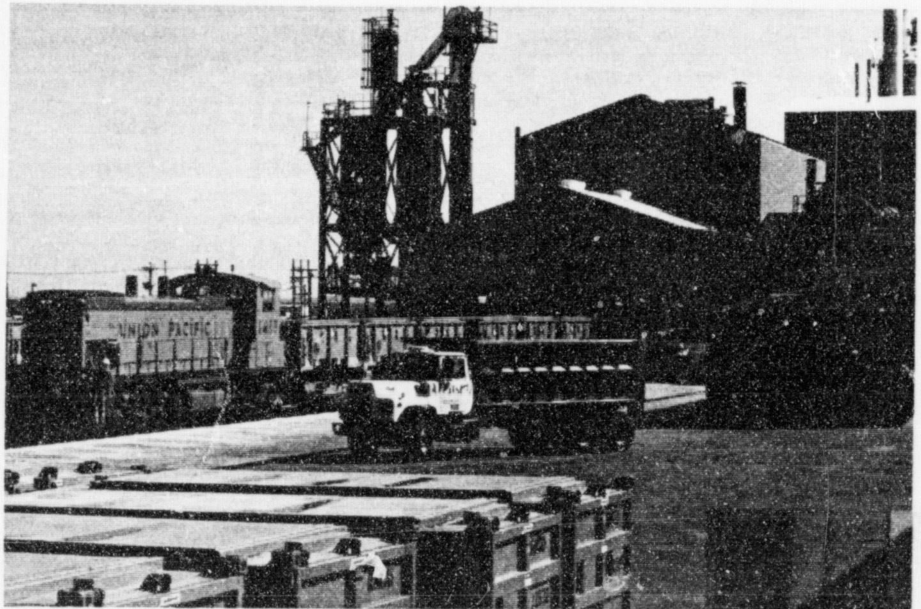
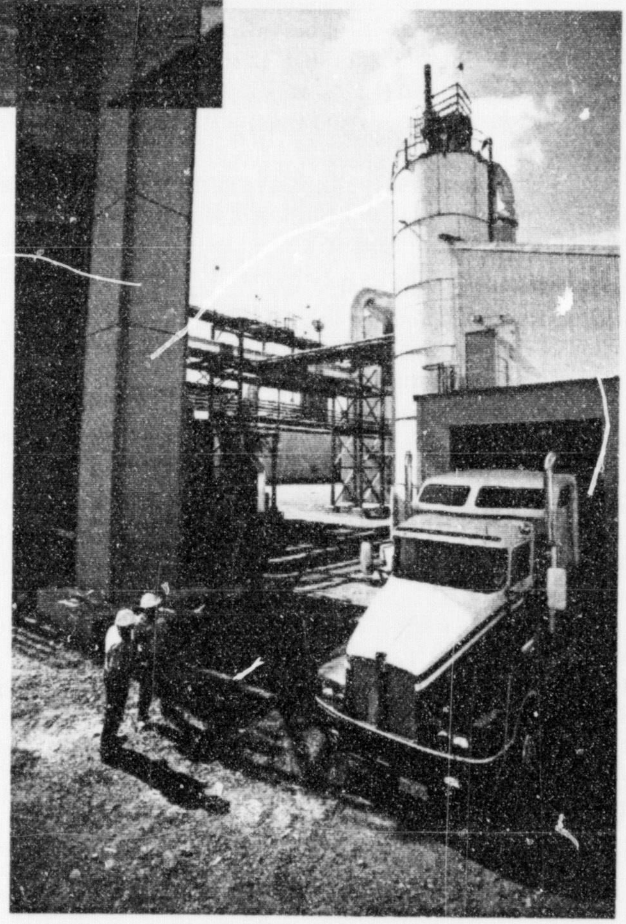
Union Pacific Railroad hauls spent potliner, a by-product of the primary aluminum production process from North American smelters. UPRR delivers the coal-like material to Reynolds Metals Company's newly converted hazardous waste treatment facility in Gum Springs, Arkansas, where it is thermally treated to produce a non-hazardous aggregate. USPCI disposes of the dust captured during the recycling process, and JTM, a USPCI subsidiary, stores and markets the aggregate for paving and other structural uses.



Union Pacific Railroad delivers spent potliner to Reynolds Metals Company's Gum Springs, Arkansas, treatment plant. A JTM truck stands by to receive the newly treated non-hazardous product.



A USPCI tractor trailer collects bag house dust from the recycling process for transport to USPCI's Lone Mountain facility in Waynoka, western Oklahoma.

Union Pacific Railroad

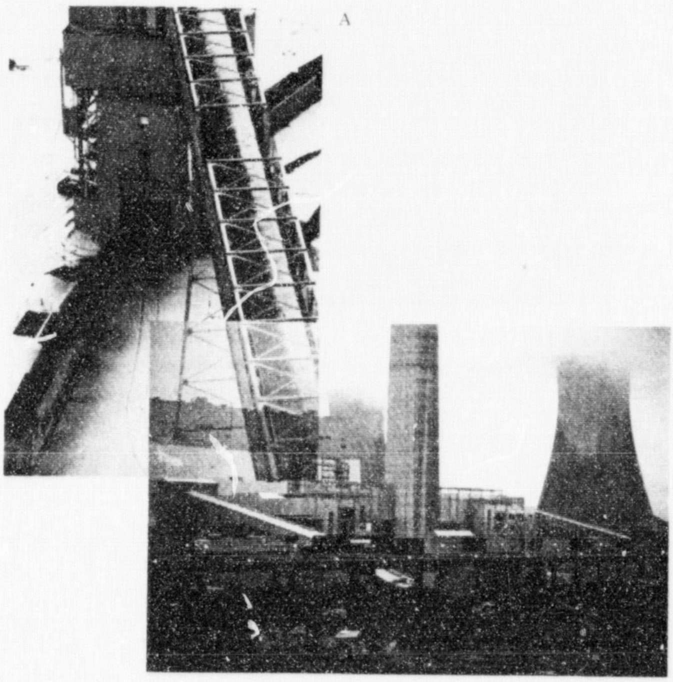
	1993	1992	1991[a]
Operating Revenues (millions of dollars)	**$4,987**	$4,897	$4,776
Operating Income (millions of dollars)	**$1,042**	$1,031	$ 190
Carloadings (thousands)	**4,619**	4,458	4,304
Operating Ratio	**79.1**	79.0	96.0

[a] Excluding the 1991 special charge, Operating Income and the Operating Ratio would have been $935 million and 80.4, respectively (see Note 3 to the Financial Statements).

Union Pacific Railroad achieved strong earnings in the face of the worst natural disasters to strike it in nearly 125 years. Excluding the accounting adjustments, net income would have been $669 million, compared to $667 million in 1992.

Severe snowstorms struck western segments of the system in January and February, requiring the use of the company's rotary snowplow on the mainline for the first time since 1949. The record flood knocked out the heart of the Railroad's track, adversely affecting traffic throughout the system. Then, with many levees still decimated, portions of UPRR's track along the Mississippi River were flooded again when heavy rains came in October.

Despite this devastation, the Railroad increased its carloadings 4 percent and maintained its operating ratio below 80 percent for the second year in a row.



Major Thrusts in 1993 - 94

Several programs launched in 1993 will strengthen Union Pacific in 1994, particularly in the most promising growth areas of Mexico, intermodal and coal.

The North American Free Trade Agreement should bolster most traffic categories. Union Pacific's shipments to Mexico were down slightly in 1993 but had been growing at double-digit rates and are expected to resume that pace for the rest of the decade. The Railroad's three major gateways into Mexico make it the pre-eminent carrier in this increasingly open market.

Another key to UPRR's growth is its expanding network of "partnerships" with major U.S. trucking companies, particularly those in the long-haul truckload business. These shipping arrangements have enhanced Union Pacific's market share in several key commodities and have maximized the use of the Railroad's equipment, generating substantial gains in intermodal traffic and promising more for the remainder of the decade.

In October, UPRR began hauling low-sulfur coal from the Powder River Basin in eastern Wyoming to Georgia Power's Plant Scherer in central Georgia – the largest contract for delivery east of the Mississippi River. This 1,800-mile haul on Union Pacific and two other railroads is the nation's longest unit-train coal run. The new contract is expected to add approximately 5 million tons to UP's coal shipments in 1994. This and other new contracts promise to provide continued improvement in energy revenues.

To support continued growth, as well as to enhance service reliability, the Railroad has embarked on several key expansion programs. Its triple-track project on the Nebraska mainline will improve the company's major traffic corridor. This corridor carries nearly 110 trains a day – the busiest in the world. In addition, intermodal expansions are under way at Memphis, Seattle and Stockton, California, while the state-of-the-art Livonia, Louisiana yard began operating in early 1994, speeding traffic throughout the lower Mississippi Valley. For Mexico, construction of a new double-track bridge connecting Union Pacific's Laredo intermodal yard with the Mexican Railway should be under way within a year.

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Realigning for the Future

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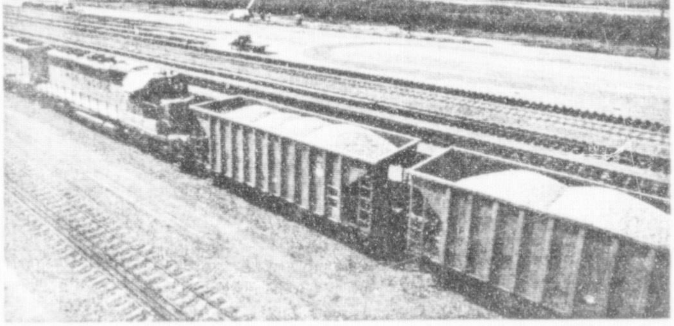


Union Pacific Resources

	1993	1992	1991[a]
Operating Revenues (millions of dollars)	**$1,323**	$1,259	$1,091
Operating Income (millions of dollars)	**$ 382**	$ 315	$ 259
Total Reserves (MMBOE)[b]	**445.4**	441.5	437.3
Total Production (MMBOE)[b]	**69.6**	67.0	60.5

[a] Excluding the 1991 special charge, Operating Income would have been $314 million (see Note 3 to the Financial Statements).
[b] Natural gas converted to millions of barrels of oil equivalent on a ratio of 6:1.

During 1993 Union Pacific Resources achieved record production and record revenues, while increasing its reserves for the sixth straight year. These increases were achieved with 15 percent fewer employees. Excluding the accounting adjustments, earnings would have risen to $309 million from $272 million in 1992.

Equally important, Resources took several steps in 1993 to ensure continued growth. A 1992 reorganization that created profit centers has led to significant cost savings, improved efficiencies and increased emphasis on profitability.

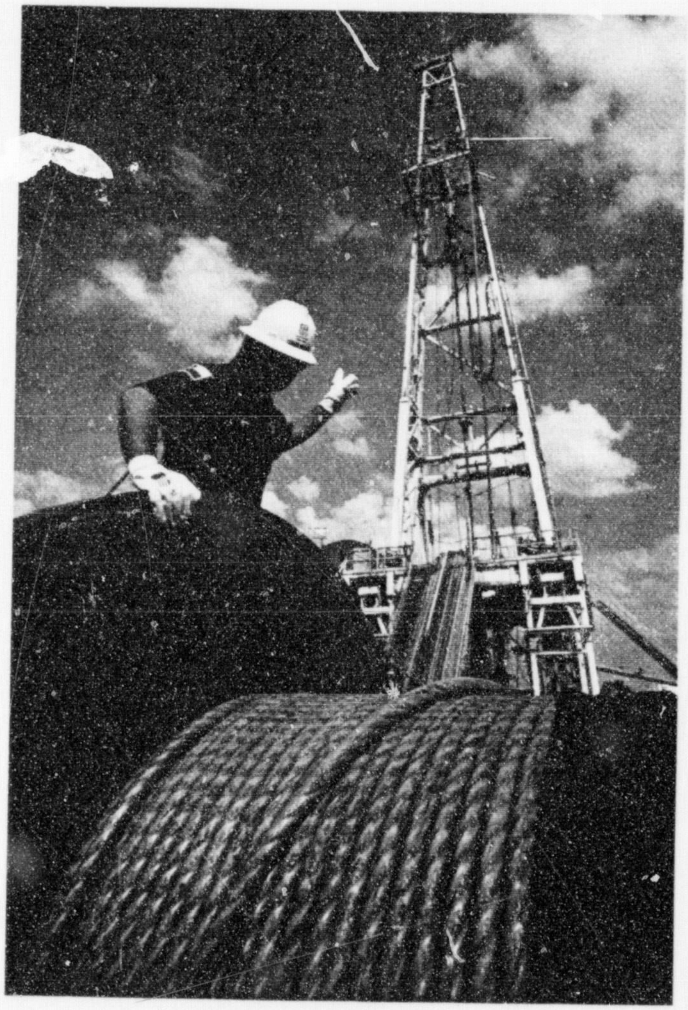
Exploration successes were encouraging, with discoveries in northeast British Columbia, the eastern Austin Chalk and offshore Gulf of Mexico. Reserve additions in 1993 were approximately 60 million barrels of oil equivalent – a direct result of the company's leading-edge oil field technology.

Land Grant Production

Nearly 40 percent of Resources' production came from the company's Land Grant acreage in Wyoming, Utah and Colorado. Resources has been drilling aggressively in the Greater Green River Basin in western Wyoming, which contains significant natural gas reserves. During the last two years, through innovative completion and design technology, Resources has reduced average well costs in this area from $1.4 million to $800,000. These lower costs should dramatically increase future drilling opportunities.

In western Wyoming, Resources is completing construction of the Wahsatch Gathering System, which will allow the company to tap up to 55 million cubic feet of gas per day that previously could not be produced and processed.

As part of its program in the Land Grant, the company is arranging to drill at least 300 wells with an industry partner in the Wattenberg area of Colorado over the next three years. In addition, Resources became a 34 percent partner in a processing plant in the Wamsutter area of Wyoming.

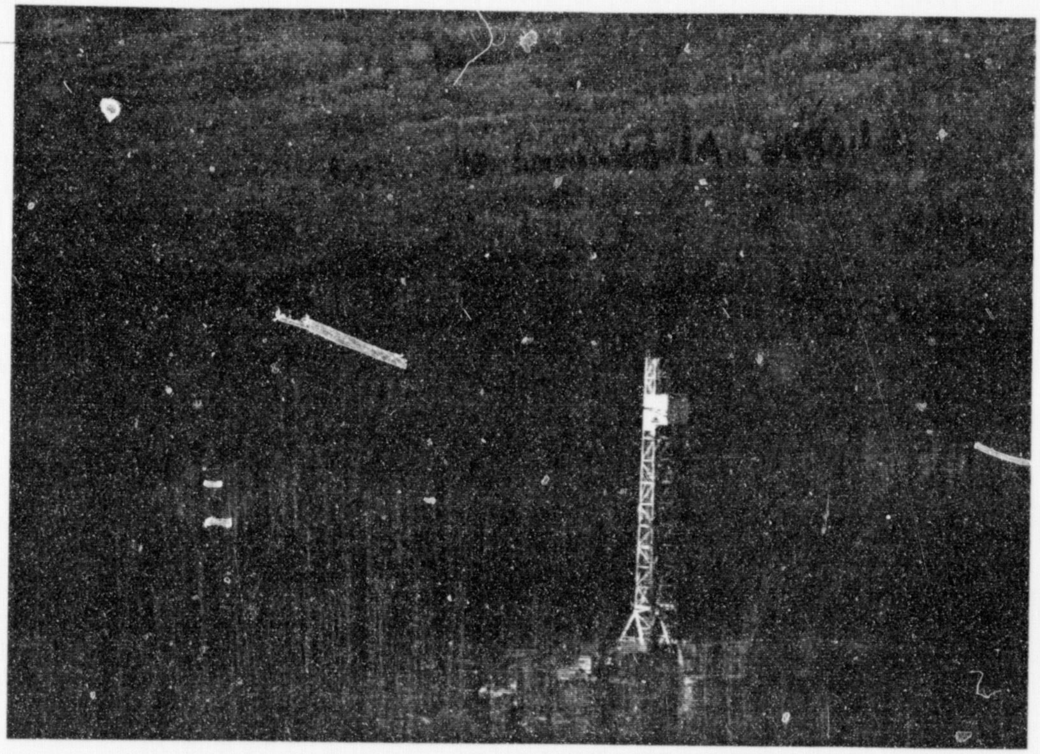


A

A Nearly a third of Resources' total oil and gas production came from the Austin Chalk area, which runs from central Texas into Louisiana.

B A major find in 1993 is this discovery well in northeastern British Columbia. Resources has acquired more than 115,000 acres in the area.

C Gas processing capacity in East Texas is being enhanced with the construction of a new plant near Carthage, Texas.



B

Austin Chalk

The Austin Chalk formation in south-central Texas and Louisiana continues to be highly productive. The company participated in the drilling of 266 horizontal wells in 1993. Of these wells, 45 were dual laterals, which typically tap two zones, and 60 were opposing laterals, which tap zones in opposite directions. During the year Resources drilled its first quad lateral well, which draws from four separate areas in a formation. Applying this technology dramatically reduces the average cost of reserve additions.

Austin Chalk production reached an average of 66,600 barrels of oil equivalent per day in 1993, a 13 percent increase over 1992. Most of the production was from the Giddings Field in south-central Texas. Resources also extended its acreage into eastern Texas and Louisiana and now controls more than one million acres throughout the area.

Because of its expertise in horizontal drilling, its understanding and application of sophisticated recovery techniques and its success in reducing drilling costs, Resources believes it can continue to extend the productive limits of this highly successful trend.

East Texas

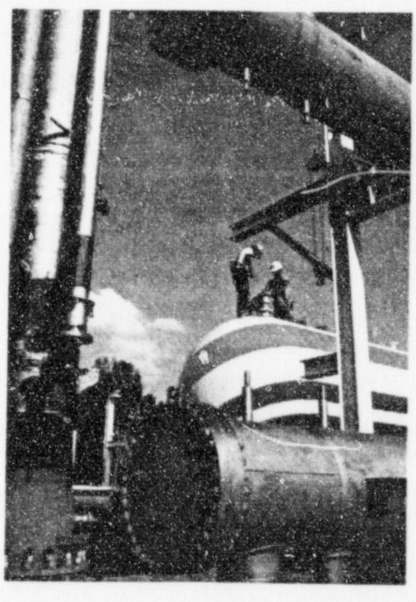
During 1993 Resources strengthened its leadership as a processor and gatherer of natural gas in East Texas. It increased its ownership to 88 percent in three key East Texas assets: the East Texas gas plant, the Carthage Hub and the Panola Pipeline, adding value through vertical integration.

In addition, the company initiated a number of related expansion projects. Construction began on a new 88 percent-owned plant that will increase gas processing capacity by 120 million cubic feet per day. An extension to the Panola Pipeline will expand capacity to transport natural gas liquids to Mt. Belvieu, Texas, the center of the natural gas liquids market.

The company is continuing to develop reserves in the Gulf of Mexico, bringing on two fields in 1993. It currently has interests in 19 platforms in the Gulf, 14 of which are company-operated.

In Canada, the company is successfully developing two exploration plays in northeast British Columbia. Resources has an interest in more than 115,000 acres in this area. Seismic and other field analyses indicate that the potential for future discoveries is very promising.

Over 25 percent of Resources' operating income came from its mineral operations, which mine and process coal and natural soda ash in the Land Grant area. Minerals also earn royalties on lands leased to others.



C

Overnite Transportation

	1993	1992	1991[a]
Operating Revenues (millions of dollars)	**$939**	$873	$800
Operating Income (millions of dollars)	**$ 69**	$ 57	$ 19
Operating Ratio	**90.2**	90.9	95.1

[a] Excluding the 1991 special charge, Operating Income and the Operating Ratio would have been $44 million and 91.9, respectively (see Note 3 to the Financial Statements).

Overnite Transportation had an excellent operating performance in 1993 despite a highly competitive pricing environment and a sluggish first half. Excluding the accounting adjustments and before goodwill amortization, net income would have increased to a record $65 million from $60 million in 1992.

Overnite achieved all-time highs in total tonnage and less-than-truckload (LTL) traffic, reflecting the company's aggressive marketing programs. Overall volume was up 4 percent, with LTL traffic up 7 percent. Average price levels increased and service standards improved in several key traffic lanes. Overnite's operating ratio of 90.2 percent remained the lowest among the top five LTL carriers. The company also invested a record $80 million, primarily to expand its service center network, to acquire more than 600 tractors and 1,800 trailers, and to launch its centralized customer service and billing center in Richmond.

Aggressive Marketing

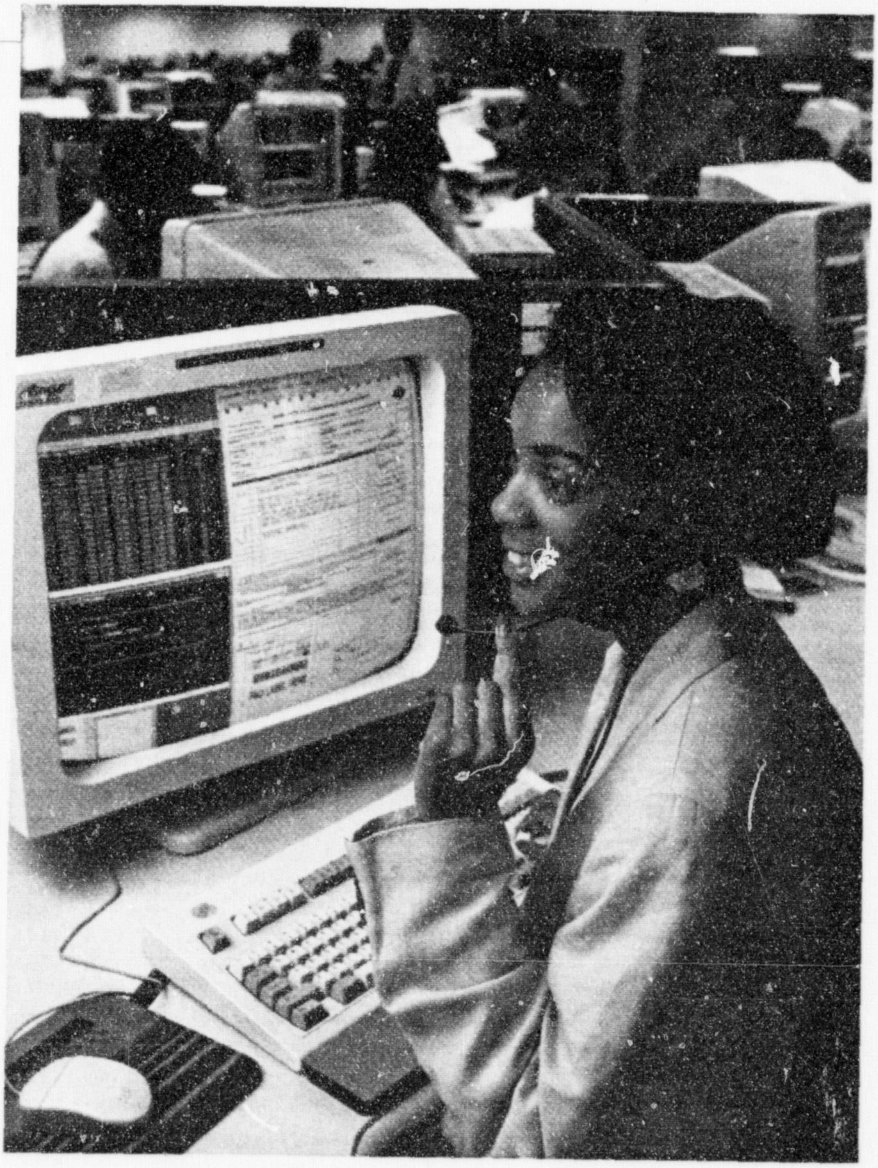
The company really hit its stride in the second half of 1993, with double-digit growth in four of its five regions – led by a 23 percent gain in the Northeast. Niteliner service, which provides next-day delivery, and Fastbreak, which focuses on 48-hour delivery on longer-distance, major-market lanes, increased tonnage both within and between regions. With geographic coverage reaching 95 percent of the country's population, Overnite can deliver across the street, across the state or across the country.

Logistical partnerships helped generate tonnage increases and greatly expanded services with many major customers. These partnerships are the future of trucking, and Overnite has been a leader in the field. The company has placed representatives on-site in several customers' facilities, creating a seamless relationship by solving transportation problems. Customers of all sizes are tying into the company's expanding electronic network.

0540

A *An Overnite truck rolls out of the busy Harrisburg, Pennsylvania, service center. This major hub handles more tonnage than any service center in the entire Overnite system, helping to increase 1993 revenue in the Northeast by 23 percent.*

B *Overnite launched its centralized customer service and billing center in Richmond in the third quarter. Each night Overnite service centers transmit electronic images of the day's shipping documents to Richmond for expedited invoicing. Centralization – to be completed in 1994 – places Overnite in the forefront of the trucking industry's technological innovation.*



B

New Technology

At the core of these partnerships is Overnite's growing sophistication in technology. In August, 1993, with assistance from UP Technologies, the company began converting its 166 service centers to its centralized customer service and billing systems in Richmond. Bills of lading at each service center are electronically scanned into the system every night, thereby expediting invoices, improving billing accuracy and creating an electronic document library for customer service. Overnite will complete the centralization of these operations during 1994.

Next target: the front line. In 1994, Overnite will test a fully integrated dispatching, yard management, dock management, and time tracking system in pilot service centers. Hand-held computers with integrated scanners and computer dock-planning models will facilitate trailer positioning and freight-loading sequencing. Such advanced technology should ensure maximum use of equipment and manpower, enabling Overnite to improve its own effectiveness while providing its customers with accurate, real-time, freight movement information.

0541

USPCI

	1993	1992	1991[a]
Operating Revenues (millions of dollars)	**$236**	$262	$251
Operating Income (Loss) (millions of dollars)	**$ (5)**	$ 8	$ (19)

[a] Excluding the 1991 special charge, Operating Income would have been $6 million (see Note 3 to the Financial Statements).

Hazardous waste volumes were significantly below industry expectations in 1993 because of the slow economic recovery, industry's reluctance to commit funds to cleanups and the regulatory uncertainty caused by the new administration in Washington. As a result, revenues were down $26 million to $236 million. Nonetheless, USPCI managed to break even before goodwill amortization of $9 million.

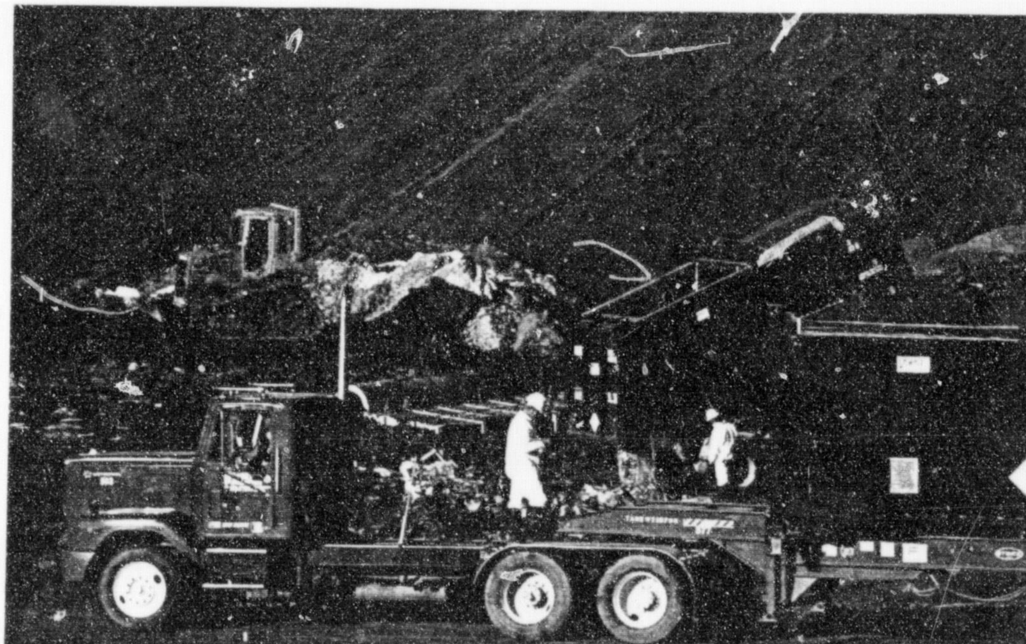
Contracts for disposal of non-hazardous waste were somewhat better. USPCI is the sole provider of non-hazardous waste disposal services for 131 automotive plants in the United States and five in Mexico. To fulfill this major long-term contract, USPCI has dedicated substantial capacity at its Echo Mountain landfill in Sawyer, North Dakota. The hazardous waste from the automotive plants is sent to USPCI's landfills in Waynoka, Oklahoma and Tooele County, Utah. Five railroads, including the Union Pacific, and a network of trucking companies haul the waste materials to USPCI's facilities.

USPCI transported demolition debris from a Burbank, California, assembly plant to its jointly owned East Carbon Development Corporation (ECDC) landfill in central Utah, using the Union Pacific Railroad. After being unloaded by ECDC's highly efficient rotary dumping equipment, the gondola cars are cleaned for hauling other products back to Los Angeles. This high utilization of equipment allows ECDC to market quality service at attractive rates to other customers.

JTM, USPCI's successful ash management company, is under contract with Reynolds Metals Company to market the non-hazardous by-product of Reynolds' patented spent potliner treatment process.

At Clive, Utah, the startup of the hazardous waste incinerator has been delayed until late 1994 because of necessary permit modifications and USPCI's comprehensive testing program.

USPCI's Echo Mountain facility in Sawyer, North Dakota, successfully completed its first full year of operation in 1993. The Echo Mountain facility accepts non-hazardous industrial waste and municipal incinerator ash for disposal in its triple-lined landfill cells.



Skyway Freight Systems

Skyway – the newest member of the Union Pacific family – is a multi-faceted logistics and transportation company headquartered in Watsonville, California. At any given hour, Skyway may be rushing a critical part for a customer by charter jet, moving an entire warehouse by stack train, running a distribution center, assembling and testing computers, or developing a comprehensive transportation and logistics strategy based on state-of-the-art information management. In a nutshell, the company specializes in customized logistical support tailored to the needs of its customers across the country.

In 1993, Skyway earned a record $5 million before goodwill amortization and also reported record revenues of over $100 million, reflecting an annual average growth rate of approximately 30 percent for the past three years. The company has several innovative programs that are expected to further expand its business. Skyway's in-transit merge and distribution services streamline product delivery and save costs on cross-country shipping. The company's next-flight-out service helps customers meet critical delivery requirements on high-value parts. And its catalog warehouse inventory and distribution program – with Skyway employees handling the entire delivery cycle for catalog sales companies – adds a new dimension to its logistics business.

Major investments in updated technologies and facilities generated improved projects and services in 1993:

Several new terminals were added, such as Skyway's state-of-the-art Sacramento, California facility and the Raleigh, North Carolina terminal, plus nine customer facilities – all operated by Skyway employees.

New information technologies now facilitate electronic communications with more customers and allow sales representatives to access up-to-the-minute information on shipments by telephone, enabling Skyway's people to keep pace with evolving customer needs.

Skyway workers at the Dallas terminal prepare customized computer kits for shipment to Hewlett-Packard customers across the country.

0543

Union Pacific Technologies

Union Pacific Technologies develops sophisticated computer software for the corporation's operating companies and aggressively pursues research in new technologies. The company also has expanded the scope of its commercial activities outside of Union Pacific.

Technologies continues to assist the Ferrocarriles Nacionales de Mexico (FNM), the national railway of Mexico, with the installation of computer software similar to that used by Union Pacific Railroad. During 1993, Technologies installed a new yard management system at FNM's 17 largest yards. The system maintains an inventory of freight cars in each yard and generates switching instructions for the assembly of outbound trains.

Technologies also helped the FNM upgrade its central computer facility in Mexico City. Over the past two years, the FNM has more than doubled the capacity of its computers, which are now electronically linked with the Association of American Railroads' computer systems. This allows for a detailed exchange of information on trains and shipments moving across the U.S.-Mexico border.

Domestically, Technologies continued with the implementation of the advanced train control work order system on the Union Pacific Railroad. Nearly 1,700 of Union Pacific's locomotives have been equipped with on-board computers capable of receiving and sending car pickup and placement information, and over 5,000 conductors have been trained in their use. By 1995, all of Union Pacific's trains will be equipped with on-board computers.

At Overnite, Technologies is assisting with the installation of a centralized billing system that uses imaging and other leading-edge systems. Technologies also modified USPCI's Facilities Information Management System (FIMS) for use at its new incinerator in Clive, Utah. FIMS tracks shipments from arrival through treatment and disposal.

Technologies' commercial sales continue to grow. The Shipment Management Service, the industry benchmark for shipment tracking, is the company's fastest growing commercial product. More than 100 companies subscribe to this service.

Consolidated Results of Operations

This review should be read in conjunction with the financial statements, notes and supplementary information.

1993 Compared to 1992

Consolidated: In the first quarter of 1993, Union Pacific Corporation (the Corporation) recorded a $175 million after-tax or $0.85 per share charge to reflect the adoption of new Financial Accounting Standards Board (FASB) pronouncements as described in Note 2 to the Financial Statements. In the third quarter, the Corporation recorded a $61 million or $0.30 per share charge reflecting a deferred tax adjustment that resulted from the Omnibus Budget Reconciliation Act of 1993 (the 1993 Tax Act) (see Note 7 to the Financial Statements). The components of these accounting adjustments are as follows:

In Millions, Except Per Share Amounts	Income (Loss) before Accounting Adjustments	Accounting Changes	1993 Tax Act	Net Income (Loss)
Railroad	$ 669	$ (72)	$ (57)	$ 540
Natural resources	309	(59)	(6)	244
Trucking	42	(79)	(1)	(38)
Waste management	(9)	–	1	(8)
Corporate services and other operations	(245)	35	2	(208)
Consolidated	$ 766	$ (175)	$ (61)	$ 530
Per share	$3.73	$(0.85)	$(0.30)	$2.58

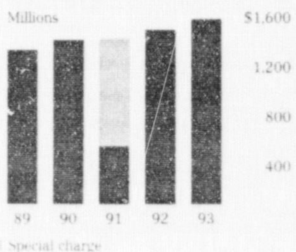
As a result of the accounting adjustments, the absence of Union Pacific Resources Company's (Resources) $63 million ($42 million after-tax) 1992 production-based tax settlement and the 1993 effects of weather-related traffic interruptions on the operations of Union Pacific Railroad Company and its affiliate Missouri Pacific Railroad Company (collectively the Railroad), the Corporation's earnings declined to $530 million ($2.58 per share) in 1993 compared to $728 million ($3.57 per share) a year ago. Excluding accounting adjustments, the Corporation's earnings would have risen to $766 million ($3.73 per share). Income, excluding accounting adjustments, would have improved at all operating units except USPCI, Inc. (USPCI).

Operating Revenues
Union Pacific Corporation

Operating revenues advanced 4% to $7.56 billion in 1993 from $7.29 billion a year ago. Revenues advanced on the strength of growing transportation volumes, rising average natural gas prices, a 5% increase in hydrocarbon sales volumes and the acquisition of Skyway Freight Systems, Inc. (Skyway) (see Note 5 to the Financial Statements).

Operating expenses rose $183 million to $6.07 billion compared to $5.89 billion in 1992. Equipment and other rents increased $52 million and fuel and utility costs rose $21 million due to higher transportation volumes and weather-related traffic interruptions at the Railroad. Depreciation charges increased $40 million, reflecting asset adjustments required by the first quarter adoption of SFAS No. 109 (Accounting for Income Taxes) and the Corporation's continued high level of capital investment, offset by lower surrendered lease activity and dry hole costs at Resources. Other taxes rose $39 million, resulting from the absence of 1992 tax settlements at Resources and the Railroad, while third party transportation costs increased $30 million mainly due to the acquisition of Skyway. In addition, weather-related inefficiencies and volume growth caused wage and benefit costs to escalate $19 million, and materials and supplies $13 million. Higher hydrocarbon sales volumes and prices caused the cost of pipeline and gas plant product purchased for resale to rise $15 million. Operating cost inflation was tempered by efficiency and productivity improvements at the Railroad and Resources and the absence of Resources' $24 million 1992 workforce reduction charge. Operating income improved 6% to $1.49 billion in 1993 compared to $1.40 billion a year ago as gains occurred at all operating units except USPCI.

Operating Income
Union Pacific Corporation



Other income declined $57 million largely due to the absence of interest related to Resources' 1992 tax settlement and diminished property sales. Interest expense also declined $36 million reflecting lower average interest rates and debt refinancing activities, while corporate expenses rose $9 million due to higher professional fees and depreciation charges. Net income – excluding accounting adjustments – as a percentage of operating revenues would have been 10.1% in 1993 and 10.0% in 1992. On the same basis, return on average common stockholders' equity would have declined to 15.7% in 1993 from 16.5% a year ago.

Railroad: The Railroad posted earnings of $540 million in 1993. Excluding the 1993 accounting adjustments, earnings would have been $669 million (before considering the effects of the harsh winter and Midwest flooding) compared to $667 million in 1992. Operating revenues improved 2% to $4.99 billion as a 4% increase in carloadings was partially offset by a 2% decline in average revenue per car. This decline resulted from volume growth of lower-rated commodities – mainly intermodal and energy – and growth of lower-rated goods within chemicals, as well as increased use of shipper-owned equipment for coal shipments. Revenues also included higher earnings from equity investments in related operations. Automotive carloadings advanced 8%, reflecting improvements in the domestic auto industry. Energy carloadings also grew 8% because of an expanding domestic customer base and higher demand created by more normal temperature patterns. Intermodal traffic improved 6% as market share continued to expand reflecting new partnership arrangements with trucking companies. In addition, chemical carloadings increased 1%, while weather-related traffic interruptions and crop damage caused grain carloadings to decline 2%. Carloading declines also occurred in food, consumer and government products (2%) and in metals, minerals and forest products (1%).

Operating expenses increased to $3.95 billion this year from $3.87 billion in 1992. Depreciation expense grew $54 million reflecting asset adjustments required by the 1993 adoption of SFAS No. 109 and continuing capital spending on equipment and track. Employee injury expense rose $29 million as continuing declines in the number of injuries were more than offset by higher settlement costs per injury. Growing volumes and weather-related traffic congestion accounted for a $25 million rise in equipment and other rents and a $17 million increase in fuel and utility costs. Wage and benefit costs also rose $6 million as weather and inflation-related cost increases were largely offset by train crew reductions. Higher operating costs were tempered by a $23 million reduction in joint facility costs and an additional $22 million of cost offsets associated with car repairs for other carriers.

Operating income at the Railroad rose $11 million in 1993 to $1.04 billion. Despite severe weather conditions, the Railroad maintained an operating ratio of 79.1 in 1993 compared to 79.0 a year ago.

Natural Resources: Resources' 1993 earnings were $244 million. Without the 1993 accounting adjustments, earnings would have risen $37 million (14%) to $309 million compared to $272 million a year ago, despite the absence of the 1992 production-based tax settlement. Operating revenues climbed $64 million (5%) to $1.32 billion in 1993 as a result of a 5% rise in total hydrocarbon sales volumes, higher average natural gas prices and pipeline volume growth. Natural gas sales volumes grew 7% to 619 mmcf/day, reflecting production improvements in the Austin Chalk and the southwestern Wyoming portion of the Land Grant. Natural gas liquids sales volumes were up 10% to 39,855 bbl/day, largely because of increased production in the Austin Chalk, the return to operation of a damaged pipeline, increased ownership in the Carthage gas processing plant and improved recoveries under processing agreements, while crude oil sales volumes held steady at 66,456 bbl/day. Including hedging activities, natural gas average prices advanced 20% to $1.82/mcf (an increase of $0.30/mcf), while crude oil prices fell $1.56/bbl (9%) to $15.66/bbl. Average prices for natural gas liquids also declined 8% to $9.84/bbl. Once again, Resources improved its reserve position, despite rising production levels, as it remained the most active driller in the United States.

Operating expenses declined to $941 million in 1993 from $944 million a year ago. Surrendered lease costs decreased $33 million because of accelerated lease surrender activity in 1992. Wage and benefit costs declined $24 million stemming from the absence of Resources' 1992 workforce reduction charge and ongoing productivity improvements. Insurance and other settlements in 1993 lowered other operating costs $12 million. Mining costs declined $9 million due to lower operating costs stemming from the ongoing effects of a favorable 1992 contract settlement at Resources' joint venture coal mine. In addition, dry hole costs decreased $8 million reflecting improved exploration success. These cost reductions were largely offset by volume-related cost increases. Depreciation and depletion charges rose $21 million reflecting higher production levels and higher per barrel rates in the Chalk. Increased exploration activities generated a $17 million expansion in geological and geophysical costs. In addition, production and other taxes rose $28 million caused by the absence of the 1992 tax settlement and growing volumes, while higher volumes and prices caused the cost of pipeline and gas plant product purchases to increase $15 million.

Operating income for all of Resources' operations improved $67 million (21%) to $382 million in 1993. Other income declined $17 million, mainly due to the absence of the interest portion of the 1992 tax settlement.

Operating income from Resources' minerals operations declined $9 million (8%) in 1993 to $102 million. This decline was the result of the absence of a favorable uranium contract settlement recognized in 1992 and volume and price declines at its soda ash joint venture. These declines were partially offset by the ongoing effects of a favorable 1992 contract settlement at Resources' coal joint venture.

Trucking: Overnite Transportation Company (Overnite) recorded a net loss of $38 million in 1993. Without the 1993 accounting adjustments, earnings would have improved $2 million to $42 million (after goodwill amortization of $23 million). Operating revenues rose $66 million (8%) to $939 million as a 3% rise in average prices combined with a 4% volume improvement. Higher volumes were generated by a 7% increase in less-than-truckload (LTL) business (driven by tonnage gains in the Northeast – reflecting the recent bankruptcy of a major regional carrier – and continued business expansion). Higher LTL volumes were partially offset by truckload traffic declines reflecting Overnite's focus on its core LTL business. Revenue growth was also stimulated by the 1993 addition of the Special Services Division, which supports the Railroad's automotive traffic.

Operating expenses increased $54 million to $870 million for the year. Salaries, wages and employee benefit costs grew $28 million in response to higher volumes and inflation. Equipment and other rents rose $15 million, largely because of increased contracted rail usage and volume-related growth in line-haul charges, while continued capital spending caused depreciation expense to rise $6 million. Operating income improved to $69 million this year from $57 million in 1992. Overnite's operating ratio, excluding goodwill amortization, improved to 90.2 from 90.9 in 1992.

Waste Management: In 1993, USPCI recorded a loss of $8 million (after goodwill amortization of $9 million and a $1 million benefit from the 1993 accounting adjustments) compared to break-even results a year ago. Operating revenues declined ($26 million or 10%) to $236 million for the year as disposal, remediation and transportation volumes fell in response to weak market demand and uncertainty over Federal environmental policies. Operating expenses declined $13 million to $241 million, largely the result of volume-related reductions in outside hauling costs as well as the positive effects of administrative restructuring. USPCI's operating loss was $5 million in 1993 compared to operating income of $8 million in 1992.

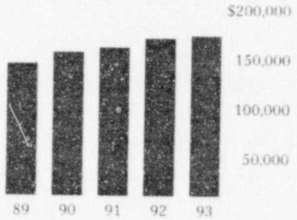
Corporate Services and Other Operations: Expenses related to Corporate Services and Other Operations – which include corporate expenses, interest expense, other income and income taxes that are not related to other segments, and the results of Skyway and other operating units – totaled $208 million in 1993. Excluding the accounting adjustments, these costs would have been $245 million compared to $251 million in 1992. This decline was largely the result of lower interest expense and improved results at other operations, partially offset by higher corporate expenses. Operating income from other operations improved $7 million to $1 million in 1993, reflecting the addition of Skyway.

1992 Compared to 1991

The Corporation's consolidated net income was $728 million in 1992, compared to $64 million in 1991. Excluding the 1991 special charge (see Note 3 to the Financial Statements), net income would have improved $89 million (14%) over 1991's earnings of $639 million. Earnings per share for 1992 were $3.57, up from $0.31 in 1991, and would have risen $0.41 (13%) over 1991's $3.16 per share excluding the special charge.

Revenues advanced $265 million (4%) to $7.29 billion as increases at all operating companies more than compensated for a $108 million decline from curtailed operations at Union Pacific Realty Company (Realty).

Revenues Per Employee
Union Pacific Corporation



Consolidated operating expenses for 1992 were $5.89 billion, a decrease of $679 million from 1991. Without the 1991 special charge, operating expenses would have risen $191 million. Depreciation, depletion and amortization increased $161 million because of exploration and production activity at Resources and the Corporation's continuing high level of capital expenditures. Salaries, wages and employee benefits expense increased $82 million, reflecting volume growth, inflation and reinstatement of incentive compensation accruals, offset by savings from continued cost containment and productivity improvement programs, including the implementation of new train crew size agreements. Partially offsetting these increases were a $40 million reduction in other taxes, resulting from a production-based tax settlement at Resources and property tax settlements at the Railroad, and a $70 million decline relating to diminished Realty operations.

The Corporation's 1992 operating income rebounded to $1.40 billion from $461 million in 1991. Excluding the 1991 special charge, operating income would have improved $74 million (6%) over 1991's $1.33 billion, principally reflecting improvements at the Railroad and Overnite, countered by curtailed operations at Realty. Other income rose $24 million, as interest income included in Resources' tax settlement was offset by reduced gains from property dispositions. Interest expense declined $28 million, reflecting lower interest rates, while corporate expenses increased $7 million. Net income as a percentage of operating revenues improved to 10.0% for 1992 from 9.1% in 1991 excluding the special charge. On the same basis, return on average stockholders' equity improved to 16.5% in 1992 from 14.2% in 1991.

Railroad: The Railroad improved earnings to $667 million in 1992 compared to $110 million in 1991. Excluding the 1991 special charge, earnings would have advanced $65 million (11%). Operating income increased to $1.03 billion from $190 million in 1991. Without the special charge, operating income would have risen $96 million (10%) from $935 million in 1991. The Railroad's operating ratio continued to improve,

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declining to 79.0 from 80.4 in 1991 (excluding the special charge), reflecting productivity improvements arising from the 1991 Presidential Emergency Board (PEB) settlement.

Revenues improved $121 million (3%) to $4.90 billion, as a 4% rise in carloadings was partly offset by a 1% decline in average revenue per car caused by traffic mix shifts, principally the growth of intermodal shipments. Automotive carloadings rose 15%, resulting from strong improvements in both parts and assembled auto traffic, while intermodal shipments were up 9% reflecting growth from both new and existing customers. In addition, metals, minerals and forest traffic rose 6% as a result of higher construction market demand, and grain increased 6% relating to expanding export markets. Other carloading increases occurred in chemicals (2%) and food, consumer and government products (1%). Energy traffic decreased 5% reflecting weak coal demand from utilities, the result of unusually mild weather and the absence of 1991 test burn activities.

Operating expenses declined $720 million to $3.87 billion in 1992. Excluding the 1991 special charge, operating expenses would have increased $25 million. Equipment and other rent expense rose $28 million relating to volume growth, and depreciation increased $15 million as a result of the Railroad's continuing capital program. In addition, outside hauling costs resulting from growth in intermodal traffic rose $6 million. Offsetting these increases were a $22 million decline in other taxes, reflecting favorable property tax settlements and a $16 million decrease in materials and supplies costs. Productivity improvements and cost containment programs continued, with salaries, wages and employee benefits increasing only $3 million as savings stemming from the 1991 PEB settlement negated increases relating to inflation and volume growth. In addition, fuel costs rose only $2 million as improvements in the consumption rate combined with lower fuel prices to offset a 4% increase in gross ton-miles.

Natural Resources: Resources' net income improved to $272 million from $207 million in 1991. Excluding the 1991 special charge, net income would have risen $29 million (12%). Operating income of $315 million improved $56 million, but would have remained essentially flat without the 1991 special charge. Results for 1992 include a favorable one-time $63 million ($42 million after-tax) production-based tax settlement and a $24 million ($16 million after-tax) charge relating to a workforce reduction program.

Revenues climbed $168 million to $1.26 billion, as a 9% increase in total sales volumes and higher average prices for natural gas more than compensated for price declines for crude oil and plant products. Sales volumes were again strengthened by expanded horizontal drilling activity in the Austin Chalk in southeastern Texas. Crude oil sales volumes rose 21% to 66,500 bbl/day and natural gas sales volumes improved 8% to 576 mmcf/day; however, plant products sales volumes dipped 5% to 36,300 bbl/day, reflecting a temporary decline caused by a pipeline disruption. Including hedging activity, average sales prices for natural gas improved 9% over 1991 to $1.52/mcf, while average prices for crude oil slipped 6% to $17.22/bbl and average prices for plant products dropped 10% to $10.67/bbl. Resources increased its hydrocarbon reserve position slightly through its drilling programs, primarily in the Austin Chalk and the Land Grant, despite the strong increase in total 1992 production.

Operating expenses increased $112 million to $944 million for 1992, but would have risen $167 million without the 1991 special charge. Depreciation, depletion and amortization rose $147 million reflecting expanded production levels, higher rates for new wells, property write-offs and accelerated lease surrender activity. In addition, the cost of pipeline and gas plant product purchased for resale increased $22 million, resulting from higher volumes. Also included in operating expenses is $24 million relating to a 15% workforce reduction program. These cost increases were partially mitigated by the production-based tax settlement, which contributed to a $17 million reduction in other taxes.

Other income increased $27 million in 1992, principally because of $39 million in interest income included in the production-based tax settlement, offset by the absence of a $13 million gain from 1991 surface rights sales.

Resources' minerals operations recorded operating income of $111 million in 1992, an 8% gain over 1991's $103 million, reflecting improvements in sales volumes and average prices at its coal joint venture.

Trucking: Overnite earned $40 million in 1992, up from $13 million in 1991, including $20 million of goodwill amortization. Excluding the 1991 special charge, 1992 earnings would have been up $10 million. Operating income improved to $57 million compared to $19 million in 1991, and would have risen $13 million over the prior year excluding the 1991 special charge. Overnite's operating ratio, excluding the 1991 special charge and goodwill amortization, improved to 90.9 compared to 91.9 in 1991.

Despite the sluggish economy, revenues increased $73 million (9%) to $873 million as a 3% improvement in average prices combined with a 6% rise in total volumes. The volume increase included a 9% advance in tonnage for Overnite's core LTL business, reflecting increased market penetration and an expanding customer base. Operating expenses were up $35 million to $816 million, and would have risen $60 million without the 1991 special charge. Salaries, wages and employee benefits expense increased $43 million as a result of inflation and increased employee levels required to handle volume gains, while the remaining expense increase was primarily volume-related, including $6 million for increased use of contracted rail transportation.

Waste Management: USPCI broke even in 1992 compared to a net loss of $20 million in 1991, including $9 million of goodwill amortization. Excluding the 1991 special charge, USPCI's results would have been $3 million better than the previous year. Operating income was $8 million, up from an operating loss of $19 million in 1991. Excluding the special charge, operating income would have improved $2 million over 1991.

Revenues increased $11 million (4%) to $262 million as remediation, treatment and ash management operations improved. Operating expenses fell $16 million from 1991 to $254 million. Without the 1991 special charge, operating expenses would have risen $9 million, as outside disposal costs and contracted transportation expense increased $10 million.

Corporate Services and Other Operations: Consolidated net income also included after-tax expense of $251 million in 1992 and $246 million in 1991 relating to Corporate Services and Other Operations. Corporate Services expense declined $18 million from 1991, as lower interest expense on corporate debt, reduced stock appreciation rights expense and the absence of the administrative portion of the 1991 special charge more than offset increased incentive compensation costs. However, reduced Realty earnings negated this improvement, causing a $5 million increase in overall expense. A $6 million operating loss was recognized in 1992 from other operations, while 1991 results included $12 million of operating income, representing Realty's sales activity countered by the 1991 special charge.

Cash Flows, Liquidity and Capital Resources

Cash from operations declined $97 million in 1993 to $1.56 billion. This decline resulted from a $232 million increase from changes in working capital, partially offset by a $51 million decline in cash used for special charges, a $40 million rise in depreciation expense and a $38 million improvement in earnings excluding the non-cash accounting adjustments.

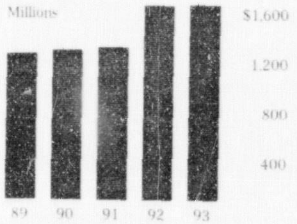
Dividend History
Union Pacific Corporation

Cash used in investing activities increased to $1.55 billion (an increase of $206 million compared to a year ago) reflecting a $195 million reduction in proceeds from property sales, the acquisition of Skyway and additional investments in Chicago and North Western Holdings Corporation (see Note 5 to the Financial Statements). The Corporation will continue its high level of capital spending in 1994. At Resources, spending will be focused on drilling in the Austin Chalk and exploitation of the Land Grant, as well as expanding Resources' production base. The Railroad will continue to expand its high-density main lines and acquire and upgrade equipment to meet customer needs. Overnite will continue to expand its distribution network, and upgrade its truck fleet and technology. Capital spending at USPCI will be reduced in 1994 as the Clive incinerator nears completion.

Major financings in 1993 included $57 million of Railroad equipment financings, $515 million of additional commercial paper and $330 million of the Corporation's notes and debentures. Debt financings were used to fund capital expenditures, repay maturing debt and to call $350 million of notes with higher than market interest rates. In 1993, the Corporation also entered into a new credit facility (see Note 8 to the Financial Statements). The quarterly common stock dividend was raised to $0.40 per share in the third quarter of 1993, up from $0.37 per share. The Corporation's ratio of debt to capital employed improved to 35.6% at December 31, 1993 compared to 36.9% at December 31, 1992. This improvement resulted from an increase in debt discount due to the adoption of SFAS No. 109, increased deferred taxes caused by the 1993 Tax Act and the inclusion of 1993 earnings, partially offset by higher debt levels.

The Corporation's 1994 capital expenditures and debt service requirements will be funded primarily through cash generated from operations, property sales and, if required, through debt financings. The Corporation expects that such sources will continue to provide sufficient funds to meet cash requirements in the foreseeable future. At December 31, 1993, the Corporation had authorization from the Board of Directors to repurchase up to $359 million of the Corporation's common stock. At year-end, the Corporation had available $475 million in short-term credit facilities and $800 million in revolving credit facilities expiring through 1998.

Capital Investments
Union Pacific Corporation



Railroad-Related Matters

Employees of the Railroad who are injured in work-related accidents are compensated under the Federal Employers' Liability Act (FELA). FELA's finding of fault and damage is

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usually assessed based on litigation or out-of-court settlements. Although the number of injury claims has continued to decline, settlement cost per claim has increased, causing annual expense to rise from $125 million in 1991 and 1992 to $154 million in 1993. The Railroad is continuing its efforts to contain these costs through aggressive training programs, improving safety in work areas, working with injured employees, and by participating in an industry-wide effort to replace FELA with a no-fault system. These efforts could significantly reduce personal injury costs while maintaining fair and equitable compensation to injured employees.

Accounting Pronouncements

The FASB has issued Statement No. 112, "Employers' Accounting for Postemployment Benefits" and Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Both Statements will be effective by January 1994. Statement No. 112 requires employers to recognize the obligation to provide benefits to former or inactive employees after employment but prior to retirement. Statement No. 115 creates new reporting classifications for investments in debt and certain equity securities. The Corporation has evaluated these Statements and has determined that the Statements will not have a significant effect on the Corporation.

Other Matters

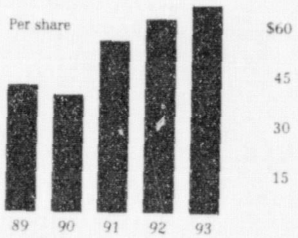
Environmental Costs: The Corporation generates, transports, remediates and disposes of hazardous and nonhazardous waste in its current and former operations. It is engaged in reducing emissions, spills and migration of hazardous materials, and spent $16 million and $12 million in 1993 and 1992, respectively, for control and prevention. Remediation of sites previously used in operations, used by tenants or contaminated by former owners required spending of $42 million in 1993 and $39 million in 1992. In 1994, it anticipates spending $7 million for control and prevention, and $42 million for remediation. The Corporation had accrued $181 million at December 31, 1993 for future remediation costs; however, the ultimate cost could be lower or as much as 50% higher. Future remediation obligations should not have a material impact on the results of operations or financial condition of the Corporation.

Inflation: The cumulative effect of long periods of inflation has significantly increased asset replacement costs for capital-intensive companies such as the Railroad and Overnite. As a result, depreciation charges on an inflation-adjusted basis, assuming that all operating assets are replaced at current price levels, would be substantially greater than historically reported amounts.

A Look Forward

General Economic Factors: The Corporation's future results can be affected by fluctuations in oil and natural gas prices and by the economic environment. Resources directly benefits from increases in hydrocarbon prices, inclusive of hedging activity, while the Railroad and Overnite can be adversely affected by increases in diesel fuel costs, to the extent that such costs are not recovered through higher revenues and improved fuel conservation or mitigated by hedging activity. In addition, certain categories of rail carloadings and trucking tonnages can be negatively impacted by a prolonged economic downturn.

Year-End Closing Stock Price
Union Pacific Corporation



1994 Outlook: Rail volumes are anticipated to improve in 1994 because of new coal contracts, growing intermodal market share, expanding traffic with Mexico, improving demand for finished autos and general economic expansion, while average revenue per car is expected to remain at 1993 levels. Sales volumes at Resources are expected to improve, while commodity price volatility is expected to continue. Resources' volume growth will reflect an expansion in natural gas and natural gas liquids sales volumes resulting from production increases in the Austin Chalk and the Land Grant in Wyoming, Utah and Colorado. Future oil and gas reserve additions will come from exploration, development of existing properties and acquisitions. The Corporation's continuing strategy is to evaluate potential reserve acquisitions, which could result in significant transactions. Overnite anticipates improvements in the current pricing environment and continued tonnage growth. Higher volumes at Overnite will be generated by continued growth in the Northeast and Midwest, and expansion in the West. At USPCI, depressed market conditions caused by regulatory uncertainty, the ongoing delay of remediation activities, and the recent restructurings by several major industry participants have caused the Corporation to begin a re-evaluation of USPCI's business environment and prospects.

Wilmington Sale: Negotiations are under way to sell the Corporation's Wilmington, California, oil field and related facilities to the Port of Long Beach, California, for cash and notes. The sale, including a provision for retained environmental and other liabilities, is expected to result in an after-tax gain. The sale of these operations will not significantly affect the Corporation's future operating results and is expected to be completed later in 1994.

Independent Auditors' Report

Deloitte & Touche

Union Pacific Corporation, its Directors and Stockholders:

We have audited the accompanying statements of consolidated financial position of Union Pacific Corporation and subsidiary companies as of December 31, 1993 and 1992, and the related statements of consolidated income, changes in common stockholders' equity, and consolidated cash flows for each of the three years in the period ended December 31, 1993. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Union Pacific Corporation and subsidiary companies at December 31, 1993 and 1992, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1993 in conformity with generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, in January 1993, the Corporation changed its method of accounting for postretirement benefits other than pensions, income taxes and transportation revenue and expense recognition.

Deloitte & Touche

New York, New York
January 20, 1994

Responsibilities for Financial Statements

The accompanying financial statements, which consolidate the accounts of Union Pacific Corporation and its subsidiaries, have been prepared in conformity with generally accepted accounting principles.

The integrity and objectivity of data in these financial statements and accompanying notes, including estimates and judgements related to matters not concluded by year-end, are the responsibility of management as is all other information in this Annual Report. Management devotes ongoing attention to review and appraisal of its system of internal controls. This system is designed to provide reasonable assurance, at an appropriate cost, that the Corporation's assets are protected, that transactions and events are recorded properly and that financial reports are reliable. The system is augmented by a staff of corporate traveling auditors supplemented by internal auditors in the subsidiary operating companies; careful attention to selection and development of qualified financial personnel; programs to further timely communication and monitoring of policies, standards and delegated authorities; and evaluation by independent public accountants during their audits of the annual financial statements.

The Audit Committee of the Board of Directors, composed entirely of outside directors, as identified on page 47, meets regularly with financial management, the corporate auditors and the independent public accountants to review the work of each. The independent public accountants and corporate auditors have free access to the Audit Committee, without management representatives present, to discuss the results of their audits and their comments on the adequacy of internal controls and the quality of financial reporting.

Drew Lewis

Chairman and Chief Executive Officer

L. White Matthews III

Executive Vice President-Finance

Charles E. Billingsley

Vice President and Controller

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Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1993	1992	1991
Operating Revenues	Railroad	**$ 4,987**	$ 4,897	$ 4,776
	Natural resources	**1,323**	1,259	1,091
	Trucking	**939**	873	800
	Waste management	**236**	262	251
	Corporate services and other operations	**76**	3	111
	Total	**$ 7,561**	$ 7,294	$ 7,029
Operating Income (Loss) (Note 3)	Railroad	**$ 1,042**	$ 1,031	$ 190
	Natural resources	**382**	315	259
	Trucking	**69**	57	19
	Waste management	**(5)**	8	(19)
	Corporate services and other operations	**1**	(6)	12
	Total	**$ 1,489**	$ 1,405	$ 461
Income (Loss) before Accounting Adjustments (Notes 2 and 7)[a]	Railroad	**$ 669**	$ 667	$ 110
	Natural resources	**309**	272	207
	Trucking	**42**	40	13
	Waste management	**(9)**	–	(20)
	Corporate services and other operations	**(245)**	(251)	(246)
	Total	**$ 766**	$ 728	$ 64
Cash from Operations	Railroad	**$ 1,074**	$ 999	$ 910
	Natural resources	**567**	776	554
	Trucking	**44**	100	116
	Waste management	**21**	42	44
	Corporate services and other operations	**(143)**	(257)	(232)
	Total	**$ 1,563**	$ 1,660	$ 1,392
Assets (at Year-End)	Railroad	**$10,014**	$ 9,397	$ 9,002
	Natural resources	**2,246**	2,061	1,962
	Trucking	**1,393**	1,350	1,319
	Waste management	**802**	693	632
	Corporate services and other operations	**546**	597	411
	Total	**$15,001**	$14,098	$13,326
Depreciation, Depletion and Amortization	Railroad	**$ 443**	$ 389	$ 374
	Natural resources	**410**	435	287
	Trucking	**58**	51	51
	Waste management	**31**	32	31
	Corporate services and other operations	**7**	2	5
	Total	**$ 949**	$ 909	$ 748
Capital Expenditures	Railroad	**$ 805**	$ 767	$ 621
	Natural resources	**507**	552	427
	Trucking	**80**	72	40
	Waste management	**114**	109	97
	Corporate services and other operations	**14**	25	6
	Total	**$ 1,520**	$ 1,525	$ 1,191

[a] Accounting adjustments consist of the cumulative effect of changes in accounting principles and the deferred tax effect of the Omnibus Budget Reconciliation Act of 1993.

This information should be read in conjunction with the accompanying accounting policies and notes to the financial statements.

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars, Except Per Share Amounts	1993	1992	1991
Operating Revenues	Sales and Revenues (Notes 2 and 4)	**$7,561**	$7,294	$7,029
Operating Expenses	Salaries, wages and employee benefits	**2,535**	2,516	2,434
	Depreciation, depletion and amortization	**949**	909	748
	Equipment and other rents	**590**	538	495
	Fuel and utilities	**506**	485	488
	Materials and supplies	**403**	390	409
	Other costs	**1,089**	1,051	1,124
	Special charge (Note 3)	–	–	870
	Total	**6,072**	5,889	6,568
Income	Operating Income	**1,489**	1,405	461
	Other Income – Net (Note 13)	**89**	146	122
	Interest Expense (Note 8)	**(324)**	(360)	(388)
	Corporate Expenses	**(99)**	(90)	(83)
	Income before Income Taxes and the Cumulative Effect of Accounting Changes	**1,155**	1,101	112
	Income Taxes (Notes 2 and 7)	**(450)**	(373)	(48)
	Income before Cumulative Effect of Changes in Accounting Principles	**705**	728	64
	Cumulative Effect to January 1, 1993 of Changes in Accounting Principles (Note 2)	**(175)**	–	–
	Net Income	**$ 530**	$ 728	$ 64
Per Share	Income before Cumulative Effect of Changes in Accounting Principles	**$ 3.43**	$ 3.57	$ 0.31
	Cumulative Effect to January 1, 1993 of Changes in Accounting Principles	**(0.85)**	–	–
	Net Income	**2.58**	3.57	0.31
	Dividends	**1.54**	1.42	1.305

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

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Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1993	1992
Assets			
Current Assets	Cash and temporary investments	$ 113	$ 245
	Accounts receivable	651	575
	Inventories	252	244
	Deferred income taxes (Notes 2 and 7)	117	151
	Other current assets	249	166
	Total	1,382	1,381
Investments	Investments in and advances to affiliated companies (Note 5)	455	417
	Other investments	170	187
	Total	625	604
Properties	Cost (Notes 6 and 8)	17,860	16,385
	Accumulated depreciation, depletion and amortization	(6,419)	(5,785)
	Net	11,441	10,600
Other	Intangible and Other Assets – Net	1,553	1,513
	Total Assets	$15,001	$14,098
Liabilities and Stockholders' Equity			
Current Liabilities	Accounts payable	$ 477	$ 523
	Accrued wages and vacation	253	242
	Dividends and interest	176	177
	Income and other taxes	162	176
	Accrued casualty costs	135	135
	Debt due within one year	115	110
	Restructuring reserve (Note 3)	107	177
	Other current liabilities	664	544
	Total	2,089	2,084
Other Liabilities and Equity	Debt Due After One Year (Notes 8 and 9)	4,069	3,989
	Deferred Income Taxes (Notes 2 and 7)	2,676	2,376
	Retiree Benefits Obligation (Notes 2 and 10)	599	175
	Restructuring Reserve (Note 3)	50	204
	Other Long-Term Liabilities (Note 12)	633	631
	Common Stockholders' Equity (page 34)	4,885	4,639
	Total Liabilities and Stockholders' Equity	$15,001	$14,098

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1993	1992	1991
Cash from Operations	Net Income	**$ 530**	$ 728	$ 64
	Non-cash charges to income:			
	Depreciation, depletion and amortization	**949**	909	748
	Deferred income taxes	**320**	217	(58)
	Cumulative effect of changes in accounting principles (Note 2)	**175**	–	–
	Special charge (Note 3)	–	–	870
	Other non-cash charges	**(141)**	(105)	(290)
	Changes in current assets and liabilities	**(128)**	104	116
	Cash used for special charges	**(142)**	(193)	(58)
	Cash from operations	**1,563**	1,660	1,392
Investing Activities	Capital investments and exploratory expenditures	**(1,574)**	(1,567)	(1,231)
	Investments and acquisitions (Note 5)	**(75)**	(71)	–
	Proceeds from sale of assets and other investing activities	**96**	291	94
	Cash used for investing activities	**(1,553)**	(1,347)	(1,137)
Equity and Financing Activities	Dividends paid	**(309)**	(282)	(257)
	Debt repaid (Note 8)	**(753)**	(677)	(373)
	Purchase of treasury stock (Note 11)	**(10)**	(5)	–
	Financings	**930**	752	350
	Cash used in equity and financing activities	**(142)**	(212)	(280)
	Net Change in Cash and Temporary Investments	**$ (132)**	$ 101	$ (25)
Changes in Current Assets and Liabilities	Accounts receivable	**$ (76)**	$ (59)	$ 29
	Inventories	**(8)**	(22)	21
	Other current assets	**(49)**	(31)	12
	Accounts, wages and vacation payable	**(35)**	143	64
	Other current liabilities	**40**	73	(10)
	Total	**$ (128)**	$ 104	$ 116

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

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Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1993	1992	1991
Common Stock	Common Stock, $2.50 par value (authorized 500,000,000 shares)			
	Balance at beginning of year (229,774,547 issued shares in 1993; 228,410,296 in 1992; 126,182,132 in 1991)	**$ 574**	$ 571	$ 315
	Conversions, exercises of stock options and other (1,013,628 shares in 1993; 1,364,251 in 1992 1,032,780 in 1991)	**3**	3	3
	Stock split (101,195,384 shares in 1991) (Note 11)	–	–	253
	Balance at end of year (230,788,175 issued shares in 1993; 229,774,547 in 1992; 228,410,296 in 1991)	**577**	574	571
Paid-in Surplus	Balance at beginning of year	**1,339**	1,288	1,235
	Conversions, exercises of stock options and other	**44**	51	53
	Balance at end of year	**1,383**	1,339	1,288
Retained Earnings	Balance at beginning of year	**4,338**	3,899	4,353
	Net Income	**530**	728	64
	Total	**4,868**	4,627	4,417
	Dividends declared:			
	Cash dividends	**(315)**	(289)	(265)
	Stock split (Note 11)	–	–	(253)
	Exchangeable note conversion (Note 8)	**(24)**	–	–
	Balance at end of year (Note 8)	**4,529**	4,338	3,899
Treasury Stock	Balance at end of year, at cost (25,626,946 shares in 1993; 25,879,742 in 1992; 25,566,455 in 1991)	**(1,604)**	(1,612)	(1,595)
	Total Common Stockholders' Equity (Note 11)	**$4,885**	$4,639	$4,163

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

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Significant Accounting Policies

Principles of Consolidation
The consolidated financial statements include the accounts of Union Pacific Corporation (the Corporation) and all subsidiaries. Investments in affiliated companies (20% to 50% owned) are accounted for on the equity method. In addition, the Corporation consolidates its proportionate share of oil, gas and mineral ventures. All material intercompany transactions are eliminated.

Cash and Temporary Investments
Temporary investments are stated at cost that approximates fair market value, and consist of investments with original maturities of three months or less.

Accounts Receivable
Union Pacific Railroad Company has sold, on a revolving basis, an undivided percentage ownership interest in a designated pool of accounts receivable. Collection risk on the pool of receivables is minimal. At December 31, 1993 and 1992, accounts receivable are presented net of the $300 million of receivables sold.

Inventories
Inventories consist primarily of materials and supplies carried at the lower of cost or market.

Exploration and Production
Oil and gas exploration costs are accounted for using the successful efforts method.

Drilling costs of unsuccessful exploratory wells, geological and geophysical costs and carrying costs are charged to expense when incurred. Costs to develop producing properties, including drilling costs and applicable leasehold acquisition costs, are capitalized.

Depletion and amortization of producing properties, including depreciation of well and support equipment and amortization of related lease costs, are determined by using a unit-of-production method based upon proved reserves. Acquisition costs of unproved properties are amortized from the date of acquisition on a composite basis, which considers past success experience and average lease life.

Property and Depreciation
Properties are carried at cost. Provisions for depreciation are computed principally on the straight-line method based on estimated service lives of depreciable property.

The cost (net of salvage) of depreciable rail property retired or replaced in the ordinary course of business is charged to accumulated depreciation. A gain or loss is recognized on all other property upon disposition.

The Corporation capitalizes interest and certain labor costs on significant construction projects during construction.

Intangible Assets
Intangible and Other Assets in 1993 and 1992 include $1.32 billion and $1.29 billion, respectively, of costs in excess of net assets of acquired businesses. Amortization is generally recorded over forty years on a straight-line basis. The Corporation regularly assesses the recoverability of costs in excess of net assets of acquired businesses through a review of cash flows and fair values of those businesses.

Revenue Recognition
Transportation revenues are recognized on a percentage-of-completion basis, while delivery costs are recognized as incurred (see Note 2).

Hedging Transactions
The Corporation periodically hedges hydrocarbon sales and purchases, and interest rates. Gains and losses from these transactions are recognized at delivery of the commodity or over the life of the instrument (see Note 4).

Earnings Per Share
Earnings per share are based on the weighted average number of common shares outstanding during the periods, plus shares issuable upon exercise of outstanding stock options (see Note 11).

Change in Presentation
Certain 1991 and 1992 amounts have been reclassified to conform to the 1993 financial presentation.

1. Business
The Corporation consists of companies operating principally in the United States engaged in rail transportation; oil, gas and minerals production; trucking; and waste management.

The following financial information is an integral part of these financial statements:

- Business Segments
- Supplementary Information (unaudited)
  - Selected Quarterly Data;
  - Oil and Gas – Proved Reserves;
  - Capitalized Exploration and Production Costs;
  - Costs Incurred in Exploration and Development;
  - Results of Operations for Producing Activities; and
  - Standardized Measure of Cash Flows

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2. Accounting Changes

The Corporation adopted the following accounting changes with a cumulative adjustment – which resulted in a $175 million or $0.85 per share after-tax charge to earnings – in January 1993:

In Millions, Except Per Share Amounts	OPEB	Income Taxes	Revenue Recogn.	Total
Railroad	$ (171)	$ 121	$ (22)	$ (72)
Natural resources	(44)	(15)	–	(59)
Trucking	(47)	(25)	(7)	(79)
Waste management	–	–	–	–
Corporate services and other operations	(9)	44	–	35
Consolidated	$ (271)	$ 125	$ (29)	$ (175)
Per share	$(1.32)	$ 0.61	$(0.14)	$(0.85)

Other Postretirement Benefits (OPEB): The Financial Accounting Standards Board (FASB) issued Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which requires that the cost of non-pension benefits for retirees be accrued during their period of employment. The adoption of this Statement will not affect future cash funding requirements for these benefits (see Note 10).

Income Taxes: The FASB issued Statement No. 109, "Accounting for Income Taxes," which requires the balance sheet approach of accounting for income taxes, whereby assets and liabilities are recorded at the tax rates currently enacted. The Corporation's results were not significantly affected by the adoption of this Statement; however, future results may be affected by changes in the corporate income tax rate. 1993's income tax expense (before accounting changes) rose $73 million as a result of the Omnibus Budget Reconciliation Act of 1993 (the 1993 Tax Act) (see Note 7).

Revenue Recognition: The Corporation changed its method of transportation revenue and expense recognition from accruing both revenues and expenses at the inception of service to the industry practice of allocating revenues between reporting periods based on relative transit time, while recognizing expenses as incurred. The Corporation's results were not significantly affected by this accounting change.

3. 1991 Special Charge

In 1991, the Corporation announced a major restructuring program, including an $870 million ($575 million after-tax) charge. The program included a provision of $480 million for severance and other costs associated with personnel reductions at Union Pacific Railroad Company and its affiliate, Missouri Pacific Railroad Company (collectively the Railroad), as well as $265 million for costs related to the disposition of light density rail lines. In addition, the Corporation provided $125 million for operational realignments at its other operating companies. The Corporation spent $142 million and $193 million in 1993 and 1992, respectively, for the restructuring program.

4. Price Risk Management

The Corporation utilizes futures contracts, option contracts and swap agreements to manage price volatility related to sales and purchases of hydrocarbons. Union Pacific Resources Company (Resources) has purchased fixed price contracts to hedge 1994 natural gas sales volumes of 161 mmcf/day at $2.27/mcf, approximately 25% of Resources' 1994 natural gas production. Overnite Transportation Company (Overnite) has purchased fixed price contracts to hedge virtually all of its 1994 diesel fuel consumption (62 million gallons at $0.48 per gallon). Credit risk related to these activities is minimal.

5. Investments and Acquisitions

In May 1993, the Corporation acquired all of the outstanding common stock of Skyway Freight Systems, Inc. (Skyway) for $65 million and the conversion of its initial $7 million preferred stock investment. Skyway specializes in providing customized logistics and transportation support for the time-definite and specialized freight markets.

In 1992, the Corporation exchanged its preferred stock investment in Chicago and North Western Holdings Corporation (CNW) for non-voting common stock (the Stock). Through additional Stock purchases, the Corporation holds a 30% equity interest in CNW. The Stock is exchangeable into voting common stock pending Interstate Commerce Commission approval. The CNW investment is accounted for on the equity method.

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6. Properties

Major property accounts are as follows:

Millions of Dollars	1993	1992
Railroad:		
Road and other	$ 7,935	$ 7,282
Equipment	4,575	4,328
Total Railroad	12,510	11,610
Natural resources	4,144	3,785
Trucking	621	555
Waste management	464	350
Other	121	85
Total	$17,860	$16,385

Accumulated depreciation, depletion and amortization are as follows:

Millions of Dollars	1993	1992
Railroad:		
Road and other	$ 1,990	$ 1,693
Equipment	1,769	1,730
Total Railroad	3,759	3,423
Natural resources	2,364	2,124
Trucking	165	138
Waste management	101	82
Other	30	18
Total	$ 6,419	$ 5,785

7. Income Taxes

In August 1993, President Clinton signed the 1993 Tax Act into law raising the Federal corporate income tax rate to 35% from 34% retroactive to January 1. As a result, 1993 income tax expense increased by $73 million: $61 million for the one-time non-cash recognition of deferred income taxes related to prior periods and $12 million of incremental current year Federal income tax expense.

Components of income tax expense are as follows:

Millions of Dollars		1993
Current:	Federal	$118
	State	12
	Total current	130
Deferred:	Federal	304
	State	16
	Total deferred	320
Total		$450

Prior years' components of tax expense, which have not been restated to reflect the accounting change (see Note 2), were $156 million in 1992 and $106 million in 1991 for current Federal income tax expense and $217 million in 1992 and $(58) million in 1991 for deferred Federal income tax expense.

Deferred tax liabilities (assets) are comprised of the following:

Millions of Dollars	1993
Net current deferred tax asset – Restructuring and other reserves	$ (117)
Excess tax over book depreciation	2,459
Exploration costs	286
State taxes – Net	221
Alternative minimum tax	(178)
Postretirement benefits	(152)
Special charge	(101)
Other	141
Net long-term deferred tax liability	2,676
Net deferred tax liability	$2,559

A reconciliation between statutory and effective tax rates is as follows:

	1993	1992	1991
Statutory tax rate	35.0%	34.0%	34.0%
Cumulative effect of Federal rate increase	5.3	–	–
State taxes – Net	1.6	–	–
Goodwill amortization	1.1	3.1	29.5
Section 29 credits	(1.2)	(1.8)	–
Dividend exclusion	(1.6)	(0.9)	(16.1)
Other	(1.2)	(0.5)	(4.5)
Effective tax rate	39.0%	33.9%	42.9%

All material IRS deficiencies prior to 1978 have been settled. In addition, the Corporation has filed refund claims for 1946 through 1967. The Corporation is contesting deficiencies in the Tax Court for 1978 and 1979. The Corporation has reached a partial settlement with the Appeals Office of the IRS for 1980 through 1983; the remaining issues will be resolved as part of the Tax Court case for 1978 and 1979, as well as the refund claim filed for 1983. The Corporation is negotiating with the Appeals Office concerning 1984 through 1986. The IRS is examining the Corporation's returns for 1987 through 1989. The Corporation believes it has adequately provided for Federal and state income taxes.

Payments of income taxes were $142 million in 1993, $168 million in 1992 and $158 million in 1991.

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8. Debt

Long-term debt is summarized below:

Millions of Dollars	1993	1992
Notes and Debentures, 4.75% to 10.80% due through 2054	**$2,189**	$2,554
Equipment obligations, 6.15% to 15.50% due through 2012	**664**	678
Commercial paper, average of 3.35% in 1993 and 3.62% in 1992	**868**	353
Mortgage bonds, 4.25% to 5.00%, due through 2030	**178**	179
Tax-exempt financings, 2.41% to 9.60% due through 2026	**206**	173
Capitalized leases	**144**	158
Unamortized discount	**(180)**	(106)
Total long-term debt	**$4,069**	$3,989

Maturities of long-term debt for each year, 1994 through 1998, are $115 million, $271 million, $65 million, $156 million and $1.147 billion, respectively.

Approximately 55% of all rail equipment and other railroad properties secure outstanding equipment obligations and mortgage bonds.

Certain tax-exempt financings had variable interest rates from 2.41% to 3.10% at December 31, 1993, and from 2.65% to 3.50% at December 31, 1992.

Commercial paper borrowings are due within one year, but have been classified as long-term debt because the Corporation intends to refinance these obligations by the issuance of additional commercial paper or other long-term debt. Long-term credit facilities are available to replace outstanding commercial paper.

The Corporation has $1.275 billion of credit facilities for general corporate purposes with various banks. These facilities consist of revolving credit facilities of $800 million that expire in 1998 and $400 million that expire in March 1994, and $75 million of other short-term facilities. Borrowings on the $400 million credit facility are payable up to one year from the date the funds are borrowed. Commitment fees and interest rates payable under these facilities are comparable to fees and rates available to the most creditworthy corporate borrowers.

In February 1993, the remaining $25 million of the 7.50% Exchangeable Guaranteed Notes due 2003, which were issued in conjunction with the acquisition of the Missouri-Kansas-Texas Railroad, were exchanged for approximately 774,000 shares of the Corporation's common stock. These common shares were held in treasury prior to the exchange.

The Corporation is subject to certain restrictions related to the payment of cash dividends. The amount of retained earnings available for dividends under the most restrictive test was $2.6 billion at December 31, 1993.

Interest expense is net of capitalized interest of $11 million in 1993, $9 million in 1992 and $6 million in 1991. Interest payments approximate gross interest expense.

The fair value of the Corporation's long and short-term debt has been estimated using quoted market prices or current borrowing rates. At December 31, 1993, the fair value of total debt exceeded the carrying value by 5%.

9. Leases

The Corporation leases certain locomotives, freight cars, trailers, production platforms and other property. Future minimum lease payments for capital and operating leases with initial or remaining non-cancelable lease terms in excess of one year as of December 31, 1993, are as follows:

Millions of Dollars	Operating Leases	Capital Leases
1994	$114	$ 27
1995	54	26
1996	47	25
1997	38	24
1998	35	21
Later years	95	200
Total minimum payments	**$383**	323
Amount representing interest		(167)
Present value of minimum lease payments		**$156**

The present value of future capital lease payments includes $12 million classified as a current liability and $144 million classified as long-term debt.

Rent expense for operating leases with terms exceeding one month was $123 million in 1993, $112 million in 1992 and $111 million in 1991. Contingent rentals and sub-rentals are not significant.

10. Retirement Plans

The Corporation and certain of its subsidiaries provide pension and postretirement health care and life insurance benefits to substantially all salaried and certain hourly employees.

Pension Benefits: Pension plan benefits are based on years of service and compensation during the last years of employment. Contributions to the plans are calculated based on the Projected Unit Credit actuarial funding method and are not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. In addition, Railroad employees are covered by the Railroad Retirement System. Contributions made to the System are expensed as incurred and amounted to $195 million, $201 million and $197 million in 1993, 1992 and 1991, respectively. Since 1989, the Corporation has settled a portion of the non-qualified unfunded supplemental plans' accumulated benefit obligation by purchasing annuities.

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Pension cost includes the following components:

Millions of Dollars	1993	1992	1991
Service cost-benefits earned during the period	**$ 32**	$ 32	$ 28
Interest on projected benefit obligation	**88**	84	77
Return on assets			
– actual gain	**(140)**	(57)	(203)
– deferred gain (loss)	**60**	(19)	132
Net amortization costs	**8**	10	8
Charge to operations	**$ 48**	$ 50	$ 42

The projected benefit obligation was determined using a discount rate of 7.0% in 1993 and 8.0% in 1992. The estimated rate of salary increase approximated 5.0% in 1993 and 6.25% in 1992. The expected long-term rate of return on plan assets was 8.0% in both years. The change in assumptions will not significantly affect 1994 pension cost. As of year-end 1993 and 1992, approximately 34% and 31%, respectively, of the funded plans' assets were held in fixed-income and short-term securities, with the remainder primarily in equity securities.

The funded status of the plans is as follows:

	Assets Exceed Accumulated Benefits		Accumulated Benefits Exceed Assets[a]	
Millions of Dollars	1993	1992	1993	1992
Plan assets at fair value	**$1,182**	$1,086	**$ –**	$ –
Actuarial present value of benefit obligations:				
Vested benefits	**923**	783	**39**	27
Non-vested benefits	**54**	39	**1**	–
Accumulated benefit obligation	**977**	822	**40**	27
Additional benefits based on estimated future salaries	**205**	239	**26**	12
Projected benefit obligation	**1,182**	1,061	**66**	39
Plan assets (over) under projected benefit obligation	**–**	(25)	**66**	39
Unamortized net transition asset (obligation)	**39**	43	**(33)**	(40)
Unrecognized prior service cost	**(46)**	(64)	**(39)**	(25)
Unrecognized net gain (loss)	**167**	194	**(30)**	(13)
Minimum liability	**–**	–	**76**	66
Pension liability	**$ 160**	$ 148	**$40**	$27

[a] Represents the Corporation's non-qualified unfunded supplemental plans.

Other Postretirement Benefits: The Corporation adopted the provisions of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (see Note 2) in January 1993. The Corporation does not currently pre-fund health care and life insurance benefit costs. Cash payments for these benefits (which were not affected by the adoption of SFAS No. 106) were $16 million in 1993. Railroad agreement employees' health care and life insurance benefits are covered by a separate multiemployer plan and therefore are not subject to the provisions of this Statement.

In late 1993, the Corporation amended its postretirement health care plans to provide greater employee cost sharing and, for the plan covering Overnite's employees, implemented stricter eligibility requirements. As a result of these amendments, future plan expense will be reduced.

Components of the postretirement health care and life insurance benefit expense are as follows:

Millions of Dollars	1993
Service cost-benefits earned during the period	**$ 7**
Interest costs on accumulated benefit obligation	**21**
Charge to operations	**$ 28**

The liability for postretirement benefit plans is as follows:

Millions of Dollars	1993
Accumulated postretirement benefit obligation (APBO):	
Retirees	**$201**
Fully eligible active employees	**21**
Other active employees	**99**
Total APBO	**321**
Unrecognized prior service gain	**76**
Unrecognized net gain	**40**
Postretirement benefits liability	**$437**

The APBO was determined using a discount rate of 7.0%. The initial assumed health care cost trend rate was 13.0%, gradually decreasing to 4.8% for 2009 and all future years. If the assumed health care cost trend rate increases by one percentage point in each subsequent year, annual postretirement benefit expense would increase by $4 million and the aggregate postretirement benefits liability would rise by $35 million.

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11. Stock Option Plans, Retention Stock Plans and Other Capital Stock

Pursuant to the Corporation's stock option, retention and restricted stock plans for directors, officers and key employees, 14,469,250, 4,095,900 and 5,530,500 common shares or options for common shares were available for grant at December 31, 1993, 1992 and 1991, respectively.

Options under the plans are granted at 100% of market value at the date of grant, become exercisable one year after that date and are exercisable for a period of ten years from the grant date. The plans also provide for granting of stock appreciation rights (SAR's) that permit certain holders to surrender related exercisable options in exchange for cash or stock in an amount equal to the excess of the market price of the Corporation's common stock on the date the right is exercised over the option price. As a result of changes in the market value of the stock, $4 million, $6 million and $18 million were charged to expense in 1993, 1992 and 1991, respectively. During 1993, 1992 and 1991, options with SAR's were granted for 437,400, 441,500 and 282,500 shares, respectively. At December 31, 1993, 1992 and 1991, there were 1,298,200, 937,400 and 969,500 shares subject to outstanding SAR's, respectively.

Changes in common stock options and SAR's outstanding are as follows:

	Shares Under Option	Price Range Per Share
Balance Dec. 31, 1990	5,784,000	$19.04 to $40.41
Granted	1,049,400	46.66 to 49.13
Exercised	(2,361,480)	20.04 to 40.41
Expired/Surrendered	(65,200)	34.07 to 40.41
Balance Dec. 31, 1991	4,406,720	19.04 to 49.13
Granted	1,322,250	54.13
Exercised	(1,511,920)	19.04 to 46.66
Expired/Surrendered	(61,100)	46.66 to 54.13
Balance Dec. 31, 1992	4,155,950	20.04 to 54.13
Granted	1,352,850	63.75
Exercised	(792,890)	20.04 to 54.13
Expired/Surrendered	(19,450)	28.32 to 54.13
Balance Dec. 31, 1993	**4,696,460**	**20.04 to 63.75**

Exercisable Dec. 31		
1991	3,357,320	$19.04 to $40.41
1992	2,833,700	20.04 to 49.13
1993	**3,343,610**	**20.04 to 54.13**

The plans also provide for granting restricted shares of common stock to eligible employees, subject to forfeiture if employment terminates during the prescribed restricted period. During 1993, 1992 and 1991, 208,700, 131,450 and 385,900 retention and restricted shares, respectively, were issued.

The Corporation has announced programs to repurchase up to $1.2 billion of its common shares. Since 1984, 15 million shares have been repurchased at a cost of $841 million. In 1991, the Corporation split its outstanding common stock on a two-for-one basis. Accordingly, all appropriate share and per share information has been restated.

12. Commitments and Contingencies

There are various lawsuits pending against the Corporation and certain of its subsidiaries. The Corporation is also subject to Federal, state and local environmental laws and regulations, and is currently participating in the investigation and remediation of numerous sites. Where the remediation costs can be reasonably determined, and where such remediation is probable, the Corporation has recorded a liability. At December 31, 1993, the Corporation had accrued $181 million for estimated future environmental costs and believes it is reasonably possible that actual environmental costs could be lower than the recorded reserve or as much as 50% higher. The Corporation has also entered into commitments and provided guarantees for specific financial and contractual obligations of its subsidiaries and affiliates. The Corporation does not expect that the lawsuits, environmental costs, commitments or guarantees will have a material adverse effect on its consolidated financial position or its results of operations.

13. Other Income – Net

Other Income – Net includes the following:

Millions of Dollars	1993	1992	1991
Rental income	$ 33	$ 38	$ 45
Net gain on property dispositions	18	36	51
Interest on tax settlements	–	55	15
Interest and other – Net	38	17	11
Total	$ 89	$146	$122

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Selected Quarterly Data

Selected unaudited quarterly data are as follows:

Millions of Dollars Except Per Share Amounts	Mar. 31	Jun. 30	Sep. 30	Dec. 31
1993				
Operating revenues	**$1,830**	**$1,848**	**$1,901**	**$1,982**
Operating income	**343**	**385**	**345**	**416**
Net income (loss)	**(11)**[a]	**198**	**108**[b]	**235**
Per share:				
Net income (loss)	**(0.06)**[a]	**0.96**	**0.53**[b]	**1.14**
Dividends	**0.37**	**0.37**	**0.40**	**0.40**
Common stock price:				
High	**62.38**	**65.38**	**67.00**	**64.88**
Low	**56.88**	**58.75**	**58.38**	**57.88**
1992				
Operating revenues	$1,745	$1,782	$1,851	$1,916
Operating income	307	376	372	350
Net income	145	206[c]	185	192
Per share:				
Net income	0.71	1.01[c]	0.91	0.94
Dividends	0.34	0.34	0.37	0.37
Common stock price:				
High	51.00	55.25	55.50	60.50
Low	44.38	45.75	48.00	50.63

[a] Income before the cumulative effect of accounting changes was $164 million or $0.80 per share.
[b] Included a $61 million ($0.30 per share) increase in income tax expense resulting from the deferred tax effect of the 1993 Tax Act (see Note 7 to the Financial Statements).
[c] Included a $63 million ($42 million after-tax) production-based tax settlement, which increased earnings per share by $0.21.

Stockholders and Dividends

The common stock of the Corporation is traded on various stock exchanges, principally the New York Stock Exchange. At January 31, 1994, there were 205,077,299 shares of outstanding common stock and approximately 63,600 common stockholders. At that date, the closing price of the common stock on the New York Stock Exchange was $65.38.

Cash dividends declared on common stock by the Corporation were $1.54 per share in 1993 and $1.42 per share in 1992. Union Pacific has paid dividends to its common stockholders during each of the past 94 years. See Note 8 to the Financial Statements for a discussion regarding restrictions relating to the payment of cash dividends.

Rail Transportation

Commodities

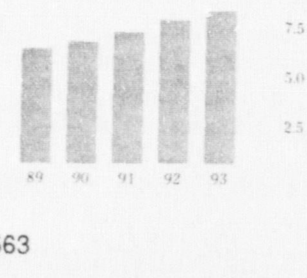
Revenue ton-miles (RTM) and freight revenue for major commodities by percent and in total are as follows:

	1993		1992		1991	
Percent of Total	RTM	Frght. Rev.	RTM	Frght. Rev.	RTM	Frght. Rev.
Automotive	**4.0%**	**11.3%**	3.7%	10.7%	3.2%	10.0%
Chemicals	**14.0**	**20.9**	14.8	21.6	14.4	21.6
Energy	**34.3**	**18.3**	31.2	17.6	33.8	18.9
Food, consumer and government	**5.8**	**6.6**	6.3	7.1	6.2	7.4
Grains and grain products	**16.1**	**12.9**	17.3	13.5	16.1	12.9
Intermodal	**12.0**	**14.3**	12.1	13.2	11.6	13.1
Metals, minerals and forest	**13.8**	**15.7**	14.6	16.3	14.7	16.1
Total	**100%**	**100%**	100%	100%	100%	100%
Amounts in Billions	**220.7**	**$4.8**	209.1	$4.7	200.9	$4.6

Equipment

Owned or leased at year-end	1993	1992	1991
Locomotives	**3,142**	3,074	3,065
Freight cars			
Covered hoppers	**23,399**	22,656	23,049
Box cars	**15,826**	16,573	18,279
Open-top hoppers	**10,885**	11,064	11,221
Gondolas	**9,969**	10,438	10,686
Other	**8,013**	8,408	8,868
Work equipment	**4,704**	4,922	5,048
Acquired during the year			
Locomotives	**74**	74	68
Freight cars	**1,394**	646	783
Average age of equipment (years)			
Locomotives	**12.2**	11.8	11.3
Freight cars	**19.8**	19.3	18.3
Bad order ratio-freight cars	**7.9%**	8.2%	11.2%

Revenue Ton-Miles Per Employee
Union Pacific Railroad



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Expenditures

Millions of Dollars	1993	1992	1991
Capital Expenditures			
Roadway and other	**$591**	$504	$440
Equipment	**214**	263	181
Total	**$805**	$767	$621
Maintenance Expenditures			
Roadway	**$247**	$273	$295
Equipment	**490**	485	463
Total	**$737**	$758	$758

Transportation Statistics

Railroad (track miles)	1993	1992	1991
Main line	**13,972**	14,032	14,563
Branch line	**3,863**	4,988	5,698
Yards, siding and other main line	**12,480**	12,717	12,401
Total	**30,315**	31,737	32,662
Track miles of continuous welded rail (at year-end)	**13,735**	13,528	13,291
Track miles under centralized traffic-control (at year-end)	**8,861**	8,847	8,790
Track miles of rail replaced			
New	**280**	373	223
Used	**254**	267	292
Track miles re-ballasted	**2,510**	3,296	3,687
Ties replaced (thousands)	**2,017**	1,946	1,785
Freight Operations			
Operating ratio	**79.1**	79.0	80.4
Carloadings (thousands)	**4,619**	4,458	4,304
Average revenue per carloading	**$1,032**	$1,055	$1,064
Average price of diesel fuel (per gallon)	**62.8¢**	63.9¢	66.5¢

Trucking

Freight Operations

	1993	1992	1991
Shipments (thousands)			
Less-than-truckload	**8,146**	7,603	7,034
Truckload	**60**	67	72
Total	**8,206**	7,670	7,106
Tonnage (thousands)			
Less-than-truckload	**4,277**	3,994	3,652
Truckload	**733**	837	914
Total	**5,010**	4,831	4,566
Revenue per hundredweight	**$9.28**	$9.03	$8.76
Operating ratio	**90.2**	90.9	91.9

Equipment and Terminals

Owned or leased at year-end	1993	1992	1991
Tractors	**5,254**	5,311	5,205
Trailers	**17,105**	16,123	14,318
Straight trucks	**93**	101	121
Automobiles and service units	**237**	385	525
Service centers	**166**	160	149
Average age of equipment (years)			
Tractors	**6.8**	7.2	7.8
Trailers	**8.0**	8.7	8.5

Capital Expenditures

Millions of Dollars	1993	1992	1991
Revenue equipment	**$40**	$48	$26
Other	**40**	24	14
Total	**$80**	$72	$40

Natural Resources

Oil and Gas — Proved Reserves

Proved reserves of crude oil, which include condensate and natural gas liquids, are as follows:

Millions of Barrels	1993	1992	1991
Beginning of year	**156.6**	161.4	153.0
Revisions of previous estimates	**5.5**	7.1	3.7
Improved recovery	**1.3**	–	6.3
Extensions, discoveries and other additions	**20.8**	27.2	22.4
Purchases (sales) of reserves-in-place	**4.6**	(7.3)	3.9
Production	**(31.9)**	(31.8)	(27.9)
End of year	**156.9**	156.6	161.4
Proved developed reserves	**153.8**	148.5	135.4

The table above includes the following amounts with respect to natural gas liquids:

Millions of Barrels	1993	1992	1991
Production	**(7.7)**	(7.5)	(7.6)
Reserves, end of year	**74.3**	67.8	64.5

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Proved natural gas reserves are as follows:

Billions of Cubic Feet	1993	1992	1991
Beginning of year	**1,709.2**	1,655.5	1,694.4
Revisions of previous estimates	**(35.6)**	37.2	15.5
Extensions, discoveries and other additions	**237.0**	427.1	147.8
Purchases (sales) of reserves-in-place	**46.6**	(199.6)	(6.9)
Production	**(226.0)**	(211.0)	(195.3)
End of year	**1,731.2**	1,709.2	1,655.5
Proved developed reserves	**1,643.5**	1,610.8	1,512.9

Over 90% of proved reserves are in the United States. At December 31, 1990, proved developed reserves of oil and gas were 130.0 million barrels and 1,595.0 billion cubic feet, respectively.

Drilling and Production Activities

Drilling	1993	1992	1991
Gross wells	**529**	483	382
Gross productive wells	**491**	435	308
Net wells:			
Exploration	**20**	33	44
Development	**303**	291	201
Net productive wells:			
Exploration	**10**	13	18
Development	**295**	285	185

At December 31, 1993, 146 gross wells and 72 net wells were in process of being drilled.

Sales Price and Cost [a]	1993	1992	1991
Crude oil sales price	**$15.66**	$17.22	$18.33
Natural gas liquids sales price	**9.84**	10.67	11.86
Gas sales price	**1.82**	1.52	1.39
Lifting cost [b]	**4.12**	4.12	4.33

[a] Average per bbl or mcf, except lifting cost which is per barrel oil equivalent converted at 6:1.

[b] Lifting cost per unit includes 6.9 million, 5.8 million and 6.2 million barrels of natural gas liquids earned through plant ownership in 1993, 1992 and 1991, respectively.

Production (per day)	1993	1992	1991
Net crude oil (thousand bbl)	**66.5**	66.5	54.9
Net natural gas liquids (thousand bbl)	**21.0**	20.6	21.4
Net natural gas (mmcf)	**619.0**	576.0	535.0
Natural gas processed (mmcf)	**949.4**	935.1	915.0

Acreage and Wells

Oil and gas acreage is as follows:

Thousands of Acres	1993	1992
Gross developed	**1,569**	1,581
Net developed	**833**	821
Gross undeveloped	**17,588**	27,529
Net undeveloped	**15,733**	24,574

Gross and net undeveloped acreage at December 31, 1993, includes 13.6 million acres and 12.8 million acres, respectively, which were acquired under foreign work programs, substantially all in South America. The table excludes 7.1 million gross acres and 6.4 million net acres, which were acquired through 19th century Congressional Land Grant Acts. Substantial portions of this acreage are considered prospective for oil and gas.

Productive oil and gas wells at December 31, 1993, are as follows:

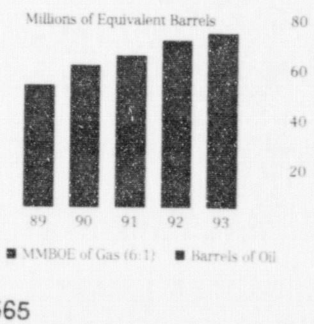
Wells	Oil	Gas
Gross [a]	**4,306**	**2,582**
Net	**1,402**	**1,509**

[a] Approximately 833 are multiple completions, 442 of which are gas wells.

Capitalized Exploration and Production Costs

Millions of Dollars	1993	1992	1991
Proved properties	**$ 386**	$ 402	$ 355
Unproved properties	**151**	134	204
Wells, related equipment and facilities	**3,110**	2,791	2,606
Uncompleted wells, equipment and facilities	**197**	200	148
Gross capitalized costs	**3,844**	3,527	3,313
Accumulated depreciation, depletion, amortization and valuation provisions	**(2,208)**	(1,983)	(1,861)
Net capitalized costs	**$1,636**	$1,544	$1,452

Production
Union Pacific Resources



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Costs Incurred in Exploration and Development

Costs incurred in oil and gas property acquisition, and exploration and development activities are as follows:

Millions of Dollars	1993	1992	1991
Costs incurred [a]			
Proved acreage	**$ 27**	$ 3	$ 29
Unproved acreage	**57**	31	42
Exploration costs	**88**	89	111
Development costs	**400**	485	309

[a] Costs incurred include capitalized costs.

Results of Operations for Producing Activities

Millions of Dollars	1993	1992	1991
Revenues – Third parties	**$1,044**	$ 957	$ 849
Production costs	**315**	300	288
Exploration expenses	**76**	89	76
Depreciation, depletion and amortization	**400**	409	270
Total costs	**791**	798	634
Pre-tax results	**253**	159	215
Income taxes	**83**	58	73
Results of operations	**$ 170**	$ 101	$ 142

Pipeline results, overhead expenses and interest costs have been excluded in computing these results of operations.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves

Millions of Dollars	1993	1992	1991
Future cash inflows from sale of oil and gas	**$4,540**	$5,256	$4,792
Future production and development costs	**(1,631)**	(1,451)	(1,406)
Future income taxes	**(859)**	(1,156)	(963)
Future net cash flows	**2,050**	2,649	2,423
10% annual discount	**(761)**	(1,097)	(919)
Standardized measure of discounted future net cash flows	**$1,289**	$1,552	$1,504

An analysis of changes in standardized measure of discounted future net cash flows follows:

Millions of Dollars	1993	1992	1991
Beginning of year	**$1,552**	$1,504	$1,689
Changes due to current year operations:			
Additions and discoveries less related production and other costs	**441**	721	371
Sales of oil and gas, net of production costs	**(733)**	(657)	(561)
Development costs	**400**	485	309
Purchases (sales) of reserves-in-place	**28**	(228)	15
Changes due to revisions in:			
Price	**(516)**	(4)	(325)
Development costs	**(358)**	(414)	(355)
Quantity estimates	**(5)**	103	43
Income taxes	**143**	(101)	133
Other	**123**	(56)	(46)
Discount accretion	**214**	199	231
End of year	**$1,289**	$1,552	$1,504

Future oil and gas sales, and production and development costs have been estimated using prices and costs in effect as of each year-end. Future net revenues were discounted to present value at 10%, a uniform rate set by the FASB. Income taxes represent the tax effect (at statutory rates) of the difference between the standardized measure values and tax bases of the underlying properties at the end of the year.

Changes in the supplies and demand for oil and natural gas, inflation, timing of production, reserve revisions and other factors make these estimates inherently imprecise and subject to substantial revision. As a result, these measures are not the Corporation's estimate of future cash flows nor do these measures serve as an estimate of current market value.

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Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, Except Per Share Amounts, Ratios and Employee Statistics

	1993 [a]	1992	1991 [b]	1990	1989	1988	1987	1986	1985	1984
Operating Revenues	**$ 7,561**	7,294	7,029	6,964	6,388	6,068	5,351	4,773	5,078	5,289
Operating Income (Loss)	**1,489**	1,405	461	1,324	1,243	1,200	991	(364)	825	946
Net Income (Loss)	**530**	728	64	618	595	644	583	(460)	501	494
Per Share:										
Net Income (Loss)	**2.58**	3.57	0.31	3.08	2.81	2.83	2.55	(2.28)	2.09	2.01
Dividends	**$ 1.54**	1.42	1.305	1.18	1.12	1.05	1.00	0.93	0.90	0.90
At Year-End										
Total Assets	**$ 15,001**	14,098	13,326	13,078	12,459	12,228	10,919	10,863	10,710	10,392
Total Debt	**4,184**	4,099	4,050	4,084	4,036	3,356	2,885	3,061	2,192	2,186
Common Stockholders' Equity	**4,885**	4,639	4,163	4,277	3,911	4,482	3,761	3,408	4,356	4,231
Per Common Share	**$ 23.81**	22.75	20.52	21.36	19.50	19.85	17.90	16.23	19.84	18.76
For the Year										
Capital Investments [c]	**$ 1,574**	1,567	1,231	1,206	1,174	1,240	748	738	1,067	1,017
Cash from Operations	**1,563**	1,660	1,392	1,467	1,483	1,391	950	1,333	1,317	1,220
Total Salaries, Wages and Employee Benefits [d]	**$ 2,863**	2,850	2,706	2,694	2,593	2,498	2,284	1,978	2,188	2,216
Average Number of Employees	**47,126**	46,039	47,090	48,323	48,126	47,259	46,559	39,476	44,419	46,388
Revenues Per Employee	**$160,400**	158,400	149,300	144,100	132,700	128,400	114,900	120,900	114,300	114,000
Financial Ratios (%)										
Debt to Total Capital Employed	**35.6**	36.9	39.2	38.5	40.3	34.5	32.7	36.1	24.7	25.8
Return on Average Common Stockholders' Equity	**11.1**	16.5	1.5	15.1	14.2	13.4	12.9	–	10.1	11.6

[a] 1993 results include a net after-tax charge of $175 million for the adoption of changes in accounting methods and a $61 million charge for the deferred tax effect of the 1993 Tax Act (see Notes 2 and 7 to the Financial Statements, respectively). Excluding these accounting adjustments, net income would have been $766 million with a return on average common stockholders' equity of 15.7%.

[b] Earnings excluding the special charge would have been $639 million with a return on average common stockholders' equity of 14.2%.

[c] Includes exploratory expenditures and capital expenditures of unconsolidated affiliated companies.

[d] Includes capitalized salaries, wages and employee benefit costs.

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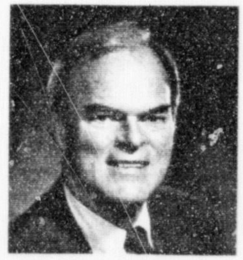
Robert P. Bauman
Chief Executive
SmithKline Beecham, p.l.c.
Pharmaceuticals and consumer products

Richard B. Cheney
Former Secretary of Defense
Senior Fellow
American Enterprise Institute
Public policy research

E. Virgil Conway
Financial Consultant



Spencer F. Eccles
Chairman and
Chief Executive Officer
First Security Corporation
Bank holding company

Judith Richards Hope
Senior Partner
Paul, Hastings, Janofsky & Walker
Law

Lawrence M. Jones
Retired Chairman and
Chief Executive Officer
The Coleman Company, Inc.
Home and recreational products

Drew Lewis
Chairman, President and
Chief Executive Officer
Union Pacific Corporation

Richard J. Mahoney
Chairman and
Chief Executive Officer
Monsanto Company
Agricultural, chemical, pharmaceutical and food products, man-made fibers and plastics

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Chairman Emeritus
Winston & Strawn
Law

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Investment Services

Robert W. Roth
Retired President and
Chief Executive Officer
Jantzen Inc.
Sportswear manufacturer

Richard D. Simmons
President
International Herald Tribu
Communications

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Elbridge T. Gerry, Jr.

Partner
Brown Brothers Harriman & Co.
Bankers

William H. Gray, III

President
United Negro College Fund
Educational assistance

Claudine B. Malone

President
Financial & Management Consulting, Inc.
Management Consulting

John R. Meyer

Professor
Harvard University

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Judith Richards Hope
Drew Lewis
John R. Meyer
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Robert W. Roth
Richard D. Simmons

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Judith Richards Hope
Richard J. Mahoney
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Richard D. Simmons

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Richard J. Mahoney
Claudine B. Malone
James D. Robinson, III

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Union Pacific Corporation

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Chairman, President and Chief Executive Officer

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Executive Vice President Finance

Ursula F. Fairbairn
Senior Vice President Human Resources

Carl W. von Bernuth
Senior Vice President and General Counsel

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Vice President and Controller

John E. Dowling
Vice President Corporate Development

John B. Gremillion, Jr.
Vice President Taxes

Mary E. McAuliffe
Vice President External Relations

Gary F. Schuster
Vice President Corporate Relations

Gary M. Stuart
Vice President and Treasurer

Judy L. Swantak
Vice President and Secretary

Union Pacific Railroad Company

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Chairman and Chief Executive Officer

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Executive Vice President Finance and Information Technologies

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Executive Vice President Marketing and Sales

Arthur L. Shoener
Executive Vice President Operations

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Senior Vice President Labor Relations

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Vice President Marketing

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Vice President National Customer Service Center

James V. Dolan
Vice President Law

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Vice President Human Resources

Kip Hawley
Vice President Reengineering

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Vice President Marketing Services

R. Bradley King
Vice President Risk Management

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Vice President Engineering Services

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Vice President Transportation

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Vice President Strategic Planning

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Vice President Marketing

Harris Wagenseil
Vice President Supply and Maintenance Operations

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Vice President Information Technologies and Chief Information Officer

James R. Young
Vice President Finance

Union Pacific Resources Company

Jack L. Messman
President and Chief Executive Officer

Dale W. Bossert
Vice President Exploration and Production

V. Richard Eales
Vice President Corporate Development

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Vice President and Chief Financial Officer

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Vice President Government Relations and Public Affairs

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Vice President Operations

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Vice President Marketing

Bill J. Zimmerman
Vice President and General Counsel

Overnite Transportation Company

Thomas W. Boswell
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Senior Vice President Finance and Administration

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Senior Vice President Operations

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Senior Vice President Customer Services and Marketing

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Vice President Regional

Alan L. Cigich
Vice President Human Resources

James A. D'Alessio
Vice President Regional

Keith K. Dobson
Vice President Fleet Services

B. W. Edwards
Vice President Safety

John W. Fain
Vice President Regional

Robert J. Flynn
Vice President Sales

Mark B. Goodwin
Vice President and General Counsel

Alan W. McBride
Vice President Regional

Timothy W. Ramsey
Vice President Regional

John J. Ritchie
Vice President Marketing

Stephen C. Robbins
Vice President Information Systems

Phillip R. Warren
Vice President Transportation

USPCI, Inc.

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Chairman

Robert S. Jackson
President and Chief Executive Officer

John R. Brooks
Vice President Government and Non-Hazardous Operations

William D. Cobb
Vice President Western Region Operations

Deborah Perry Estrin
Vice President Human Resources

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President and Chief Executive Officer JTM Industries

Ken Jackson
Vice President Business Development

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Vice President Government Affairs and Regulatory Compliance

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Vice President Sales and Eastern Region Operations

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Merrick C. Walton
Vice President and General Counsel

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Vice President Transportation Systems and Services

Skyway Freight Systems, Inc.

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Chief Executive Officer

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Raymond J. Lutz
Senior Vice President Sales and Marketing

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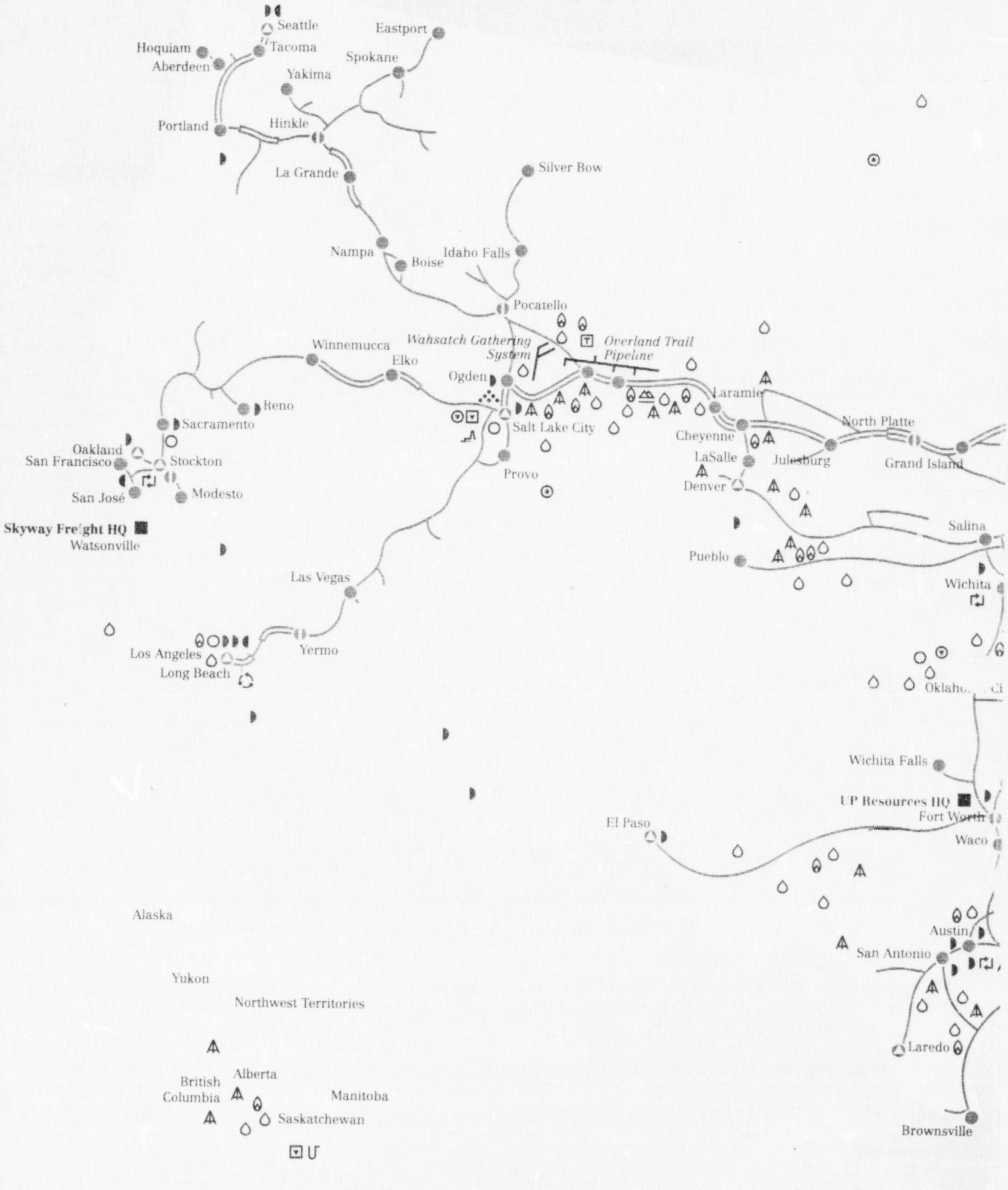
Vice President Finance

Gary L. Roberts
Vice President Information Services

Union Pacific Corporation



Union Pacific Corporation

Union Pacific Railroad

- Headquarters
- Single, Double and Triple Track
- Classification Yards
- Major Intermodal Trailer/Container Terminals

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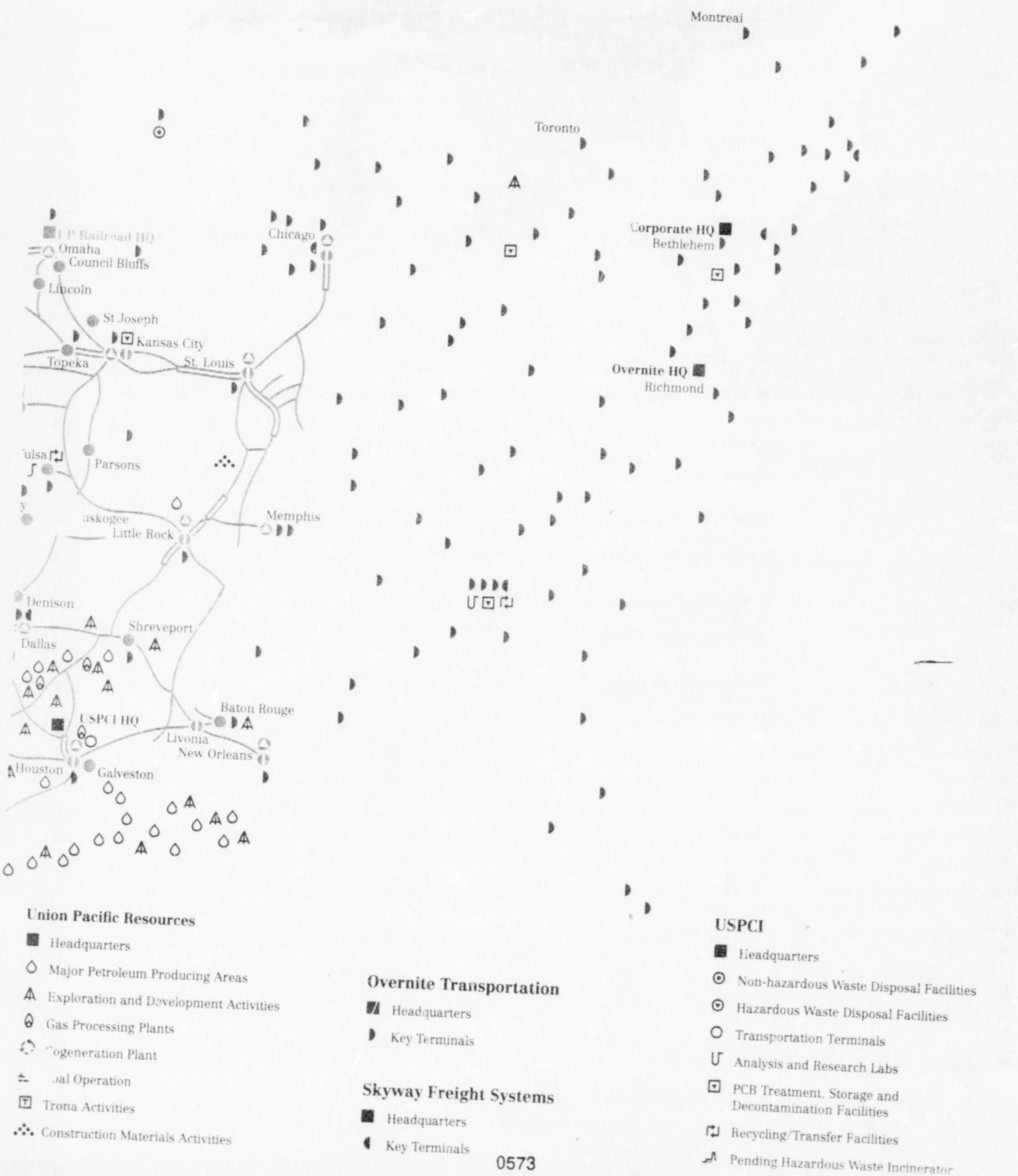
Montreal
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Bethlehem
Overnite HQ
Richmond
UP Railroad HQ
Omaha
Council Bluffs
Lincoln
St Joseph
Kansas City
Topeka
St. Louis
Chicago
Parsons
Memphis
Little Rock
Denison
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Headquarters
Major Petroleum Producing Areas
Exploration and Development Activities
Gas Processing Plants
Trona Activities
Construction Materials Activities
Overnite Transportation
Headquarters
Key Terminals
Skyway Freight Systems
Headquarters
Key Terminals
USPCI
Headquarters
Non-hazardous Waste Disposal Facilities
Hazardous Waste Disposal Facilities
Transportation Terminals
Analysis and Research Labs
PCB Treatment, Storage and Decontamination Facilities
Recycling/Transfer Facilities
Pending Hazardous Waste Incinerator

Executive Offices
Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018
(610) 861-3200

Union Pacific Railroad Company
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Omaha, Nebraska 68179

Union Pacific Resources Company
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Fort Worth, Texas 76102

Overnite Transportation Company
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Richmond, Virginia 23209

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Union Pacific Technologies
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St. Louis, Missouri 63117

Skyway Freight Systems, Inc.
225 Westridge Drive
Watsonville, California 95076

External Relations Office
555-13th Street, N.W., Suite 450 W.
Washington, D.C. 20004

Transfer Agent and Registrar of Stock
First Chicago Trust Company of New York
Post Office Box 2500
Jersey City, New Jersey 07303-2500

If you have any questions regarding your account, contact First Chicago's Telephone Response Center at (800) 446-2617 on weekdays between 8 a.m. and 10 p.m. and Saturdays between 8 a.m. and 3:30 p.m. (Eastern Time) or write to First Chicago at the above address.

Stock Listing
New York Stock Exchange
Ticker Symbol: UNP

Annual Meeting of Stockholders
May 11, 1994, 8:30 a.m.
Little America Hotel
Salt Lake City, Utah

The proxy statement and proxy form will be mailed in March.

SEC Form 10-K
A copy of the Corporation's 1993 Annual Report on Form 10-K, filed with the Securities and Exchange Commission, may be obtained by writing to:

Secretary
Union Pacific Corporation
Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018

Quarterly Earnings Information
Beginning in 1994, Union Pacific will discontinue distributing quarterly reports to shareholders. Copies of press releases and Securities and Exchange Commission filings covering quarterly earnings information may be obtained by telephoning (toll-free) or writing the Corporation's Transfer Agent as listed above.

◄ Map

Union Pacific 1994 Annual Report

Partnership

Union Pacific Corporation and Subsidiary Companies

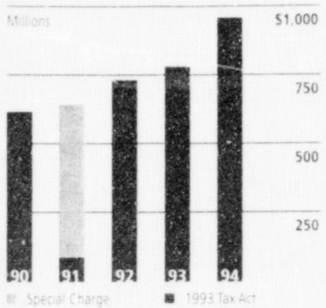
	Millions of Dollars, Except Ratios and Per Share Amounts	1994 [a]	1993 [b]	1992
For the Year	Operating revenues	**$7,798**	$7,325	$7,032
	Operating income	**1,595**	1,494	1,397
	Income from continuing operations	**958**	714	728
	Loss from discontinued operations	**(412)**	(9)	—
	Cumulative effect of accounting changes	—	(175)	—
	Net income	**546**	530	728
	Cash from operations	**1,909**	1,563	1,660
	Capital investments	**1,597**	1,574	1,567
At Year-End	Total debt	**$4,560**	$4,183	$4,098
	Common stockholders' equity	**5,131**	4,885	4,639
Measurements	Earnings per share:			
	Income from continuing operations	**$ 4.66**	$ 3.47	$ 3.57
	Loss from discontinued operations	**(2.00)**	(0.04)	—
	Cumulative effect of accounting changes	—	(0.85)	—
	Net income	**2.66**	2.58	3.57
	Dividends declared per share	**1.66**	1.54	1.42
	Debt to total capital employed	**36.3%**	35.6%	36.8%
	Return on average common stockholders' equity	**10.9%**	11.1%	16.5%

[a] 1994 results include a net after-tax loss from discontinued operations of $412 million from the sale of the Corporation's waste management operations (see Note 2 to the Financial Statements). Excluding this loss, return on average common stockholders' equity would have been 18.4%. All information presented has been restated to reflect USPCI, Inc. as discontinued operations.

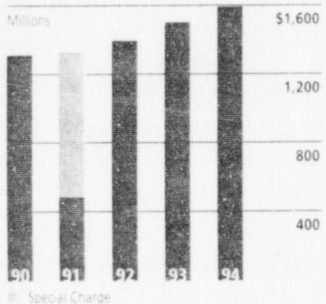
[b] 1993 results include a net after-tax charge of $175 million for the adoption of changes in accounting methods and a one-time $62 million charge for the deferred tax effect of the Omnibus Budget Reconciliation Act of 1993 (the 1993 Tax Act) (see Notes 3 and 7 to the Financial Statements, respectively). Excluding the effects of the 1993 Tax Act, income from continuing operations would have been $776 million ($3.77 per share) with a return on average common stockholders' equity of 15.9%.

Contents

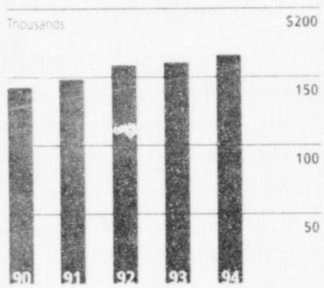
Income From Continuing Operations
Union Pacific Corporation

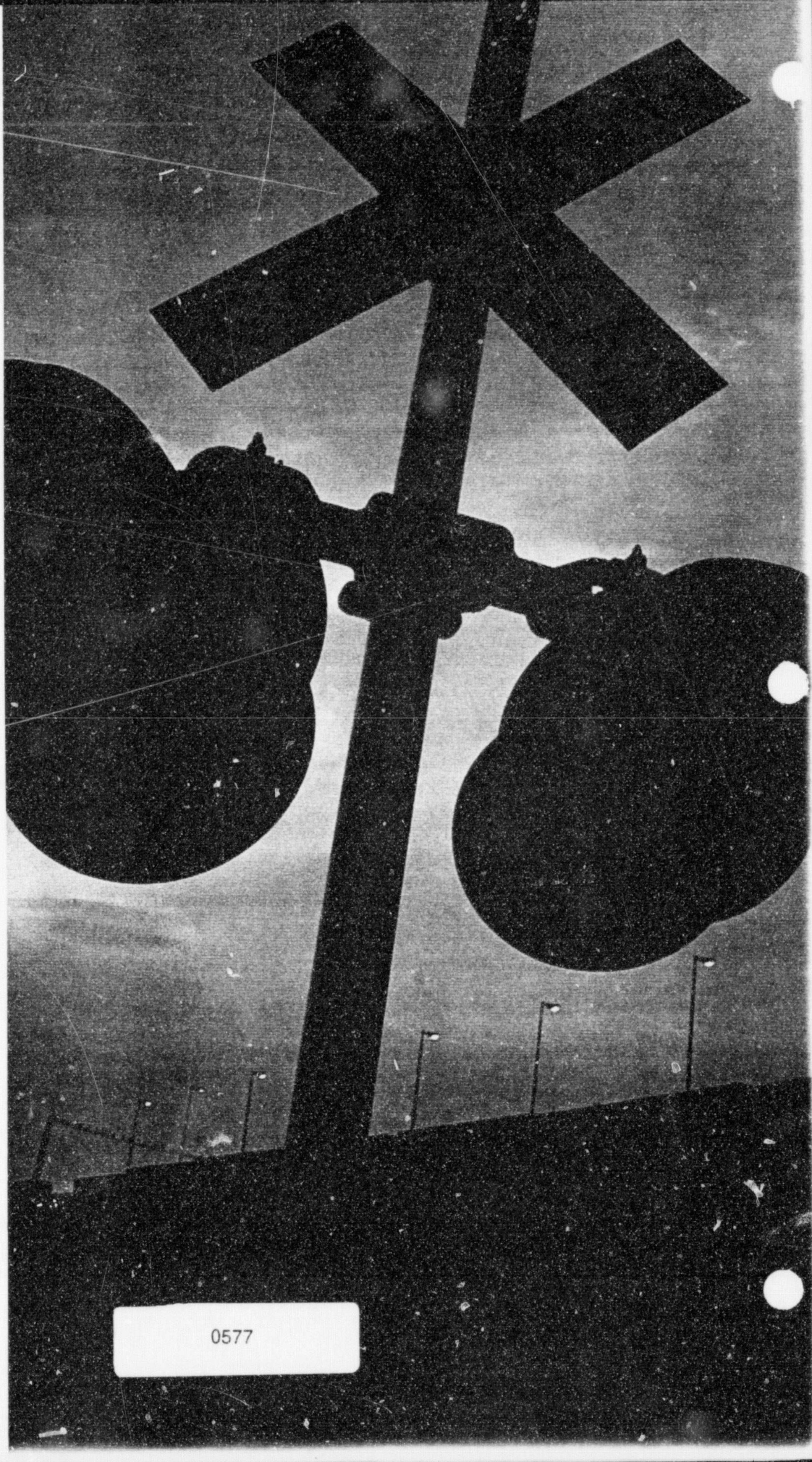


Operating Income
Union Pacific Corporation



Revenues Per Employee
Union Pacific Corporation





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When you first look at the word "partnership," you see an unbroken group of letters depicting togetherness, oneness, a union. At Union Pacific, we see "partnership" as two words – partner and ship – that become one when we partner with our customers.

The dictionary says a partnership is a relationship between individuals or groups characterized by mutual cooperation and responsibility for achievement of a goal. That defines exactly how we view our association with all of our customers, whether it's shipping goods by rail, truck, air, pipeline or interchanging data via fiber-optic cable. Partnership is a way of life at Union Pacific.

When you are in the highly competitive, service-sensitive businesses that we are, performance is your product. Our Railroad performed well enough to make it to the finals in the 1994 Malcolm Baldrige National Quality Award competition, and quality will continue to be our watchword because our customers demand and deserve nothing but our best performance.

A Strong Year for Union Pacific

Union Pacific had its strongest year ever in 1994 – thanks in large part to our resourceful employees. Our earnings from continuing operations, including $116 million from the sale of our Wilmington, California oil field, climbed to $958 million, compared to $776 million before accounting adjustments in 1993. A $404 million write-down and an $8 million loss for USPCI, which was sold to Laidlaw, reduced our 1994 earnings to $546 million. Here's how our operating companies performed compared to last year, excluding the 1993 accounting adjustments.

The Railroad: One of a Kind

Union Pacific Railroad continued to furnish proof that it is the premier American railroad. It increased earnings nearly 13 percent to $754 million, with strong growth expected for the rest of the decade. Carloadings were up over 8 percent, led by autos, intermodal, coal and chemicals. Shipments across the board were strong except for grain, which was hurt by a very weak export market.

The Railroad's operating ratio – costs versus revenues – improved to a new low of 77.9. And the Railroad's return on assets – 7.3 percent – was the highest in the rail industry.

Record coal shipments flowed out of the Powder River Basin, while the Railroad continued to ease capacity constraints in the busiest traffic corridor in the world – our Nebraska main line. Segments of this corridor are being triple- and even quadruple-tracked, with trains expected to run through certain areas every 14 minutes. In short, the Railroad is really rolling.

One key development in mid-December bolstered the Railroad's prospects. The Interstate Commerce Commission approved our petition to control the Chicago & North Western, permitting us to convert our 30 percent of C&NW non-voting common stock to voting stock and to add two directors to the expanded C&NW board. This should facilitate even closer coordination between the two roads, improving our traffic flow out of the Powder River Basin and to and from Chicago.

Resources: A Strong Year

Union Pacific Resources remained the country's most active driller and one of the most profitable independents in 1994. Through the skillful use of technology, focused exploration, and resourceful cost-cutting, UPRC achieved record earnings of $390 million, despite weak prices for much of the year. Net income included Resources' $100 million share of the gain from the Wilmington sale. The sales proceeds from this declining, low-margin oil field helped to finance the $725 million purchase of Amax ~~Oil &~~ Gas, with its long-lived gas reserves, along with a large inventory of drilling prospects in West Texas and southern Louisiana. The Ozona field in West Texas, for example, has wells that may require only a week to drill but can often produce for well over 30 years. These properties will provide gas marketing opportunities well into the next century.

Resources had the best production year in its nearly 80-year history, with overall output up 15 percent. At the same time, reserves rose for the seventh consecutive year, reflecting exploration successes and the Amax acquisition, a remarkable performance in a country that some observers claim is approaching depletion. The Austin Chalk had record production for the fifth year in a row. Ozona's output is expected to rise, with plans to drill a well a day in this prolific area through 1996.

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Overnite: A Difficult Year

Overnite Transportation had the most difficult winter in its history, then rolled into the Teamsters' strike against other truckers, with both events driving up operating costs. As a result, Overnite's earnings were essentially flat for the year at $64 million before goodwill.

In January, 1995, several management changes were made, including the election of Jim Douglas as president and chief operating officer, upon the resignation of Tom Boswell. We believe these changes will give Overnite a strong, decisive team in this highly competitive industry.

Skyway and UP Technologies

Skyway completed its first full year as a member of the Union Pacific family, adding several key partnerships to its growing customer base. Kip Hawley, formerly vice president of reengineering for our Railroad, became Skyway's chief executive officer on January 1, 1995, replacing Bob Baker, who retired.

Union Pacific Technologies' innovative computer applications continued to find a wider use within the corporation and a greater market in the transportation industry. In 1994, Technologies completed the critical task of providing disaster recovery capabilities for our computer systems corporation-wide.

The Sale of USPCI

At year-end, we completed the sale of USPCI to Laidlaw of Ontario, Canada, for $225 million, plus the assumption of certain debt and other liabilities.

For the past several years, USPCI had been a disappointment to Union Pacific. The market fell far short of expectations, cleanup of Superfund sites lagged behind timetables, cement kilns undercut margins for incinerating hazardous waste, and industries became adept at minimizing their wastes. Despite the efforts of the management and employee team, the company never achieved the ambitious goals we had set for it.

The Sante Fe Pacific Merger Bid

In October, we presented a competing bid for the Sante Fe Pacific Railway. We believed that our system, combined with Sante Fe's, offered a significant growth opportunity for our shareholders. Unfortunately, the Sante Fe board rejected all of our improved bids. These rejections – coupled with a selective "poison pill" that prevented Sante Fe shareholders from choosing between competing bids – caused us to withdraw our proposal rather than pay more for Sante Fe than it was worth. Despite our disappointment, we continue to be the premier railroad in the country and remain committed to improving service for our customers.

A Good Year for Union Pacific

All in all, 1994 was a good year for Union Pacific. The profile of the company changed slightly with the Amax acquisition and the sale of USPCI. One thing, however, remains constant – our commitment to lasting partnerships with our customers and with our shareholders. Whether you look at partnership as one word or two is less important than understanding that Union Pacific's dedicated workforce views it as a pledge to getting the job done – together.

Drew Lewis

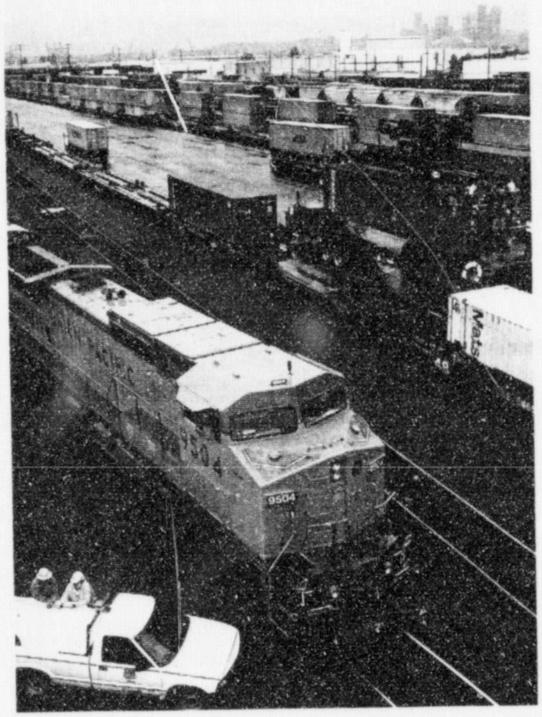
Drew Lewis
Chief Executive Officer
Bethlehem, Pennsylvania
February 23, 1995

Union Pacific Railroad

	1994	1993	1992
Operating Revenues (millions of dollars)	**$5,318**	$4,987	$4,897
Operating Income (millions of dollars)	**$1,173**	$1,042	$1,031
Carloadings (thousands)	**4,991**	4,619	4,458
Operating Ratio	**77.9**	79.1	79.0

The Railroad enjoyed tremendous success in 1994 due to the hard work of its service-minded employees, increased traffic and improved weather conditions. All financial results were favorable. Earnings improved to $754 million – nearly 13 percent over last year's $669 million, excluding the 1993 accounting adjustments. Carloadings rose more than 8 percent overall, as five of seven commodities posted gains.

The operating ratio continued its downward trend, dropping 1.2 percentage points to 77.9 – better than any other western railroad. To top the year, the Railroad was one of five service companies selected as a finalist in the prestigious Malcolm Baldrige National Quality Award competition. Adopting the Baldrige's high standard heightened the Railroad's commitment to quality service.



One of eight dedicated piggypackers loads a container onto a flatcar at the Railroad's busy Seattle Argo Yard. In 1994, intermodal ramps doubled at the Argo Yard and all other traffic was diverted to the nearby Van Asselt Yard. As a result, trailer and container lifts increased significantly at Argo.

Highlights for 1994

The Railroad's partnership successes are as varied as the commodity mix it hauls – the most diversified in the industry.

Intermodal traffic still ranks as the Railroad's fastest growing and most schedule-sensitive business. Volume grew to a record 1.45 million loads in 1994, up 14 percent over 1993, helped by increases from UPRR's trucking partners. An upward trend is forecast to continue into the next century, and the Railroad has established aggressive action plans to handle this substantial growth. The state-of-the-art Lathrop Intermodal Facility in central California became operational in the fourth quarter of 1994. Yard expansions and technology improvements such as computer scanning were introduced throughout the system, expediting intermodal traffic.

The Railroad hauled nearly 130 million tons of coal last year – with 86 million tons originating in the Powder River Basin (PRB) of Wyoming. PRB tonnage has doubled since 1989, and demand for this low-sulfur, environmentally preferred fuel remains strong. Triple- and quadruple-tracking projects currently under way along links of the PRB coal chain will help the Railroad meet the challenges of this demanding schedule. Additionally, higher-volume, lighter-weight aluminum cars added to the PRB fleet permit longer trains and heavier loading.

UPRR's auto traffic reached record levels in 1994, with 11 percent growth. With 21 strategically located loading ramps and direct access to four auto assembly plants, the Railroad leads the western rail carriers in auto volume. To improve service and increase

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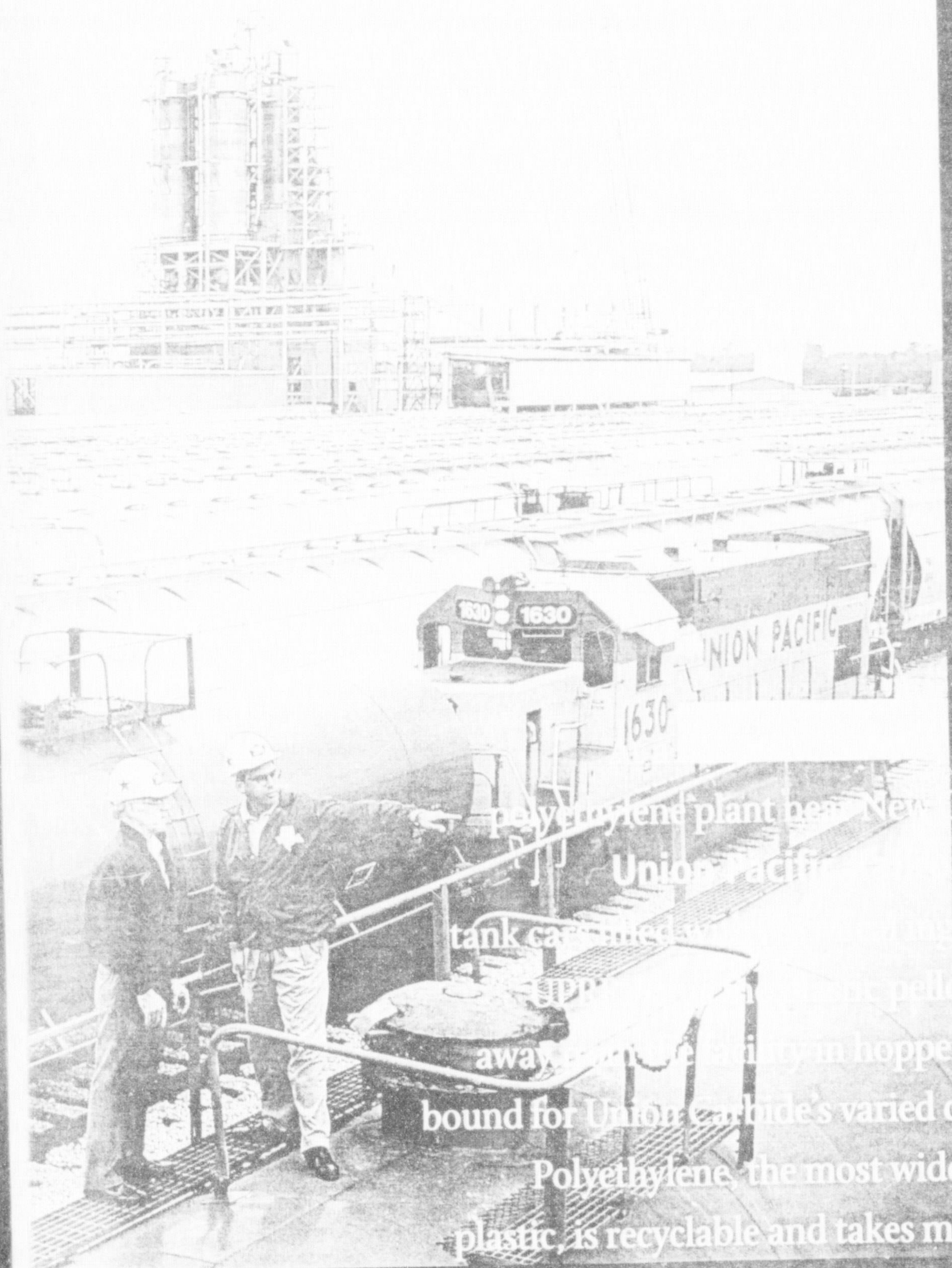
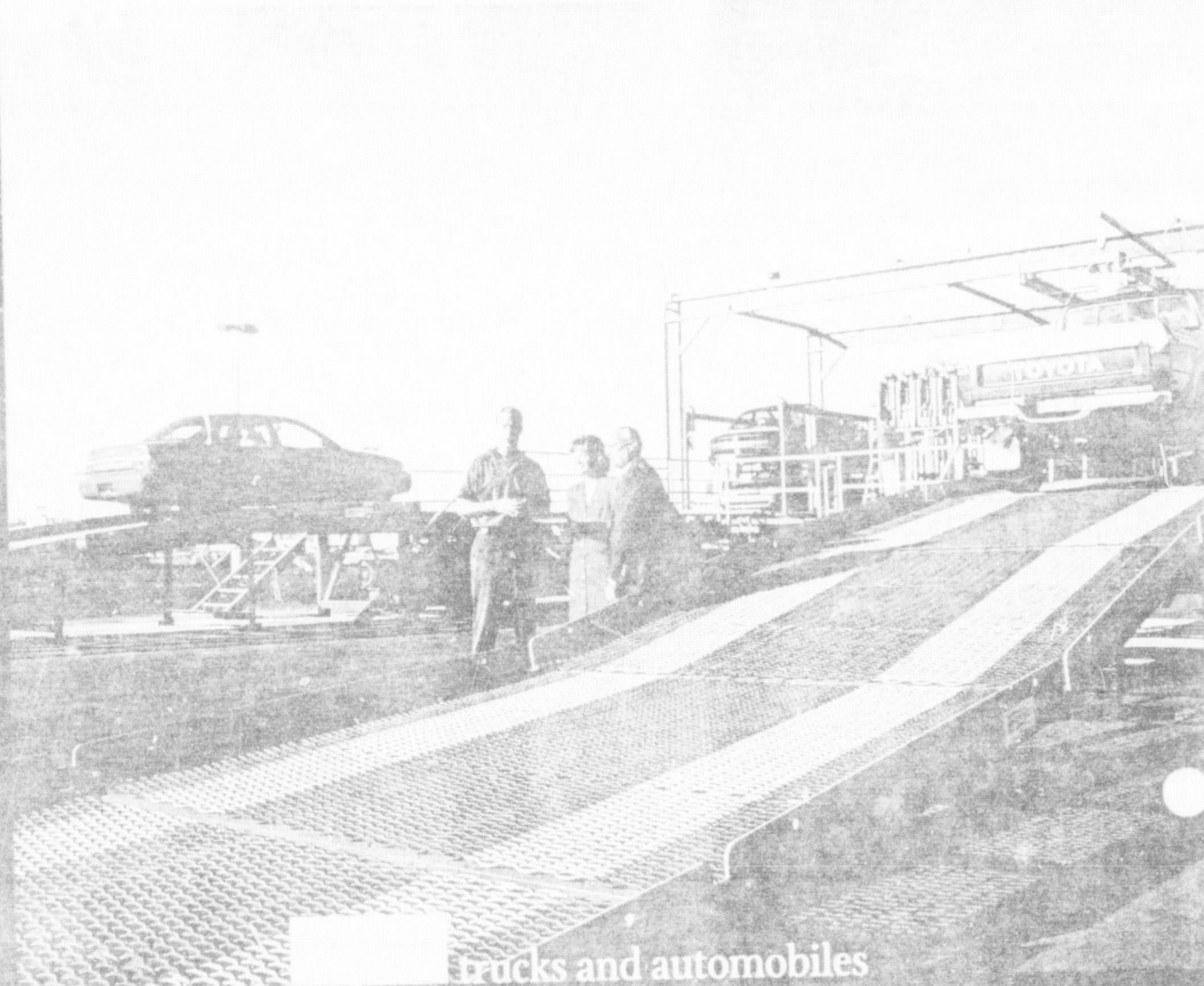
PARTNERS

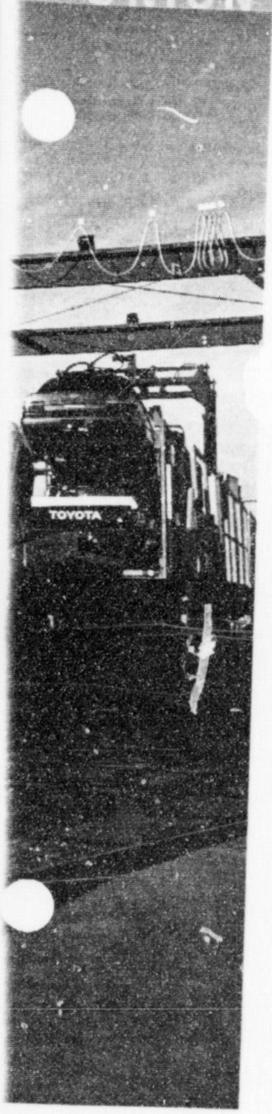


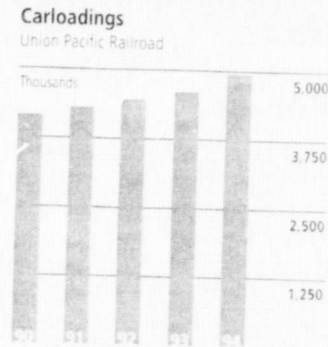
polyethylene plant near New Orleans, Union Pacific [illegible]ad positions tank cars filled w[illegible]ingredients. [illegible] UPRR [illegible] pellet product away [illegible] in hopper cars bound for Union Carbide's varied customers.

Polyethylene, the most widely used plastic, is recyclable and takes many forms from food wraps to toys.



trucks and automobiles glide into **Union Pacific Railroad** containers in prototype Autostack racks at the New United Motor Manufacturing plant in Milpitas, California. UPRR's Julie Johnson and Larry Palmer discuss startup of this damage reduction pilot with Toyota's Mike Magnason.





market share, UPRR's Automotive Business Team has created an automotive train network with dedicated trains running from Chicago to southern and northern California and the Pacific Northwest. The network's unit trains provide customers with improved vehicle handling.

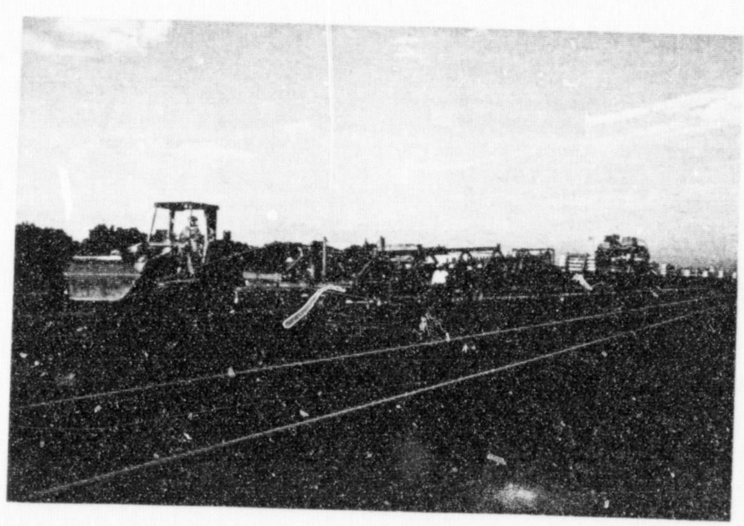
Chemicals accounted for over $1.1 billion in Railroad revenue in 1994 – more than any other commodity. To sustain this performance, the Chemical Business Team has captured significant new petrochemical business in the Houston area. UPRR will complete the capital improvements, including trackage to new customers, to support this strategic initiative in 1995 and 1996 at a cost of approximately $37 million.

Mexico revenues were up 20 percent to $348 million. Grain, chemicals and intermodal have shown the greatest increases. The North American Free Trade Agreement, coupled with successful joint efforts to facilitate border interchanges, have substantially increased efficiencies in handling traffic to and from Mexico. UPRR added four classification tracks at its growing Port Laredo, Texas yard.

New Horizons

While the commitment to strengthen partnerships through quality improvement progresses steadily, dramatic gains are envisioned from new technologies, redesigned processes and strategic ventures. For example, the use of distributed power and AC (alternating current) traction could produce as big a breakthrough in locomotive power as the shift from steam to diesel engines did in the 1950s.

Eight-hundred pound, concrete crossties drop into place at two-foot intervals as a third main line is constructed to alleviate traffic constraints between North Platte and Brady, Nebraska. In the same operation, this special equipment installs continuous welded rails, laying a mile or more of track in a day.



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Revenue Ton-Miles Per Employee

Distributed power allows locomotives to be placed throughout a train in up to four locations – all controlled from the lead locomotive. This reduces in-train stresses and permits longer trains throughout the system – even in mountainous regions. Separate AC traction motors improve wheel adhesion and braking performance, while their smaller size leaves more room for the higher horsepower main diesel engines.

The Railroad knows its customers place a premium on reliability and a hassle-free business environment. To better serve its customers, UPRR's reengineering program, established in 1993, identifies and removes barriers that stand in the way of improved service. Eventually, all core business processes – from deal making to bill-collecting – will be scrutinized by reengineering teams. Initially, improved terminal operations at Hinkle, Oregon and better train scheduling everywhere are the prime focus of reengineering teams.

Last December, the ICC approved the Railroad's application for authority to control UPRR's railroad partner, the Chicago & North Western (C&NW). The ICC action will enable Union Pacific to vote its 30 percent block of C&NW stock and increase UPRR's representation on the C&NW board of directors to three of nine members. The synergism made possible by increased cooperation with the C&NW, together with new technologies and superior processes, should prove a potent combination for the future of the Railroad and its shipping partners.

UPRR delivers auto parts to and hauls finished automobiles from General Motors' Arlington, Texas automobile manufacturing plant. The Railroad also transports new GM vehicles from other plants to Arlington for distribution to regional dealerships.

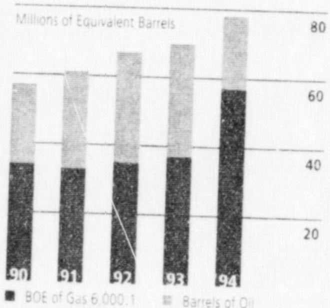
Safer tank cars and careful handling demonstrate the [redacted] and **Union Pacific Railroad** joint commitment to incident-free chemical transport. UPRR moves Monsanto's specially designed phosphorous cars at reduced speeds along main lines equipped to detect mechanical problems more quickly. Monsanto converts the sensitive cargo to phosphoric acid at its Carondelet plant in St. Louis.

[redacted]

	1994	1993	1992
Operating Revenues (millions of dollars)	$1,306	$1,323	$1,259
Operating Income (millions of dollars)	$ 351	$ 382	$ 315
Total Reserves (MMBOE)[a/b]	509.0	445.4	441.5
Total Production (MMBOE)[a/b]	77.7	69.6	67.0

[a] Natural gas converted on a BTU basis to barrels of oil equivalent on a ratio of 6,000 cubic feet of gas to one barrel of oil.
[b] Includes the first quarter 1994 acquisition of Amax Oil & Gas, Inc.

Production
Union Pacific Resources

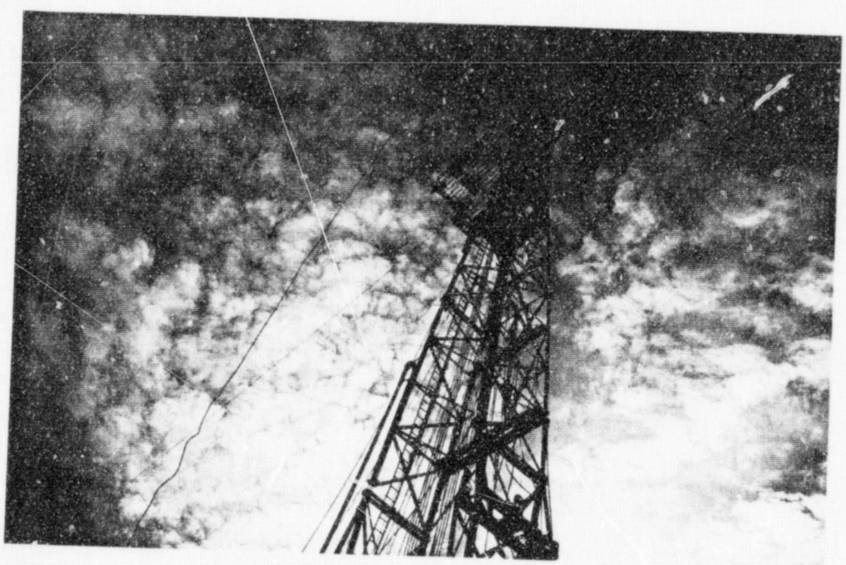


Union Pacific Resources achieved another record year in the face of flat or declining prices. Net income was $390 million in 1994, compared to $309 million in 1993 (excluding accounting adjustments). The 1994 results included a $100 million gain from UPRC's share of the Wilmington sale.

An aggressive exploration and production program helped UPRC remain a leading domestic independent oil company and the most active driller in the United States. This program, along with the purchase of Amax Oil & Gas, boosted the company's production 15 percent to 242,000 barrels of oil equivalent (BOE) a day, while total reserves grew from 445 to 509 million BOE.

Thriving in a Low-Price World

UPRC has become a pre-eminent independent by crafting a strategy that allows it to thrive in a low-price world. That strategy is driven by four factors: the development of a large drill site inventory; the quick application of new technology; one of the most pro-active cost-cutting programs in the industry, including an intensive reengineering effort; and a continuing focus on natural gas and the gas value chain.



Union Pacific Resources purchased Amax Oil & Gas in March and has accelerated development of Ozona, its huge natural gas field in West Texas, with plans to drill a well a day through 1996.

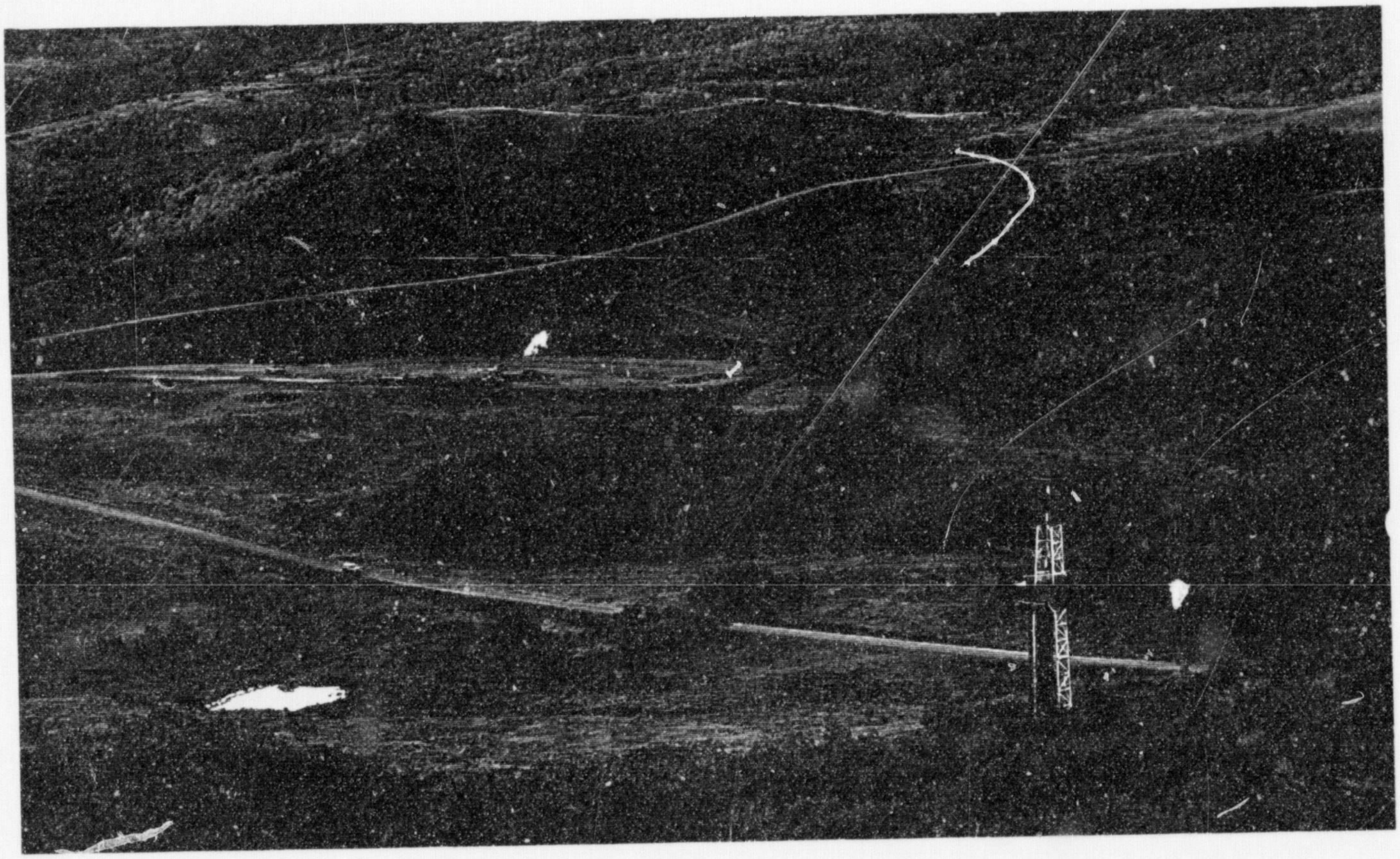
UPRC's largest thrust in 1994 was the $725 million purchase of Amax, which provided an additional core area – Ozona in West Texas – along with promising properties in south Louisiana and East Texas. With numerous potential drill sites, Ozona will help to underwrite UPRC's future long into the twenty-first century. In 1995, for example, the company plans to drill a well a day in the area. These wells require as little as a week to drill, but can have a productive life of over 30 years.

UPRC's other core areas – or profit centers – include East and South Texas (Carthage), the Land Grant and the Austin Chalk. All had substantial gains in production in 1994.

In East Texas, UPRC has remained a strong producer, increasing output in the Carthage area to over 90 million cubic feet a day (MMCF/D), while further expanding one of the largest gas processing facilities in the country. This unit delivers gas to the Carthage hub that serves 15 pipelines supplying gas throughout the East and Midwest.

[redacted] has designated UP Fuels as a major supplier of natural gas.

UPRC currently supplies approximately one-half of GE's domestic needs, including gas to fuel GE's plastics resin plant in Selkirk, New York, above. Resources assures deliveries by working closely with pipeline companies.



UPRC's successful well in the Lodgepole field in northern Utah was the first completed horizontal well in the Overthrust Belt of the Land Grant. This field will be developed aggressively in the nineties.

In the Land Grant, Resources has brought six wells on-line to feed the Wahsatch Gathering System in southwestern Wyoming and Utah; these wells have a combined production of 80 MMCF/D. Further south, in Utah, UPRC has completed its first four horizontal oil wells in the Overthrust Belt and expects to drill up to 10 wells in the Lodgepole area in 1995.

The huge Austin Chalk Trend in central Texas has been UPRC's success story of the nineties, with nearly 1,000 completed horizontal wells. Production reached another record, rising from an average of 66,600 equivalent barrels a day in 1993 to 73,300 barrels in 1994; 43 percent of this output is natural gas.

Two other promising areas are being developed: south Louisiana and the Gulf of Mexico. The south Louisiana play has been created by the Amax purchase, with UPRC's

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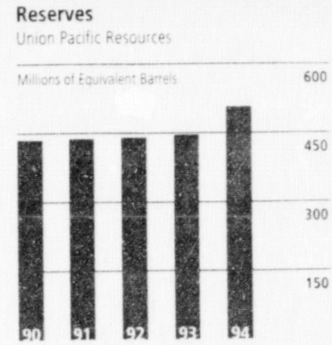


first well producing 15 MMCF/D. Several more wells are planned in 1995. In 1994, three successful wells in the Gulf of Mexico were drilled; these platforms will come on-stream in 1995, with a combined output of 100 MMCF a day.

Technology and Cost Cutting

UPRC's technical staff has expertly applied the latest technology available – particularly horizontal drilling, 3-D seismology and fracturing – to Resources' core areas with a high degree of success. This resourcefulness made the Austin Chalk one of the richest domestic oil and gas plays of the decade, substantially enhanced well economics, improved drilling success rates, and made UPRC the forerunner in advanced hydraulic fracturing of difficult tight-gas formations.

Technology also has provided Resources with a prime tool for cutting costs and enhancing productivity. In 1994, UPRC's cost-reduction program drove development drilling expenses down from $5.15 to $4.80 per BOE, while monthly operating costs per well were lowered by over 35 percent. On the productivity front, UPRC increased its operated well count by 43 percent with the Amax purchase – without increasing its general and administrative head count.

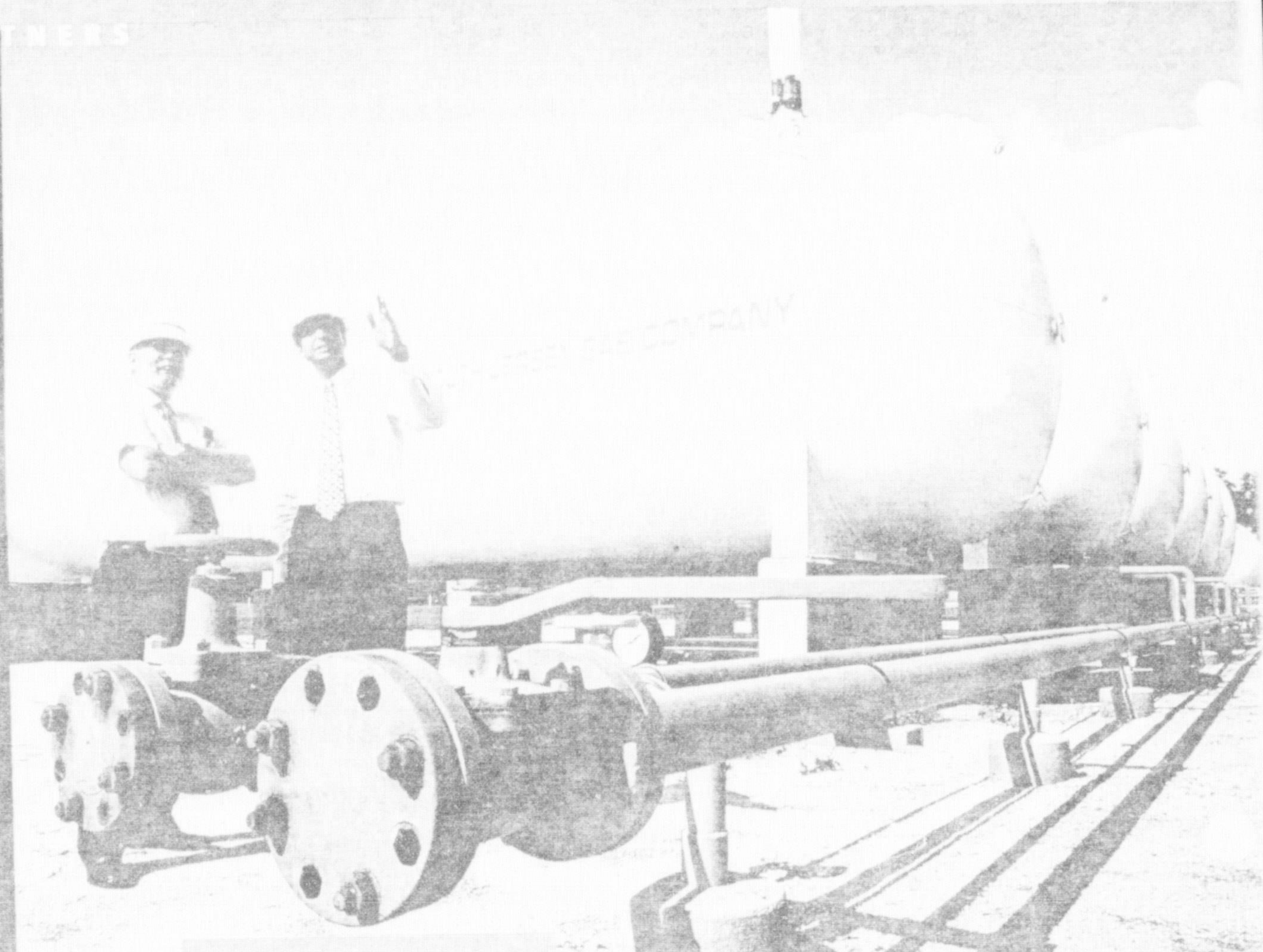
UPRC will continue its relentless war on costs. Its reengineering campaign has six teams studying and improving every phase and process of how UPRC does its work – from the front office to the most remote leasehold.

UPRC's Jacque Wolf, left, and Dixie Barrett from the Williams Companies discuss transactions on the Streamline system, an electronic natural gas trading system developed by Williams and operated by East Texas Gas Systems, a UP Fuels subsidiary. Streamline increases activity at UPRC's Carthage hub in East Texas.

The Natural Gas Value Chain

For the past five years, UPRC has shifted its focus to finding, producing and marketing natural gas. UPRC grades gas with four A's: it is abundant, affordable, acceptable environmentally and American. The company's major acquisitions and properties are primarily in prolific, long-lived gas regions. In 1994, UPRC increased its daily production 25 percent to 772 MMCF, with half of the gain attributable to the Amax properties.

The gas value chain strategy involves investing in downstream facilities to generate enhanced value from all gas produced, including gathering, processing, transporting and marketing. In Texas and Wyoming, UPRC has become a pre-eminent player by investing in gathering systems, plants and pipelines that multiply value from wellhead to burner tip. For example, new or expanded gas processing plants in Carthage, Brookeland and Ozona, Texas, and in Echo Springs, Wyoming raised UPRC's total processing capacity from 940 MMCF to 1,290 MMCF per day in 1994.

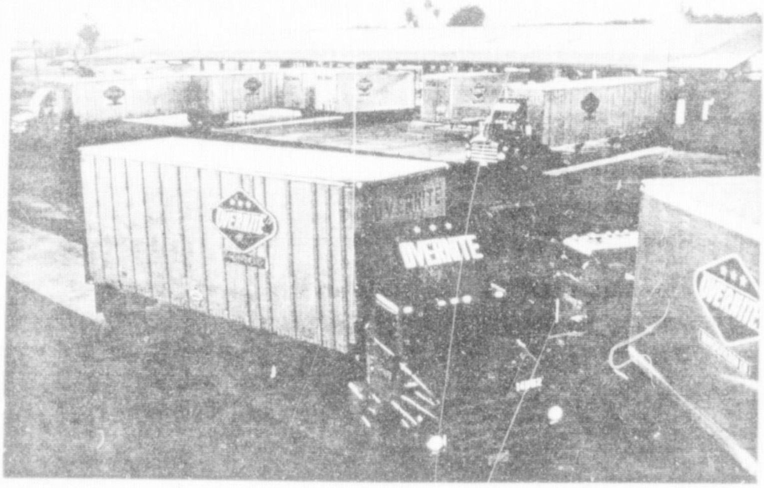


South Jersey Gas representatives,
Stanley Redrow, left, and Jeffrey DuBois
at the company's operations
near McKee City, New Jersey.
South Jersey permits UP Resources
to store gas in Pennsylvania and New York,
improving service to eastern customers
while UPRC permits South Jersey to
buy gas at discounted summer prices.

Overnite Transportation

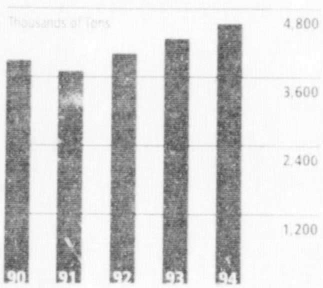
Prospects for 1995

Overnite rigs leave the new Fullerton, California terminal for customers in the Los Angeles Basin. Overnite now has 173 service centers in 45 states serving all 50



Ron Green is
part of the Overnite team
that has become the dominant
logistical partner with [redacted],
handling inbound raw materials and,
through the Raleigh-Durham, North Carolina
terminal, outbound products to
nearly all major markets east
of the Mississippi River.

Less-Than-Truckload Tonnage



Overnite offers a comprehensive array of products and services, including next-day, intra-state and regional shipping, providing nationwide service to 95 percent of the U.S. population and entry to portions of Canada and Mexico. Overnite's service encompasses toll-free phone access to a state-of-the-art customer service center; electronic shipment-tracking information; and on-site representatives at customer locations, who facilitate partnerships with such major customers as DuPont and Philip Morris.

Technology on the Cutting Edge

Overnite is placing itself in the forefront of technology in the trucking industry. It started with the centralized customer service and billing center in Richmond, the first of its kind in the industry. The center serves all 173 Overnite terminals – accepting imaged bills of lading from all over the country and sending invoices to customers every morning.

In 1995, Overnite will centralize over-the-road dispatching in its Richmond headquarters. The company is continuing to develop an integrated dispatching, yard management, dock management, and time-tracking system, using hand-held computers and mobile communications.

As part of a southeastern distribution program, an Overnite truck picks up a delivery for Kodak at its major hub north of Atlanta.

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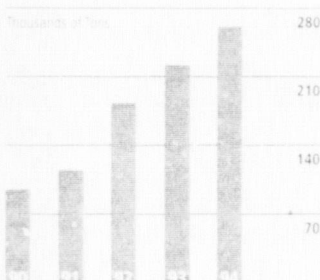
Total Weight Shipped

Skyway Freight Systems



In 1994, Skyway continued to distinguish itself as a leading technology-based logistics operating company, providing an array of services to its shipping partners. Revenue for 1994 climbed to $124 million, surpassing expectations and reflecting growth of 23 percent over 1993. In 1995, Skyway will exploit opportunities presented by NAFTA by expanding time-sensitive transportation and information services into Canada and Mexico, including door-to-door shipment tracking and customs processing.

Ground-breaking Developments in 1994

- A logistics and transportation program that bypasses distribution centers for a major retailer. This pilot delivery system dramatically reduces order-fulfillment time for customers. Skyway expects to expand this program to similar retailers in 1995.
- The industry's first Electronic Packing Slip, a single electronic transmission that provides manufacturers and their consignees access to shipment information prior to delivery. This enables Skyway customers to lower costs, improve inventory management, reduce receiving time and, in many cases, accelerate payment cycles.
- The Catapult Project – an aggressive reengineering effort using advanced technology to put Skyway ahead of its competition by revamping business processes, accelerating product development and automating training.
- A satellite tracking system for transcontinental trucks that allows customers the tightest control possible over the shipment of their goods.
- The addition of second distribution stations in San Francisco and Dallas to handle increasing volumes.

A Skyway driver makes an on-time delivery to a Pea in the Pod maternity apparel shop in a Santa Clara, California mall. Skyway plays an important part in Pea in the Pod's advanced logistical network.

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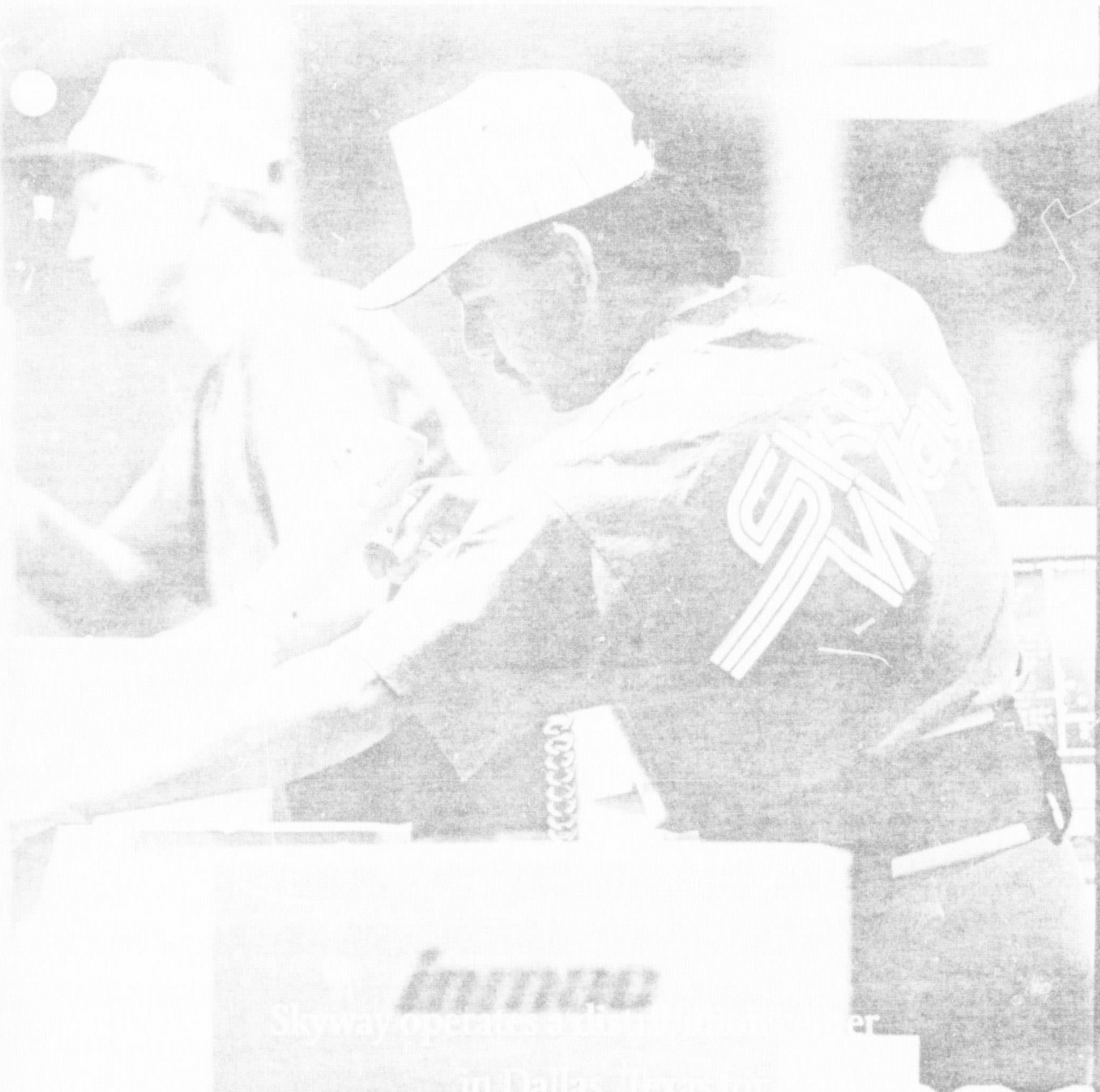


Skyway operates a distribution center

in Dallas, Texas for

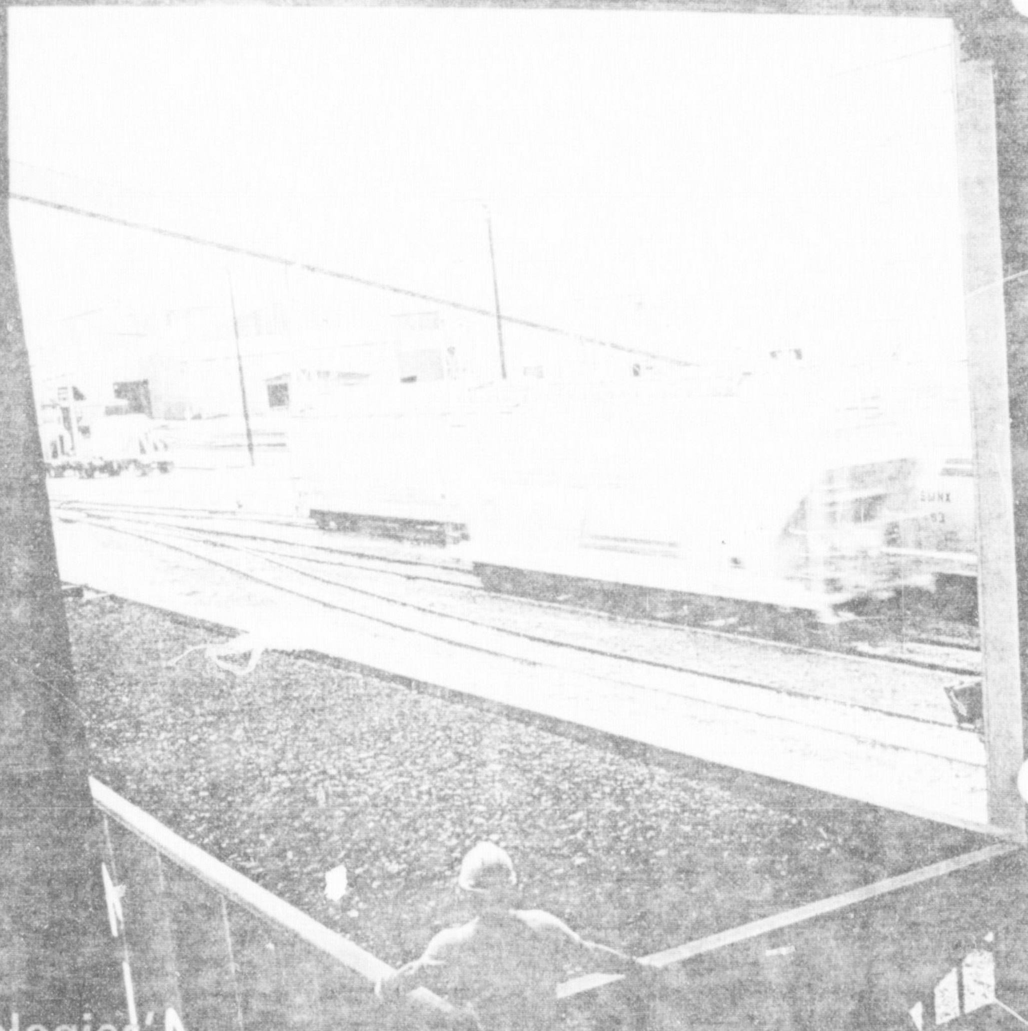
an international electronics distributor.

Skyway employees efficiently handle

6,000 products from 400 vendors

that move through the facility

bound for retailers.



UP Technologies'

detention billing service has helped cut

Solvay Minerals' soda ash car

cycle time in half, enabling Solvay to serve

more customers with fewer cars. The Union Pacific

Railroad also serves Solvay's

Wyoming soda ash complex, delivering coal

to its power plant and soda ash to customers.

Union Pacific Technologies

The Wisconsin Central credits Union Pacific Technologies' Transportation Control System (TCS) in large measure for its steady growth and solid reputation. In the customer service area, TCS handles Wisconsin Central's car ordering and shipment tracking and billing. On the operations side, TCS manages car scheduling, train movement and locomotive maintenance.

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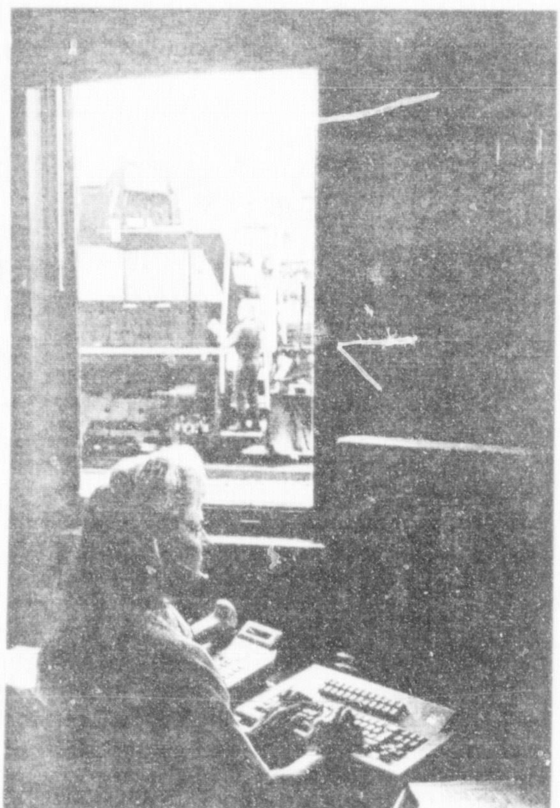

Stateside and Worldwide Partnerships

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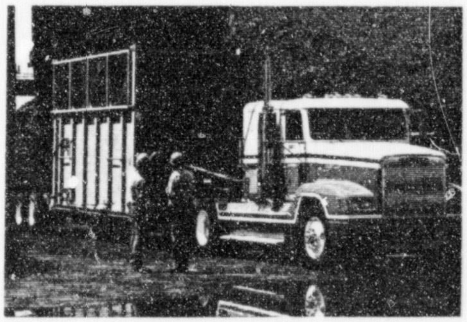
Because of continued depressed market conditions in the waste management industry, Union Pacific decided in September to exit the business by divesting itself of USPCI. The corporation recorded a $404 million after-tax write-down of assets and reclassified USPCI as a discontinued operation.

In October, Union Pacific signed a letter of intent to sell USPCI to Laidlaw Inc. of Burlington, Ontario, Canada for $225 million, plus the assumption of certain debt and liabilities. A definitive agreement for the sale was signed on December 5, and the transaction closed at year-end.

USPCI fell far short of the corporation's expectations for a variety of reasons: the sluggish cleanup of the nation's Superfund sites; increased waste minimization efforts by many corporations; and a general decline in hazardous waste volumes because of the recession in the early nineties. In addition, strong competition from cement kilns was expected to reduce the income from USPCI's hazardous waste incinerator – now on the verge of commercial operation – since cement kilns are not held to the same high standards of operation.

USPCI carefully removes contaminated soil around a Texas Eastern Pipeline Company compressor station near Shermans Dale, Pennsylvania – while the station remains in service. Tainted earth from this and several more sites along the pipeline is disposed of at USPCI's Grassy Mountain facility in Utah.

USPCI containers loaded with nonmetallic residue from a Los Angeles automobile reclamation operation are trucked to USPCI's East Carbon Development Corporation landfill in Utah.



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Consolidated Results of Operations

This review should be read in conjunction with the financial statements, notes and supplementary information.

1994 Compared to 1993

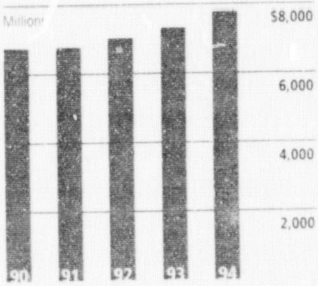
Consolidated Results: In September 1994, Union Pacific Corporation (the Corporation or UPC) committed to dispose of its waste management subsidiary, USPCI, Inc. (USPCI), and in December 1994 completed the sale of USPCI to Laidlaw Inc. (Laidlaw) for \$225 million in notes that were subsequently collected in January 1995 (see Note 2 to the Financial Statements). In the third quarter of 1994, the Corporation recorded a \$654 million (\$425 million after-tax) provision for discontinued operations. This provision included a write-down of USPCI's assets to UPC's estimate of their net realizable value and provided for costs associated with the disposition. In the fourth quarter of 1994, the Corporation adjusted its original loss provision to reflect the sale of USPCI to Laidlaw by reducing the provision by \$54 million (\$21 million after tax).

The Corporation reported net income of \$546 million or \$2.66 per share in 1994, including a net loss from discontinued operations of \$412 million or \$2.00 per share. The loss from discontinued operations included a loss from USPCI's 1994 operations of \$10 million (\$8 million after tax). In 1993, the Corporation reported net income of \$530 million or \$2.58 per share, which included a \$237 million after-tax charge for the 1993 accounting adjustments – \$175 million (\$0.85 per share) for changes in accounting methods and \$62 million (\$0.30 per share) from the implementation of the Omnibus Budget Reconciliation Act of 1993 (the 1993 Tax Act) (see Notes 3 and 7 to the Financial Statements). 1993 earnings also included a \$9 million net loss from discontinued operations.

Results of Continuing Operations: The Corporation reported income from continuing operations of \$958 million or \$4.66 per share, including the one-time benefit of a \$116 million (\$0.56 per share) after-tax gain resulting from the first quarter sale of Union Pacific Resources Company's (Resources) Wilmington, California oil and gas operations (see Note 4 to the Financial Statements). This compares to income before the 1993 accounting adjustments of \$776 million or \$3.77 per share in 1993, which included a \$34 million after-tax reduction in operating results at Union Pacific Railroad Company and its affiliate Missouri Pacific Railroad Company (collectively the Railroad) caused by the 1993 Midwest flood. In 1994, earnings improved at the Railroad and Resources, while earnings declined slightly at Overnite Transportation Company (Overnite).

Operating revenues grew 6% to \$7.80 billion from \$7.33 billion in 1993, as increased transportation volumes at the Railroad and Overnite, higher hydrocarbon sales volumes at Resources and the May 1993 addition of Skyway Freight Systems, Inc. (Skyway) (see Note 4 to the Financial Statements) were partially offset by hydrocarbon sales price declines. Operating expenses rose \$372 million to \$6.20 billion for the period. Higher volumes, severe winter weather in the Eastern U.S. in the first quarter of 1994 and the effects of unfavorable traffic shifts at Overnite (the result of an April 1994 Teamsters' strike) caused increases in salaries, wages and employee benefits (\$94 million), equipment and other rents (\$70 million), third-party transportation (\$38 million), other taxes (\$38 million), and materials and supplies (\$11 million). Depreciation charges increased \$87 million – the result of both the Corporation's continued commitment to upgrade equipment and technology, and higher production volumes at Resources. Personal injury expense rose \$42 million, while professional fees rose \$17 million as the Corporation pursued various strategic transactions in 1994. These cost increases were partially offset by lower costs associated with pipeline and gas plant product purchases for resale, reduced mining costs and lower fuel costs.

Operating Revenues
Union Pacific Corporation



Operating income advanced \$101 million (7%) to \$1.60 billion in 1994. Other income increased \$170 million to \$259 million, largely the result of the Wilmington sale, while interest expense increased \$21 million, reflecting higher debt levels to fund the AMAX Oil & Gas, Inc. (AMAX) acquisition (see Note 4 to the Financial Statements). Income from continuing operations – excluding the one-time effect of the 1993 Tax Act – as a percentage of operating revenues would have been 12.3% in 1994 and 10.6% in 1993. On the same basis, return on average common stockholders' equity would have improved to 18.4% in 1994 from 15.9% a year ago.

0599

Railroad: Net income at the Railroad was $754 million in 1994. Earnings before the effects of the 1993 accounting adjustments would have improved $85 million (13%) from $669 million a year ago. 1993 results also included the adverse effects of the flooding in the Midwest, which reduced operating results by approximately $52 million ($34 million after tax).

Operating revenues improved $331 million (7%) to $5.32 billion in 1994. Higher revenues were generated by an 8% (over 371,000 loads) rise in 1994 carloadings. Intermodal volumes improved 14% because of business expansion with the Railroad's trucking partners and growing container traffic. New coal contracts, inventory replenishment by major utilities and the absence of 1993 flood-related traffic interruptions accounted for a 13% increase in energy carloadings. Automotive traffic climbed 11%, the result of higher carloadings for both finished autos (14%) and auto parts (4%), reflecting improving economic conditions in the automotive industry. Food, consumer and government carloadings advanced 8% due to improvements in the food group – mainly canned and frozen goods – and growth in the consumer segment, reflecting growing shipments of waste/recyclables and transportation equipment. Chemical carloadings also advanced 5% from a year ago, reflecting increases in phosphorous, soda ash and fertilizer volumes. Grain traffic declined 6%, primarily the result of weak export markets for corn and lower fourth quarter wheat shipments, while metals, minerals and forest products traffic also declined 2%. The positive effect of higher volumes was partially offset by a 1% decline in average commodity revenue per car, largely the result of volume growth of lower-rated commodities – mainly energy and intermodal.

Operating expenses increased to $4.15 billion in 1994 compared to $3.95 billion last year. Personal injury expense rose $40 million, as a 34% decline in reportable injuries was more than offset by higher average settlement costs per injury. Wages and benefits rose $36 million, as higher volumes and inflation were partially offset by continued improvements in labor productivity, as the average workforce declined slightly year-over-year. Volume growth and inflation also accounted for a $36 million rise in equipment and other rents, a $16 million escalation in third-party transportation costs (reflecting higher intermodal shipments) and a $9 million increase in materials and supplies costs. Other taxes increased $20 million because of higher use and property taxes, while depreciation expense grew $25 million, reflecting the Railroad's continuing investment in equipment and capacity. These cost increases were partially mitigated by an $8 million reduction in fuel and utility costs, the result of lower fuel prices, hedging gains and an improved fuel consumption rate. Operating income at the Railroad advanced $131 million (13%) in 1994 to $1.17 billion. The Railroad's operating ratio improved 1.2 points to 77.9 from 79.1 a year ago.

Natural Resources: Resources reported 1994 net income of $390 million, including a $100 million after-tax gain on the sale of the Wilmington properties. Earnings before the effects of the 1993 accounting adjustments would have improved $81 million from $309 million a year ago. Operating revenues declined $17 million from 1993 to $1.31 billion, as a 15% increase in overall sales volumes was more than offset by a 6% decline in sales prices (including the effects of Resources' hedging program) (see Note 5 to the Financial Statements), lower pipeline and other revenues, and reduced minerals revenues. Despite rising production volumes and the sale of the Wilmington Field and other properties, Resources improved its reserve position in 1994 through the acquisition of AMAX and exploitation of its existing properties, as Resources remained the most active driller in the U.S. for the third consecutive year.

Natural gas sales volumes rose 25% to 772 mmcf/day, primarily the result of the first quarter AMAX acquisition and higher Austin Chalk production. Natural gas liquids sales volumes ~~also~~ improved 25% to 49,996 bbl/day because of the addition of the AMAX properties, the Carthage gas plant and improved production in the Austin Chalk. Crude oil sales volumes declined 5% to 63,070 bbl/day, reflecting the first quarter Wilmington sale and production declines in other fields. Average prices for crude oil fell $1.32/bbl (8%) to $14.34/bbl, while natural gas liquids prices declined $0.66/bbl (7%) to $9.18/bbl. Natural gas average prices were unchanged at $1.82/mcf. Pipeline and other revenues declined $81 million, largely the result of the reclassification of certain pipeline revenues, lower Section 29 revenues, the absence of lawsuit and insurance recoveries from 1993, and the sale of the Harbor Cogeneration facility as part of the Wilmington sale.

0600

Operating expenses rose $14 million to $955 million in 1994. Depreciation and depletion charges increased $48 million due to the addition of new gas processing facilities and pipelines, as well as higher production levels. In addition, other expenses increased $19 million, largely the result of higher lease operating costs (reflecting higher volumes) and gas plant expenses (the result of the addition of new plants), while inflation pushed up wages and benefits $11 million. Dry hole costs also increased $7 million, the result of a more extensive drilling program in 1994. These higher costs were countered by a $30 million decline in pipeline and gas plant product purchases for resale, a $29 million reduction in mining costs (as a result of a favorable contract settlement) and a $9 million decrease in geological and geophysical costs, reflecting the completion of an exploration program in West Texas.

Operating income for all of Resources' operations declined to $351 million in 1994 from $382 million in 1993. Operating income from Resources' minerals operations improved $14 million in 1994 to $116 million, reflecting higher coal sales and increased soda ash and coal royalties.

Trucking: Overnite's 1994 net income was $41 million. This compares to 1993 earnings of $42 million before the effects of the 1993 accounting adjustments. This decline was the result of higher operating costs caused by the worst winter in decades for the Eastern U.S. and reduced efficiency associated with shifts in freight flows from shorter-haul, more profitable, intra-regional business to longer-haul traffic. Results for both periods included goodwill amortization of $23 million.

Overnite's operating revenues exceeded the $1 billion level for the first time in its history, as revenues advanced $98 million (10%) to $1.04 billion. Average prices rose 6%, reflecting the shift to longer-haul traffic, contractual rate increases and the effects of a January 1994 price increase on non-contract business. Volumes improved 4%, as a 7% rise in less-than-truckload (LTL) business was partially offset by truckload traffic declines. Volume improvements were generated by the April 1994 Teamsters' strike against other unionized carriers, the third quarter 1993 bankruptcy of a major Eastern carrier and continued business expansion.

Growing volumes, the effects of the severe winter and higher miles associated with shifts in freight flows caused operating expenses to increase $100 million in 1994 to $970 million. Increases occurred in wages and benefits ($41 million), equipment rents ($27 million), mileage-based insurance and claims accruals ($9 million), taxes and licenses ($7 million) and materials and supplies ($5 million). Depreciation expense also increased $5 million as a result of continuing capital programs. Operating income declined to $67 million in 1994 from $69 million a year ago. Overnite's operating ratio, excluding goodwill amortization, increased to 91.3 in 1994 from 90.2 in 1993.

Corporate Services and Other Operations: Expenses related to Corporate Services and Other Operations – which include corporate expenses, third-party interest charges, intercompany interest allocations, other income and income taxes that are not related to other segments, and the results of other operating units – totaled $227 million in 1994. Excluding the effects of the 1993 accounting adjustments, these costs declined $17 million from $244 million a year ago. Lower stock incentive compensation and increased interest charges to subsidiaries (mainly the result of the AMAX acquisition, subsidiaries' capital spending and pension funding at Overnite) were only partially offset by higher interest expense to third parties and increased professional fees. Other operations reported operating income of $4 million for 1994, up $3 million from a year ago, as a result of the 1993 addition of Skyway and improved operating results at the Corporation's other operations.

1993 Compared to 1992

Consolidated Results: In the first quarter of 1993, the Corporation recorded a $175 million or $0.85 per share after-tax charge to reflect the adoption of new Financial Accounting Standards Board (FASB) pronouncements as described in Note 3 to the Financial Statements. In the third quarter of 1993, the Corporation recorded a $62 million or $0.30 per share charge reflecting a deferred tax adjustment that resulted from the implementation of the 1993 Tax Act (see Note 7 to the Financial Statements). 1993 results also included a $9 million net loss from the discontinued operations of USPCI.

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The components of the accounting adjustments for the year ended December 31, 199 are as follows:

In Millions, Except Per Share Amounts	Income/(Loss) before Accounting Adjustments	Accounting Changes	1993 Tax Act	Net Income/(Loss)
Railroad	$ 669	$ (72)	$ (57)	$ 540
Natural resources	309	(59)	(6)	244
Trucking	42	(79)	(1)	(38)
Corporate services and other operations [a]	(253)	35	2	(216)
Consolidated [a]	$ 767	$ (175)	$ (62)	$ 530
Per share [a]	$3.73	$(0.85)	$(0.30)	$2.58

[a] Includes the discontinued operating results of USPCI. Income from continuing operations excluding the one-time effects of the 1993 Tax Act would have been $776 million or $3.77 per share.

As a result of the 1993 accounting adjustments, the absence of Resources' $63 million ($42 million after-tax) 1992 production-based tax settlement and the 1993 effects of weather-related traffic interruptions on the operations of the Railroad, the Corporation's earnings declined to $530 million ($2.58 per share) in 1993 compared to $728 million ($3.57 per share) in 1992. Excluding accounting adjustments, the Corporation's earnings would have risen to $767 million ($3.73 per share). Income excluding accounting adjustments would have improved at all operating units.

Operating revenues advanced 4% to $7.33 billion in 1993 from $7.03 billion in 1992. Revenues advanced on the strength of growing transportation volumes, rising average natural gas prices, a 5% increase in hydrocarbon sales volumes and the acquisition of Skyway.

Operating expenses rose $196 million to $5.83 billion from $5.64 billion in 1992. Equipment and other rents increased $51 million and fuel and utility costs rose $19 million due to higher transportation volumes and weather-related traffic interruptions at the Railroad. Depreciation charges increased $41 million, reflecting asset adjustments required by the first quarter adoption of SFAS No. 109 (Accounting for Income Taxes) and the Corporation's continued high level of capital investment, offset by lower surrendered lease activity and dry hole costs at Resources. Other taxes rose $39 million, resulting from the absence of 1992 tax settlements at Resources and the Railroad, while third-party transportation costs increased $32 million mainly due to the acquisition of Skyway. In addition, weather-related inefficiencies and volume growth caused wage and benefit costs to escalate $20 million, and materials and supplies $9 million. Higher hydrocarbon sales volumes and prices caused the cost of pipeline and gas plant product purchased for resale to rise $15 million. Operating cost inflation was tempered by efficiency and productivity improvements at the Railroad and Resources and the absence of Resources' $24 million 1992 workforce reduction charge. Operating income improved 7% to $1.49 billion in 1993 compared to $1.40 billion in 1992 as gains occurred at all operating units.

Other income declined $57 million largely due to the absence of interest related to Resources' 1992 tax settlement and diminished property sales. Interest expense also declined $40 million, reflecting lower average interest rates and debt refinancing activities, while corporate expenses rose $9 million due to higher professional fees and depreciation charges. Income from continuing operations – excluding the effects of the 1993 Tax Act – as a percentage of operating revenues would have been 10.6% in 1993 and 10.4% in 1992. On the same basis, return on average common stockholders' equity would have declined to 15.9% in 1993 from 16.5% in 1992.

Railroad: The Railroad posted earnings of $540 million in 1993. Excluding the 1993 accounting adjustments, earnings would have been $669 million (before considering the effects of the harsh winter and Midwest flooding) compared to $667 million in 1992. Operating revenues improved 2% to $4.99 billion as a 4% increase in carloadings was partially offset by a 2% decline in average commodity revenue per car. This decline resulted from volume growth of lower-rated commodities – mainly intermodal and energy – and growth of lower-rated goods within chemicals, as well as increased use of shipper-owned equipment for coal shipments. Revenues also included higher earnings from equity investments in related operations. Automotive carloadings advanced 8%, reflecting improvements in the domestic auto industry. Energy carloadings also grew 8% because of an expanding domestic customer base and higher demand created by more normal temperature patterns. Intermodal traffic improved 6% as market share continued to expand, reflecting new partnership arrangements with trucking companies. In addition, chemical carloadings increased 1%, while weather-related traffic interruptions and crop damage caused grain carloadings to decline 2%. Carloading declines also occurred in food, consumer and government products (2%) and in metals, minerals and forest products (1%).

0602

Operating expenses increased to $3.95 billion in 1993 from $3.87 billion in 1992. Depreciation expense grew $54 million, reflecting asset adjustments required by the 1993 adoption of SFAS No. 109 and continuing capital spending on equipment and track. Employee injury expense rose $26 million as continuing declines in the number of injuries were more than offset by higher average settlement costs per injury. Growing volumes and weather-related traffic congestion accounted for a $25 million rise in equipment and other rents and a $17 million increase in fuel and utility costs. Wage and benefit costs also rose $6 million as weather and inflation-related cost increases were largely offset by train crew reductions. Higher operating costs were tempered by a $23 million reduction in joint facility costs and an additional $22 million of cost offsets associated with car repairs for other carriers.

Operating income at the Railroad rose $11 million in 1993 to $1.04 billion. Despite severe weather conditions, the Railroad maintained an operating ratio of 79.1 in 1993 compared to 79.0 in 1992.

Natural Resources: Resources' 1993 earnings were $244 million. Without the 1993 accounting adjustments, earnings would have risen $37 million (14%) to $309 million compared to $272 million in 1992, despite the absence of the $63 million ($42 million after-tax) 1992 production-based tax settlement. Operating revenues climbed $64 million (5%) to $1.32 billion in 1993 as a result of a 5% rise in total hydrocarbon sales volumes, higher average natural gas prices and pipeline volume growth. Natural gas sales volumes grew 7% to 619 mmcf/day, reflecting production improvements in the Austin Chalk and the southwestern Wyoming portion of the Land Grant. Natural gas liquids sales volumes were up 10% to 39,855 bbl/day, largely because of increased production in the Austin Chalk, the return to operation of a damaged pipeline, increased ownership in the Carthage gas processing plant and improved recoveries under processing agreements, while crude oil sales volumes held steady at 66,456 bbl/day. Including hedging activities, natural gas average prices advanced 20% to $1.82/mcf (an increase of $0.30/mcf), while crude oil prices fell $1.56/bbl (9%) to $15.66/bbl. Average prices for natural gas liquids also declined 8% to $9.84/bbl. Once again, Resources improved its reserve position, despite rising production levels, as it remained the most active driller in the United States.

Operating expenses declined to $941 million in 1993 from $944 million in 1992. Surrendered lease costs decreased $33 million because of accelerated lease surrender activity in 1992. Wage and benefit costs declined $24 million stemming from the absence of Resources' 1992 workforce reduction charge and ongoing productivity improvements. Insurance and other settlements in 1993 lowered other operating costs $12 million. Mining costs declined $9 million due to lower operating costs stemming from the ongoing effects of a favorable 1992 contract settlement at Resources' joint venture coal mine. In addition, dry hole costs decreased $8 million, reflecting improved exploration success. These cost reductions were largely offset by volume-related cost increases. Depreciation and depletion charges rose $21 million, reflecting higher production levels and higher per barrel rates in the Chalk. Increased exploration activities generated a $17 million expansion in geological and geophysical costs. In addition, production and other taxes rose $28 million caused by the absence of the 1992 tax settlement and growing volumes, while higher volumes and prices caused the cost of pipeline and gas plant product purchases to increase $15 million.

Operating income for all of Resources' operations improved $67 million (21%) to $382 million in 1993. Other income declined $17 million, mainly due to the absence of the interest portion of the 1992 tax settlement.

Operating income from Resources' minerals operations declined $9 million (8%) in 1993 to $102 million. This decline was the result of the absence of a favorable uranium contract settlement recognized in 1992 and volume and price declines at its soda ash joint venture. These declines were partially offset by the ongoing effects of a favorable 1992 contract settlement at Resources' coal joint venture.

Trucking: Overnite recorded a net loss of $38 million in 1993. Without the 1993 accounting adjustments, earnings would have improved $2 million to $42 million (after goodwill amortization of $23 million). Operating revenues rose $66 million (8%) to $959 million as a 3% rise in average prices combined with a 4% volume improvement. Higher volumes were generated by a 7% increase in LTL business (driven by tonnage gains in the Northeast – reflecting the bankruptcy of a major regional carrier – and continued business expansion). Higher LTL volumes were partially offset by truckload traffic declines, reflecting Overnite's focus on its core LTL business. Revenue growth was also stimulated by the 1993 addition of the Special Services Division, which supports the Railroad's automotive traffic.

0603

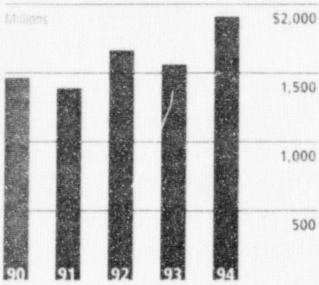
Operating expenses increased $54 million to $870 million in 1993. Salaries, wages and employee benefit costs grew $28 million in response to higher volumes and inflation. Equipment and other rents rose $15 million, largely because of increased contracted rail usage and volume-related growth in line-haul charges, while continued capital spending caused depreciation expense to rise $6 million. Operating income improved to $69 million in 1993 from $57 million in 1992. Overnite's operating ratio, excluding goodwill amortization, improved to 90.2 from 90.9 in 1992.

Corporate Services and Other Operations: Expenses related to Corporate Services and Other Operations totaled $207 million in 1993. Excluding the accounting adjustments, these costs would have been $244 million compared to $251 million in 1992. This decline was largely the result of lower interest expense and improved results at other operations, partially offset by higher corporate expenses. Operating income from other operations improved $7 million to $1 million in 1993, reflecting the addition of Skyway.

Cash Flows, Liquidity and Capital Resources

In 1994, cash from operations was $1.91 billion, compared to $1.56 billion in 1993. This increase was largely the result of improved operating results and a higher proportion of non-cash expenses. Non-cash charges to earnings increased as a result of higher depreciation, increased personal injury accruals, lower Section 29 revenues at Resources and higher deferred taxes. Cash from operations also benefitted from lower cash outlays related to the 1991 special charge. Offsetting these operating cash improvements were the negative effects of changes in working capital. Higher working capital levels reflected increases in current taxes receivable (generated by the recognition of tax benefits from the USPCI sale), in notes receivable (from the USPCI and Wilmington sales) and in accounts receivable (the result of higher revenue levels and the AMAX acquisition), partially offset by higher short-term borrowings.

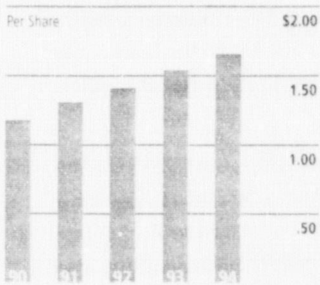
Operating Cash Flow
Union Pacific Corporation



Cash used in investing activities of $1.96 billion reflected a $408 million increase over 1993. The Corporation acquired AMAX in March 1994 for a net purchase price of $725 million in cash. Capital expenditures grew $22 million over 1993, largely due to development activities at Resources (mainly the Austin Chalk and AMAX properties) and fleet expansion and renewal at Overnite. The AMAX purchase and higher capital spending were partially offset by $343 million of cash proceeds generated by the Wilmington sale.

Outstanding debt levels increased $377 million in 1994 and included $500 million in new offerings of the Corporation's notes and debentures and $88 million of Railroad equipment financings, offset by lower commercial paper borrowings. Debt financings were used to fund capital expenditures and the AMAX acquisition, and repay maturing debt. The quarterly common stock dividend was raised to $0.43 per share in the third quarter of 1994, up from $0.40 per share. The ratio of debt to total capital employed increased to 36.3% at December 31, 1994 from 35.6% at December 31, 1993. This increase reflected the higher debt levels incurred to fund the AMAX acquisition, partially offset by 1994 earnings.

Dividend History
Union Pacific Corporation



The Corporation's 1995 capital expenditures and debt service requirements will be funded primarily through cash generated from operations, property sales and, if required, through additional debt financings. The Corporation expects that such sources will continue to provide sufficient funds to meet cash requirements in the foreseeable future. At December 31, 1994, the Corporation had authorization from the Board of Directors to repurchase up to $359 million of the Corporation's common stock. At year-end, the Corporation had available $1.06 billion in short-term credit facilities and $800 million in long-term credit facilities expiring in 1999.

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Railroad-Related Matters

Personal Injury: Over the past ten years work-related injuries have declined by more than 10% annually (reflecting aggressive safety and training programs), while average settlement cost per claim has continued to rise. Compensation for work-related accidents is governed by the Federal Employers' Liability Act (FELA). FELA's finding of fault and damage is usually assessed based on litigation or out-of-court settlements. In addition, the Railroad offers a comprehensive variety of services and rehabilitation programs for employees who are injured at work. Annual expenses for injury-related events were $194 million in 1994, $154 million in 1993 and $128 million in 1992. The Railroad is also participating with other rail carriers in an industry-wide effort to replace FELA with a no-fault system that could significantly reduce personal injury costs while fairly compensating injured employees.

Other Matters

Environmental Costs: The Corporation generates, transports, remediates and disposes of hazardous and non-hazardous waste in its current and former operations, and is subject to Federal, state and local environmental laws and regulations. The Corporation has identified approximately 150 sites, including approximately 50 sites currently on the Superfund National Priorities List or state superfund lists, at which it is or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. Certain Federal legislation imposes joint and several liability for the remediation of identified sites; consequently, the Corporation's ultimate environmental liability may include costs relating to other parties in addition to costs relating to its own activities at each site.

A liability of $243 million has been accrued for future costs of all sites where the Corporation's obligation is probable and where such costs can be reasonably estimated; however, the ultimate cost could be lower or as much as 25% higher. The December 31, 1994 liability balance included $50 million for the obligation to participate in the environmental remediation of the Wilmington, California properties. The liability included future costs for remediation and restoration of sites as well as for ongoing monitoring costs, but excluded any anticipated recoveries from third parties. Cost estimates were based on information available for each site, financial viability of other potentially responsible parties (PRP), and existing technology, laws and regulations. The Corporation believes that it has adequately accrued for its ultimate share of costs at sites subject to joint and several liability. The ultimate liability for remediation is difficult to determine with certainty because of the number of PRPs involved, site-specific cost sharing arrangements with other PRPs, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites and/or the speculative nature of remediation costs.

Remediation of identified sites previously used in operations, used by tenants or contaminated by former owners required spending of $43 million in 1994 and $42 million in 1993. The Corporation is also engaged in reducing emissions, spills and migration of hazardous materials, and spent $14 million and $16 million in 1994 and 1993, respectively, for control and prevention, a portion of which had been capitalized. In 1995, the Corporation anticipates spending $37 million for remediation and $10 million for control and prevention. The majority of the December 31, 1994 environmental liability is expected to be paid out over the next five years, funded by cash generated from operations. Future environmental obligations are not expected to have a material impact on the results of operations or financial condition of the Corporation.

Inflation: The cumulative effect of long periods of inflation has significantly increased asset replacement costs for capital-intensive companies such as the Railroad and Overnite. As a result, depreciation charges on an inflation-adjusted basis, assuming that all operating assets are replaced at current price levels, would be substantially greater than historically reported amounts.

Financial Instruments: The Corporation uses derivative financial instruments to protect against unfavorable hydrocarbon price movements, interest rate movements and foreign currency exchange risk. While the use of these hedging arrangements limits the downside risk of adverse price and rate movements, it may also limit future gains from favorable movements. All hedging is accomplished pursuant to exchange-traded contracts or master swap agreements based on standard forms. UPC does not hold or issue

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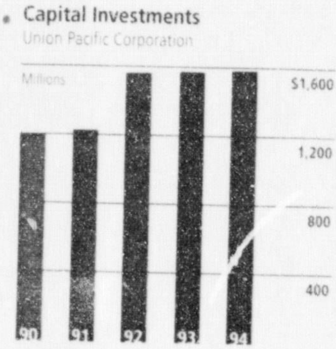
financial instruments for trading purposes. The Corporation addresses market risk by selecting instruments whose value fluctuations correlate strongly with the underlying item or risk being hedged. Credit risk related to hedging activities, which is minimal, is managed by requiring minimum credit standards for counterparties, periodic settlements and/or mark-to-market evaluations. A further discussion of the Corporation's use of financial instruments is included in Note 5 to the Financial Statements.

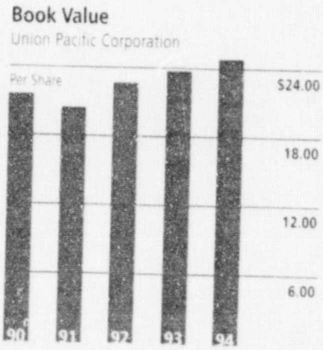
A Look Forward

General Economic Factors: The Corporation's future results can be affected by fluctuations in oil and natural gas prices, and by the economic environment. Resources directly benefits from increases in hydrocarbon prices to the extent that these gains are not limited by hedging activity, while the Railroad and Overnite can be adversely affected by increases in diesel fuel costs, to the extent that such costs are not recovered through higher revenues and improved fuel conservation or mitigated by hedging activity. In addition, certain categories of rail carloadings and trucking tonnages can be negatively impacted by a prolonged economic downturn.

1995 Capital Spending: The Corporation expects to maintain its high level of capital spending in 1995. At Resources, capital spending will be focused on drilling in the Austin Chalk, the AMAX properties and the Land Grant. The Railroad's capital expenditures will be used to continue to expand capacity on its main lines and upgrade equipment to meet customer needs, while Overnite will continue to expand its distribution network and upgrade its truck fleet and technology. UPC will also continue to expand its core businesses through strategic acquisitions.



1995 Business Outlook: Rail volumes are anticipated to improve in 1995 because of continued growth in coal shipments (reflecting growing demand for low-sulfur coal), expansion of the Railroad's intermodal business, and higher grain shipments resulting from stronger export demand and growth in feed grain shipments. Average commodity revenue per car is expected to remain at 1994 levels as price increases will be offset by volume growth in lower rated commodities – mainly intermodal and coal. At Resources, overall sales volumes are anticipated to improve. This anticipated volume growth reflects an expansion in natural gas and natural gas liquids sales volumes, resulting from the addition of the AMAX properties, and production increases in the Austin Chalk and in the Rockies. These volume improvements will be partially offset by crude oil sales volume declines, reflecting the Wilmington sale and reduced crude oil production in the Austin Chalk. Natural gas prices are expected to decline in 1995, while crude oil and natural gas liquids sales prices are expected to improve somewhat. Overnite anticipates improvements in the current pricing environment and continued tonnage growth – although there is a risk of price discounting due to increasing competition by regional, non-union carriers. Higher volumes at Overnite will be generated by continued growth in the Northeast and Midwest and expansion in the Southwest and West. Overnite's operations should also benefit from an expected stabilization of traffic patterns in 1995.



USPCI Sale: The sale of USPCI will not have a significant impact on the Corporation's future operating results or financial condition. Sales proceeds and tax benefits derived from the sale will be used for general corporate purposes, including the reduction of outstanding debt levels.

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Independent Auditors' Report

Deloitte & Touche LLP

Union Pacific Corporation, its Directors and Stockholders:

We have audited the accompanying statements of consolidated financial position of Union Pacific Corporation and subsidiary companies as of December 31, 1994 and 1993, and the related statements of consolidated income, changes in common stockholders' equity, and consolidated cash flows for each of the three years in the period ended December 31, 1994. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Union Pacific Corporation and subsidiary companies at December 31, 1994 and 1993, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1994 in conformity with generally accepted accounting principles.

As discussed in Note 3 to the consolidated financial statements, in January 1993, the Corporation changed its method of accounting for postretirement benefits other than pensions, income taxes and transportation revenue and expense recognition.

Deloitte & Touche LLP

New York, New York
January 19, 1995

Responsibilities for Financial Statements

The accompanying financial statements, which consolidate the accounts of Union Pacific Corporation and its subsidiaries, have been prepared in conformity with generally accepted accounting principles.

The integrity and objectivity of data in these financial statements and accompanying notes, including estimates and judgements related to matters not concluded by year-end, are the responsibility of management as is all other information in this Annual Report. Management devotes ongoing attention to review and appraisal of its system of internal controls. This system is designed to provide reasonable assurance, at an appropriate cost, that the Corporation's assets are protected, that transactions and events are recorded properly and that financial reports are reliable. The system is augmented by a staff of corporate traveling auditors supplemented by internal auditors in the subsidiary operating companies; careful attention to selection and development of qualified financial personnel; programs to further timely communication and monitoring of policies, standards and delegated authorities; and evaluation by independent auditors during their audits of the annual financial statements.

The Audit Committee of the Board of Directors, composed entirely of outside directors, as identified on page 51, meets regularly with financial management, the corporate auditors and the independent auditors to review the work of each. The independent auditors and corporate auditors have free access to the Audit Committee, without management representatives present, to discuss the results of their audits and their comments on the adequacy of internal controls and the quality of financial reporting.

Drew Lewis

Chairman and Chief Executive Officer

L. White Matthews III

Executive Vice President-Finance

Charles E. Billingsley

Vice President and Controller

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Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1994	1993	1992
Operating Revenues	Railroad	$ 5,318	$ 4,987	$ 4,897
	Natural resources	1,306	1,323	1,259
	Trucking	1,037	939	873
	Corporate services and other operations	137	76	3
	Total	$ 7,798	$ 7,325	$ 7,032
Operating Income (Loss)	Railroad	$ 1,173	$ 1,042	$ 1,031
	Natural resources	351	382	315
	Trucking	67	69	57
	Corporate services and other operations	4	1	(6)
	Total	$ 1,595	$ 1,494	$ 1,397
Income (Loss) from Continuing Operations Excluding the 1993 Tax Act (Note 7)	Railroad	$ 754	$ 669	$ 667
	Natural resources	390	309	272
	Trucking	41	42	40
	Corporate services and other operations	(227)	(244)	(251)
	Total	$ 958	$ 776	$ 728
Cash from Operations	Railroad	$ 1,061	$ 1,074	$ 999
	Natural resources	821	567	776
	Trucking	116	44	100
	Corporate services and other operations	(89)	(122)	(215)
	Total	$ 1,909	$ 1,563	$ 1,660
Assets (at Year-End)	Railroad	$10,455	$10,014	$ 9,397
	Natural resources	3,180	2,246	2,061
	Trucking	1,420	1,393	1,350
	Corporate services and other operations	887	1,242	1,193
	Total	$15,942	$14,895	$14,001
Depreciation, Depletion and Amortization	Railroad	$ 468	$ 443	$ 389
	Natural resources	464	410	435
	Trucking	63	58	51
	Corporate services and other operations	10	7	2
	Total	$ 1,005	$ 918	$ 877
Capital Expenditures	Railroad	$ 769	$ 805	$ 767
	Natural resources	613	507	552
	Trucking	93	80	72
	Corporate services and other operations	71	128	134
	Total	$ 1,546	$ 1,520	$ 1,525

This information should be read in conjunction with the accompanying accounting policies and notes to the financial statements.

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Statement of Consolidated Income

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars, Except Per Share Amounts	1994	1993	1992
Operating Revenues	Sales and Revenues (Notes 3 and 5)	**$7,798**	$7,325	$7,032
Operating Expenses	Salaries, wages and employee benefits	**2,562**	2,468	2,448
	Depreciation, depletion and amortization	**1,005**	918	877
	Equipment and other rents	**646**	576	525
	Fuel and utilities (Note 5)	**488**	496	477
	Materials and supplies	**378**	367	358
	Other costs	**1,124**	1,006	950
	Total	**6,203**	5,831	5,635
Income	Operating Income	**1,595**	1,494	1,397
	Other Income – Net (Notes 4 and 13)	**259**	89	146
	Interest Expense (Note 8)	**(336)**	(315)	(355)
	Corporate Expenses	**(99)**	(99)	(90)
	Income before Income Taxes	**1,419**	1,169	1,098
	Income Taxes (Notes 3 and 7)	**(461)**	(455)	(370)
	Income from Continuing Operations	**958**	714	728
	Discontinued Operations: (Note 2)			
	Provision for Disposal – Net of Tax Benefits of $196 Million	**(404)**	—	—
	Operating Losses	**(8)**	(9)	—
	Loss from Discontinued Operations	**(412)**	(9)	—
	Income before Cumulative Effect of Changes in Accounting Principles	**546**	705	728
	Cumulative Effect to January 1, 1993 of Changes in Accounting Principles (Note 3)	**—**	(175)	—
	Net Income	**$ 546**	$ 530	$ 728
Per Share	Income from Continuing Operations	**$ 4.66**	$ 3.47	$ 3.57
	Loss from Discontinued Operations	**(2.00)**	(0.04)	—
	Cumulative Effect to January 1, 1993 of Changes in Accounting Principles	**—**	(0.85)	—
	Net Income	**2.66**	2.58	3.57
	Dividends	**1.66**	1.54	1.42

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

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Statement of Consolidated Financial Position

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1994	1993
Assets			
Current Assets	Cash and temporary investments	$ 121	$ 113
	Accounts receivable (Note 5)	648	593
	Inventories	315	252
	Notes receivable (Notes 2 and 4)	291	6
	Income taxes receivable (Note 2)	285	46
	Deferred income taxes (Notes 3 and 7)	—	117
	Other current assets	162	190
	Total	1,822	1,317
Investments	Investments in and advances to affiliated companies	492	453
	Other investments	170	170
	Total	662	623
Properties	Cost (Notes 2, 4 and 6)	18,885	17,396
	Accumulated depreciation, depletion and amortization	(6,614)	(6,318)
	Net	12,271	11,078
Other	Excess Acquisition Costs – Net	939	963
	Net Assets of Discontinued Operations (Note 2)	—	697
	Other Assets	248	217
	Total Assets	$15,942	$14,895
Liabilities and Stockholders' Equity			
Current Liabilities	Accounts payable	$ 463	$ 439
	Accrued wages and vacation	223	249
	Income and other taxes	198	158
	Dividends and interest	192	176
	Accrued casualty costs	163	135
	Debt due within one year	470	115
	Other current liabilities	796	758
	Total	2,505	2,030
Other Liabilities and Equity	Debt Due After One Year (Notes 8 and 9)	4,090	4,068
	Deferred Income Taxes (Notes 3 and 7)	2,856	2,678
	Retiree Benefits Obligation (Notes 3 and 10)	603	600
	Other Long-Term Liabilities (Note 12)	757	634
	Common Stockholders' Equity (page 36)	5,131	4,885
	Total Liabilities and Stockholders' Equity	$15,942	$14,895

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

Statement of Consolidated Cash Flows

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1994	1993	1992
Cash from Operations	Net Income	$ 546	$ 530	$ 728
	Non-cash charges to income:			
	Depreciation, depletion and amortization	1,005	918	877
	Deferred income taxes	349	310	214
	Write-down of discontinued operations (Note 2)	404	—	—
	Gain on property dispositions and retirements (Note 4)	(220)	(35)	(58)
	Cumulative effect of changes in accounting principles (Note 3)	—	175	—
	Other – Net	(95)	(70)	(10)
	Changes in current assets and liabilities	(22)	(128)	101
	Cash used for special charge	(58)	(137)	(192)
	Cash from operations	1,909	1,563	1,660
Investing Activities	Capital investments and exploratory expenditures	(1,597)	(1,574)	(1,567)
	Investments and acquisitions (Note 4)	(725)	(75)	(71)
	Proceeds from sale of assets and other investing activities (Note 4)	361	96	291
	Cash used for investing activities	(1,961)	(1,553)	(1,347)
Equity and Financing Activities	Dividends paid	(334)	(309)	(282)
	Debt repaid (Note 8)	(338)	(753)	(677)
	Purchase of treasury stock (Note 11)	(1)	(10)	(5)
	Financings	733	926	750
	Cash used in equity and financing activities	60	(146)	(214)
	Net Change in Cash and Temporary Investments	$ 8	$ (136)	$ 99
Changes in Current Assets and Liabilities	Accounts receivable	$ (55)	$ (71)	$ (68)
	Inventories	(63)	(8)	(22)
	Other current assets	(379)	(48)	(31)
	Accounts, wages and vacation payable	(2)	(40)	138
	Other current liabilities	477	39	84
	Total	$ (22)	$ (128)	$ 101

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

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Statement of Changes in Common Stockholders' Equity

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars	1994	1993	1992
Common Stock	Common Stock, $2.50 par value (authorized 500,000,000 shares)			
	Balance at beginning of year (230,788,175 issued shares in 1994; 229,774,547 in 1993; 228,410,296 in 1992)	$ 577	$ 574	$ 571
	Conversions, exercises of stock options and other (1,049,801 shares in 1994; 1,013,628 in 1993; 1,364,251 in 1992)	3	3	3
	Balance at end of year (231,837,976 issued shares in 1994; 230,788,175 in 1993; 229,774,547 in 1992)	580	577	574
Paid-in Surplus	Balance at beginning of year	1,383	1,339	1,288
	Conversions, exercises of stock options and other	45	44	51
	Balance at end of year	1,428	1,383	1,339
Retained Earnings	Balance at beginning of year	4,529	4,338	3,899
	Net Income	546	530	728
	Total	5,075	4,868	4,627
	Cash dividends declared	(341)	(315)	(289)
	Exchangeable note conversion (Note 8)	—	(24)	—
	Balance at end of year (Note 8)	4,734	4,529	4,338
Treasury Stock	Balance at end of year, at cost (25,900,775 shares in 1994; 25,626,946 in 1993; 25,879,742 in 1992)	(1,611)	(1,604)	(1,612)
	Total Common Stockholders' Equity (Note 11)	$5,131	$4,885	$4,639

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

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Significant Accounting Policies

Principles of Consolidation
The consolidated financial statements include the accounts of Union Pacific Corporation (the Corporation or Union Pacific) and all subsidiaries. Investments in affiliated companies (20% to 50% owned) are accounted for on the equity method. In addition, the Corporation consolidates its proportionate share of oil, gas and mineral ventures. All material intercompany transactions are eliminated.

Cash and Temporary Investments
Temporary investments are stated at cost that approximates fair market value, and consist of investments with original maturities of three months or less.

Inventories
Inventories consist primarily of materials and supplies carried at the lower of cost or market.

Exploration and Production
Oil and gas exploration costs are accounted for using the successful efforts method.

Drilling costs of unsuccessful exploratory wells, geological and geophysical costs and carrying costs are charged to expense when incurred. Costs to develop producing properties, including drilling costs and applicable leasehold acquisition costs, are capitalized.

Depletion and amortization of producing properties, including depreciation of well and support equipment and amortization of related lease costs, are determined by using a unit-of-production method based upon proved reserves. Acquisition costs of unproved properties are amortized from the date of acquisition on a composite basis, which considers past success experience and average lease life.

Property and Depreciation
Properties are carried at cost. Provisions for depreciation are computed principally on the straight-line method based on estimated service lives of depreciable property.

The cost (net of salvage) of depreciable rail property retired or replaced in the ordinary course of business is charged to accumulated depreciation. A gain or loss is recognized on all other property upon disposition.

Intangible Assets
Amortization of costs in excess of net assets of acquired businesses is generally recorded over forty years on a straight-line basis. The Corporation regularly assesses the recoverability of such costs through a review of cash flows and fair values of those businesses.

Revenue Recognition
Transportation revenues are recognized on a percentage-of-completion basis, while delivery costs are recognized as incurred (see Note 3).

Hedging Transactions
The Corporation periodically hedges hydrocarbon sales and purchases, interest rates and foreign currency exchange risk. Gains and losses from these transactions are recognized at delivery of the commodity or, with respect to interest rates and foreign currency, over the life of the instrument (see Note 5).

Earnings Per Share
Earnings per share are based on the weighted average number of common shares outstanding during the periods, plus shares issuable upon exercise of outstanding stock options (see Note 11).

Change in Presentation
1992 and 1993 amounts have been restated to conform to the 1994 financial presentation of USPCI, Inc. (USPCI) as a discontinued operation (see Note 2).

1. Business

Union Pacific consists of companies operating principally in the United States engaged in rail transportation; oil, gas and minerals production; and trucking.

The following financial information is an integral part of these financial statements:

Business Segments
Supplementary Information (unaudited)
- Selected Quarterly Data;
- Oil and Gas – Proved Reserves;
- Capitalized Exploration and Production Costs;
- Costs Incurred in Exploration and Development;
- Results of Operations for Producing Activities;
- and Standardized Measure of Future Net Cash Flows

2. Sale of USPCI

In September 1994, Union Pacific's Board of Directors approved a formal plan to dispose of its waste management business. As a result of this decision, the Corporation recorded a $654 million ($425 million after-tax) loss on discontinued operations in the third quarter of 1994 to write down the Corporation's investment in USPCI's assets to estimated net realizable value and to provide for estimated closing costs and certain retained liabilities.

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At year-end, the Corporation completed the sale of USPCI to Laidlaw Inc. for $225 million in notes. These notes were collected in January 1995. As a result of the sale, the Corporation adjusted its original loss provision in the fourth quarter of 1994 by reducing the provision by $54 million ($21 million after tax). The sale of USPCI will not have a significant impact on the Corporation's future operating results or financial condition. Sales proceeds and cash tax benefits derived from the sale of USPCI will be used for general corporate purposes, including the reduction of outstanding debt levels.

Operating revenues of USPCI were $342 million in 1994, $236 million in 1993 and $262 million in 1992. Capital expenditures at USPCI were $66 million in 1994, $114 million in 1993 and $109 million in 1992.

3. Accounting Changes

The Corporation adopted the following accounting changes in January 1993:

In Millions, Except Per Share Amounts	OPEB	Income Taxes	Revenue Recognition	Total
Railroad	$ (171)	$ 121	$ (22)	$ (72)
Natural resources	(44)	(15)	—	(59)
Trucking	(47)	(25)	(7)	(79)
Corporate services and other operations	(9)	44	—	35
Consolidated	$ (271)	$ 125	$ (29)	$ (175)
Per share	$(1.32)	$0.61	$(0.14)	$(0.85)

Other Postretirement Benefits (OPEB)

The Financial Accounting Standards Board (FASB) issued Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which requires that the cost of non-pension benefits for retirees be accrued during their period of employment. The adoption of this Statement does not affect future cash funding requirements for these benefits (see Note 10).

Income Taxes

The FASB issued Statement No. 109, "Accounting for Income Taxes," which requires the balance-sheet approach of accounting for income taxes, whereby assets and liabilities are recorded at the tax rates currently enacted. The Corporation's future results may be affected by changes in the corporate income tax rate (see Note 7).

Revenue Recognition

The Corporation changed its method of transportation revenue and expense recognition from accruing both revenues and expenses at the inception of service to the industry practice of allocating revenues between reporting periods based on relative transit time, while recognizing expenses as incurred.

4. Acquisitions and Property Dispositions

AMAX Oil & Gas, Inc. (AMAX)

In March 1994, Union Pacific Resources Company (Resources) acquired AMAX from Cyprus AMAX Minerals Company for a net purchase price of $725 million. AMAX's operations primarily consist of natural gas producing, transportation and processing properties in West Texas and Louisiana. These properties include interests in 14 major fields, encompassing approximately 600,000 acres and 2,000 producing wells. Resources recorded 92 million barrels of oil equivalent of proved reserves related to the AMAX acquisition.

Skyway Freight Systems, Inc. (Skyway)

In May 1993, the Corporation acquired all of the outstanding common stock of Skyway for $65 million and the conversion of its initial $7 million preferred stock investment. Skyway specializes in providing customized logistics and transportation support for the time-definite and specialized freight markets.

Wilmington Sale

In March 1994, Resources sold its interest in the Wilmington, California oil field's surface rights and hydrocarbon reserves, and its interest in the Harbor Cogeneration Plant, to the City of Long Beach, California for $405 million in cash and notes. The Wilmington sale resulted in a $184 million ($116 million after-tax) gain – $159 million ($100 million after tax) at Resources and $25 million ($16 million after tax) at Union Pacific Railroad Company, the latter related to land and trackage rights. Wilmington hydrocarbon reserves represented approximately 3% of Resources' year-end 1993 proved reserves and the sale of the Wilmington properties will not significantly affect Resources' ongoing operating results.

As part of the Wilmington sales agreement, the Corporation has agreed to participate with the City of Long Beach in funding site preparation and environmental remediation. As a result, the determination of the gain on the sale of the Wilmington properties included provisions of $112 million for such future costs.

5. Financial Instruments

Hedging

The Corporation uses derivative financial instruments to protect against unfavorable hydrocarbon price movements, interest rate movements and foreign currency exchange risk. While the use of these hedging arrangements limits the downside risk of adverse price and rate movements, it may also limit future gains from favorable movements. All hedging is accomplished pursuant to exchange-traded contracts or master swap agreements based on standard forms. Union Pacific does not hold or issue financial instruments for trading purposes. The Corporation addresses market risk by selecting instruments whose value fluctuations correlate strongly with the underlying item or risk being hedged. Credit risk related to hedging activities, which is minimal, is managed by requiring minimum credit standards for counterparties, periodic settlements and/or mark-to-market evaluations. The largest credit risk associated with any of the Corporation's counterparties was $25 million at December 31, 1994. The Corporation has not been required to provide, nor has it received any significant amount of collateral relating to its hedging activity.

Unrecognized mark-to-market gains or losses approximate the fair market value of the related derivative position at December 31, 1994 and were determined based upon current market value, as quoted by recognized dealers, assuming a round lot transaction and using a mid-market convention without regard to market liquidity.

Hydrocarbons: Resources uses exchange-traded futures contracts, swaps and forward contracts to fix selling prices or margins on hydrocarbon volumes. At December 31, 1994, Resources had entered into futures contracts and price swaps for 1995 natural gas sales volumes of 200 mmcf/day at $1.91/mcf, approximately 23% of its 1995 natural gas production. Resources had also entered into long-term fixed price sales agreements for 98 bcf of natural gas at an average price of $2.89/mcf covering the period 1995 thru 2008, comprising average annual sales of 7 bcf, less than 4% of its expected annual production. In addition, Resources' marketing subsidiary uses swaps, futures and forward contracts to lock-in margins on purchase and sales commitments, which generally mature over the next five years. At December 31, 1994, Resources had an unrecognized mark-to-market gain of $43 million relating to hedging arrangements.

Fuel purchase hedging fixes diesel fuel prices using price swaps in which Union Pacific Railroad Company and its affiliate Missouri Pacific Railroad Company (collectively the Railroad) and Overnite Transportation Company (Overnite) pay fixed prices in exchange for market prices for equivalent notional amounts of fuel. At December 31, 1994, the Railroad had no hedging agreements in place, while Overnite had hedged virtually all of its first quarter 1995 fuel consumption (17 million gallons at $0.48 per gallon). At December 31, 1994, Overnite had an unrecognized mark-to-market gain of $300,000 relating to these arrangements.

Interest Rates and Foreign Currency: The Corporation uses interest rate swaps to manage its exposure to increasing interest rates and uses cross-currency swaps to eliminate foreign exchange rate risk in connection with debt denominated in foreign currency. At December 31, 1994, the total notional principal amount of debt affected by these instruments was $288 million with a recognized gain of $24 million included in the carrying value of the debt instrument, as well as an unrecognized mark-to-market loss of $12 million. Hedging of foreign currency transactions offsets actual foreign currency losses. Had the Corporation not hedged its foreign currency obligations, other income would have been $8 million and $7 million lower in 1994 and 1993, respectively, and would not have been affected in 1992. Interest rate hedging activity increased interest expense by $8 million in each of 1994, 1993 and 1992, raising the weighted average borrowing rate by no more than 0.2 of 1% in any year during the period.

Fair Value of Financial Instruments

The fair market value of the Corporation's long and short-term debt has been estimated using quoted market prices or current borrowing rates. At December 31, 1994, the carrying value of total debt exceeded the fair market value by approximately 5%. The carrying value of all other financial instruments approximates fair market value.

Off-Balance-Sheet Risk

Union Pacific Railroad Company has sold, on a revolving basis, an undivided percentage ownership interest in a designated pool of accounts receivable. Collection risk on the pool of receivables is minimal. At December 31, 1994 and 1993, accounts receivable are presented net of the $300 million of receivables sold.

6. Properties

Major property accounts are as follows:

Millions of Dollars	1994	1993
Railroad:		
Road and other	$ 8,428	$ 7,935
Equipment	4,658	4,575
Total Railroad	13,086	12,510
Natural resources	4,965	4,144
Trucking	704	621
Other	130	121
Total	$18,885	$17,396

Accumulated depreciation, depletion and amortization are as follows:

Millions of Dollars	1994	1993
Railroad:		
Road and other	$2,131	$1,990
Equipment	1,881	1,769
Total Railroad	4,012	3,759
Natural resources	2,365	2,364
Trucking	200	165
Other	37	30
Total	$6,614	$6,318

7. Income Taxes

Components of income tax expense including discontinued operations are as follows:

Millions of Dollars	1994	1993
Current:		
Federal	$ (81)	$118
State	30	12
Total current	(51)	130
Deferred:		
Federal	314	304
State	2	16
Total deferred	316	320
Total	$265	$450

In August 1993, President Clinton signed the Omnibus Budget Reconciliation Act (the 1993 Tax Act) into law raising the Federal corporate income tax rate to 35% from 34%, retroactive to January 1, 1993. As a result, 1993 income tax expense increased by $74 million: $62 million for the one-time, non-cash recognition of deferred income taxes related to prior periods and $12 million of incremental current year Federal income tax expense.

The 1992 components of tax expense, which have not been restated to reflect the accounting change (see Note 3), were $155 million for current Federal income tax expense and $215 million for deferred Federal income tax expense.

Deferred tax liabilities (assets) are comprised of the following:

Millions of Dollars	1994	1993
Net current deferred tax (asset) liability	$ 66	$ (117)
Excess tax over book depreciation	2,705	2,457
Exploration costs	343	286
State taxes – Net	223	221
Other liabilities	(150)	(195)
Postretirement benefits	(140)	(152)
Alternative minimum tax	(135)	(178)
Other	10	239
Net long-term deferred tax liability	2,856	2,678
Net deferred tax liability	$2,922	$2,561

A reconciliation between statutory and effective tax rates of continuing operations is as follows:

	1994	1993	1992
Statutory tax rate	35.0%	35.0%	34.0%
Cumulative effect of Federal rate increase	—	5.3	—
State taxes – Net	1.5	1.6	—
Goodwill amortization	0.8	0.8	2.7
Section 29 credits	(3.7)	(1.2)	(1.8)
Dividend exclusion	(1.1)	(1.6)	(0.9)
Other	(0.1)	(1.0)	(0.3)
Effective tax rate	32.4%	38.9%	33.7%

All material IRS deficiencies prior to 1978 have been settled. The Corporation is contesting deficiencies in the Tax Court for 1978 and 1979. The Corporation has reached a partial settlement with the Appeals Office of the IRS for 1980 through 1983; the remaining issues will be resolved as part of the Tax Court case for 1978 and 1979, as well as the refund claim filed for 1983. The Corporation is negotiating with the Appeals Office concerning 1984 through 1986. The IRS is examining the Corporation's returns for 1987 through 1989. The Corporation believes it has adequately provided for Federal and state income taxes.

Net payments of income taxes were $119 million in 1994, $142 million in 1993 and $168 million in 1992.

8. Debt

Total debt is summarized below:

Millions of Dollars	1994	1993
Notes and Debentures, 4.75% to 10.08% due through 2054	$2,634	$2,225
Equipment obligations, 6.12% to 15.50% due through 2012	748	732
Commercial paper, average of 6.2% in 1994 and 3.35% in 1993	767	868
Mortgage bonds, 4.25% to 5.00% due through 2030	178	178
Tax-exempt financings, 3.75% to 9.60% due through 2026	206	206
Capitalized leases	207	156
Unamortized discount	(180)	(182)
Total debt	4,560	4,183
Less current portion	(470)	(115)
Total long-term debt	$4,090	$4,068

Debt maturities for each year, 1996 through 1999, are $269 million, $108 million, $457 million and $1 billion, respectively. Interest payments approximate gross interest expense.

Approximately 54% of all rail equipment and other railroad properties secures outstanding equipment obligations and mortgage bonds.

Certain tax-exempt financings had variable interest rates from 3.75% to 4.85% at December 31, 1994, and from 2.41% to 3.10% at December 31, 1993.

The Corporation has $1.86 billion of available credit facilities for general corporate purposes with various banks. These facilities consist of revolving credit facilities of $1 billion that expire in 1995 and $800 million that expire in 1999, and $60 million of other short-term facilities. Commitment fees and interest rates payable under these facilities are similar to fees and rates available to the most creditworthy corporate borrowers.

To the extent the Corporation has long-term credit facilities available, a portion of commercial paper borrowings and tax-exempt financings, which are due within one year, have been classified as long-term debt. This classification reflects the Corporation's intent to refinance these short-term borrowings on a long-term basis through the issuance of additional commercial paper and/or new long-term financings, or by using the currently available credit facilities if alternative financing is not available.

The Corporation is subject to certain restrictions related to the payment of cash dividends. The amount of retained earnings available for dividends under the most restrictive test was $2.7 billion at December 31, 1994.

In February 1993, the remaining $25 million of the 7.50% Exchangeable Guaranteed Notes due 2003, which were issued in conjunction with the acquisition of the Missouri-Kansas-Texas Railroad, were exchanged for approximately 774,000 shares of the Corporation's common stock. These common shares were held in treasury prior to the exchange.

9. Leases

The Corporation leases certain locomotives, freight cars, trailers, production platforms and other property. Future minimum lease payments for capital and operating leases with initial or remaining non-cancelable lease terms in excess of one year as of December 31, 1994, are as follows:

Millions of Dollars	Operating Leases	Capital Leases
1995	$131	$ 35
1996	78	35
1997	67	33
1998	61	30
1999	42	29
Later years	247	208
Total minimum payments	**$626**	370
Amount representing interest		(163)
Present value of minimum lease payments		**$207**

Rent expense for operating leases with terms exceeding one month was $119 million in 1994, $113 million in 1993 and $105 million in 1992. Contingent rentals and sub-rentals are not significant.

10. Retirement Plans

The Corporation and certain of its subsidiaries provide pension and postretirement health care and life insurance benefits to all eligible retirees.

Pension Benefits

Pension plan benefits are based on years of service and compensation during the last years of employment. Contributions to the plans are calculated based on the Projected Unit Credit actuarial funding method and are not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. In addition, Railroad employees are covered by the Railroad Retirement System. Contributions made to the System are expensed as incurred and amounted to approximately $200 million annually over the past three years. Since 1989, the Corporation has settled a portion of the non-qualified unfunded supplemental plans' accumulated benefit obligation by purchasing annuities.

Pension cost includes the following components:

Millions of Dollars	1994	1993	1992
Service cost – Benefits earned during the period	**$36**	$ 30	$30
Interest on projected benefit obligation	**87**	87	84
Return on assets:			
Actual (gain) loss	**12**	(140)	(57)
Deferred gain (loss)	**(99)**	60	(19)
Net amortization costs	**11**	9	11
Charge to operations	**$47**	$ 46	$49

The projected benefit obligation was determined using a discount rate of 8.0% in 1994 and 7.0% in 1993. The estimated rate of salary increase approximated 6.0% in 1994 and 5.0% in 1993. The expected long-term rate of return on plan assets was 8.0% in both years. The change in assumptions will not significantly affect 1995 pension cost. As of year-end 1994 and 1993, approximately 32% and 34%, respectively, of the funded plans' assets were held in fixed-income and short-term securities, with the remainder primarily in equity securities.

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The funded status of the plans is as follows:

Millions of Dollars	Assets Exceed Accumulated Benefits		Accumulated Benefits Exceed Assets [a]	
	1994	1993	1994	1993
Plan assets at fair value	$1,115	$1,180	$—	$—
Actuarial present value of benefit obligations:				
Vested benefits	867	922	33	39
Non-vested benefits	45	54	2	1
Accumulated benefit obligation	912	976	35	40
Additional benefits based on estimated future salaries	233	201	32	26
Projected benefit obligation	1,145	1,177	67	66
Plan assets (over) under projected benefit obligation	30	(3)	67	66
Unamortized net transition asset (obligation)	35	39	(26)	(33)
Unrecognized prior service cost	(44)	(46)	(36)	(39)
Unrecognized net gain (loss)	146	168	(32)	(30)
Minimum liability	—	—	62	76
Pension liability	$ 167	$ 158	$ 35	$ 40

[a] Represents the Corporation's non-qualified unfunded supplemental plans.

Other Postretirement Benefits

In January 1993, the Corporation adopted the provisions of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (see Note 3). The Corporation does not currently pre-fund health care and life insurance benefit costs. Cash payments for these benefits were $15 million in 1994 and $16 million in 1993.

Railroad agreement employees' health care and life insurance benefits are covered by a separate multiemployer plan and therefore are not subject to the provisions of this Statement.

Components of the postretirement health care and life insurance benefit expense are as follows:

Millions of Dollars	1994	1993
Service cost – Benefits earned during the period	$ 8	$ 7
Interest costs on accumulated benefit obligation	22	21
Net amortization costs	(12)	—
Charge to operations	$18	$28

The liability for postretirement benefit plans is as follows:

Millions of Dollars	1994	1993
Accumulated postretirement benefit obligation (APBO):		
Retirees	$213	$201
Fully eligible active employees	20	21
Other active employees	88	99
Total APBO	321	321
Unrecognized prior service gain	66	76
Unrecognized net gain	53	40
Postretirement benefits liability	$440	$437

The APBO was determined using a discount rate of 8.0% in 1994 and 7.0% in 1993. The health care cost trend rate is assumed to gradually decrease from 12.4% for 1995 to 5.8% for 2009 and all future years. If the assumed health care cost trend rate increases by one percentage point in each subsequent year, the aggregate of the service and interest cost components of annual postretirement benefit expense would increase by $4 million and the APBO would rise by $33 million.

11. Stock Option Plans, Retention Stock Plans and Other Capital Stock

Pursuant to the Corporation's stock option, retention and restricted stock plans for directors, officers and key employees, 9,747,370, 14,469,250 and 4,095,900 common shares or options for common shares were available for grant at December 31, 1994, 1993 and 1992, respectively.

Options under the plans are granted at 100% of market value at the date of grant and are exercisable for a period of ten years from the grant date. While options become exercisable no earlier than one year after grant, in 1994 a multiyear grant was made covering normal annual grants for three years, becoming exercisable over a three-year period, provided designated target Union Pacific common stock prices are met, or becoming fully exercisable in any event after nine years. The plans also provide for granting of options containing stock appreciation rights (SARs) features; however, all outstanding SARs were voluntarily surrendered during 1994.

Changes in common stock options and SARs outstanding are as follows:

	Shares Under Option	Price Range Per Share		
Balance Dec. 31, 1991	4,406,720	$19.04	to	$49.13
Granted	1,322,250		54.13	
Exercised	(1,511,920)	19.04	to	46.66
Expired/Surrendered	(61,100)	46.66	to	54.13
Balance Dec. 31, 1992	4,155,950	20.04	to	54.13
Granted	1,352,850		63.75	
Exercised	(792,890)	20.04	to	54.13
Expired/Surrendered	(19,450)	28.32	to	54.13
Balance Dec. 31, 1993	4,696,460	20.04	to	63.75
Granted	3,990,200		47.00	
Exercised	(205,000)	20.04	to	54.13
Expired/Surrendered	(31,550)	46.66	to	63.75
Balance Dec. 31, 1994	**8,450,110**	**23.07**	**to**	**63.75**
Exercisable Dec. 31				
1992	2,833,700	$20.04	to	$49.13
1993	3,343,610	20.04	to	54.13
1994	4,459,910	23.07	to	63.75

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The plans also provide for awarding restricted shares of common stock to eligible employees, generally subject to forfeiture if employment terminates during the prescribed restricted period. In addition, a multiyear award was made in 1994 covering a performance period thru 1998, with vesting dependent upon the achievement of certain Union Pacific stock price targets. During 1994, 1993 and 1992, 755,230, 208,700 and 131,450 retention and restricted shares, respectively, were issued.

The Corporation has announced programs to repurchase up to $1.2 billion of its common shares. Since 1984, 15 million shares have been repurchased at a cost of $841 million.

12. Commitments and Contingencies

There are various lawsuits pending against the Corporation and certain of its subsidiaries. The Corporation is also subject to Federal, state and local environmental laws and regulations, and is currently participating in the investigation and remediation of numerous sites. Where the remediation costs can be reasonably determined, and where such remediation is probable, the Corporation has recorded a liability. At December 31, 1994, the Corporation had accrued $243 million for estimated future environmental costs and believes it is reasonably possible that actual environmental costs could be lower than the recorded reserve or as much as 25% higher. The Corporation has also entered into commitments and provided guarantees for specific financial and contractual obligations of its subsidiaries and affiliates. The Corporation does not expect that the lawsuits, environmental costs, commitments or guarantees will have a material adverse effect on its consolidated financial position or its results of operations.

13. Other Income – Net

Other Income – Net includes the following:

Millions of Dollars	1994	1993	1992
Rental income	$ 32	$33	$ 38
Net gain on property dispositions (Note 4)	216	18	36
Interest on tax settlements	—	—	55
Interest and other – Net	11	38	17
Total	$259	$89	$146

Selected Quarterly Data

Selected unaudited quarterly data are as follows:

Millions of Dollars Except Per Share Amounts	Mar. 31	Jun. 30	Sep. 30	Dec. 31
1994				
Operating revenues	$1,860	$1,988	$1,958	$1,992
Operating income	345	421	428	401
Income from continuing operations	285 [a]	228	210	235
Net income (loss)	283 [a]	220	(213) [b]	256 [c]
Per share:				
Continuing operations	1.39 [a]	1.11	1.02	1.14
Net income (loss)	1.38 [a]	1.07	(1.04) [b]	1.25 [c]
Dividends	0.40	0.40	0.43	0.43
Common stock price:				
High	67.13	59.75	60.13	53.75
Low	55.50	55.38	52.75	44.50
1993				
Operating revenues	$1,777	$1,796	$1,839	$1,913
Operating income	345	389	344	416
Income from continuing operations	167	204	108 [e]	235
Net income (loss)	(11) [d]	198	108 [e]	235
Per share:				
Continuing operations	0.81	0.99	0.53 [e]	1.14
Net income (loss)	(0.06) [d]	0.96	0.53 [e]	1.14
Dividends	0.37	0.37	0.40	0.40
Common stock price:				
High	62.38	65.38	67.00	64.88
Low	56.88	58.75	58.38	57.88

[a] Included a one-time $116 million ($0.56 per share) after-tax gain resulting from the sale of the Corporation's oil and gas properties in Wilmington, California.

[b] Included an after-tax loss from discontinued operations of $423 million ($2.06 per share), reflecting a write-down of USPCI's assets to estimated ~~net~~ realizable value and a provision for costs associated with the disposition of USPCI.

[c] Included a $21 million after-tax ($0.11 per share) reduction in the Corporation's original USPCI loss provision to reflect the sale of USPCI to Laidlaw Inc.

[d] Included a $175 million ($0.86 per share) after-tax charge for changes in accounting principles.

[e] Included a $62 million ($0.30 per share) increase in income tax expense resulting from the deferred tax effect of the 1993 Tax Act.

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Stockholders and Dividends

The common stock of the Corporation is traded on various stock exchanges, principally the New York Stock Exchange. At January 31, 1995, there were 205,911,244 shares of outstanding common stock and approximately 62,500 common stockholders. At that date, the closing price of the common stock on the New York Stock Exchange was $50.25.

Cash dividends declared on common stock by the Corporation were $1.66 per share in 1994 and $1.54 per share in 1993. Union Pacific has paid dividends to its common stockholders during each of the past 95 years. See Note 8 to the Financial Statements for a discussion regarding restrictions relating to the payment of cash dividends.

Rail Transportation

Commodities

Revenue ton-miles (RTM) and commodity revenue (CR) for major commodities by percent and in total are as follows:

	1994		1993		1992	
Percent of Total	RTM	CR	RTM	CR	RTM	CR
Automotive	3.8%	11.3%	4.0%	11.3%	3.7%	10.7%
Chemicals	14.6	21.1	14.0	20.9	14.8	21.6
Energy	35.9	18.9	34.3	18.3	31.2	17.6
Food, consumer and government	5.7	6.6	5.8	6.6	6.3	7.1
Grains and grain products	14.3	11.7	16.1	12.9	17.3	13.5
Intermodal	12.5	15.6	12.0	14.3	12.1	13.2
Metals, minerals and forest	13.2	14.8	13.8	15.7	14.6	16.3
Total (%)	100%	100%	100%	100%	100%	100%
Total (Billions)	235.8	$5.2	220.7	$4.9	209.1	$4.8

Equipment

Owned or leased at year-end	1994	1993	1992
Locomotives	3,132	3,142	3,074
Freight cars:			
Covered hoppers	24,009	23,399	22,656
Box cars	15,670	15,826	16,573
Open-top hoppers	11,256	10,885	11,064
Gondolas	9,678	9,969	10,438
Other	7,698	8,013	8,408
Work equipment	4,529	4,704	4,922
Acquired during the year:			
Locomotives	49	74	74
Freight cars	1,784	1,394	646
Average age of equipment (years):			
Locomotives	13.0	12.2	11.8
Freight cars	20.2	19.8	19.3
Bad order ratio – Freight cars	6.4%	7.9%	8.2%

Expenditures

Millions of Dollars	1994	1993	1992
Capital expenditures:			
Roadway and other	$586	$591	$504
Equipment	183	214	263
Total	$769	$805	$767
Maintenance expenditures:			
Roadway	$258	$247	$273
Equipment	500	490	485
Total	$758	$737	$758

Track

Miles	1994	1993	1992
Main line	13,836	13,972	14,032
Branch line	3,663	3,863	4,988
Yards, siding and other main line	12,279	12,480	12,717
Total	29,778	30,315	31,737
Track miles of continuous welded rail (at year-end)	13,988	13,735	13,528
Track miles under centralized traffic-control (at year-end)	8,900	8,861	8,847
Track miles of rail replaced:			
New	278	280	373
Used	252	254	267
Track miles re-ballasted	2,442	2,510	3,296
Ties replaced (thousands)	1,623	2,017	1,946

Freight Operations

	1994	1993	1992
Operating ratio	77.9	79.1	79.0
Carloadings (thousands)	4,991	4,619	4,458
Average commodity revenue per carloading	$1,045	$1,055	$1,081
Average price of diesel fuel (per gallon)	58.7¢	62.8¢	63.9¢

Trucking

Freight Operations

	1994	1993	1992
Shipments (thousands):			
Less-than-truckload	8,535	8,146	7,603
Truckload	58	60	67
Total	8,593	8,206	7,670
Tonnage (thousands):			
Less-than-truckload	4,557	4,277	3,994
Truckload	667	733	837
Total	5,224	5,010	4,831
Revenue per hundredweight	$9.82	$9.28	$9.03
Operating ratio	91.3	90.2	90.9

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Equipment and Terminals

Owned or leased at year-end	1994	1993	1992
Tractors	5,364	5,254	5,311
Trailers	18,858	17,105	16,123
Straight trucks	87	93	101
Automobiles and service units	214	237	385
Service centers	173	166	160
Average age of equipment (years):			
Tractors	6.5	6.8	7.2
Trailers	7.0	8.0	8.7

Capital Expenditures

Millions of Dollars	1994	1993	1992
Revenue equipment	$58	$40	$48
Other	35	40	24
Total	$93	$80	$72

Natural Resources

Oil and Gas – Proved Reserves

Proved reserves of crude oil, which include condensate and natural gas liquids, are as follows:

Millions of Barrels	1994	1993	1992
Beginning of year	156.9	156.6	161.4
Revisions of previous estimates	(1.7)	5.5	7.1
Improved recovery	—	1.3	—
Extensions, discoveries and other additions	29.1	20.8	27.2
Purchases (sales) of reserves-in-place	1.1	4.6	(7.3)
Production	(30.7)	(31.9)	(31.8)
End of year	154.7	156.9	156.6
Proved developed reserves	151.1	153.8	148.5

The table above includes the following amounts with respect to natural gas liquids:

Millions of Barrels	1994	1993	1992
Production	(8.5)	(7.7)	(7.5)
Reserves, end of year	83.8	74.3	67.8

Proved natural gas reserves are as follows:

Billions of Cubic Feet	1994	1993	1992
Beginning of year	1,731.2	1,709.2	1,655.5
Revisions of previous estimates	(33.1)	(35.6)	37.2
Extensions, discoveries and other additions	360.3	237.0	427.1
Purchases (sales) of reserves-in-place	349.4	46.6	(199.6)
Production	(281.8)	(226.0)	(211.0)
End of year	2,126.0	1,731.2	1,709.2
Proved developed reserves	2,054.4	1,643.5	1,610.8

Reserve estimates for 1994 include the effects of the AMAX Oil & Gas, Inc. acquisition and the sale of Wilmington, California properties (see Note 4 to the Financial Statements). Over 90% of proved reserves are in the United States. At December 31, 1991, proved developed reserves of oil and gas were 135.4 million barrels and 1,512.9 billion cubic feet, respectively.

Drilling and Production Activities

Drilling	1994	1993	1992
Gross wells	677	529	483
Gross productive wells	644	491	435
Net wells:			
Exploration	24	20	33
Development	373	303	291
Net productive wells:			
Exploration	16	10	13
Development	365	295	285

At December 31, 1994, 134 gross wells and 45 net wells were in process of being drilled.

Sales Price and Cost [a]	1994	1993	1992
Crude oil sales price	$14.34	$15.66	$17.22
Natural gas liquids sales price	9.18	9.84	10.67
Gas sales price	1.82	1.82	1.52
Lifting cost [b]	3.57	4.12	4.12

[a] Average per bbl or mcf, except lifting cost which is per barrel oil equivalent converted at 6:1.

[b] Lifting cost per unit includes 9.8 million, 6.9 million and 5.8 million barrels of natural gas liquids earned through plant ownership in 1994, 1993 and 1992, respectively.

Production (per day)	1994	1993	1992
Net crude oil (thousand bbl)	63.1	66.5	66.5
Net natural gas liquids (thousand bbl)	23.2	21.0	20.6
Net natural gas (mmcf)	772.0	619.0	576.0
Natural gas processed (mmcf)	1,122.4	949.4	935.1

Acreage and Wells

Oil and gas acreage is as follows:

Thousands of Acres	1994	1993
Gross developed	1,811	1,569
Net developed	847	833
Gross undeveloped	4,252	17,588
Net undeveloped	3,083	15,733

The table excludes 7.1 million gross acres and 6.4 million net acres, which were acquired through 19th century Congressional Land Grant Acts. Substantial portions of this acreage are considered prospective for oil and gas.

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Productive oil and gas wells at December 31, 1994, are as follows:

Wells	Oil	Gas
Gross [a]	3,565	4,109
Net	1,272	2,513

[a] Approximately 785 are multiple completions, 449 of which are gas wells.

Capitalized Exploration and Production Costs

Millions of Dollars	1994	1993	1992
Proved properties	$ 786	$ 386	$ 402
Unproved properties	146	151	134
Wells, related equipment and facilities	3,448	3,110	2,791
Uncompleted wells, equipment and facilities	172	197	200
Gross capitalized costs	4,552	3,844	3,527
Accumulated depreciation, depletion, amortization and valuation provisions	(2,218)	(2,208)	(1,983)
Net capitalized costs	$2,334	$1,636	$1,544

Costs Incurred in Exploration and Development

Costs incurred in oil and gas property acquisitions, and exploration and development activities are as follows:

Millions of Dollars	1994	1993	1992
Costs incurred: [a]			
Proved acreage	$441	$ 27	$ 3
Unproved acreage	35	57	31
Exploration costs	104	88	89
Development costs	746	400	485

[a] Costs incurred include capitalized costs.

Results of Operations for Producing Activities

Millions of Dollars	1994	1993	1992
Revenues – third parties	$1,059	$1,044	$957
Production costs	(315)	(315)	(300)
Exploration expenses	(73)	(76)	(89)
Depreciation, depletion and amortization	(447)	(400)	(409)
Total costs	(835)	(791)	(798)
Pre-tax results	224	253	159
Income taxes	(80)	(83)	(58)
Results of operations	$ 144	$ 170	$101

Pipeline results, overhead expenses and interest costs have been excluded in computing these results of operations.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserves

Millions of Dollars	1994	1993	1992
Future cash inflows from sale of oil and gas	$5,023	$4,540	$5,256
Future production and development costs	(1,791)	(1,631)	(1,451)
Future income taxes	(722)	(859)	(1,156)
Future net cash flows	2,510	2,050	2,649
10% annual discount	(851)	(761)	(1,097)
Standardized measure of discounted future net cash flows	$1,659	$1,289	$1,552

An analysis of changes in standardized measure of discounted future net cash flows follows:

Millions of Dollars	1994	1993	1992
Beginning of year	$1,289	$1,552	$1,504
Changes due to current year operations:			
Additions and discoveries less related production and other costs	571	441	721
Sales of oil and gas – Net of production costs	(744)	(733)	(657)
Development costs	745	400	485
Purchases (sales) of reserves-in-place	235	28	(228)
Changes due to revisions in:			
Price	(10)	(516)	(4)
Development costs	(812)	(358)	(414)
Quantity estimates	(80)	(5)	103
Income taxes	224	143	(101)
Other	67	123	(56)
Discount accretion	174	214	199
End of year	$1,659	$1,289	$1,552

Future oil and gas sales, and production and development costs have been estimated using prices and costs in effect as of each year-end. Future net revenues were discounted to present value at 10%, a uniform rate set by the FASB. Income taxes represent the tax effect (at statutory rates) of the difference between the standardized measure values and tax bases of the underlying properties at the end of the year.

Changes in the supplies and demand for oil and natural gas, inflation, timing of production, reserve revisions and other factors make these estimates inherently imprecise and subject to substantial revision. As a result, these measures are not the Corporation's estimate of future cash flows nor do these measures serve as an estimate of current market value.

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Ten-Year Financial Summary[a/b]

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, Except Per Share Amounts, Ratios and Employee Statistics

	1994	1993[c]	1992	1991[d]	1990	1989	1988	1987	1986[d]	1985
Operating Revenues	**$ 7,798**	7,325	7,032	6,778	6,735	6,246	5,951	5,351	4,773	5,078
Operating Income (Loss)	**1,595**	1,494	1,397	480	1,309	1,240	1,197	991	(364)	825
Income (Loss) from										
Continuing Operations	**958**	714	728	84	614	598	561	495	(270)	464
Net Income (Loss)	**546**	530	728	64	618	595	644	583	(460)	501
Per Share:										
Continuing Operations	**4.66**	3.47	3.57	0.41	3.06	2.83	2.46	2.16	(1.40)	1.94
Net Income (Loss)	**2.66**	2.58	3.57	0.31	3.08	2.81	2.83	2.55	(2.28)	2.09
Dividends	**$ 1.66**	1.54	1.42	1.31	1.18	1.12	1.06	1.00	0.93	0.90
At Year-End										
Total Assets	**$ 15,942**	14,895	14,001	13,226	13,008	12,421	12,182	10,919	10,863	10,710
Total Debt	**4,560**	4,183	4,098	4,049	4,083	4,034	3,353	2,885	3,061	2,192
Common Stockholders' Equity	**5,131**	4,885	4,639	4,163	4,277	3,911	4,482	3,761	3,408	4,356
Equity Per Common Share	**$ 24.92**	23.81	22.75	20.52	21.63	19.50	19.85	17.90	16.23	19.84
For the Year										
Capital Investments[e]	**$ 1,597**	1,574	1,567	1,231	1,206	1,174	1,240	748	738	1,067
Cash from Operations	**1,909**	1,563	1,660	1,392	1,467	1,483	1,391	950	1,333	1,317
Total Salaries, Wages and										
Employee Benefits[f]	**$ 2,863**	2,786	2,778	2,635	2,634	2,552	2,436	2,284	1,978	2,188
Average Number of										
Employees	**46,900**	45,500	44,400	45,500	47,000	47,100	46,300	46,600	39,500	44,400
Revenues Per Employee	**$166,300**	161,000	158,500	148,900	143,200	134,800	128,500	114,900	120,900	114,300
Financial Ratios (%)										
Debt to Total Capital Employed	**36.3**	35.6	36.8	39.1	38.5	40.3	34.4	32.7	36.1	24.7
Return on Average Common										
Stockholders' Equity	**10.9**	11.1	16.5	1.5	15.1	14.2	13.4	12.9	—	10.1

[a] 1994 results include a net after-tax loss from discontinued operations of $412 million from the sale of the Corporation's waste management operations (see Note 2 to the Financial Statements). Excluding this loss, return on average common stockholders' equity would have been 18.4%. All information presented has been restated to reflect USPCI, Inc. as discontinued operations.

[b] Data include the effects of the AMAX Oil & Gas, Inc. acquisition as of March 31, 1994, the Skyway Freight Systems, Inc. acquisition as of May 31, 1993 and the Missouri-Kansas-Texas Railroad Company acquisition as of August 1, 1988.

[c] 1993 results include a net after-tax charge of $175 million for the adoption of changes in accounting methods and a one-time $62 million charge for the deferred tax effect of the Omnibus Budget Reconciliation Act of 1993 (the 1993 Tax Act) (see Notes 3 and 7 to the Financial Statements, respectively). Excluding the effects of the 1993 Tax Act, income from continuing operations would have been $776 million ($3.77 per share) with a return on average common stockholders' equity of 15.9%.

[d] Earnings excluding the special charges would have been $639 million in 1991 with a return on average common stockholders' equity of 14.2% and would have been $485 million in 1986 with a return on average common stockholders' equity of 11.1%.

[e] Includes exploratory expenditures and capital expenditures of unconsolidated affiliated companies.

[f] Includes capitalized salaries, wages and employee benefit costs.

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Union Pacific Corporation

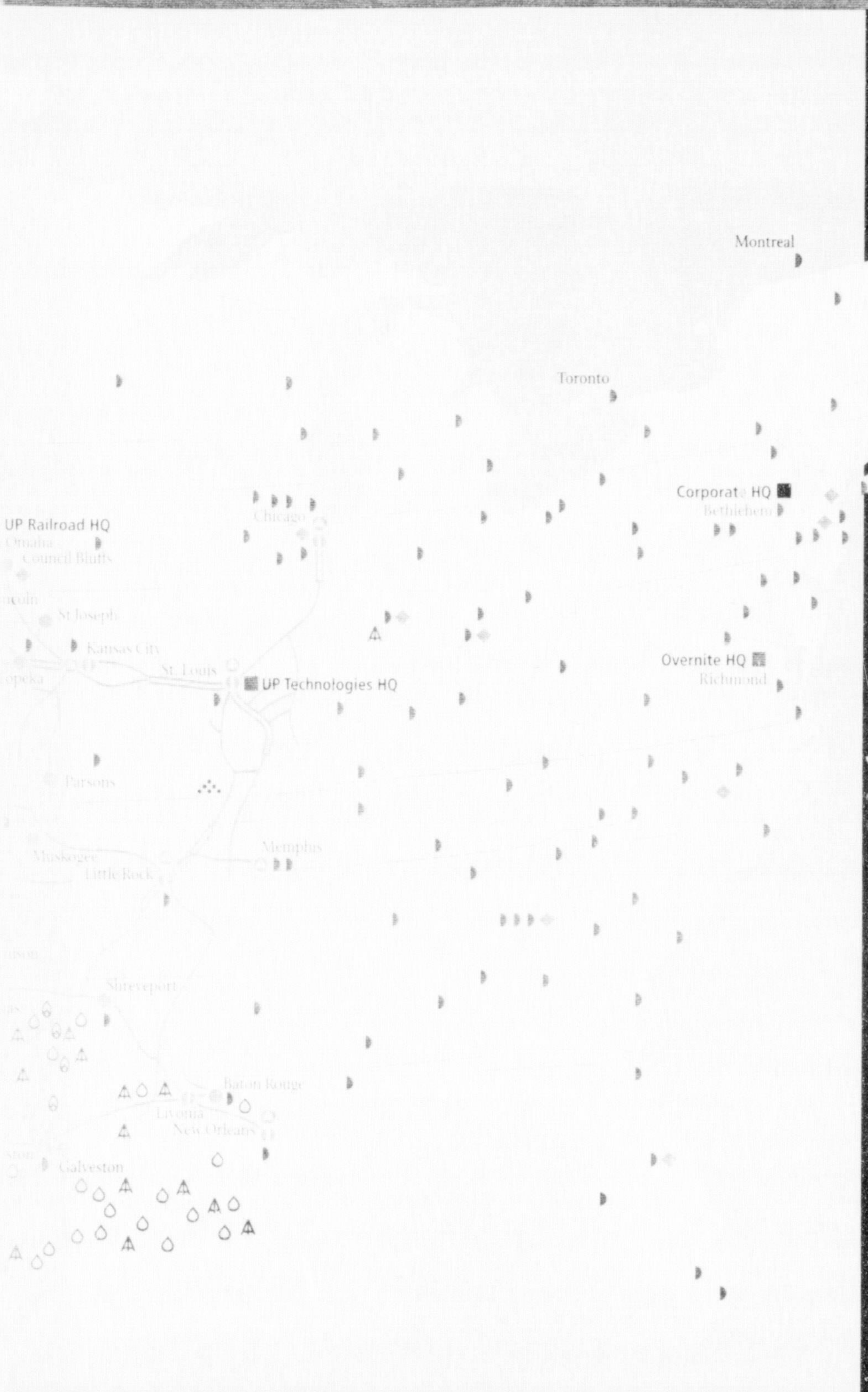
Union Pacific Railroad

Headquarters

Union Pacific Resources

Headquarters

Coal Operation



Overnite Transportation
- Headquarters
- Key Terminals

Skyway Freight Systems
- Headquarters
- Key Terminals

Union Pacific Technologies
- Headquarters

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Board of Directors

Robert P. Bauman

Chairman
British Aerospace p.l.c.
Aircraft and aerospace manufacturer

Richard B. Cheney

Former Secretary of Defense
Senior Fellow
American Enterprise Institute
Public policy research

E. Virgil Conway

Financial Consultant

Richard K. Davidson

President
Union Pacific Corporation

Chairman and CEO
Union Pacific Railroad Company

Lawrence M. Jones

Retired Chairman and
Chief Executive Officer
The Coleman Company, Inc.
Home and recreational products

Drew Lewis

Chairman and
Chief Executive Officer
Union Pacific Corporation

Richard J. Mahoney

Chairman and
Chief Executive Officer
Monsanto Company
Agricultural, chemical, pharmaceutical and food products, man-made fibers and plastics

Claudine B. Malone

President
Financial & Management Consulting, Inc.
Management consulting

James D. Robinson, III

President
J. D. Robinson, Inc.
Strategic advisory and principal investing services

Robert W. Roth

Retired President and
Chief Executive Officer
Jantzen Inc.
Sportswear manufacturer

Richard D. Simmons

President
International Herald Tribune
Communications

Spencer F. Eccles

Chairman and
Chief Executive Officer
First Security Corporation
Bank holding company

Elbridge T. Gerry, Jr.

Partner
Brown Brothers Harriman & Co.
Bankers

William H. Gray, III

President
United Negro College Fund
Educational assistance

Judith Richards Hope

Senior Partner
Paul, Hastings,
Janofsky & Walker
Law

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Executive Vice President,
Finance
Union Pacific Corporation

Jack L. Messman

President and
Chief Executive Officer
Union Pacific Resources
Company

John R. Meyer

Professor
Harvard University

Thomas A. Reynolds, Jr.

Chairman Emeritus
Winston & Strawn
Law

Executive Committee

Elbridge T. Gerry, Jr., Chairman
E. Virgil Conway
Judith Richards Hope
Drew Lewis
L. White Matthews, III
John R. Meyer
James D. Robinson, III
Robert W. Roth
Richard D. Simmons

Compensation, Benefits and Nominating Committee

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Robert P. Bauman
Richard B. Cheney
William H. Gray, III
Judith Richards Hope
Richard J. Mahoney
Thomas A. Reynolds, Jr.
Richard D. Simmons

Audit Committee

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Richard B. Cheney
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Elbridge T. Gerry, Jr.
Judith Richards Hope
Lawrence M. Jones
Claudine B. Malone
John R. Meyer
Thomas A. Reynolds, Jr.

Finance and Corporate Development Committee

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Spencer F. Eccles
Elbridge T. Gerry, Jr.
William H. Gray, III
Lawrence M. Jones
Richard J. Mahoney
Claudine B. Malone
Jack L. Messman
James D. Robinson, III

Union Pacific Corporation

Drew Lewis
Chairman and Chief Executive Officer

Richard K. Davidson
President

L. White Matthews, III
Executive Vice President Finance

Ursula F. Fairbairn
Senior Vice President Human Resources

Carl W. von Bernuth
Senior Vice President and General Counsel

Charles E. Billingsley
Vice President and Controller

John E. Dowling
Vice President Corporate Development

John B. Gremillion, Jr.
Vice President Taxes

Mary E. McAuliffe
Vice President External Relations

Gary F. Schuster
Vice President Corporate Relations

Gary M. Stuart
Vice President and Treasurer

Judy L. Swantak
Vice President and Corporate Secretary

Union Pacific Railroad Company

Richard K. Davidson
Chairman and Chief Executive Officer

John J. Koraleski
Executive Vice President Finance and Information Technologies

James A. Shattuck
Executive Vice President Marketing and Sales

Arthur L. Shoener
Executive Vice President Operations

Thomas L. Watts
Senior Vice President Labor Relations

Henry L. Arms
Vice President Energy

James J. Damman, Jr.
Vice President National Customer Service Center

James V. Dolan
Vice President Law

Dennis J. Duffy
Vice President Quality

Charles R. Eisele
Vice President Purchasing

Michael F. Kelly
Vice President Marketing

R. Bradley King
Vice President Risk Management

Stanley J. McLaughlin
Vice President Engineering Services

Robert D. Naro
Vice President Transportation

John H. Rebensdorf
Vice President Strategic Planning

Barbara W. Schaefer
Vice President Human Resources

J. Edward Sims
Vice President Marketing

Morris B. Smith
Vice President Finance

Harris Wagenseil
Vice President Maintenance Operations

Joyce M. Wrenn
Vice President Information Technologies and Chief Information Officer

James R. Young
Vice President Reengineering

Union Pacific Resources Company

Jack L. Messman
President and Chief Executive Officer

Dale W. Bossert
Vice President Exploration and Production

V. Richard Eales
Vice President Corporate Development

Patrick D. Hanley
Vice President and Chief Financial Officer

Mark S. Knouse
Vice President Government Relations and Public Affairs

George Lindahl, III
Vice President Operations

Donald W. Niemiec
Vice President Marketing

Bill J. Zimmerman
Vice President and General Counsel

Overnite Transportation Company

James D. Douglas
President and Chief Operating Officer

Daniel W. Avramovich
Senior Vice President Marketing and Sales

John W. Fain
Senior Vice President Operations

J. Paul Heaton
Senior Vice President Operations Strategy

Malcolm H. Bronson
Vice President Regional

James A. D'Alessio
Vice President Regional

Keith K. Dobson
Vice President Fleet Services

B.W. Edwards
Vice President Safety

Stephen J. Enright
Vice President Human Resources

Robert J. Flynn
Vice President Marketing

Mark B. Goodwin
Vice President and General Counsel

Timothy W. Ramsey
Vice President Regional

Stephen C. Robbins
Vice President Information and Communication Systems

Richard N. Sechrist
Vice President Regional

David Tuttle
Vice President Finance and Information Technologies

Phillip R. Warren
Vice President Transportation

Tod Webster
Vice President Customer Service

Union Pacific Technologies

L. Merill Bryan, Jr.
President and Chief Executive Officer

George J. Gagen
Executive Vice President

Phillip C. Seifert
Vice President Transportation Systems and Services

Skyway Freight Systems, Inc.

Kip Hawley
President and Chief Executive Officer

Stephen E. Holbert
Senior Vice President Operations

Raymond J. Lutz
Senior Vice President Sales and Marketing

Susan Beer
Vice President Customer Processes

David G. Hansen
Vice President Finance

Gary L. Roberts
Vice President Information Services

Luis Solis
Vice President International Business Development

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Executive Offices
Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018
(610) 861-3200

Union Pacific Railroad Company
1416 Dodge Street
Omaha, Nebraska 68179

Union Pacific Resources Company
801 Cherry Street
Fort Worth, Texas 76102

Overnite Transportation Company
1000 Semmes Avenue
P. O. Box 1216
Richmond, Virginia 23209

Union Pacific Technologies
7930 Clayton Road
St. Louis, Missouri 63117

Skyway Freight Systems, Inc.
225 Westridge Drive
Watsonville, California 95076

External Relations Office
555 13th Street, N.W.
Suite 450 West
Washington, D.C. 20004

Transfer Agent and Registrar of Stock
First Chicago Trust Company of New York
Post Office Box 2500
Jersey City, New Jersey 07303-2500

If you have any questions regarding your account, contact First Chicago's Telephone Response Center at (800) 446-2617 on weekdays between 8 A.M. and 10 P.M. and Saturdays between 8 A.M. and 3:30 P.M. (Eastern Time) or write to First Chicago at the above address.

Stock Listing
New York Stock Exchange
Ticker Symbol: UNP

Annual Meeting of Stockholders
April 21, 1995, 8:30 A.M.
Little America Hotel
Salt Lake City, Utah

SEC Form 10-K
A copy of the Corporation's 1994 Annual Report on Form 10-K, filed with the Securities and Exchange Commission, may be obtained by writing to:

Secretary
Union Pacific Corporation
Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018

Quarterly Earnings Information
Beginning in 1994, Union Pacific discontinued distributing quarterly reports to shareholders. Copies of press releases and Securities and Exchange Commission filings covering quarterly earnings information may be obtained by telephoning (toll-free) or writing the Corporation's Transfer Agent as listed above.

Union Pacific
Corporation

Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018
(610) 861-3200

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1993 Annual Report

Southern Pacific Rail Corporation

CONTENTS

MISSION STATEMENT

Southern Pacific Lines' mission is to anticipate and satisfy the requirements of its customers for highly responsive and cost-effective transportation and distribution services.

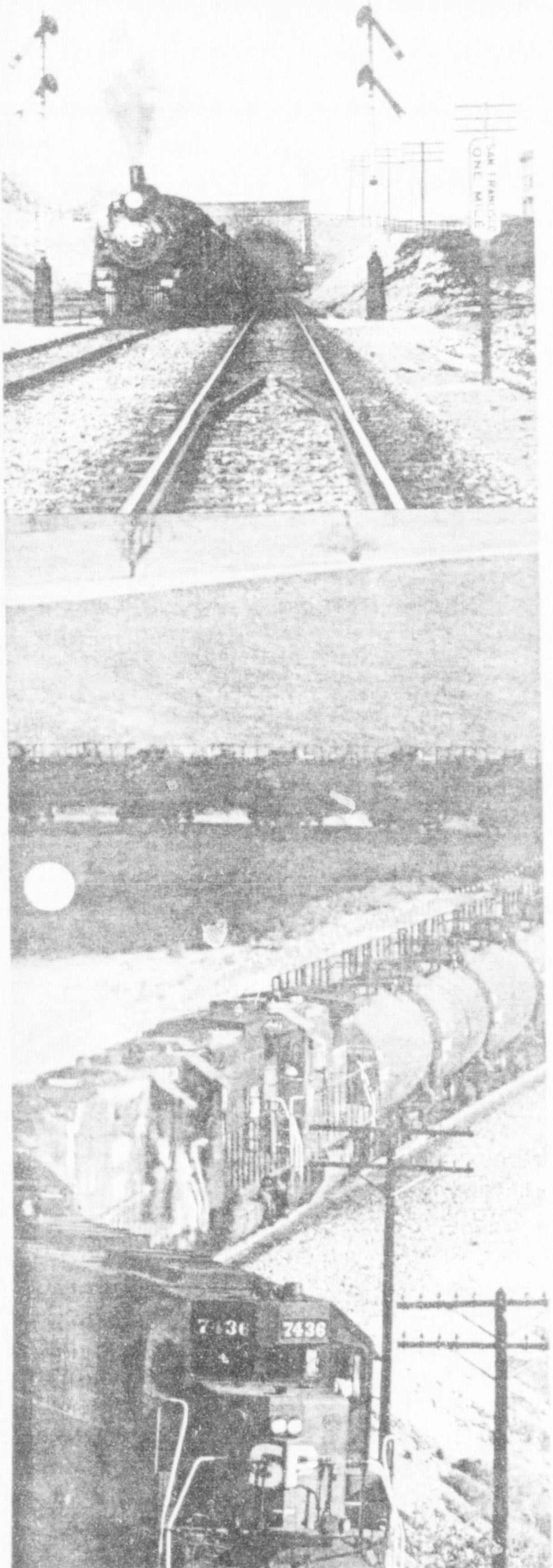
CORPORATE PROFILE

Southern Pacific Rail Corporation, through the integrated railroad network of its principal subsidiaries, transports freight in the Western and Southwestern United States. The Company's five main routes cover 15 states over approximately 15,000 miles of track.

Its rail lines serve most West Coast ports and large Western population centers; connect with Eastern railroads at all major gateways; and reach the principal Gulf Coast ports south from Chicago and east from the Los Angeles Basin. SP also has six gateways into Mexico, more than any other U.S. railroad.

The Company is the leading U.S. rail carrier of containerized freight, and its Intermodal Container Transfer Facility in Southern California is the nation's largest international container yard.

(Top photo on facing page.) ***1911:*** *One mile out of San Francisco, San Jose local passenger No. 28 roars out of tunnel No. 2 on the new Bay Shore Cutoff.*



Company History

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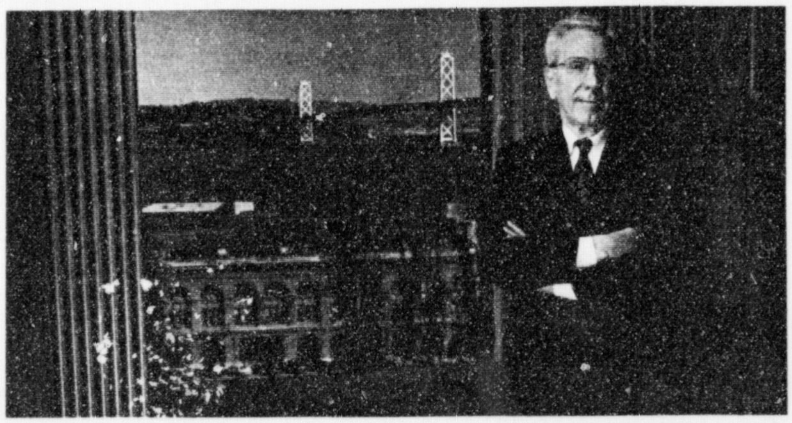
To Our Stockholders



EDWARD L. MOYERS
President and
Chief Executive Officer

I welcome my first opportunity to report to you as President and Chief Executive Officer of Southern Pacific Rail Corporation, which has been publicly held since August 1993. The people of Southern Pacific have dedicated themselves to creating a customer-oriented company focused on enhancing stockholder value. I'm pleased to report that 1993 was a year of solid achievements in many important areas.

Through its recent equity offerings, the Company has substantially enhanced its financial structure by adding $900 million of equity. In addition, the Company refinanced $375 million of debt on greatly improved terms and has $200 million of unused capacity under its new bank revolving line of credit. This has enabled the Company to significantly improve its liquidity, debt to capitalization ratio and required debt repayment schedule. Most importantly, these steps have given the Company the financial resources necessary to move forward with our locomotive program and to focus on operations, while reducing dependence on asset sales.

For the year, operating income remained stable at $103 million on revenues of $2.92 billion, compared with operating income of $109 million on revenues of $2.88 billion for 1992. Our operating ratio (operating expenses divided by revenues) for 1993 was 96.5%, slightly above the operating ratio of 96.2% for 1992.

Revenues and operating income would have been higher (and our operating ratio lower) had it not been for the Midwestern flooding during the third and fourth quarter. While other railroads suffered more physical damage, SP lost revenues and incurred additional costs estimated at approximately $60-$65 million due to detours, delays and the shared costs of repairs to other railroads' property. A fourth-quarter charge for centralizing our train dispatching operations and eliminating facilities also reduced our operating income.

Operating Issues Progress

On the positive side, the operating income shortfalls from the flooding raised the profile of the operating issues facing SP, which helped us in our efforts to communicate those issues through the fall. During the fourth quarter we began to make accelerated progress in rationalizing both our route system and our workforce, and we also launched the largest upgrade of our locomotive fleet in the history of Southern Pacific.

When the locomotive program is completed this year, SP will have acquired 150 new locomotives and 133 remanufactured units. We will also have

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completed the rebuilding or heavy repair of 300 locomotives, at our Burnham Shop in Denver and under power-by-the-mile servicing agreements. This program, at an overall cost of approximately $350 million, is critical to improving our service pattern. The success of all our programs for increasing efficiency and customer satisfaction depends on reliable power to pull our trains.

Another key to our success in this area is the effective management of our operations departments. Last September, the out-of-service ratio for our locomotive fleet was an unacceptable 17%. In the first quarter of 1994, our mechanical department has reduced that number to an average of 11–12%, the lowest such figures at SP since 1982.

In 1992, temporary slow orders on main SP track affected 235 miles. At the end of 1993, the engineering department had reduced that total by 55%, to about 105 miles. In March 1994 we were running at approximately 94 miles, which is the lowest on record at SP.

These dramatic improvements have a strong positive impact on the running times of our trains. Furthermore, SP is accomplishing these results while making major force reductions.

The SP operations team has also turned in strong gains in service improvement on our important long-haul business. Since the first week of December, the on-time dock-to-dock performance of our intermodal traffic has improved 58%, and the on-time dock-to-dock performance of our carload traffic has improved 68%.

Increased Efficiency and Productivity

We also have dramatically reduced the number of railcars on line. When congestion is reduced on line and car movements are expedited through yards, service to our customers improves and car-hire expenses drop. Last fall we had 108,000 freight cars on line. Into the first quarter of 1994, we cut that figure to about 90,000 even though our business had increased. Key to reducing the number of cars on line is turning each car around faster. Recent improvements in turning our coal cars in Colorado and Utah up to 2.4 times a month result in better service to our customers.

The many productivity gains we have made throughout the Company are a tribute to our employees, who have consistently stepped up to the challenge of doing more work with fewer people. We are ahead of schedule on our announced reduction from roughly 22,800 workers at the start of 1993 to 18,000 by the end of 1994, and we see no obstacles to accomplishing that goal. An equally important development, which leads us positively to the next round of labor negotiations, is the 1993 agreement reached with the United Transportation Union Western Lines, representing 2,100 trainmen. They have agreed to stabilize wages through 1997, to give us a chance to restore the health of the railroad and its ability to provide long-term employment opportunities. I want to point out that our workforce reductions affect all levels of management, including the elimination of seven vice president positions.

We also arranged to outsource our entire management information systems function to IBM's services subsidiary. This gets us out of the computer business and enables us to focus more closely on our core transportation business.

Another cost-saving opportunity is the rationalization of our track system, which includes many stretches of unnecessary double track. During 1992 we identified roughly 2,300 miles of surplus track for lease, sale, or (if the

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other options were unavailable) abandonment under federal rules. In 1993, we divested 835 miles of the high-cost, low-yield trackage initially identified, and had an additional 318 miles pending abandonment authority at year end. In the coming months we plan to divest the balance plus additional trackage now under study.

In divesting railroad lines we prefer to sell them for metropolitan transit corridors, because such sales yield both important revenues for SP and a significant public benefit. We still possess an outstanding portfolio of transit corridors and other real property. Although our five-year average for proceeds from asset sales is more than $289 million a year, sales of transit corridors and other real estate in 1993 were disappointing, totaling approximately $41 million. The sale of the Alameda Corridor to the ports of Los Angeles and Long Beach did not occur in 1993, as originally anticipated.

Expanded Commercial Opportunities

Looking forward, our biggest commercial opportunities lie in the transportation of coal, chemicals and intermodal containers, as well as freight bound to and from Mexico. Our domestic shipments of both coal and chemicals turned up in 1993, and we anticipate continued growth; indeed, our new Chicago-Utah iron ore movement for Geneva Steel will sharply increase our coal hauling capacity by using the same cars to carry coal to the Midwest and East.

SP has more gateways into Mexico than any other U.S. railroad. This advantage has contributed to our recent double-digit growth in Mexican business, and the passage of NAFTA during 1993 should support that trend.

Overall, we anticipate revenue growth for the Company in 1994, based on current economic conditions and strong traffic volumes in the first quarter.

In closing, I want to make it clear that we are still a long way from where we want to be, both in terms of our service quality and our profitability. But the recapitalization of the Company puts us on a solid financial footing and enables us to implement our operating strategies with more speed and effectiveness. Southern Pacific's franchise is stronger today than it has ever been, with access to Chicago from the south and west, a strong Central Corridor and route strength in parts of the country that historically have grown faster than the national average.

Our physical plant is in excellent condition, and our equipment is undergoing a transformation that will enable us to increase our traffic volume, handle it more cost-effectively, and provide our customers with the service they deserve. Our management team is forging the kind of cooperation and spirit needed to create major change in a company of our size, and our employees are responding to the challenge.

The coming year offers SP and those of us associated with it the greatest opportunity the Company has seen in a very long time for growth, improvement in service, increases in customer satisfaction, and solid gains in stockholder value.

Sincerely,

Edward L. Moyers

EDWARD L. MOYERS
President and Chief Executive Officer
March 11, 1994

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In 1993, SP increased its operating efficiency by streamlining or eliminating a variety of practices and procedures. Highlights of this effort include implementation of computerized crew scheduling and the nation's first real-time locomotive management system, both of which enable SP to make more efficient use of key resources. SP also reduced its workforce (including management) by 3,800 people. As a result of these and other efforts, revenue ton miles per employee increased 15% for the year. SP also implemented a gang maintenance strategy to speed track maintenance work and reduce interference with train traffic.

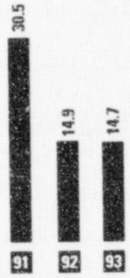
Because locomotives play such a vital role in the operation of a railroad, SP in 1993 concentrated on improving utilization of its own locomotives and reducing its use of leased power. In 1992, SP renovated its Burnham Shop in Denver and through 1993 has cut the average rebuild time per locomotive by more than half. In 1993 SP also found new ways to reduce locomotive "turn times" in railroad yards, so engines get back on line sooner.

These gains in efficiency translate into higher overall utilization rates for power, and longer locomotive mean time between failures.

Better Service at Lower Cost

SP in 1993 became the first Class I railroad to outsource its management information services (MIS) outside of the rail industry. The arrangement with Integrated Systems Solutions Corp. (ISSC), a services subsidiary of International Business Machines (IBM), will reduce overall MIS costs and keep the Company's computer technology current without requiring major new investment. More importantly, it frees SP to focus on its own core business at a time when information technology is undergoing rapid change.

REVENUE TON MILES PER EMPLOYEE



AVERAGE REBUILD TIME IN DAYS PER LOCOMOTIVE (Burnham opened summer 1992)

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Reliable, Responsive Service

Southern Pacific in 1993 launched the most extensive upgrade of its locomotive fleet in its history. SP is acquiring 150 new and 133 remanufactured locomotives, and is rebuilding or repairing hundreds of existing locomotives. By the end of 1994, 50% of SP's locomotive fleet will be new or rebuilt since 1991. A revitalized locomotive fleet is dramatically increasing our ability to serve our customers, while reducing fuel and maintenance costs.

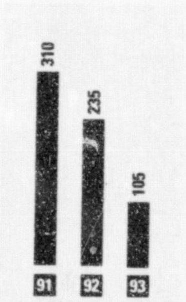
Commitment to Customer Satisfaction

SP's ambitious locomotive program is matched by a continuing shift to scheduled operations, which offers customers greater transit time consistency and service reliability. By the end of 1993 all intermodal trains were scheduled. By March 1994, the Company had scheduled all five of its service corridors; and on-time dock-to-dock performance has been rising steadily toward goals established for intermodal and carload traffic.

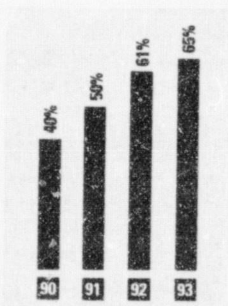
Another key to improved reliability in 1993 was careful attention to keeping people in good health and equipment in service. During the year personal injuries were reduced by 14%. Increased efficiency in terminals and yards enabled reduction of "dwell" times for freight cars at major terminals. The number of route miles with "slow orders"—sections of track where pending maintenance requires trains to reduce speed—was cut dramatically.

As reliability increases, doing business with SP also becomes easier. SP has shortened contract cycles, increased the number of customers taking advantage of electronic data interchange (EDI) programs, and assigned national account managers to give key customers a single point of contact. The Customer Service Center is newly reorganized along geographic lines and now includes Service Quality Managers who work with the operating department to ensure that problems are solved and commitments are fulfilled.

LOCOMOTIVE FLEET NEW OR REBUILT (annual)



CORE ROUTE SLOW ORDERS (track miles)



CUSTOMERS USING EDI

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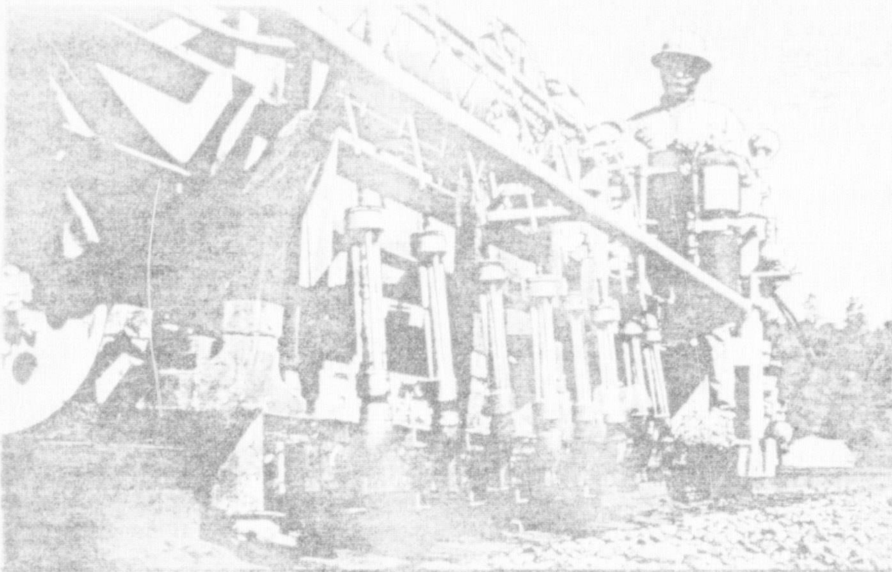
7533
9342
9342
SP



Increased Efficiency and Productivity

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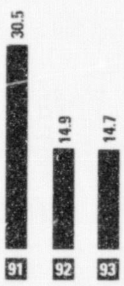
REVENUE TON MILES PER EMPLOYEE



AVERAGE REBUILD TIME IN DAYS PER LOCOMOTIVE (Burnham opened summer 1992)

0641

Effective Asset Management

SP possesses an impressive array of human resources, real estate, and physical assets, and manages them to improve operations and increase stockholder value.

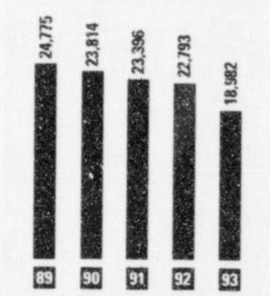
During 1991–92, SP and its employees conducted local negotiations which led to an unprecedented deviation from the national wage settlement. This continues to result in a reduction in labor costs for the Company compared to its competitors. This labor cooperation will help SP restore both its profitability and its long-term health as a major employer in its 15-state territory.

SP's management of its physical plant and equipment includes a commitment to recycling efforts that eliminate or delay new expenditures. For example, the Company has identified ties and track as available for re-use which will save SP approximately $100 million, and in 1993 raised its number of refurbished and upgraded railcars to 12,970, 31% of its total railcar fleet.

During 1993, the Company also divested itself of 835 miles of the 2,300 miles of high-cost, low-yield track it had targeted for sale, lease or abandonment.

Outstanding Asset Portfolio

SP's rights of way include extensive holdings throughout California and Texas and in the major metropolitan centers of much of its service area states. SP will continue to aggressively market this inventory for sale or lease to public agencies. During the past five years, SP has generated an average of more than $289 million each year (despite a decline in 1993) by selling selected parcels, especially for use as metropolitan transit corridors.



NUMBER OF EMPLOYEES

REFURBISHED AND UPGRADED RAILCARS (annual)

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SP
Pacific


8290
8290

Financial Review

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

The following selected consolidated financial data relating to the Company have been taken or derived from the consolidated financial statements of the Company and other records of the Company. The consolidated statements of operations and changes in stockholders' equity (deficit) and statements of cash flows for each of the Company's fiscal years ended December 31, 1993, 1992, 1991, 1990 and 1989 and the balance sheets as of December 31, 1993, 1992, 1991, 1990 and 1989 have been audited by KPMG Peat Marwick, independent certified public accountants. The selected financial data should be read in conjunction with the Consolidated Financial Statements and related notes and other financial information included elsewhere herein.

	Year Ended December 31,				
(dollars in millions, except as indicated)	**1993**	**1992**	**1991**	**1990**	**1989**
STATEMENT OF OPERATIONS DATA					
Operating revenues	$ 2,918.6	$ 2,878.0	$ 2,785.6	$ 2,822.1	$ 2,701.9
Operating expenses	2,815.4	2,769.1	2,694.1	2,678.1	2,558.1
Special charge(a)	—	—	259.9	—	—
Operating income (loss)	103.2	108.9	(168.4)	144.0	143.8
Other income (expense)(b)	(22.4)	90.2	37.2	65.8	82.8
Interest expense	156.0	143.3	152.0	183.0	202.9
Income (loss) before income taxes and cumulative effect of change in accounting charge/extraordinary item	(75.2)	55.8	(283.2)	26.8	23.7
Income tax expense (benefit)	(30.3)	22.7	(107.5)	9.9	9.3
Cumulative effect of change in accounting charge/extraordinary item(c)	(104.2)	—	—	12.8	—
NET INCOME (LOSS)	$ (149.1)	$ 33.1	$ (175.7)	$ 29.7	$ 14.4
Preferred dividends	$ 5.8	$ 9.0	$ 9.0	$ 9.0	$ 9.0
Net income (loss) available to common stock	(154.9)	24.1	(184.7)	(33.7)(d)	5.4
PER SHARE DATA(d)					
Net income (loss) before cumulative effect of change in accounting charge/extraordinary item (dollars)	$ (0.46)	$ 0.24	$ (1.85)	$ (0.47)	$ 0.05
Net income (loss) (dollars)	(1.39)	0.24	(1.85)	(0.34)	0.05
Weighted average shares outstanding (thousands)	111,544	100,000	100,000	100,000	100,000
OTHER DATA					
Depreciation and amortization	$ 133.2	$ 138.9	$ 124.9	$ 108.6	$ 73.9
Capital expenditures(e)	311.2	340.7	305.1	387.8	451.5
BALANCE SHEET DATA AS OF PERIOD END					
Cash and cash equivalents	$ 65.5	$ 61.3	$ 52.8	$ 88.9	$ 91.2
Total assets	3,434.0	3,204.5	3,355.0	3,650.7	3,557.8
Long-term debt (including current maturities)	1,475.0	1,329.0	1,411.2	1,591.0	1,639.9
Redeemable preference shares of a subsidiary (including current portion)	23.0	23.9	24.6	25.2	25.6
Preferred stock	—	75.0	75.0	75.0	75.0
Stockholders' equity (deficit) before common stock subject to repurchase	312.5	88.6	64.6	256.3	235.6
Stockholders' equity (deficit)	312.5	(76.9)	(100.9)	90.8(d)	124.5

(continued)

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(continued)

(dollars in millions, except as indicated)	1993	1992	1991	1990	1989
	Year Ended December 31,				
OPERATING DATA					
Total employees (at period end)	18,982	22,793	23,396	23,814	24,775
Total carloads (thousands)(f)	2,077.8	1,994.9	1,873.4	1,876.2	1,688.1
Route miles (period end)(g)	14,829	15,134	15,941	16,337	15,292
Revenue ton-miles (billions)(h)	123.6	115.4	104.1	101.6	100.6
Revenue per ton-mile (dollars)(i)	$ .022	$ .023	$ .025	$ .026	$ .025
Fuel consumption (millions of gallons)	408.9	390.3	360.2	354.5	383.9
Average fuel price per gallon (dollars)	$ .59	$ .61	$ .63	$ .71	$ .58
Revenue ton-miles per employee (thousands)(j)	5,845	5,063	4,449	4,266	4,061
Carloads per employee(j)	98.3	87.5	80.1	78.8	68.1
Revenues per employee (dollars in thousands)(j)	$ 138.0	$ 126.3	$ 119.1	$ 118.5	$ 109.1
Operating ratio(k)	96.5%	96.2%	106.0%(a)	94.9%	94.7%

(a) The special charge in 1991 consisted primarily of accruals for labor, environmental and legal costs. See Note 2 to the Consolidated Financial Statements. Excluding the special charge, operating income would have been $91.5 million, the operating ratio would have been 96.7%, net income (loss) would have been $(14.5) million and net income (loss) per share would have been $(0.24) for the year ended December 31, 1991.

(b) Consists primarily of gains from sales of transit corridors and other real estate assets and non-operating expenses. The 1993 amount also includes the write-off of deferred loan costs and early repayment premiums associated with the retirement of certain indebtedness following the initial public offering and sale of 30,783,750 shares of common stock (the "IPO") and the issuance and sale of Senior Notes (the "Debt Offering") completed by the Company in August 1993.

(c) Includes the effects of a $168.5 million pre-tax accrual of retiree health and welfare benefit costs pursuant to Statement of Financial Accounting Standards No. 106 in 1993 and a $12.8 million after-tax extraordinary gain in 1990. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Accounting Matters."

(d) Prior to the consummation of the IPO, certain shares of the common stock were subject to repurchase at the option of the holders thereof. In 1990, the carrying value of common stock subject to repurchase increased $54.4 million which reduced both net income available to common stock and stockholders' equity (deficit). All shares of common stock subject to repurchase are included in weighted average shares outstanding. See Note 10 to the Consolidated Financial Statements. The Company's commitment to repurchase common stock terminated upon completion of the IPO.

(e) Capital expenditures exclude capital leases. In addition, for purposes of this table, "Selected Consolidated Financial and Operating Data" and the Company's Consolidated Statements of Cash Flows included elsewhere herein, capital expenditures include railroad and non-railroad related expenditures, and, in 1993, expenditures for equipment previously operated by the Company under operating leases which was purchased with a portion of the proceeds of the IPO and the Debt Offering.

(f) Includes intermodal carloads and assumes two containers per intermodal carload.

(g) Route miles include track owned (including track leased to third parties) and trackage rights over lines owned by other railroads.

(h) Revenue ton-miles equal the product of the weight in tons of freight carried for hire and the distance in miles between origin and destination.

(i) Revenue per ton-mile equals net freight revenue divided by revenue ton-miles of freight traffic.

(j) For fiscal years 1989 through 1992, revenue ton-miles per employee, carloads per employee, and revenues per employee have been calculated on the basis of the number of employees at the end of each such period. However, the Company reduced the number of its employees from 22,793 at December 31, 1992 to 18,982 at December 31, 1993. Because of this substantial reduction in employees during 1993, the Company does not believe that calculating these statistics on the basis of the number of employees at December 31, 1993 would accurately reflect the actual per employee data for 1993. Accordingly, for 1993 this data has been computed on the basis of the average number of employees during the year, which in turn was calculated as the arithmetic average of the number of employees at the end of each of the 12 months in 1993.

(k) Operating ratio represents consolidated operating expenses as a percentage of consolidated operating revenues.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in connection with the Consolidated Financial Statements, related Notes and other financial information included elsewhere herein.

Results of Operations

YEAR ENDED DECEMBER 31, 1993 COMPARED TO YEAR ENDED DECEMBER 31, 1992

The Company had a net loss of $149.1 million for 1993 compared to a net income of $33.1 million for 1992. The 1993 amount includes a $104.2 million after-tax charge for the cumulative effect of a change in accounting for post-retirement benefits other than pensions under Statement of Financial Accounting Standards ("FAS") No. 106 adopted by the Company effective January 1, 1993. The Company had operating income of $103.2 million for 1993 compared to $108.9 million for 1992. Operating income for 1993 was adversely affected by severe weather and flooding in certain western states during the first quarter of the year and in certain midwestern states during the third and fourth quarters of the year. In addition, the Company experienced a significant decline in automotive shipments, a shortage of power due to a temporary reduction in the number of locomotives leased by the Company and a slower than anticipated recovery in certain segments of the economy. The Company addressed the power shortage by continuing to lease additional locomotives on a short-term basis. The Company estimates that the midwest floods in the second half of 1993, which caused delays, detours and additional repair costs, resulted in additional costs and revenue shortfalls of approximately $60 million to $65 million for 1993. The foregoing estimate is based on a number of assumptions and the actual amount of additional costs and revenue shortfalls is uncertain. Partially offsetting an increase in operating expenses for 1993 was reduced joint facility rent expense of approximately $10.0 million as a result of the negotiated settlement of a joint facility case, as well as reduced property tax expense of approximately $17.5 million due to revised state property tax assessments and to the favorable settlement of prior years' disputed property taxes in California.

Operating Revenues

In 1993, railroad operating revenues increased $27.4 million compared to 1992. Railroad freight operating revenues increased $39.1 million primarily due to increased intermodal and coal carloads partially offset by decreased automobile and food and agricultural carloads. Other railroad revenues (primarily passenger, switching and demurrage) decreased $11.7 million compared to 1992. Passenger revenues decreased because SPT discontinued operating commuter service in 1992, following the sale of the Company's peninsula corridor in the San Francisco Bay Area (the "Peninsula Corridor"). There was a similar decrease in commuter operating expense. Partially offsetting this decline were increased demurrage and other incidental revenues associated with increased traffic volume. For 1993, carloads increased 4.2% and revenue ton-miles increased 7.1% compared to 1992. The average freight revenue per ton-mile declined by 3.5% compared to 1992 due to continued competitive pressures on rates and changes in traffic to lower revenue per ton-mile commodities and routes. In 1993 lower than average revenue per ton-mile coal traffic carloads increased by 18.8%, while higher than average revenue per ton-mile automobile traffic carloads decreased by 29.4% principally due to a plant closing and the loss of a major contract, contributing to the decline in average freight revenue per ton-mile.

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The following table compares traffic volume (in carloads), gross freight revenues (before contract allowances and adjustments) and gross freight revenues per carload by commodity group for 1993 compared to 1992:

CARLOAD AND GROSS FREIGHT REVENUE COMPARISON

Years Ended December 31, 1993 and 1992

	Carloads			Gross Freight Revenues			Gross Freight Revenue per Carload		
	1993	**1992**	**% Change**	**1993**	**1992**	**% Change**	**1993**	**1992**	**% Change**
	(in thousands)			*(dollars in millions)*			*(dollars)*		
Intermodal	607.6	549.4	10.6%	$ 731.9	$ 670.5	9.2%	$ 1,205	$1,220	(1.3)%
Chemical and petroleum products	344.2	347.7	(1.0)	589.2	571.1	3.2	1,712	1,642	4.3
Food and agricultural products	249.0	250.2	(0.5)	392.9	401.0	(2.0)	1,578	1,603	(1.6)
Coal	263.4	221.8	18.8	245.6	206.7	18.8	932	932	—
Forest products	221.4	209.2	5.8	398.4	396.2	0.6	1,799	1,894	(5.0)
Metals and ores	173.5	174.8	(0.7)	259.9	261.0	(0.4)	1,498	1,494	0.3
Construction materials and minerals	153.6	149.5	2.7	151.2	148.9	1.5	984	996	(1.2)
Automotive	65.1	92.2	(29.4)	166.6	238.7	(30.2)	2,562	2,589	(1.1)
TOTAL	2,077.8	1,994.8	4.2%	$2,935.7	$2,894.1	1.4%	$ 1,413	$1,451	(2.6)%

- Both segments of the intermodal business, container-on-flatcar ("COFC") and trailer-on-flatcar ("TOFC"), contributed to the increase in 1993 intermodal volume and revenue over 1992 levels. COFC growth primarily came from increased business with major steamship customers and increases in domestic doublestack business. TOFC volumes grew primarily as a result of increased business with motor carriers.
- Chemical and petroleum products carloads were down 1% in 1993 due to reduced demand by Company-served plastics shippers, a corresponding reduction in plastic feedstocks, reduced carloads of soda ash and crude oil and completion of an environmental waste contract in 1992. Revenue per carload increased due to an increase in long-haul traffic and yield improvement strategies, particularly in plastics.
- Coal carloads and revenue increased in 1993 due in large part to the United Mine Workers strike affecting eastern mine operations between June and December 1993, which increased demand for coal from Company-served mines. The strike was settled in December 1993. The increased coal carloads and revenues in 1993 were also due to strong summer demand by utilities and continued demand for western coal to be used in utility test burns. The Company expects that settlement of the coal strike, which was a significant factor in the increase in coal carloads and revenues in 1993, will result in reductions or eliminations of coal shipments for certain customers, but the Company cannot predict the effect of such settlement on total coal carloads in the future.
- Carload volume in forest products increased in 1993 through growth in shipments of paper products, while lumber product carloadings maintained 1992 levels primarily due to weak construction markets. Revenue for forest products grew at a slower rate than carloads due to a reduction in revenue per carload which was brought about by changes in product and market mix.
- Automobile traffic declined in 1993 as compared to 1992 because of the closing of a General Motors plant in California and the loss of a contract for transportation of finished automobiles.

Operating Expenses

Railroad operating expenses for 1993 increased $32.4 million, or 1.2%, compared to 1992. The Company estimates that approximately $50 million to $55 million of increased operating expenses were associated with the severe flooding that occurred in the midwest during the third and fourth quarters of 1993. The foregoing estimate is based on a number of assumptions and the actual amount of additional operating expenses is uncertain. Equipment rental costs and fuel costs also increased in 1993, while labor and fringe benefit costs and material and supply costs decreased in 1993 compared to 1992 as discussed below. Total 1993 operating expenses also included a $10.5 million charge primarily to cover the remaining costs of centralizing crew dispatching and calling and eliminating facilities no longer needed for operations.

The following table sets forth a comparison of the Company's operating expenses for 1993 and 1992:

RAILROAD OPERATING EXPENSE COMPARISON

	Years Ended December 31, 1993 and 1992		
(dollars in millions)	**1993**	**1992**	**% Change**
Labor and fringe benefits	$ 1,132.5	$ 1,167.0	(3.0)%
Fuel	252.4	236.9	6.5
Materials and supplies	217.6	244.7	(11.1)
Equipment rental	331.0	288.0	14.9
Depreciation and amortization	133.2	138.9	(4.1)
Other	665.4	624.2	6.6
TOTAL	$ 2,732.1	$ 2,699.7	1.2%

- Labor and fringe benefit expenses decreased $34.5 million, or 3.0%, for 1993 compared to 1992. At December 31, 1993 Company employment had substantially declined compared to December 31, 1992, primarily due to a decline in roadway maintenance employees during the last four months of 1993 resulting in reduced labor costs for day-to-day repair and maintenance activities, as well as to a decline in transportation employees in December 1993 resulting from the November 1993 ratification of a UTU agreement. During 1993, train crew starts declined by 1.4% compared to 1992, even though adversely impacted by the midwest floods in the third and fourth quarters of 1993, contributing to the overall decline in labor costs. In addition, included in the expense reduction above is reduced payroll tax expense due to reduced employment and the elimination in 1993 of the railroad unemployment insurance repayment tax.
- Fuel expense increased $15.5 million, or 6.5%, due primarily to increased fuel consumption associated with increased traffic volume, partially offset by a 2.5% decline in the average cost per gallon of fuel from $.61 in 1992 to $.59 in 1993.
- Material and supply expenses decreased $27.1 million, or 11.1%, for 1993 compared to 1992 due primarily to reduced running repairs on locomotives, reduced roadway repair and maintenance activity, the use of recycled and reconditioned second-hand materials, as well as to reduced purchases of material during the first quarter of 1993 in response to reduced revenues in that quarter compared to 1992. There was also a $5.0 million non-recurring inventory adjustment during 1993. During the year, the Company rebuilt or performed heavy repairs on 219 locomotives compared to heavy repairs on 159 locomotives in 1992. Costs associated with the rebuilding of 61 locomotives in 1993 were capitalized.
- Equipment rental costs increased $43.0 million, or 14.9%, due to a combination of the effects of the midwest floods causing increased equipment cycle time and increased short-term locomotive lease costs associated with increased traffic volume and a shortage of locomotives in certain areas. Included in the increase is a $18.9 million increase in net car hire, and a $12.9 million increase in locomotive lease costs over 1992.
- Depreciation and amortization expense decreased $5.7 million, or 4.1%, due primarily to reduced depreciation rates as well as to a reduced equipment depreciation base resulting from the Company's sale/leaseback transactions in 1992 and 1993.

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- Other expenses increased $41.2 million, or 6.6%, for 1993 compared to 1992. This category of expense includes purchased repairs and services, joint facility rent and maintenance costs, casualty costs and property and other taxes. The 1993 increase is due primarily to detour fees and joint facility maintenance and operations costs associated with the midwest floods which were estimated to be approximately $27 million. The foregoing estimate is based on a number of assumptions and the actual amount of additional flood-related costs is uncertain. Also showing an increase for 1993 were casualty costs (due in part to the fact that 1992 casualty costs were reduced by insurance recoveries received with respect to claims accrued in 1992 and prior years), environmental cost accruals, data processing equipment rental costs as well as an increase in taxes on fuel beginning in the fourth quarter of 1993. Partially offsetting the expense increases in this category were reduced joint facility rent expense of approximately $10.0 million as a result of the negotiated settlement of a joint facility case earlier in the year, as well as reduced property tax expense of approximately $17.5 million due to revised state property tax assessments and to a favorable settlement of prior years' disputed property taxes in California.

Other Income and Interest Expense

Other income in total was an expense of $22.4 million in 1993 compared to income of $90.2 million in 1992, a decrease of $112.6 million. Gains on sales of property and real estate decreased $93.6 million to a total of $25.1 million in 1993. Rental income increased $3.7 million due in part to non-recurring rental income associated with a fiber optic conduit easement with Southern Pacific Telecommunications Company ("SP Telecom"). Interest income remained relatively stable with an increase of $0.3 million during 1993. The remaining portion of other income was an expense of $75.2 million in 1993 compared to an expense of $52.2 million in 1992, an increased expense of $23.0 million. This increase is due in part to the write-off of $17.0 million of deferred loan costs and a payment of $10.7 million for redemption premiums attributable to the repayment of SPTCH's subordinated debentures and RGH's subordinated debentures in connection with the recapitalization in August 1993. Expenses associated with the sale of accounts receivable increased $10.6 million in 1993 and were partially offset by reduced expenses associated with properties held for sale. In addition, in November 1993, the Company received $27.1 million in cash from SP Telecom in full redemption of the SP Telecom preferred stock owned by the Company plus accrued dividends on the preferred stock, resulting in other income of $14.9 million. Interest expense was $156.0 million in 1993 compared to $143.3 million in 1992, an increase of $12.6 million due primarily to a higher level of outstanding debt during 1993.

YEAR ENDED DECEMBER 31, 1992 COMPARED TO YEAR ENDED DECEMBER 31, 1991

The Company had net income of $33.1 million for the year ended December 31, 1992 compared to a net loss of $175.7 million in 1991 after recording a special charge of $259.9 million (the "1991 Special Charge"). See "—Accounting Matters." The Company had operating income in 1992 of $108.9 million compared to $91.5 million in 1991 before the 1991 Special Charge. Wage settlements concluded in 1991 resulted in a one-time reduction of $25.0 million in reserves for labor and payroll related costs accrued in prior periods. The operating results for 1992 were adversely affected by a slower than anticipated recovery in the economy, but included benefits relating to crew labor costs accrued for in the 1991 Special Charge. For the year, operating revenues increased at a greater rate than operating expenses, compared to the prior year.

Operating Revenues

In 1992, railroad operating revenues increased $76.9 million, or 2.8%, compared to 1991. Railroad freight revenues for 1992 increased $99.7 million due to increases in traffic, while other railroad revenues, primarily passenger, switching and demurrage, decreased $22.8 million from 1991. Passenger revenues decreased primarily because SPT discontinued operating commuter service on July 1, 1992, following the sale of the Peninsula Corridor. There was a similar decrease in Peninsula Corridor operating expenses. In 1992, carloads increased 6.5% and revenue ton-miles increased 10.9% compared to 1991. Average freight revenue per ton-mile for 1992 decreased 5.7% from 1991. The decline in average revenue per ton-mile was due to continued competitive pressures on rates and changes in traffic to lower revenue per ton-mile commodities and routes. By commodity groups, the most significant carload increases were in intermodal traffic, food and agricultural products, construction materials and minerals and chemical and petroleum products, while only metals and ores showed carload declines for 1992.

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The following table compares traffic volume (in carloads) and gross freight revenues (before contract allowances and adjustments) and gross freight revenue per carload by commodity group for the years ended December 31, 1992 and 1991:

CARLOAD AND GROSS FREIGHT REVENUE COMPARISON

Years Ended December 31, 1992 and 1991

	Carloads			Gross Freight Revenues			Gross Freight Revenue per Carload		
	1992	**1991**	**% Change**	**1992**	**1991**	**% Change**	**1992**	**1991**	**% Change**
	(in thousands)			*(dollars in millions)*			*(dollars)*		
Intermodal	549.4	513.1	7.1%	$ 670.5	$ 636.3	5.4%	$ 1,220	$1,240	(1.6)%
Chemical and petroleum products	347.7	320.1	8.6	571.1	541.4	5.5	1,642	1,692	(2.9)
Food and agricultural products	250.2	228.3	9.6	401.0	376.2	6.6	1,603	1,648	(2.8)
Coal	221.8	214.6	3.4	206.7	190.2	8.7	932	886	5.1
Forest products	209.2	195.9	6.8	396.2	380.4	4.2	1,894	1,941	(2.5)
Metals and ores	174.8	175.2	(0.2)	261.0	276.4	(5.6)	1,494	1,578	(5.3)
Construction materials and minerals	149.5	136.6	9.4	148.9	155.6	(4.3)	996	1,139	(12.6)
Automotive	92.2	89.7	2.8	238.7	233.0	2.4	2,589	2,598	(0.3)
TOTAL	1,994.8	1,873.5	6.5%	$2,894.1	$2,789.5	3.7%	$ 1,451	$1,489	(2.6)%

- For intermodal, both COFC and TOFC traffic increased in 1992 compared to 1991. The increase in TOFC traffic was attributable to the Company's decision to re-emphasize that market, primarily through marketing arrangements with trucking companies. Revenues reflected competitive pricing pressures.
- Chemical and petroleum products traffic volume increased compared to 1991 as plastics carloadings benefited from increased demand for plastics as an industrial feedstock.
- Food and agricultural traffic increased as a result of increased grain and grain product exports to Mexico.
- Coal carloads and revenue per carload increased in 1992 over 1991 partly as a result of several spot movements of low sulfur coal to eastern utilities for test burns. These spot moves carried a higher revenue per carload than those under long-term contracts.
- Forest products traffic increases in 1992 included both lumber and paper products. The increase in lumber traffic was due primarily to general improvement in the economy during the second half of 1992.
- The decline in metals and ores revenue per carload in 1992 was related to the decline in movements of high revenue per carload gas transmission pipe, which occurred in 1991. This business was replaced in 1992 by scrap and semi-finished steel, which provides a lower revenue per carload.
- Construction materials carloads also increased in 1992 because of general improvement in the economy. However, revenue per carload declined as a result of the decline in movements of military equipment in late 1991 associated with Operation Desert Shield. Military equipment has a higher revenue per carload compared to other construction materials, which increased in carloads.
- Automotive carloads increased in 1992 primarily due to improvements in general economic conditions.

Operating Expenses

Railroad operating expenses for 1992 increased $59.3 million, or 2.2%, compared to 1991 (after excluding the 1991 Special Charge), a rate of increase that was less than the rates of increase for both revenues and carloads. Operating expenses for 1992 include increased costs associated with increased operations between Kansas City and Chicago where traffic volume (in revenue ton-miles) increased approximately 60% over 1991.

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The following table sets forth a comparison of the Company's railroad operating expenses during the years ended December 31, 1992 and 1991:

RAILROAD OPERATING EXPENSE COMPARISON

	Years Ended December 31, 1992 and 1991		
(dollars in millions)	**1992**	**1991**	**% Change**
Labor and fringe benefits	$ 1,167.0	$ 1,164.3	0.2%
Fuel	236.9	228.8	3.5
Materials and supplies	244.7	220.3	11.1
Equipment rental	288.0	253.9	13.4
Depreciation and amortization	138.9	124.9	11.2
Other	624.2	648.2	(3.7)
Subtotal	2,699.7	2,640.4	2.2
Special Charge	—	259.9	(100.0)
TOTAL	$ 2,699.7	$ 2,900.3	(6.9)%

- Labor and fringe benefit expenses increased $2.7 million, or 0.2%, for 1992 compared to 1991. The 1992 amount excluded $26.0 million of reserve board costs accrued for in the 1991 Special Charge and the 1991 amount included a one-time reduction of $25.0 million in reserves for labor and fringe benefit costs accrued in prior periods relating to negotiated wage settlements, which permitted the Company to reverse accruals from previous periods. Labor and fringe benefit costs increased in 1992 due to increased costs attributable to operations between Kansas City and Chicago and to an increased number of employees associated with a shift in staffing of the ICTF from an independent firm to Company employees represented by the Transportation Communications Union.
- Fuel expenses increased $8.1 million, or 3.5%, due to increased consumption associated with higher traffic volume, partially offset by a 4.5% decrease in the average cost per gallon of fuel to $.61 per gallon.
- Material and supply expenses increased $24.4 million, or 11.1%, due primarily to increased locomotive repair costs during 1992 associated with the overhaul of 159 locomotives during the year at the new Denver, Colorado repair facility. During 1991, only 12 locomotives were overhauled at the Sacramento, California facility which was in the process of moving to Denver, Colorado.
- Equipment rental costs increased $34.1 million, or 13.4%, attributable in part to increased traffic volume in 1992, as well as to increased lease costs associated with the Company's 1989, 1990 and 1992 sale/leaseback transactions.
- Depreciation and amortization expense increased $14.0 million, or 11.2%, due to an increased depreciable property base.
- Other expenses decreased $24.0 million or 3.7% for 1992 compared to 1991. This category of expense includes purchased repairs and services, joint facility rent and maintenance costs, casualty costs and property and other taxes. Casualty expenses were lower in 1992 due primarily to the 1991 derailments and associated costs at Dunsmuir and Seacliff, California. Joint facility costs decreased in 1992 due to the discontinuance of certain joint operations with Soo Line in February 1992. Partially offsetting these expense decreases were increased sales and use tax expense and increased property tax expense due to a partial refund of property taxes in 1991.

Other Income and Interest Expense

Other income in total was $90.2 million in 1992 compared to $37.2 million in 1991, an increase of $53.0 million. Gains on sales of property and real estate increased $51.1 million to a total of $118.7 million in 1992, based on cash proceeds totaling $362.4 million from transit corridor sales to the Peninsula Corridor Joint Powers Board (the "JPB") in California ($124.0 million), the Metro Transit in Houston, Texas ($45.0 million), the Los Angeles County Transportation Commission (the "LACTC") ($83.0 million), as well as other sales. Rental income in 1992 decreased $7.6 million due to non-recurring easement income in 1991 coupled with increased expenses

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associated with leased properties and properties held for sale. Interest income was $3.0 million lower in 1992 due to lower levels of investment and lower interest rates. The remaining portion of other income was an expense of $52.2 million in 1992 compared to an expense of $64.7 million in 1991, a decreased expense of $12.5 million. This decreased expense was primarily due to a $27.6 million reduction in discounts and other expenses associated with the sale of accounts receivable, partially offset by a $18.0 million charge associated with preparing properties for sale. Interest expense was $143.3 million in 1992 compared to $152.0 million in 1991, a decrease of $8.7 million. The decrease was due to a lower level of outstanding debt and lower interest rates.

Liquidity and Capital Resources

The Company's business is capital intensive and requires ongoing substantial expenditures for, among other things, improvements to roadway, structures and technology, acquisitions and repair of equipment, and maintenance of the rail system. In 1993, and for a number of years before that, the Company's railroad operations did not produce sufficient cash flows to meet its capital expenditures, debt service, preferred stock dividend requirements and other cash needs. As a result, the Company relied on proceeds from transit corridor, real estate and other asset sales, borrowings and other financings for these purposes.

The Company closed the IPO and the Debt Offering in August 1993. In addition, SPT replaced its bank revolving credit facility with a new bank Credit Agreement at that time. On March 2, 1994, the Company closed an offering of 25,000,000 shares of common stock (the "Offering") for net proceeds of $503.7 million, which were used to repay the $117 million outstanding under the RGH credit facilities, to repay the $175 million outstanding under the SPT Credit Agreement and for general corporate purposes. These measures provided the Company with a significant cash infusion and improved the Company's liquidity; however, the Company anticipates that, for the next several years, cash flows generated by rail operating results will continue to be insufficient to meet its cash needs. In order to satisfy these cash flow requirements, as well as to satisfy financial covenants in its credit facilities (including the Senior Note Indenture and the Credit Agreement), the Company must not only improve its operating results but also continue to sell transit corridors and other real estate assets with substantial values that are not necessary to its transportation operations.

The Company's real estate department will continue its "traditional" real estate activities consisting of sales and leases of industrial and commercial properties located in developed areas on the Company's system. In addition, the Company will emphasize sales of transit corridors for use by public transportation systems and consolidated freight corridors for use by more than one railroad. The timing of sales to public agencies often is difficult to predict and such sales can be subject to delays created by funding issues and other matters. Thus, levels of asset sales may vary substantially from period to period, which in turn can cause significant variations in the Company's net income or loss and cash flows. In addition, the closing of real estate sales is customarily subject to the satisfaction of various closing conditions and similar contingencies.

On January 31, 1994, an agreement between SPT and the Ports of Los Angeles and Long Beach (together, the "Ports") to sell a transit corridor and other related properties and facilities, located between downtown Los Angeles and the Ports (the "Alameda Corridor") for approximately $248 million cash and other consideration expired in accordance with its terms. Under the agreement, SPT would retain operating rights to serve the Ports and other local customers after the sale. The Alameda Corridor, after substantial enhancements and improvements, would be used as a consolidated freight corridor by SPT and other railroads. Closing of the sale was conditioned upon the Ports, SPT and another railroad entering into a memorandum of understanding concerning operation of the Alameda Corridor when developed. The other railroad did not execute the memorandum negotiated by SPT and the Ports, and the Ports declined to waive the requirement for the memorandum. Although the Ports have indicated a continuing interest in pursuing their acquisition of the Alameda Corridor and the Company will consider opportunities to sell the Alameda Corridor if they arise, the Company cannot predict if or when a sale of the Alameda Corridor might occur.

As a result of the variations in levels of asset sales, the Company's liquidity may vary substantially, thus requiring the Company to make substantial borrowings under the Credit Agreement, the outstanding balance of which was retired following the Offering.

In addition, implementation of the Company's strategic plan will require the continued availability of additional sources of funding, including secured equipment and capital lease financing to upgrade the Company's locomotive and railcar fleet and borrowings under the Credit Agreement. Management believes, based upon current levels of operation and anticipated improvements in operating results, that cash flow from

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operations and transit corridor and traditional real estate sales, together with borrowings under the Credit Agreement, expected secured equipment and capital lease financings and other financing sources, will be adequate to make required payments of principal and interest on debt, to permit anticipated capital expenditures, to fund working capital requirements and other cash needs, and to enable the Company to comply with the terms of its debt agreements. Nevertheless, after giving effect to the Offering, the Company will remain leveraged to a significant extent and its debt service obligations will continue to be substantial. Amounts that could become due to Union Pacific during the next year or two under the SSW trackage rights case (in which Union Pacific claimed approximately $60 million as of December 31, 1993) could add substantially to the Company's cash requirements for the near term. If the Company's sources of funds were to fail to satisfy the Company's requirements, the Company would need to refinance its existing debt or obtain additional financing. There is no assurance either of those alternatives would be available, and, in any case, any such refinancing or new financing (if available) would be expected to be more costly and burdensome than the debt agreements currently in place. The availability of any such new financing would likely depend in part upon whether the Company has been able to improve its results of operations. No assurance can be given that the Company's sources of funds will be sufficient to satisfy its cash needs.

Operating Activities

As shown in the Consolidated Statements of Cash Flows, cash provided by (used for) operating activities was $(105.4) million, $107.3 million and $(44.6) million in 1993, 1992 and 1991, respectively. The changes between periods are due primarily to the net effect of changes in accounts receivable and payable between periods based on the timing of receipts and payments. The 1993 amount includes cash used in connection with the early buyback of equipment under operating leases and cash used to pay costs associated with the debt repayments during 1993. The 1992 amount showed improvement over 1991 due in part to improved operating results in 1992 coupled with reduced receivables and the receipt of approximately $26.0 million in proceeds from the initial sale of D&RGW accounts receivable to ABS Commercial Paper, Inc. ("ABS"). Included in operating cash flows are cash payments of $55.4 million, $82.7 million and $6.5 million in 1993, 1992 and 1991, respectively, for severance and relocation of employees previously accrued for in the special charges taken in 1988 and 1991. The Company also has made and will continue to make expenditures relating to the assessment and remediation of environmental conditions.

The Company had working capital deficits of $562.0 million and $755.1 million at December 31, 1993 and 1992, respectively. The improvement is due primarily to reductions in current payables and in the current portion of long-term debt. The deficit in general is caused by the capital intensive nature of the railroad business, items accrued for in the 1991 Special Charge and the large number of one-year accruals funded out of future operations.

The Company received cash proceeds from sales and retirements of real estate and other property totalling $53.8 million in 1993, $362.4 million in 1992 and $516.7 million in 1991. The 1993 amount includes proceeds of $6.0 million from a sale to the Regional Transportation District in Denver, Colorado. The 1992 amount includes $124.0 million from sales to the JPB, $45.0 million from sales to the Metro Transit in Houston, Texas, $83.0 million from sales to the LACTC and $36.5 million from the sale/leaseback of D&RGW locomotives and freight cars in June 1992. Metro Transit has indicated recently that it believes an adjustment or credit should be made with respect to the purchase price for the property it purchased in 1992. The Company believes no such adjustment or credit is required but no assurances can be given in that regard. Discussions are continuing. The 1991 amount includes $321.7 million from sales to the LACTC and $91.9 million from sales to the JPP. The Company has also made and will continue to make expenditures relating to the assessment and remediation of environmental conditions on properties held for sale. At December 31, 1993, certain properties remaining from the Company's acquisitions of SPT and D&RGW were classified as real estate held for sale with an allocated cost for financial reporting purposes of $363.4 million. Assets categorized as real estate held for sale on the Company's balance sheet constitute only a part of the properties and assets that the Company intends to seek to sell over the next several years. The Company has identified certain operating properties that it might sell in the future if it can do so without impacting its railroad operations. Management has not made a firm decision to remove any of these properties from its operating system. In order to enhance the value of certain properties and facilitate their disposition, the Company has in the past and may in the future participate with others in the development of such properties by contributing the property and funding to joint ventures or other entities, participating in sale and leaseback arrangements and engaging in other transactions that do not involve immediate cash proceeds.

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The Company estimates that the midwest floods in the second half of 1993, which caused delays, detours and additional repair costs, resulted in additional costs and revenue shortfalls of approximately $60 million to $65 million for 1993. The foregoing estimate is based on a number of assumptions and the actual amount of additional costs and revenue shortfalls is uncertain. The increased costs from delays and detours include costs for additional crew-starts, short-term leased locomotives, increased equipment cycle time, and added fuel costs and detour fees. In addition, the Company has incurred rail line repair costs attributable to joint facilities with other railroads.

On January 17, 1994, Los Angeles, California experienced a substantial earthquake. The earthquake resulted in the derailment of one of the Company's trains and structural damage to some of the Company's track in the affected area. Overall equipment and track damage due to the earthquake is expected to be less than $1.5 million. The Company expects no material impact on its rail operations as a result of the earthquake.

Capital Expenditures

Capital expenditures for railroad operations (exclusive of capital leases and equipment under operating leases purchased with a portion of the proceeds of the IPO and the Debt Offering) for 1993 were $244.4 million compared to $338.9 million and $288.0 million for 1992 and 1991, respectively. During the three year period, the Company spent $704.4 million for capital expenditures to upgrade its roadway and structures, including $19.0 million for the remodeling of the Company's Burnham facility, and spent $145.8 million for railroad equipment. Of these amounts for the three year period, $103.8 million was financed by specific debt obligations. The Company expects 1994 capital expenditures for railroad operations to be approximately $251 million (exclusive of capital leases).

In 1994, the Company intends to focus on improving customer service through the expansion and upgrading of its locomotive fleet. The Company has ordered and has financing for 50 new locomotives, 17 of which were delivered in the last quarter of 1993 and 33 of which will be delivered by the end of the first half of 1994, and 133 remanufactured locomotives to be delivered in 1994. These locomotives will be financed by capital leases (for which the total present value of minimum lease payments is expected to be approximately $131 million) and therefore are not included in the 1994 capital expenditure budget. The Company expects to further upgrade its locomotive fleet by investing in additional new or remanufactured locomotives over the next several years, subject to the Company's ability to obtain financing. The Company has options to acquire up to an additional 100 new locomotives for delivery in 1994 at a cost of approximately $135 million (which amount also is not included in the 1994 capital expenditure budget). The Company acquired 1,651 freight cars in 1993 under capital leases with a total present value of minimum lease payments of approximately $43 million and expects to acquire more by capital lease in 1994.

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Financing Activities

The Company closed the IPO and the Debt Offering on August 17, 1993. The sources and uses of funds for these transactions are shown below:

(in millions)		**Amount**
SOURCES		
Gross proceeds from the IPO	$	415.6
Gross proceeds from the Debt Offering		375.0
TOTAL SOURCES	$	790.6
USES		
Retire SPTCH 12⅛% subordinated debentures	$	210.0
Repay SPT term loan		169.0
Retire RGH 13⅝% subordinated notes		65.7
Retire RGH 14⅜% subordinated debentures		36.5
Purchase SPT equipment operated pursuant to operating leases		99.1
Redeem Company 12% preferred stock		75.0
Underwriting discounts, fees and expenses		33.5
General corporate purposes (including accrued dividends on preferred stock and interest on debt retired with proceeds)		101.8
TOTAL USES	$	790.6

The $375 million aggregate principal amount of Senior Notes bear interest at 9⅜% payable semi-annually on February 15 and August 15. The Senior Notes mature on August 15, 2005. The Senior Note Indenture contains certain covenants which, among other things and subject to certain exceptions, restrict the amount of additional indebtedness the Company can incur and also limit the amount of cash dividends payable to stockholders of the Company based upon, among other things, a debt to net worth test and a fixed charge coverage test both of which are determined as of the end of each calendar quarter.

In addition, as part of the foregoing transactions, SPT entered into a $200 million three-year unsecured Credit Agreement (replacing SPT's bank revolving credit facility) and made an initial $125 million drawdown thereunder. The Credit Agreement contains several quarterly financial covenants including, subject to certain exceptions, required minimum tangible net worth; a maximum funded debt to tangible ~~net worth~~ ratio; and a minimum fixed charge coverage ratio. As a result of delays in asset sales and the effects of severe midwestern floods, SPT was required to obtain waivers of compliance with certain Credit Agreement financial covenants as of September 30, 1993. Further, because of the delays in asset sales and effects of the flooding, SPT entered into amendments to the Credit Agreement with its banking group in December 1993 to modify certain financial covenant tests.

On March 2, 1994, the Company closed the Offering for net proceeds of $503.7 million. The proceeds were used to repay the $117 million outstanding under the RGH credit facilities, to repay the $175 million outstanding under the SPT Credit Agreement and for general corporate purposes.

SPT closed the sale of $290 million aggregate principal amount of SPT Notes on April 6, 1993. The SPT Notes are secured by the rail lines of SSW, are guaranteed by SSW, and are required to be repaid over the three-year period from 1997 to 1999. The net proceeds of the financing were used to make a $100 million payment on SPT's bank term loan, a $125 million payment on SPT's bank revolving credit facility, to repay short-term indebtedness and for general corporate purposes. The SPT Note Indenture contains certain covenants and restrictions, including restrictions (subject to certain exceptions) on additional borrowings and dividend payments or advances by SPT.

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In order to accelerate their realization on their accounts receivable, beginning in 1989 the Company's principal rail subsidiaries began selling certain net accounts receivable to ABS Commercial Paper, Inc. ("ABS"), an unaffiliated third party. ABS finances its purchases by the sale of its commercial paper, secured by the receivables it purchases, up to a maximum aggregate principal amount of $300.0 million at any time outstanding. The proceeds of issuance of the commercial paper are paid to the railroads for the receivables. Payment of the commercial paper is supported by certain banks that have agreed to provide liquidity on an as-needed basis. As of December 31, 1993, 1992 and 1991, the Company had sold $391.7 million, $366.5 million and $369.2 million of net outstanding receivables, respectively, and had receivables relating to future proceeds from ABS for receivables sold of $62.7 million, $39.7 million and $63.9 million, respectively. The initial terms of the agreements were to expire in 1994. The Company has obtained commitments of the banks to extend the facility for a period of one year.

As part of an ongoing program to improve its locomotive fleet, the Company acquired through capital lease 15 new locomotives in the last quarter of 1993 and borrowed a total of $103.8 million in 1992 and 1991 to purchase a total of 55 new and 45 remanufactured locomotives. In addition, over the three years ended December 31, 1993, the Company completed sale leaseback transactions, for terms ranging from seven to 15 years, relating to 159 locomotives and approximately 6,500 cars. Under these arrangements, certain of the locomotives and approximately 5,500 freight cars were reconditioned by the purchasers before they were leased back to the Company. Of these reconditioned cars approximately 3,800 were leased back to the Company under operating leases and approximately 1,700 were leased back under capital leases. Up to 3,300 additional cars are expected to be renovated under similar programs in the future. The Company's net equipment lease and rental expense was $331.0 million, $288.0 million and $253.9 million for the years ended December 31, 1993, 1992 and 1991, respectively.

Pursuant to the agreement recently entered into between the Company and ISSC, the Company is obligated to pay annual base charges of between $45 million and $50 million (which covers, among other things, payments for MIS equipment) over a ten-year period, subject to adjustments for cost of living increases and variations in the levels of service provided under the agreement. Contingent rentals and sublease rentals were not significant.

Total maturities of long-term debt at December 31, 1993, including capital lease obligations, from January 1, 1994 through December 31, 1998 were $700.7 million. The total amount of mandatory redemptions and mandatory dividends of SSW's Series A and Series B Redeemable Preference Shares scheduled for payment from January 1, 1994 through December 31, 1998 are $20.[illegible] million. The Company also has substantial future lease commitments relating to its locomotive and car fleet, and other substantial commitments. See Notes 11 and 12 to the Consolidated Financial Statements included elsewhere herein.

Energy Tax

On August 10, 1993, the President signed into law legislation which imposes a tax on certain fuels. The tax is expected to increase the Company's fuel costs for 1994 by approximately $15 million to $20 million. However, certain of the Company's freight contracts have escalation clauses that would help to offset such increased fuel costs. The Company also posted certain rate increases effective October 1, 1993 that represent a surcharge intended to mitigate the impact of the fuel tax.

Inflation

In prior years, the Company has experienced increased costs due to the effect of inflation on the cost of compensation and benefits, and in the replacement of or additions to property and equipment. A portion of the increased labor costs directly affects expenses through increased operating costs. Fuel costs have fluctuated with market conditions and have directly affected operating results. Operating efficiencies have, however, partially offset this impact. Competition and other market factors have adversely affected the Company's ability to price services to fully recover cost increases. Certain of the wage agreements obtained in 1991, 1992 and 1993 have reduced the effects of inflation on future operating costs until they expire and become subject to renegotiation in 1995 (1998 with respect to the agreement covering the Western Lines).

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Accounting Matters

The Company's Consolidated Financial Statements are prepared on the purchase accounting basis. The railroad subsidiaries report their financial position and results of operations on the historical cost basis. As a result, the Company reflects less depreciation expense than its combined railroad subsidiaries, as well as smaller gains on the sale of properties classified as real estate held for sale. See Note 1 to the Company's Consolidated Financial Statements included elsewhere herein.

In 1991, the Company recorded the 1991 Special Charge of $259.9 million. The 1991 Special Charge provided for employee separation and relocation related primarily to labor agreements reached in 1991, sale, lease or abandonment of low density lines, restoration and clean-up costs and certain legal matters. See Note 2 to the Consolidated Financial Statements included elsewhere herein.

The Company adopted FAS 106 "Employers' Accounting for Post-retirement Benefits Other Than Pensions" effective January 1, 1993, thus incurring an after-tax charge of $104.2 million for the cumulative effect of change in accounting principle relating to the Company's retiree welfare plan. The Company has amended its retiree benefit policies and estimates that its liability for such retiree benefits at January 1, 1993 was approximately $168.5 million before tax, after reflecting these policy amendments. See Note 12 to the Company's Consolidated Financial Statements included elsewhere herein.

In February 1992, FAS 109 "Accounting for Income Taxes" was issued. Through December 31, 1992, the Company accounted for income taxes under the asset and liability method prescribed by FAS 96, "Accounting for Income Taxes". Management adopted FAS 109 prospectively in the first quarter of 1993. The impact of adoption of FAS 109 did not have a material effect on the Company's consolidated financial statements.

Under both FAS 96 and FAS 109, deferred tax liabilities and assets are recorded based on the enacted income tax rates which are expected to be in effect in the periods in which the deferred tax liability or asset is expected to be settled or realized. A change in the tax laws or rates results in adjustments to the deferred tax liabilities and assets. The effect of such adjustments shall be included in income in the period in which the tax laws or rates are changed.

In November 1992, FAS 112 "Employers' Accounting for Post-employment Benefits" was issued. FAS 112 requires employers to recognize the obligation to provide benefits to former or inactive employees after employment but before retirement, if certain conditions are met. The initial effect of applying FAS 112 is to be reported as the effect of a change in accounting method and previously issued financial statements are not to be restated. The Company will adopt FAS 112 and take a pre-tax charge of approximately $10 million in the first quarter of 1994 as required by FAS 112. See Note 1 to the Company's Consolidated Financial Statements included elsewhere herein.

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STB FD 32760 11-30-95 A 1648V26 5/7

Independent Auditors' Report

THE BOARD OF DIRECTORS

SOUTHERN PACIFIC RAIL CORPORATION:

We have audited the accompanying consolidated balance sheets of Southern Pacific Rail Corporation and Subsidiary Companies (formerly Rio Grande Industries, Inc.) as of December 31, 1993 and 1992, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the three year period ended December 31, 1993. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Pacific Rail Corporation and Subsidiary Companies as of December 31, 1993 and 1992, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 1993 in conformity with generally accepted accounting principles.

As discussed in Note 1 to the financial statements, effective January 1, 1993 the Company changed its methods of accounting for income taxes and post-retirement benefits other than pensions.

KPMG Peat Marwick

KPMG PEAT MARWICK

San Francisco, California

February 17, 1994, except as to the third paragraph of Note 17, which is as of March 2, 1994.

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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Southern Pacific Rail Corporation have been prepared by management, which is responsible for their content and integrity. The statements present the results of operations, cash flows and financial position of the Company in conformity with generally accepted accounting principles and, accordingly, include amounts based on management's ongoing judgments and estimates. Information in other sections of the Annual Report is consistent with that included in the financial statements.

The Company's accounting systems are supported by internal accounting controls which are established to 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 accounting control should not exceed the benefits and that no system of internal controls can detect and prevent all errors and irregularities.

As part of their audit of the financial statements, the Company's independent auditors review and assess the effectiveness of selected internal accounting controls to establish a basis for reliance thereon in determining the nature, timing and extent of audit tests to be applied as they deem necessary to express an opinion on the fairness of the consolidated financial statements. In addition, the Company maintains a well-qualified internal audit department which evaluates, monitors, and reports to management on compliance with the Company's internal control policies and procedures.

The Board of Directors pursues its responsibility for the Company's financial statements through its Audit Committee, which is composed solely of directors who are not officers or employees of the Company. The independent auditors and the Company's internal auditors have direct access to the Audit Committee, with and without the presence of management representatives, to discuss the scope and results of their audit work and their comments on the adequacy of internal accounting controls and financial reporting.

Edward L. Moyers | Cannon Y. Harvey | Lawrence C. Yarberry

EDWARD L. MOYERS
President and Chief Executive Officer

CANNON Y. HARVEY
Senior Vice President—Finance and Law

LAWRENCE C. YARBERRY
Vice President—Finance

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CONSOLIDATED BALANCE SHEETS

Assets	December 31,	
(dollars in millions)	**1993**	**1992**
CURRENT ASSETS		
Cash and cash equivalents (includes restricted cash of $5.4 in 1993 and 1992)	$ 65.5	$ 61.3
Accounts receivable, net of allowance for doubtful accounts of $7.2 in 1993 and $7.8 in 1992 (Note 3)	122.1	122.1
Materials and supplies, at cost	56.9	53.8
Accounts receivable sales proceeds receivable (Note 3)	62.7	39.7
Other notes receivable	2.8	6.7
Other current assets	44.2	44.1
Total current assets	354.2	327.7
REAL ESTATE HELD FOR SALE (Note 4)	363.4	374.1
PROPERTY, at cost (Notes 4, 6, 11 and 14)		
Roadway and structures	2,103.0	1,912.1
Equipment	702.2	599.0
Land and other property	287.1	277.3
Total property	3,092.3	2,788.4
Less accumulated depreciation and amortization	560.6	469.7
Property, net	2,531.7	2,318.7
OTHER ASSETS AND DEFERRED CHARGES		
Notes receivable and other investments	51.0	49.3
Notes receivable from The Anschutz Corporation (Note 17)	—	9.7
Other (Note 3)	133.7	125.0
Total other assets	184.7	184.0
TOTAL	$ 3,434.0	$ 3,204.5

See accompanying notes to consolidated financial statements.

(continued)

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CONSOLIDATED BALANCE SHEETS *(continued)*

Liabilities and Stockholders' Equity (Deficit) *(dollars in millions)*	December 31, 1993	1992
CURRENT LIABILITIES		
Accounts and wages payable	$ 125.3	$ 156.7
Accrued payables		
Taxes	52.9	66.8
Interest	40.8	23.3
Vacation pay	67.1	73.6
Current portion of long-term debt (Note 6)	66.7	153.5
Redeemable preference shares of a subsidiary (Note 8)	1.8	2.2
Other current liabilities (Note 5)	561.6	606.7
Total current liabilities	916.2	1,082.8
LONG-TERM DEBT (Note 6)	1,408.3	1,175.5
DEFERRED INCOME TAXES (Note 7)	67.6	163.4
OTHER LIABILITIES (Notes 5 and 12)	708.2	597.5
REDEEMABLE PREFERENCE SHARES OF A SUBSIDIARY (Note 8)	21.2	21.7
12% CUMULATIVE REDEEMABLE EXCHANGEABLE PREFERRED STOCK (Notes 9 and 17)	—	75.0
COMMON STOCK SUBJECT TO REPURCHASE (Notes 10 and 17)	—	165.5
COMMITMENTS AND CONTINGENCIES (Notes 7, 11, 12 and 14)		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common Stock, par value $.001 per share; 300,000,000 shares authorized; 130,783,750 and 100,000,000 shares issued and outstanding in 1993 and 1992, respectively (Note 17)	0.1	0.1
Additional paid-in capital	611.9	221.2
Accumulated deficit	(299.5)	(132.7)
Stockholders' equity before Common Stock subject to repurchase	312.5	88.6
Common Stock subject to repurchase (Notes 10 and 17)	—	(165.5)
Total stockholders' equity (deficit)	312.5	(76.9)
TOTAL	$ 3,434.0	$ 3,204.5

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
(in millions, except per share amounts)	**1993**	**1992**	**1991**
OPERATING REVENUES			
Railroad	$ 2,837.7	$ 2,810.3	$ 2,733.4
Other	80.9	67.7	52.1
Total	2,918.6	2,878.0	2,785.5
OPERATING EXPENSES			
Railroad			
Labor and fringe benefits (Note 12)	1,132.5	1,167.0	1,164.3
Fuel	252.4	236.9	228.8
Materials and supplies	217.6	244.7	220.3
Equipment rental	331.0	288.0	253.9
Depreciation and amortization (Note 4)	133.2	138.9	124.9
Other	665.4	624.2	648.2
Special charge (Note 2)	—	—	259.9
Total railroad	2,732.1	2,699.7	2,900.3
Other	83.3	69.4	53.6
Total	2,815.4	2,769.1	2,953.9
OPERATING INCOME (LOSS)	103.2	108.9	(168.4)
OTHER INCOME			
Gains from sales of property and real estate (Note 4)	25.1	118.7	67.5
Real estate and other rentals, net	20.3	16.6	24.3
Interest income	7.4	7.1	10.1
Other income (expense), net (Note 3)	(75.2)	(52.2)	(64.7)
Total	(22.4)	9[illegible]	37.2
INTEREST EXPENSE (Note 6)	156.0	143.3	152.0
INCOME (LOSS) BEFORE INCOME TAXES	(75.2)	55.8	(283.2)
INCOME TAXES (BENEFIT) (Note 7)			
Current	—	0.1	(0.1)
Deferred	(30.3)	22.6	(107.4)
Total	(30.3)	22.7	(107.5)
NET INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING	(44.9)	33.1	(175.7)
CUMULATIVE EFFECT ON YEARS PRIOR TO 1993 OF CHANGE IN ACCOUNTING FOR POST-RETIREMENT BENEFITS OTHER THAN PENSIONS (Net of tax benefit of $64.3) (Note 12)	(104.2)	—	—
NET INCOME (LOSS)	$ (149.1)	$ 33.1	$ (175.7)
INCOME (LOSS) APPLICABLE TO COMMON STOCKHOLDERS	$ (154.9)	$ 24.1	$ (184.7)
PRIMARY EARNINGS PER SHARE			
Net income (loss) before cumulative effect of change in accounting	$ (0.54)	$ 0.34	$ (2.59)
Cumulative effect of change in accounting	$ (1.11)	$ —	$ —
NET INCOME (LOSS)	$ (1.65)	$ 0.34	$ (2.59)
FULLY DILUTED EARNINGS (LOSS) PER SHARE			
Net income (loss) before cumulative effect of change in accounting	$ (0.46)	$ 0.24	$ (1.85)
Cumulative effect of change in accounting	$ (0.93)	$ —	$ —
NET INCOME (LOSS)	$ (1.39)	$ 0.24	$ (1.85)

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

Years Ended December 31, 1993, 1992 and 1991

(in millions, except per share amounts)	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Common Stock Subject to Repurchase	Total Stockholders' Equity (Deficit)
BALANCES AS OF DECEMBER 31, 1990	100	$ 0.1	$ 221.2	$ 34.9	(165.5)	$ 90.7
Net loss	—	—	—	(175.7)	—	(175.7)
Dividends on preferred stock ($120 per share)	—	—	—	(9.0)	—	(9.0)
Dividends on common stock ($0.07 per share)	—	—	—	(7.0)	—	(7.0)
BALANCES AS OF DECEMBER 31, 1991	100	0.1	221.2	(156.8)	(165.5)	(101.0)
Net income	—	—	—	33.1	—	33.1
Dividends on preferred stock ($120 per share)	—	—	—	(9.0)	—	(9.0)
BALANCES AS OF DECEMBER 31, 1992	100	0.1	221.2	(132.7)	(165.5)	(76.9)
Net loss	—	—	—	(149.1)	—	(149.1)
Dividends on preferred stock ($78 per share)	—	—	—	(5.8)	—	(5.8)
Common stock issued (Note 17)	31	—	390.7	—	165.5	556.2
Cancellation of notes receivable from The Anschutz Corporation (Note 17)	—	—	—	(11.9)	—	(11.9)
BALANCES AS OF DECEMBER 31, 1993	131	$ 0.1	$ 611.9	$ (299.5)	$ —	$ 312.5

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)	Year Ended December 31, 1993	1992	1991
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$ (149.1)	$ 33.1	$ (175.7)
Adjustments to net income (loss)			
Depreciation and amortization	133.2	138.9	124.9
Special charge	—	—	259.9
Deferred income taxes	(94.6)	22.6	(107.4)
Gains on sales of property	(25.1)	(118.7)	(67.5)
Cumulative effect of change in accounting for post-retirement benefits other than pensions	168.5	—	—
Changes in:			
Receivables, net	(18.4)	60.5	(3.2)
Materials and supplies	(3.1)	1.2	17.9
Income taxes payable/receivable	(13.9)	1.2	0.2
Other current and noncurrent assets	23.5	10.5	0.8
Other current and noncurrent liabilities	(126.4)	(42.0)	(94.5)
Total adjustments	43.7	74.2	131.1
Net cash provided by (used for) operating activities	(105.4)	107.3	(44.6)
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(311.2)	(340.7)	(305.1)
Sales of real estate held for sale	5.8	175.8	360.2
Sales of land	35.6	161.0	144.1
Sales of equipment and other property	12.4	25.6	12.4
Change in notes receivable and other investments, net	(2.9)	(23.5)	8.3
Net cash provided by (used for) investing activities	(260.3)	(1.8)	219.9
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of debt, net of costs	796.6	510.7	75.1
Debt repayment, net	(734.5)	(596.6)	(269.2)
Proceeds from issuance of common stock, net of costs	390.7	—	—
Redemption of preferred stock	(75.0)	—	—
Dividends paid	(5.8)	(9.0)	(16.0)
Redeemable preference shares repayment	(2.1)	(2.1)	(1.3)
Net cash provided by (used for) financing activities	369.9	(97.0)	(211.4)
NET CHANGE IN CASH AND CASH EQUIVALENTS	4.2	8.5	(36.1)
CASH AND CASH EQUIVALENTS—BEGINNING OF YEAR	61.3	52.8	88.9
CASH AND CASH EQUIVALENTS—END OF YEAR	$ 65.5	$ 61.3	$ 52.8

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Ownership, Principles of Consolidation and Basis of Presentation

Southern Pacific Rail Corporation ("SPRC") (formerly Rio Grande Industries, Inc.) was formed in June 1988 to acquire and hold the common stock of Rio Grande Holding, Inc. ("RGH") and SPTC Holding, Inc. ("SPTCH"). The Company refers to Southern Pacific Rail Corporation together with its subsidiaries. SPTCH was the parent company of Southern Pacific Transportation Company ("SPT") until 1993 and RGH is the parent company of The Denver and Rio Grande Western Railroad Company ("D&RGW"). Effective with the common stock and debt transactions discussed in Note 17, SPTCH was merged into SPRC. Management of the Company continues to review and consider the placement of various subsidiaries within the corporate structure of the Company. The Company intends to combine D&RGW and SPT in the future as part of an overall plan to simplify the Company's corporate structure.

The consolidated financial statements are prepared on the purchase accounting basis and include the accounts of the Company and its subsidiaries on a consolidated basis. The railroad subsidiaries report to the Interstate Commerce Commission ("ICC") their financial position and results of operations on the historical cost basis. Because the Company's purchase price of the railroad subsidiaries was significantly lower than their historical cost basis, depreciation expense reflected by the Company is substantially lower than the expense reflected by the railroads. In addition, gains on sales of real estate held for sale by the Company are substantially lower than gains reflected by the railroads since these properties were allocated a greater value by the Company under purchase accounting.

Cash and Cash Equivalents

For statement of cash flows purposes, the Company considers commercial paper, municipal securities and certificates of deposit with original maturities when purchased of three months or less to be cash equivalents.

Investments

Investments in affiliated companies (those in which the Company has a 20% to 50% ownership interest) are accounted for by the equity method. Other investments are stated at cost which does not exceed market.

Real Estate Held for Sale

At the time of the acquisitions of D&RGW and SPT, the Company identified for sale certain real estate properties that were not essential to its transportation operations. These properties have been classified as Real Estate Held for Sale. Real estate properties held for sale are stated at the lower of cost or amounts expected to be realized upon sale. Since 1988, no properties have been added to this classification. In order to facilitate disposition of these properties, the Company may participate in joint ventures or other arrangements that do not result in immediate sales.

Property

Property accounting procedures followed by the Company and its railroad subsidiaries are prescribed by the ICC. In accordance with the Company's definition of unit of property, all costs associated with the installation of rail, ties, ballast and other track improvements are capitalized. Other costs are capitalized to the extent they increase asset values or extend useful lives. Retirements are generally recorded using a systemwide first-in first-out basis. The cost of property and equipment (including removal and restoration costs) is depreciated on the straight line composite group method, generally based on estimated service lives. Pursuant to ICC regulation, periodic depreciation studies are required and changes in service life estimates are subject to the review and approval of the ICC. Gains or losses from disposition of depreciable railroad operating property are credited or charged to accumulated depreciation except for significant disposals of equipment. Gains or losses resulting from sales of real estate no longer required for railroad operations are recognized as other income in the consolidated statement of operations.

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Revenues

Freight revenues from rail transportation operations are recognized based on the percentage of completed service method. Other railroad revenues and other revenues are recognized as earned.

Retiree Welfare Benefits

Prior to January 1, 1993, the Company expensed retiree welfare benefits when paid. Effective January 1, 1993 the Company adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and recorded the estimate of its liability under Statement No. 106 of $168.5 million, which net of income taxes resulted in a charge to earnings of $104.2 million (See Note 12). Statement No. 106 requires that all employers sponsoring a retiree welfare plan use a single actuarial cost method as is required for pension plan accounting and that they disclose specific information about their plan in their financial statements.

Post-employment Benefits

In November 1992, Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits" was issued. Statement No. 112 requires employers to recognize the obligation to provide benefits to former or inactive employees after employment but before retirement, if certain conditions are met. The initial effect of applying Statement No. 112 is to be reported as the effect of a change in accounting method and previously issued financial statements are not to be restated. The Company will adopt Statement No. 112 and take a pre-tax charge of approximately $10 million in the first quarter of 1994.

Income Taxes

Prior to January 1, 1993, income taxes were reported using the liability method prescribed by Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes." Under Statement No. 96, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities.

Effective January 1, 1993, the Company prospectively adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." The impact of adoption of Statement No. 109 was not material to the Company's consolidated financial statements.

Under both Statement No. 96 and Statement No. 109, deferred tax liabilities and assets are recorded based on the statutory income tax rates which are expected to be settled or realized. A change in the tax laws or rates results in adjustments to the deferred tax liabilities and assets. The effect of such adjustments shall be included in income in the period in which the tax laws or rates are changed.

Earnings per Share

Earnings per share are determined by dividing net income, after deduction of preferred stock dividends, by the weighted average number of shares of common stock outstanding. The weighted average number of shares of common stock outstanding in the calculation of primary earnings per share excludes the number of shares of common stock subject to repurchase. These shares are included in the calculation of fully diluted earnings per share. The following summarizes the weighted average number of shares used in these calculations:

	Shares at Year Ended December 31,		
(in thousands)	**1993**	**1992**	**1991**
Primary	93,575	71,250	71,250
Fully diluted	111,544	100,000	100,000

Reclassifications

Certain of the amounts previously reported have been reclassified to conform to the current consolidated financial statement presentation.

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2. Special Charge

In the fourth quarter of 1991, the Company recorded a $259.9 million Special Charge. Approximately $136 million of the Special Charge is related to labor agreements then recently concluded and then in progress which have resulted in crew size reduction and payments to approximately 1,100 employees and relocation costs over the next several years. Approximately $14 million of the Special Charge was credited to accumulated depreciation to reserve for 1,200 miles of low density rail lines identified for sale or abandonment. The remainder of the charge was to provide for restoration and clean-up costs on certain properties ($94 million) and for various legal matters ($1[illegible] million).

Expenditures in 1993 and 1992 applied against the reserves were $55.4 million and $82.7 million for employee separation and relocation and $18.3 million and $26.6 million for restoration and clean-up costs, respectively.

3. Sale of Receivables

Beginning in 1989, some of the Company's rail subsidiaries began selling certain net receivables (including interline accounts), with limited recourse, to ABS Commercial Paper, Inc. ("ABS") on a continuing basis for a period of up to five years subject to certain terms and conditions. The Company has agreed to service the receivables sold and is paid a fee for such services. The sale price for the receivables sold is based upon the face amount of the receivables and is reduced by discounts for expected defaults, servicing costs and anticipated collection periods. The Company retains a residual interest in the receivables should actual collections exceed the projected collections upon which the default discounts are calculated.

ABS purchases an undivided interest in the receivables up to an aggregate amount of approximately $300.0 million, net of discounts, at any one time, for a period up to five years subject to certain conditions. ABS finances its purchases by the sale of its commercial paper, secured by the receivables it purchases, up to a maximum aggregate principal amount of $300.0 million at any time outstanding. The ability of ABS to sell commercial paper is supported by certain banks which have agreed to provide liquidity to ABS on an as-needed basis. The liquidity banks must maintain a P-1 rating or there would need to be one or more replacement banks or a reduction in the maximum amount of commercial paper which ABS could issue. During 1991, one bank's rating was reduced and additional bank commitments were obtained from the remaining banks.

As of December 31, 1993, 1992 and 1991, the Company had sold $391.7 million, $366.5 million and $369.1 million of net outstanding receivables to ABS and had receivables relating to future proceeds from ABS for receivables sold of $62.7 million, $39.7 million and $63.9 million, and had an interest bearing deposit held by ABS of $30 million at December 31, 1993, 1992 and 1991, which is included in other assets. Included in other income (expense), net is approximately ($41.8) million in 1993, ($31.1) million in 1992, and ($58.7) million in 1991 of discounts and other expenses associated with the sales of accounts receivable. The initial term of the agreements expire on October 31, 1994. The Company has obtained commitments of the banks to extend the facility for a period of one year.

4. Property and Real Estate Held for Sale

The average depreciation rates for the Company's property and equipment were approximately 10% for roadway and structures, 8% for locomotives and 2% for freight cars for 1993. Because of purchase accounting, assets placed in service since the acquisition of SPT in 1988 have substantially longer useful lives than the property and equipment owned by SPT when it was acquired.

The Company received cash proceeds from sales and retirements of real estate and property of $53.8 million, $362.4 million and $516.7 million in 1993, 1992 and 1991, respectively. The 1993 amount includes proceeds of $6.0 million from a sale to the Regional Transportation District in Denver, Colorado. The 1992 amount includes $124.0 million from sales to the Peninsula Corridor Joint Powers Board ("JPB"), $45.0 million from sales to Metro Transit of Houston, Texas, $83.0 million from sales to the Los Angeles County Transportation Commission ("LACTC"), and $36.5 million from the sale/leaseback of locomotives and freight cars in June 1992. The 1991 amount includes $321.7 million from sales to the LACTC and $91.9 million from sales to the JPB. The Company expensed approximately $12 million in 1993 and $18 million in each of 1992 and 1991 in costs relating to environmental conditions on properties held for sale.

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As a result of the acquisition of SPT in 1988, certain specific real estate properties were identified as not being essential to transportation operations and were classified as Real Estate Held for Sale at their estimated current fair value. Sales of these properties result in substantially reduced gains when compared to gains reported by the respective railroad subsidiaries. Sales of other land not in Real Estate Held for Sale usually result in substantially higher gains.

The Company has granted the JPB options to purchase additional rights-of-way and land within five years after the closing of the sale of the Peninsula Main Line for approximately $110 million. The Company will retain exclusive freight rights on the sold properties.

5. Other Current Liabilities and Other Liabilities

Other current liabilities include the following amounts:

	December 31,	
(dollars in millions)	**1993**	**1992**
Reserves for casualty, freight-related claims, and other (current portion)	$ 165.3	$ 204.1
Accrued repairs, equipment rentals and other payables	350.7	355.4
Post-retirement benefit obligation	20.6	—
Reserve for employee separation and relocation (current portion)	25.0	47.2
TOTAL	$ 561.6	$ 606.7

Included in other non-current liabilities are $329.0 million and $316.7 million for casualty and freight-related claims and $35.3 million and $66.0 million for employee separation and relocation at December 31, 1993 and 1992, respectively, in addition to $148.8 million for post-retirement benefits other than pensions at December 31, 1993.

6. Long-Term Debt

Long-term debt is summarized as follows:

	December 31,	
(dollars in millions)	**1993**	**1992**
RGH subordinated notes and debentures (13.625–14.375%; due 2005)	$ —	$ 101.4
SPTCH subordinated debentures (12.125%; due 2000)	—	200.0
Equipment obligations (8.00–14.25%; due 1994 to 2005)	380.4	442.6
Mortgage bonds (2.75–8.2%; due 1994 to 2001)	39.6	42.1
SPT bank credit facility (5.438–7.75%; due 1994 to 1996)	—	335.0
SPT credit agreement (various; due 1996)	125.0	—
RGH credit facilities (4.688–6.0%; due 1995 to 1997)	117.0	117.0
SPT senior secured notes (10.5%; due 1999)	290.0	—
SPRC senior notes (9.375%; due 2005)	375.0	—
Other debt (4.0–6.0%; due 1994 to 2018)	88.1	88.1
Capitalized lease obligations (Note 11)	73.5	19.4
Total	1,488.6	1,345.6
Less discount recorded in purchase accounting	(13.6)	(16.6)
Less current portion	(66.7)	(153.5)
TOTAL LONG-TERM	$ 1,408.3	$ 1,175.5

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On May 12, 1992, SPT completed a refinancing of its $525 million bank loan and other credit facilities and obtained a $450 million credit facility from a group of banks (the "Bank Credit Facility"), which consisted of a $325 million four-year amortizing term loan (the "SPT Term Loan") and a $125 million four-year non-amortizing revolver (the "SPT Revolver"). On August 17, 1993, the Bank Credit Facility was repaid as part of the common stock and debt transactions which included the issuance of $375 million of 9⅜% Senior Notes and an initial drawdown of $125 million under a new $200 million three-year unsecured Credit Agreement described below.

SPT closed $290 million of 10½% Senior Secured Notes on April 6, 1993. The Notes are secured by the rail lines of the St. Louis Southwestern Railway Company ("SSW") and are required to be repaid over the three-year period 1997–1999. Proceeds of the financing were used to make a $100 million payment on the SPT Term Loan, a $125 million payment on the SPT Revolver, and for general corporate purposes. The Notes contain certain covenants and restrictions on dividends, loans and affiliate transactions, and provided registration rights to their holders. The registration rights were satisfied by an exchange offer of substantially identical notes completed in November 1993.

The $375 million Senior Notes bear interest at 9⅜% payable semi-annually on February 15, and August 15 commencing in 1994. The Senior Notes mature on August 15, 2005. The Senior Note Indenture contains certain covenants which, among other things and subject to certain exceptions, restrict the amount of additional indebtedness the Company can incur and also limit the amount of cash dividends payable to stockholders of the Company based upon, among other things, a debt to net worth test and a fixed charge coverage test both of which are determined as of the end of each calendar quarter.

In August 1993, SPT entered into a $200 million three-year unsecured credit agreement (the "Credit Agreement") (replacing the SPT Revolver) and made an initial $125 million drawdown thereunder. The Credit Agreement contains several quarterly financial covenants including, subject to certain exceptions, required minimum tangible net worth; a maximum funded debt to tangible net worth ratio; and a minimum fixed charge coverage ratio. As a result of delays in asset sales and the continuing effects of severe midwestern floods, SPT was required to obtain waivers of compliance with certain financial covenants applicable as of September 30, 1993 contained in the Credit Agreement. Further, because of the delays in asset sales and continuing effects of the flooding, SPT entered into amendments to the Credit Agreement with its banking group in December 1993 to modify certain financial covenant tests.

RGH's long-term credit facilities also contain various restrictions as to net worth, quarterly interest coverage and other matters. RGH satisfied these tests as of December 31, 1993.

As part of an on-going program to improve its locomotive fleet, the Company acquired through capital lease 15 new locomotives in 1993 and borrowed a total of $103.8 million in 1991 and 1992 to purchase a total of 55 new and 45 remanufactured locomotives.

Contractual maturities of long-term debt (including capital lease obligations) during each of the five years subsequent to 1993 and thereafter are as follows:

(dollars in millions)	
1994	$ 66.7
1995	132.5
1996	174.5
1997	188.7
1998	138.3
Thereafter	787.9
TOTAL	$ 1,488.6

Management estimates the fair value of the Company's debt at December 31, 1993 and 1992 was approximately $1,581 million and $1,374 million, respectively, based on interest rates for similar issues and financings.

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At December 31, 1993 the Company is a party to interest rate swap agreements with an aggregate notional amount of $100 million, which is used to hedge its interest rate exposure and is accounted for as an adjustment of interest expense over the life of the debt.

A significant portion of railroad equipment and certain railroad property is subject to liens securing the mortgage bonds, equipment obligations, or other debt.

7. Income Taxes

The following summarizes income tax expense (benefit) for the years indicated:

	Year Ended December 31,		
(dollars in millions)	1993	1992	1991
CURRENT			
Federal	$ —	$ —	$ —
State	—	0.1	(0.1)
Total current	—	0.1	(0.1)
DEFERRED			
Federal	(25.1)	18.9	(107.2)
State	(5.2)	3.7	(0.2)
Total deferred	(30.3)	22.6	(107.4)
DEFERRED TAXES on cumulative effect of change in accounting for post-retirement benefits other than pensions			
Federal	(54.6)	—	—
State	(9.7)	—	—
Total deferred taxes on cumulative effect	(64.3)	—	—
TOTAL INCOME TAX EXPENSE (BENEFIT)	$ (94.6)	$ 22.7	$ (107.5)

Deferred tax expense in 1993 includes $1.2 million related to the change in the Federal tax rate.

Total income tax expense (benefit) differed from the amounts computed by applying the statutory Federal income tax rate to income before income taxes as a result of the following for the years ended December 31, 1993, 1992 and 1991:

	December 31,		
	1993	1992	1991
Statutory rate	(35.0%)	34.0%	(34.0%)
State income taxes (net of Federal income tax benefit)	(4.5)	4.5	(0.1)
Cumulative effect of Federal tax rate change (from 34% to 35%)	1.6	—	—
Other, net	(2.4)	2.2	(3.9)
EFFECTIVE RATE	(40.3%)	40.7%	(38.0%)

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1993 and January 1, 1993 are presented below:

(dollars in millions)	December 31, 1993	January 1, 1993
DEFERRED TAX ASSETS		
Accruals and reserves not deducted for tax purposes until paid	$ 363.1	$ 308.7
Net operating loss carryforwards	609.3	509.5
Other	65.8	73.3
Total gross deferred tax assets	1,038.2	891.5
DEFERRED TAX LIABILITIES		
Differences in depreciation and cost capitalization methods (including deferred gains on property)	(1,089.6)	(999.1)
Other	(16.2)	(55.8)
Total gross deferred tax liabilities	(1,105.8)	(1,054.9)
NET DEFERRED TAX LIABILITY	$ (67.6)	$ (163.4)

The Company has analyzed the sources and expected reversal periods of its deferred tax assets and liabilities. The Company believes that the tax benefits attributable to deductible temporary differences and operating loss carryforwards will be realized by the recognition of future taxable amounts related to taxable temporary differences for which deferred tax liabilities have been recorded. Accordingly, the Company believes a valuation allowance for its deferred tax assets is not necessary.

The former parent of SPT has agreed to indemnify the Company against any Federal income tax liability that may be imposed on SPT or its 80%-owned subsidiaries for tax periods ending on or prior to October 13, 1988 (the "Acquisition Date"). Years prior to 1984 are closed. The Company agreed to pay to the former parent any refund of federal income taxes attributable to the 80%-owned subsidiaries received by the Company after the Acquisition Date for any tax period ending on or prior to the Acquisition Date. Further, the former parent will also indemnify the Company, at least in part, for state, local and other taxes in respect of periods to and including the Acquisition Date, but only to the extent that such taxes are due or reportable for periods prior to the Acquisition Date.

As of December 31, 1993 the Company had approximately $1.5 billion of net operating loss carryforwards ("NOLs") which expire in 2003 through 2008. The NOLs are subject to review and potential disallowance, in whole or in part, by the Internal Revenue Service ("IRS") upon audit of the Federal income tax returns of the Company. The Company's consolidated Federal income tax returns are currently being examined for the period October 14, 1988 through 1990. Management believes adequate provision has been made for any potential adverse result.

The IRS's audit of RGH's returns for 1980, 1983 and the period ending October 31, 1984, led to the issuance of a notice of deficiency in October 1992. The notice has been petitioned to the United States Tax Court. RGH does not expect a trial or other resolution of the case in 1994; however, management believes adequate reserves have been provided to cover any anticipated deficiency. RGH's taxable periods while it was included in the consolidated returns of The Anschutz Corporation ("TAC") from November 1984 through October 13, 1988, are currently under audit as part of the TAC audit (See Notes 14 and 17).

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8. Redeemable Preference Shares of a Subsidiary

SSW, a 99.9% owned subsidiary of SPT, originally issued $53.5 million ($48.5 million Series A and $5 million Series B) of SSW's non-voting redeemable preference shares. The current carrying amount on the balance sheets at December 31, 1993 and 1992 reflects the outstanding balances of the redeemable preference shares of $46.0 million and $48.2 million, respectively, less purchase accounting discounts of $23.0 million and $24.3 million, respectively.

The Series A shares are subject to mandatory redemption at face value over a 20-year period commencing in 1991, at which time mandatory dividends shall be declared and paid over the same period. The overall effective interest rate since the date of issue is approximately 2.0%. The Series B shares are subject to mandatory redemption at face value over a 15-year period commencing in 1989. Mandatory dividends shall be declared and paid over a 10-year period commencing in 1994. The overall effective interest rate since the date of issue is approximately 4.9%.

Mandatory redemptions and mandatory dividends of Series A and Series B shares scheduled for payment during each of the five years subsequent to 1993 are as follows:

(dollars in millions)	
1994	$ 4.1
1995	4.2
1996	4.2
1997	4.2
1998	4.2

The Series A and Series B shares restrict certain dividend payments by SSW to its common and preferred stockholders. Under these provisions, at December 31, 1993, $9.3 million of SSW's historical cost basis retained income was not restricted. No estimate of the fair value of the preference shares was made by the Company.

9. 12% Cumulative Redeemable Exchangeable Preferred Stock

The Board of Directors of the Company is authorized without further stockholder action to provide for the issuance from time to time of up to one million shares of preferred stock, in one or more series. Of such number of authorized shares, 75,000 shares of preferred stock designated as 12% Cumulative Redeemable Exchangeable preferred stock ("preferred stock") were issued and outstanding as of December 31, 1992. The preferred stock ranked senior to the Company's common stock with respect to dividend rights and rights on liquidation. The preferred stock had a liquidation value of $1,000 per share and dividends on the preferred stock were cumulative at the annual rate of $120 per share.

On August 17, 1993, as part of the IPO and the Debt Offering (See Note 17), the preferred stock was redeemed.

10. Common Stock Subject to Repurchase

Pursuant to a Subscription Agreement between the Company and The Morgan Stanley Leveraged Equity Fund II, L.P. ("MSLEF II"), on October 13, 1988, the Company issued 25 million shares of its common stock. The Subscription Agreement restricted the ability of TAC and MSLEF II to transfer their shares of common stock and provided that shares of common stock issued to any other investors ("Investors") be privately placed pursuant to separate stock purchase agreements that similarly restricted transfers. The Subscription Agreement gave MSLEF II the right at any time on or after October 13, 1992, by irrevocable notice (a "Put Notice"), to require that the Company purchase all, but not less than all, of the common stock then owned by MSLEF II and the Investors, if one or more nationally recognized independent experts determined that the Company was financially capable of doing so.

On September 29, 1990, pursuant to a Stock Purchase Agreement, five million shares of common stock of the Company were sold on a proportionate basis by the stockholders of the Company to a new investor. The Stock Purchase Agreement contained several provisions regarding the transferability of the shares which were similar to those contained in the Subscription Agreement, including a similar right to require the Company to purchase the shares on or after the seventh anniversary date of the Stock Purchase Agreement (September 29, 1997), subject to the same conditions described above relating to MSLEF II.

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At December 31, 1991 and 1992, 28,750,000 shares of common stock were classified as common stock Subject to Repurchase in the accompanying financial statements and were recorded at the cost of the shares to the respective holders because no "fair market value" appraisal had been performed and there had been no Put Notice given. A reasonable estimate of the fair value could not be made without incurring excessive costs. The Company's commitment to repurchase the 28,750,000 shares of common stock terminated upon completion of the common stock Offering (See Note 17). As a result, common stock Subject to Repurchase of $165.5 million was eliminated.

11. Leases

The Company leases certain freight cars, locomotives, data processing equipment and other property. Future minimum lease payments under noncancellable leases as of December 31, 1993 are summarized as follows:

	Year Ended December 31,	
(dollars in millions)	Capital Leases	Operating Leases
1994	$ 12.4	$ 130.2
1995	13.5	114.3
1996	13.0	97.6
1997	12.3	90.0
1998	10.6	61.7
Later years through 2025	73.6	217.7
TOTAL MINIMUM PAYMENTS	135.4	$ 711.5
Less amount representing interest (at rates ranging from 4.1% to 13.3%)	(61.9)	
PRESENT VALUE OF MINIMUM LEASE PAYMENTS	$ 73.5	

Rental expense for noncancellable operating leases with terms over one year was $156.5 million, $117.6 million, $151.7 million for the years ended December 31, 1993, 1992 and 1991, respectively. Contingent rentals and sublease rentals were not significant.

During the fourth quarter of 1993, the Company committed to a capital lease financing for 50 new locomotives. The locomotives will be leased for a term of 21 years. The first 17 locomotives were delivered in the fourth quarter 1993, with the remainder to be delivered in the first half of 1994. In addition, the Company committed to acquire 133 remanufactured locomotives in 1994 to be financed with a capital lease. The total present value of minimum lease payments relating to the 183 locomotives is expected to be approximately $131 million.

In 1984, the Company entered into a long-term lease agreement with the Ports of Los Angeles and Long Beach. Under the terms of the lease, the Company is obligated to make certain future minimum lease payments and is subject to additional contingent rentals which are based on the annual volume of container movement at the Intermodal Container Transfer Facility. The minimum lease payments, ranging from approximately $3.0 million to $4.5 million per year for 1994 to 1998 are included in the table above. However, for each 5-year period from 1998 through 2036, the amount of the annual minimum lease payments and contingent rentals will be determined by the Ports based on independent appraisals of the fair rental value of the property, and therefore, no amounts are included in the above table for such years. The 1993 expense was $6.5 million.

In late 1990, the Company entered into an agreement to sell up to 9,000 of its freight cars to a company which would recondition the cars and lease them back to the Company or third parties under a full-maintenance lease agreement. As of December 31, 1993, approximately 5,680 freight cars have been sold under the agreement for approximately $43 million in cash and notes receivable. The Company realized a gain of $19.3 million from these sales, which has been deferred and is being amortized over the terms of the leases. Annual rental for the reconditioned freight cars leased back to the Company under operating leases for periods up to 10 years is expected to be approximately $30.9 million in 1994. In 1993, the Company entered into a capital lease covering 1,651 freight cars with a total present value of minimum lease payments of approximately $43 million.

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In 1992, the Company commenced a sale/leaseback transaction consisting of 100 locomotives which were sold to a rebuilder for their net book value of approximately $10.2 million, and were leased back (when rebuilt) under an operating lease agreement over a term of nine years. Also in 1992, the Company completed a sale/leaseback transaction whereby it sold 61 locomotives and 989 freight cars for $36.5 million, and leased them back for terms of between seven and 15 years. The Company realized a gain of $16.2 million on this sale, which has been deferred and is being amortized over the terms of the leases. Initial annual rental under the lease is $5.3 million. A majority of the proceeds ($30.7 million) from this transaction was used to pay down maturing equipment debt obligations in June 1992.

The Company leases operating rights on track owned by other railroads and shares costs of transportation facilities and operations with other railroads. These include rights on Union Pacific lines between Kansas City and St. Louis and on Burlington Northern Railroad Company lines between Kansas City and Chicago. The Company has the right to terminate its usage with certain notice periods. Net rent expense for trackage rights was $1.9 million in 1993, $13.0 million in 1992, and $16.6 million in 1991. The 1993 amount includes the benefit of the negotiated settlement of a joint facility case of approximately $10 million.

The Company pays for the use of transportation equipment owned by others and receives income from others for the use of its equipment. It also shares the cost of other transportation facilities with other railroads. Rental expense and income from equipment and the operation of joint facilities are included in operating expenses on a net basis. Total net equipment lease, rent and car hire expense was $331 million, $288 million and $254 million for 1993, 1992 and 1991, respectively.

12. Employee Benefit and Compensation Plans

Pension Plan

The Company's Pension Plan (the "Pension Plan") is a defined benefit noncontributory pension plan covering employees not covered by a collective bargaining agreement. The Pension Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). Pension benefits for normal retirement are calculated under a formula which utilizes average compensation, years of benefit service, and Railroad Retirement and Social Security pay levels. The Company's funding policy is to contribute each year an amount not less than the minimum required contribution under ERISA nor greater than the maximum tax deductible contribution. The assets of the Pension Plan consist of a variety of investments including U.S. Government and agency securities, corporate stocks and bonds and money market funds.

The following summarizes the components of the Company's net periodic pension cost under the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions":

	Year Ended December 31,		
(dollars in millions)	**1993**	**1992**	**1991**
Service cost—benefits covered during the year	$ 5.5	$ 4.9	$ 4.4
Interest cost on projected benefit obligation	31.2	31.5	31.5
Actual return on plan assets	(40.1)	(17.6)	(86.9)
Net amortization and deferral	7.5	(16.1)	58.3
NET PERIODIC PENSION COST	$ 4.1	$ 2.7	$ 7.3

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The following summarizes the funded status and amounts recognized in the Company's balance sheets for the Pension Plan at December 31, 1993 and 1992:

	December 31,	
(dollars in millions)	**1993**	**1992**
Actuarial present value of benefit obligations		
Vested benefits	$ 366.0	$ 347.8
Non-vested benefits	7.8	4.7
ACCUMULATED BENEFIT OBLIGATION	$ 373.8	$ 352.5
Projected benefit obligation	420.8	405.3
Fair value of assets in plan	363.2	377.9
Projected benefit obligation in excess of plan assets	(57.6)	(27.4)
Unrecognized transition amount	(4.6)	(5.2)
Unrecognized gain or loss	20.7	4.1
Unrecognized prior service cost	4.8	5.3
NET PENSION LIABILITY INCLUDED IN BALANCE SHEET	$ (36.7)	$ (23.2)

The following summarizes the significant assumptions used in accounting for the Pension Plan:

	December 31,		
	1993	**1992**	**1991**
Weighted average discount rate	7.25%	8.0%	8.5%
Expected rate of increase in future compensation levels	6.0%	6.0%	6.0%
Weighted average expected long-term rate of return on plan assets	9.0%	9.0%	9.0%

Thrift Plan

The Company has established a defined contribution plan (the "Thrift Plan") as an individual account savings and investment plan for employees of the Company who are not subject to a collective bargaining agreement. Eligible participants may contribute a percentage of their compensation and the Company also contributes using a formula based on participant contributions.

Post-retirement Benefits Other Than Pensions

The Company sponsors several plans which provide health care and life insurance benefits to retirees who have met age and service requirements. The contribution rates that are paid by retirees are adjusted annually to offset increases in health care costs, if any, and fix the amounts payable by the Company. The life insurance plans provide life insurance benefits for certain retirees. The amount of life insurance is dependent upon length of service, employment dates, and several other factors, and increases in coverage beyond certain minimum levels are borne by the employee. Prior to January 1, 1993, the Company's policy was to expense and fund the cost of all retiree welfare benefits only as the benefits were payable. The Company charged to expense $24.4 million and $19.9 million in 1992 and 1991, respectively, for these benefits.

The Company adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions," effective January 1, 1993. The effect of adopting Statement No. 106 on net income and the net periodic benefit cost (expense) for 1993 was a charge to earnings of $168.5 million (less income taxes of $64.3 million) and an increase in expense of $0.9 million, respectively. The Company's policy continues to be to fund the cost of all retiree welfare benefits only as the benefits are payable. Accordingly, there are no plan assets.

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The following table summarizes the plan's accumulated post-retirement benefit obligation at December 31, 1993:

(dollars in millions)	Health Care	Life Insurance	Total
Retirees	$ 47.2	$ 107.7	$ 154.9
Fully eligible plan participants	10.9	7.7	18.6
ACCUMULATED POST-RETIREMENT BENEFIT OBLIGATION	$ 58.1	$ 115.4	173.5
Unrecognized net gain (loss)			(8.4)
Plan amendment			4.3
ACCRUED POST-RETIREMENT BENEFIT COST INCLUDED IN OTHER LIABILITIES			$ 169.4

As of December 31, 1993, the current portion of accrued post-retirement benefit cost was approximately $20.6 million and the long-term portion was approximately $148.8 million.

The net periodic post-retirement benefit costs for 1993 includes the following components:

(dollars in millions)	**1993**
Service cost	$ 0.7
Interest cost	12.7
NET PERIODIC POST-RETIREMENT BENEFIT COST	$ 13.4

For measurement purposes, the Company has not assumed an annual rate of increase in the per capita cost of covered benefits for future years, since the Company has limited its future contributions to current levels. The weighted average discount rate used in determining the benefit obligation was 7.25%.

1990–1994 Long-Term Earnings Growth Incentive Plan and Annual Incentive Compensation Plans

Certain officers of the Company participate in the 1990–1994 Long-Term Earnings Growth Incentive Plan of the Company. The 1992 and 1993 Incentive Compensation Plans covered all exempt employees of the Company. Based on the provisions of these plans, no amounts were charged to expense in 1993, 1992 or 1991.

Executive Compensation Plans

The Company has an employment agreement with its chief executive officer ("CEO") which provides for an annual base salary and provides that, if the Company achieves an operating ratio of 89.5% for 1994, 88.0% for 1995 or 85.0% for 1996, the CEO will receive 200,000 shares, 300,000 shares and 350,000 shares of common stock, respectively, as a stock bonus under the Company's Equity Incentive Plan. If the required operating ratio for any year is not achieved, the Compensation Committee of the Board of Directors may in its discretion award a portion of such shares.

The Compensation Committee has authorized the grant of stock bonuses covering up to 1,375,000 shares of common stock, in the aggregate, to 27 additional key executive employees of the Company in addition to the CEO, contingent upon the attainment of certain pre-established corporate financial and individual performance objectives based on many of the same criteria as the CEO's agreement. A portion of each stock bonus grant is subject to the achievement of such corporate financial and individual performance objectives during each of 1994, 1995, 1996 and 1997.

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13. Related Parties

The Company has maintained separate accountability for the operating activities of its principal railroad subsidiaries as to the sharing of freight revenues and charges for use of railroad equipment and joint facilities. Interline accounts receivable and payable continue to be settled through the traditional clearing process between railroads. The railroads are coordinating and, where considered appropriate, consolidating the marketing, administration, transportation and maintenance operations of the railroads.

The Company and TAC have engaged in a variety of transactions primarily related to administration and equipment owned and used by the companies for which amounts are billed to and from the Company and functions relating to the purchase of fuel and entering fuel futures contracts on behalf of the Company. Such transactions are based on the usage or services performed. In addition, the Company has entered into an arrangement with TAC whereby TAC administers the Company's mineral interests, including but not limited to oil and gas and hard mineral estates. The Company believes that the terms of these transactions are comparable to those that could be obtained from unaffiliated parties.

In January 1994, the Board of Directors of the Company approved the acquisition of an office building in Denver from family trusts in which Mr. Anschutz and certain members of his family have an interest. Following those approvals, the Company and the family trusts entered into an option agreement pursuant to which the Company has the option, exercisable at any time after March 1, 1994 and prior to December 31, 1994, to purchase the building for a price of $5.5 million plus an amount equal to 9½% per annum from March 1, 1994 to closing of the purchase. The purchase price represents a negotiated amount that would reimburse the sellers of the building for their purchase price for the building in 1991, the costs of improvements they have made to the building and expenses and carrying costs, plus a rate of return of approximately 10% per annum on such amounts. The terms of the agreement provide that the Company may exercise the option to purchase the building either for cash or for a three-year note, prepayable at any time without penalty, that bears interest at 9½% per annum. The Company has obtained an independent appraisal of the building pursuant to which the fair market value of the building was determined to be in excess of the option purchase price. The Company currently plans to exercise the option to purchase the building under the agreement.

14. Commitments and Contingencies

As a holding company, the Company is dependent upon the business activity and real estate sales of its subsidiaries to meet its consolidated debt obligations and to make payments to buy-out surplus employees and make capital expenditures expected to be required by the Company. In order to meet such obligations and to make such payments and capital expenditures, the Company must improve operating results and sell property, real estate and other assets with substantial values that are not necessary to its transportation operations.

The various debt agreements of SPT, RGH and SPTCH contain restrictions as to payment of dividends to the Company. SPT is permitted to make advances or dividends to its parent in order for certain specified interest and dividends to be paid by its parent. As of December 31, 1993, RGH is permitted to make aggregate dividend payments of approximately $21 million plus amounts relating to net gains on certain real estate sales, as defined.

On November 4, 1993, the Company and Integrated Systems Solutions Corporation ("ISSC"), a subsidiary of IBM, entered into a ten-year agreement under which ISSC will handle all of the Company's management information services ("MIS") functions. These include systems operations, application development and implementation of a disaster recovery plan. Pursuant to the agreement, the Company is obligated to pay annual base charges of between $45 million and $50 million (which covers, among other things, payments for MIS equipment) over a ten-year period, subject to adjustments for cost of living increases and variations in the levels of service provided under the agreement.

Inherent in the operations of the transportation and real estate business is the possibility that there may exist environmental conditions as a result of current and past operations which might be in violation of various federal and state laws relating to the protection of the environment. In certain instances, the Company has received notices of asserted violation of such laws and regulations and has taken or plans to take steps to address the problems cited or to contest the allegations of violation. The Company has recorded reserves to provide for environmental costs on certain operating and non-operating properties as a result of past operations. Environmental costs include site remediation and restoration on a site-by-site basis as well as costs for initial site surveys and environmental studies of potentially contaminated sites. The Company has made and will continue to make substantial expenditures relating to environmental conditions on its properties, including properties held for sale. In assessing its potential environmental liabilities, the Company typically causes ongoing examinations of newly identified sites and evaluations of existing clean-up efforts to be

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performed by environmental engineers. These assessments, which usually consider a combination of factors such as the engineering reports, site visits, area investigations and other steps, are reviewed periodically by counsel. Due to uncertainties as to various issues such as the required level of remediation and the extent of participation in clean-up efforts by others, the Company's total clean-up costs for environmental matters cannot be predicted with certainty. The Company has accrued reserves for environmental matters with respect to operating and non-operating properties not held for sale, as well as certain properties previously sold, based on the costs estimated to be incurred when such estimated amounts (or at least a minimum amount) can be reasonably determined based on information available. During the years ended December 31, 1993, 1992 and 1991, the Company recognized expenses of $24.2 million, $27.6 million and $94.1 million, respectively, related to environmental matters. At December 31, 1993 and 1992, the Company had accrued reserves for environmental contingencies of $62.3 million and $72.1 million, respectively, which includes $17.1 million and $20.0 million, respectively, in current liabilities. These reserves relate to estimated liabilities for operating and non-operating properties not held for sale and certain properties previously sold, and were exclusive of any significant future recoveries from insurance carriers. Based on the Company's assessments described above, other available information and the amounts of the Company's established reserves, management does not believe that disposition of environmental matters known to the Company will have a material adverse effect on the Company's financial position. However, there can be no assurance that material liabilities or costs related to environmental matters will not be incurred in the future.

A substantial portion of the Company's railroad employees are covered by collective bargaining agreements with national railway labor organizations that are organized along craft lines. These agreements are generally negotiated on a multi-employer basis, with the railroad industry represented by a bargaining committee. The culmination of various Presidential and legislative events in 1992 resulted in the Company negotiating most of its labor agreements separately. Certain of the completed agreements allowed the Company not to make lump sum payments previously accrued and to incur smaller wage increases in the future than other railroads. A substantial number of the labor agreements expire in 1995.

As a condition to its approval of the consolidation of Union Pacific, Missouri Pacific Railroad Company ("MP") and Western Pacific Railroad Company in 1982, the ICC awarded SSW trackage rights to operate over the MP lines between Kansas City and St. Louis. The ICC's initial decision did not fix the compensation SSW would pay for the trackage rights, which commenced in January 1983. After a series of hearings, the ICC set forth new principles to govern the computation of charges. Union Pacific has asserted a claim for additional amounts due against the Company of approximately $60 million (including interest) as of December 31, 1993 and has filed a collection action in Federal District Court. SPT has contested the amounts claimed. On December 6, 1993, the District Court dismissed Union Pacific's action without prejudice. Union Pacific has requested the District Court to reconsider and set aside its decision. Whether or not the Company's position is sustained, the amount owed Union Pacific will be substantial. Management has made provision that it believes to be adequate for this matter in current liabilities in its financial statements.

In July 1991, a derailment near Dunsmuir, California, occurred. While certain litigation continues and the total amount of damages and related costs cannot be determined at this time, SPT is insured against most types of damages and related costs involved with the Dunsmuir derailment to the extent that they exceed $10 million. As of December 31, 1993, SPT had paid approximately $44.7 million related to the Dunsmuir derailment, of which $12 million was charged to expense primarily to cover the $10 million deductible. The balance has been or is in the process of being collected from insurance carriers. As of December 31, 1993, approximately $24.9 million had been recovered by SPT from insurers. SPT expects to recover substantially all additional damages and costs under its insurance policies. As a result, disposition of these matters is not expected to have a material adverse effect on the Company's financial condition.

Although the Company has purchased insurance, the Company has retained certain risks with respect to losses for third-party liability and property claims. In addition, various claims, lawsuits and contingent liabilities are pending against the Company. Management has made provisions for these matters which it believes to be adequate. As a result, the ultimate disposition of these matters is not expected to have a material adverse effect on the Company's consolidated financial position.

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15. Supplemental Cash Flow Information

Supplemental cash flow information for the years ended December 31, 1993, 1992, and 1991 is as follows:

	December 31,		
(dollars in millions)	**1993**	**1992**	**1991**
CASH PAYMENTS (REFUNDS)			
Interest	$ 115.0	$ 124.5	$ 147.4
Income taxes	(0.5)	1.0	1.9
NONCASH TRANSACTIONS			
Sale of real estate for a note receivable	—	—	124.0
Purchase of locomotives	—	—	69.8
Capital lease obligations for railroad equipment	57.0	—	—

16 Quarterly Data (Unaudited)

(in millions, except per share amounts)	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
1993				
Operating revenues	$ 676.3	$ 745.7	$ 753.8	$ 742.8
Operating income	20.9	59.8	0.1	22.4
Other income (expense)	3.1	(4.1)	(41.2)	19.8
Net income (loss) (a)	(110.7)	10.4	(52.7)	3.9
Earnings per share:				
Primary:				
Before effect of change in accounting	$ (0.12)	$ 0.11	$ (0.54)	$ 0.03
Cumulative effect of change in accounting	$ (1.46)	—	—	—
TOTAL	$ (1.58)	$ 0.11	$ (0.54)	$ 0.03
Fully diluted:				
Before effect of change in accounting	$ (0.09)	$ 0.08	$ (0.47)	$ 0.03
Cumulative effect of change in accounting	$ (1.04)	—	—	—
TOTAL	$ (1.13)	$ 0.08	$ (0.47)	$ 0.03
1992				
Operating revenues	$ 708.1	$ 740.2	$ 718.5	$ 711.2
Operating income	10.8	42.2	30.7	25.2
Other income (expense)	3.1	(7.2)	(0.3)	94.6
Net income (loss)	(12.6)	(0.4)	(6.1)	52.2
Earnings per share:				
Primary	$ (0.21)	$ (0.04)	$ (0.12)	$ 0.70
Fully diluted	$ (0.15)	$ (0.03)	$ (0.08)	$ 0.50

(a) First quarter 1993 data includes an extraordinary charge of $104.2 million (net of taxes) for the change in accounting for post-retirement benefits other than pensions (FAS 106).

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17. Common Stock and Debt Transactions

The Company closed the offering and sale of 30,783,750 shares of common stock ($.001 par value per share) for $13.50 per share (before underwriting discounts and commissions and offering expenses) on August 17, 1993. Also on August 17, 1993, the Company issued and sold $375 million principal amount of 9⅜% Senior Notes due 2005 (See Note 6). The sources and uses of funds for these transactions are shown below:

(in millions)	**Amount**
SOURCES	
Gross proceeds from Common Stock Offering	$ 415.6
Gross proceeds from Senior Notes	375.0
TOTAL SOURCES	$ 790.6
USES	
Retire 12⅛% SPTCH Subordinated Debentures	210.0
Repay SPT Term Loan	169.0
Retire 13⅜% RGH Subordinated Notes	65.7
Retire 14⅜% RGH Subordinated Debentures	36.5
Purchase SPT equipment operated pursuant to operating leases	99.1
Redeem 12% SPRC Preferred Stock	75.0
Underwriting discounts, fees and expenses	33.5
General corporate purposes (including accrued dividends on preferred stock and interest on debt retired with proceeds)	101.8
TOTAL USES	$ 790.6

Prior to the public offerings of common stock and debt and because of existing uncertainties, the boards of directors of the Company, RGH and TAC approved termination of the tax allocation agreement among the companies and cancellation of the notes issued thereunder and of any claims by RGH against TAC or by TAC against RGH. Accordingly, and concurrent with the common stock and debt transactions, the Company cancelled the notes receivable from TAC totalling $9.7 million plus accrued interest of $2.2 million and terminated the tax allocation agreement.

On March 2, 1994, the Company closed the Offering for net proceeds of $503.7 million. The proceeds were used to repay the $117 million outstanding under the RGH credit facilities, to repay the $175 million outstanding under the SPT Credit Agreement and for general corporate purposes.

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SUPPLEMENTARY INFORMATION *(unaudited)*

The Company's common stock is listed on the New York Stock Exchange under the symbol "RSP." The common stock was listed in connection with its initial public offering completed in August 1993.

The following table sets forth the high and low reported last sale prices for the common stock for the calendar quarters indicated below as reported on the New York Stock Exchange Composite Tape:

	High	Low
1993		
Third Quarter (from August 10)	$ 16½	$ 15
Fourth Quarter	21¼	15½

At February 28, 1994, the closing price of the common stock on the New York Stock Exchange was $21.

As of February 28, 1994, there were approximately 457 record holders of the common stock.

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DIRECTORS OF SOUTHERN PACIFIC RAIL CORPORATION

PHILIP F. ANSCHUTZ ••
Chairman
Southern Pacific Rail Corporation
San Francisco, California
Director, Chairman of the Board and President
The Anschutz Corporation
Denver, Colorado

EDWARD L. MOYERS •
President and Chief Executive Officer
Southern Pacific Rail Corporation
San Francisco, California

ROBERT F. STARZEL •
Vice Chairman
Southern Pacific Rail Corporation
San Francisco, California

JORDAN L. HAINES •▲
Director and retired Chairman
Fourth Financial Corporation
Wichita, Kansas

DOUGLAS L. POLSON
Director and Vice President
The Anschutz Corporation
Denver, Colorado

FRANK V. SICA ••▲
Managing Director
Morgan Stanley & Co. Incorporated
New York, New York

- • Executive Committee
- • Compensation and Benefits Committee
- ▲ Audit Committee

OFFICERS OF SOUTHERN PACIFIC RAIL CORPORATION

PHILIP F. ANSCHUTZ
Chairman

EDWARD L. MOYERS
President and Chief Executive Officer

ROBERT F. STARZEL
Vice Chairman

CANNON Y. HARVEY
Senior Vice President—Finance and Law

LAWRENCE C. YARBERRY
Vice President—Finance

LYNN K. DUCKEN
Treasurer

BRIAN C. KANE
Controller

THOMAS F. O'DONNELL
Secretary

DIRECTORS OF SOUTHERN PACIFIC RAIL CORPORATION: *Seated (from left to right)—Edward L. Moyers, Philip F. Anschutz. Standing (from left to right)—Douglas L. Polson, Frank V. Sica, Jordan L. Haines, Robert F. Starzel.*

EXECUTIVE OFFICERS OF SOUTHERN PACIFIC LINES

EDWARD L. MOYERS
Chairman, President and Chief Executive Officer

ROBERT F. STARZEL
Vice Chairman

DONALD C. ORRIS
Executive Vice President—Distribution Services

CANNON Y. HARVEY
Vice President and General Counsel

THOMAS J. MATTHEWS
Vice President—Administration

GLENN P. MICHAEL
Vice President—Operations

LAWRENCE C. YARBERRY
Vice President—Finance

HENRY M. CHIDGEY
Vice President and Chief Mechanical Officer

MICHAEL D. ONGERTH
Vice President—Strategic Development

EUGENE P. REILLY
Vice President and Chief Engineer

S. DAVID STEEL
Vice President—Real Estate Sales/Development

W. KENT STERETT
Vice President—Quality

LYNN K. DUCKEN
Treasurer

BRIAN C. KANE
Controller

THOMAS F. O'DONNELL
Secretary

CORPORATE INFORMATION

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INDEPENDENT AUDITORS
KPMG Peat Marwick
San Francisco, California

ANNUAL MEETING
The annual meeting of stockholders will be held at the Hyatt Regency, Five Embarcadero Center, San Francisco, California on Wednesday, April 27, 1994, at 10:00 a.m.

FORM 10-K
The Form 10-K annual report will be available to stockholders free of charge upon written request to the Director of Investor Relations at his above address.

Southern Pacific Rail Corporation
One Market Plaza
San Francisco, CA 94105
(415) 541-1000


SP
Southern Pacific Rail Corporation
1994 Annual Report

Corporate Profile

Southern Pacific Rail Corporation, through the integrated railroad network of its principal subsidiaries, transports freight in the Western and Southwestern United States. The Company's five main routes cover 15 states with approximately 14,500 miles of first main track.

Southern Pacific rail lines serve an historic and unparalleled franchise that stretches along more than 1,000 miles of the Pacific Coast and reaches east to the Great Lakes and the Gulf Coast. Southern Pacific and its predecessor lines have been in continuous operation for more than 140 years, and have served Mexico for well over 100 years. The Company today has six gateways into Mexico, more than any other U.S. railroad.

Southern Pacific pioneered the linkage of shipping companies and rail lines known as intermodal transport, and remains the leader in the fast-growing U.S. intermodal market. The Company's Intermodal Container Transfer Facility (ICTF) in Southern California is the nation's largest international container yard.

Since returning to public ownership in 1993, Southern Pacific has moved aggressively to modernize its facilities and consolidate operations so that it can provide more efficient and responsive service to its customers. The Company's current program to upgrade its locomotive fleet is the largest such investment in its history.

Southern Pacific is serving its unparalleled franchise with increasing efficiency, to take advantage of growing commercial opportunities.

Contents

Financial Highlights

Year ended December 31, Dollars in millions except ratios and per-share data	1994	1993
Operating revenues	$3,142.6	$2,918.6
Operating income	$345.7	$103.2
Net income (loss)*	$247.8	($44.9)
Operating ratio	89.0%	96.5%
Debt to capitalization ratio	53%	78%
Earnings (Loss) per common share*	$1.63	($.46)

*Before cumulative effect of change in accounting

Jerry R. Davis

President and

Chief Executive Officer

I am pleased to address you as the new Chief Executive Officer of Southern Pacific Rail Corporation, and to report on the actions we are taking to improve both customer service and shareholder value.

In 1994 Southern Pacific set new records for earnings, gross freight revenues, and total carload volume. At the same time the Company made great strides in rebuilding its locomotive fleet and consolidating operations to better serve its customers.

During 1994 the Company substantially improved its liquidity and debt-to-capitalization ratio. As a result of improved operating results, the sale of the Alameda Corridor in Los Angeles for $235 million, and $504 million of new equity capital, SP significantly reduced its debt. This included the year-end call of $290 million in high-cost debentures. As a result, the Company's debt-to-capitalization ratio, which stood at 94% on December 31, 1992, was reduced to 53% at the end of 1994.

Total freight volume rose by more than 195,000 carloads to—2,273,600 carloads—the highest level in SP history.

Gross freight revenues rose 10.7% to nearly $3.25 billion. In some months of 1994 volume was as much as 14% higher than in the same month of 1993; but by putting the right people in the right place, SP met the challenge. In fact, the Company increased its revenue per employee in 1994 by more than 22%.

Another major accomplishment, one that sets the stage for future growth, was the purchase or heavy overhaul of more than 500 locomotives, roughly a quarter of the current fleet. All of the 133 new locomotives purchased during 1994 are 4000- or 4400-horsepower engines. In addition, during 1995 we will take delivery of 203 new 4400-horsepower and three new 6000-horsepower AC locomotives. As a result of this ongoing program, more units are available to serve customers. For example, as a result of improved maintenance and new power, the percentage of locomotives out of service was cut from 18% in 1992 to less than 10% at the end of 1994. In 1994 the percentage of time that locomotives were actually pulling trains rose from 42% to better than 50%.

By successfully handling higher traffic volumes with greater efficiency, Southern Pacific strongly improved earnings compared to previous years. For the year, SP earned net income of $247.8 million on operating revenues of $3.14 billion, compared to a net loss ($44.9 million) in 1993 on operating revenues of $2.9 billion (results for both years excluding the cumulative effects of changes in accounting). Operating income for the year increased by 235% to $345.7 million, compared to 1993 operating income of $103.2 million. As a result, the Company's operating ratio improved a full seven and a half points, from 96.5% in 1993 to 89.0% for 1994.

During the fourth quarter, a cross-functional team of 30 senior managers was formed to work full-time on a single mandate: improving our service. The service improvement team began achieving measurable results well before the year's end, and it is now a permanent part of SP's service improvement plan. We believe, in particular, that SP's intensified focus on scheduled operations is fundamental to the Company's goal of improving customer service and increasing shareholder value, and we are committed to doing whatever it takes to achieve that objective.

Franchise Strength

Southern Pacific has a unique business franchise. As you can see from the route map on page 12, SP reaches from the Pacific Coast across the Rockies and the Southwest to meet river barges, trucks, and major eastern railroads at Chicago, St. Louis, Memphis, and New Orleans. Since the beginning of the century, business and industry of all kinds have developed along SP routes. In 1994, the Company's unmatched route structure was a major reason that it achieved a higher percentage of volume increase than any other Class I railroad.

Intermodal volume, representing approximately 26% of 1994 gross freight revenues, grew 16.4% for the

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year. SP's leadership in the U.S. intermodal business is based in part on our advantageous geographic position on the Pacific Rim, and on our Intermodal Container Transfer Facility (ICTF) serving the ports of Los Angeles and Long Beach. The ICTF, located four miles from the ports, handled 13.8% more container lifts last year compared to 1993 and remains the nation's busiest international container facility. The ICTF's sister facilities in Southern California, in the City of Industry and at the Los Angeles Transportation Center, also increased their carloadings as the U.S. trucking industry continued its conversion to intermodal transport.

Another key growth area for SP is in coal from Colorado and Utah. Demand for this high-BTU, low-sulfur coal has soared as utilities switch to it in order to meet progressively higher environmental standards under the Clean Air Act. SP offers unique access to the coal mines of Colorado and Utah, and as a result SP's coal revenues for the year increased 21.9% compared to 1993.

To further leverage this opportunity, SP is loading many of its Utah and Colorado coal trains in both directions. Trains that carry iron ore from the midwest to Geneva Steel, one of our large customers in Utah, are reloaded with coal for eastern and midwestern utilities. In addition to doubling the utilization of those trains, this program helped SP identify customers with demand for millions of additional tons of coal.

The 1994 growth in transport of metals and ores is attributable to SP's unique access to Arizona mines that produce a large portion of the nation's copper. As in Southern California, SP combines advantageous geographic franchise with superior facilities for serving customer needs. SP operates the largest fleet of equipment dedicated to the copper industry, enabling the Company to earn seven times as much revenue from copper as any other western railroad.

In yet another example of a commercial growth opportunity that arises from the geographic franchise, SP in 1994 recorded double-digit growth in volume to and from Mexico. With six gateways into Mexico ranged along the U.S. border from California to Texas, SP is well positioned to benefit from growing U.S. trade with Mexico.

Looking Ahead

Looking ahead through 1995, we expect to build on the momentum we achieved in 1994 and continue to improve our operations. Our franchise is strong, and we will continue to utilize it efficiently to achieve higher levels of customer satisfaction. In particular, we expect continued growth in transportation of intermodal containers and in coal volume. Although the rate of growth of shipments to and from Mexico may slow due to current economic uncertainties, we are excited about the positive, longer-term prospects for our Mexico business.

Our outlook is based strongly on the fact that SP is giving its people the tools and infrastructure they need to succeed. In 1995, the upgraded locomotive fleet will include 357 new and 133 remanufactured locomotives

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and 647 locomotives that have received heavy overhauls. These totals include 206 new high horsepower AC traction units from General Electric, giving us the latest technology in train-pulling power. We will continue to bring other forms of advanced technology to bear on our operations as well, from automatic equipment identification scanners along our tracks to hand-held computers used on trains and in yards.

SP is continually improving track capacity, which in turn improves transit times. Both the Company's high-growth routes between California and New Orleans and between California and Chicago, for example, pass through a congested area in Arizona. We are double-tracking key segments in this area to relieve congestion and improve on-time performance. To minimize costs, we are recycling materials from lower-volume routes with unnecessary double tracks. We also are increasing tunnel clearances on the I-5 Corridor between Southern California and Portland, Oregon, to accommodate doublestack container trains.

During 1994 SP completed a consolidation of train dispatching and crew-calling functions from three widespread locations, in California, Texas, and Colorado, to a single location, in Denver. This is just one example of the many steps being taken to increase efficiency and teamwork among departments.

All these programs and efforts depend, in the final analysis, on the people who execute them. It is a measure of the dedication of the people of SP that they have stepped up to the challenge of moving more freight than ever while simultaneously reducing the rail workforce by a total of nearly 5,000 in two years—to 17,785 at the end of 1994.

In discussing the people of Southern Pacific, I especially wish to thank all of the people here who have contributed so much over the last five years to bring about the changes that led directly to Southern Pacific's successes in 1994. I also specifically would like to thank my predecessor, Mr. Edward L. Moyers, for his contributions to the Company. On behalf of everyone at the Company and others who have worked with Ed Moyers during his long railroad career, I wish him well in his retirement.

Since joining Southern Pacific, I have been impressed with the quality and commitment of the Company's management team and operating personnel. I am excited with the possibilities presented by SP's impressive franchise. In the coming year we intend to build on the gains of the past, with a particular emphasis on service improvement. We are committed to providing the service product that our customers demand, and to creating shareholder value for you, our investors.

SINCERELY,

Jerry R. Davis

JERRY R. DAVIS

PRESIDENT AND CHIEF EXECUTIVE OFFICER
MARCH 10, 1995

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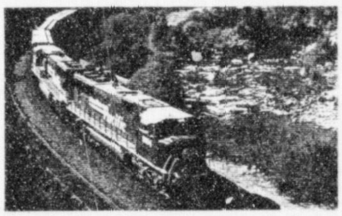
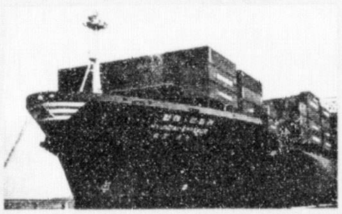
Southern Pacific's route structure serves the nation's two most populous states, the fast-growing American Southwest, the Pacific Rim through access to the nation's top two ports, and more gateways into Mexico than any other U.S. railroad.

The petrochemical industry along the Gulf Coast. The rich coal and copper mines of Arizona, Colorado, and Utah. The forests of the Pacific Northwest. The nation's railroad hub in Chicago, plus connections to eastern railroads at St. Louis, Memphis, and New Orleans. This is the Southern Pacific, covering 15 states with 14,500 miles of first main track.

SP also reaches the world through the nation's top two international container ports, the country's largest intermodal container facility, and six gateways into Mexico.



SP's I-5 CORRIDOR COVERS MORE OF CALIFORNIA THAN ANY OTHER RAILROAD LINE.



SP LEADS ALL U.S. RAILROADS IN INTERMODAL CONTAINER TRAFFIC.

This unparalleled franchise puts SP where the growth is, whether it's in coal or chemicals, cars or containers, metals or construction materials, food or forest products.

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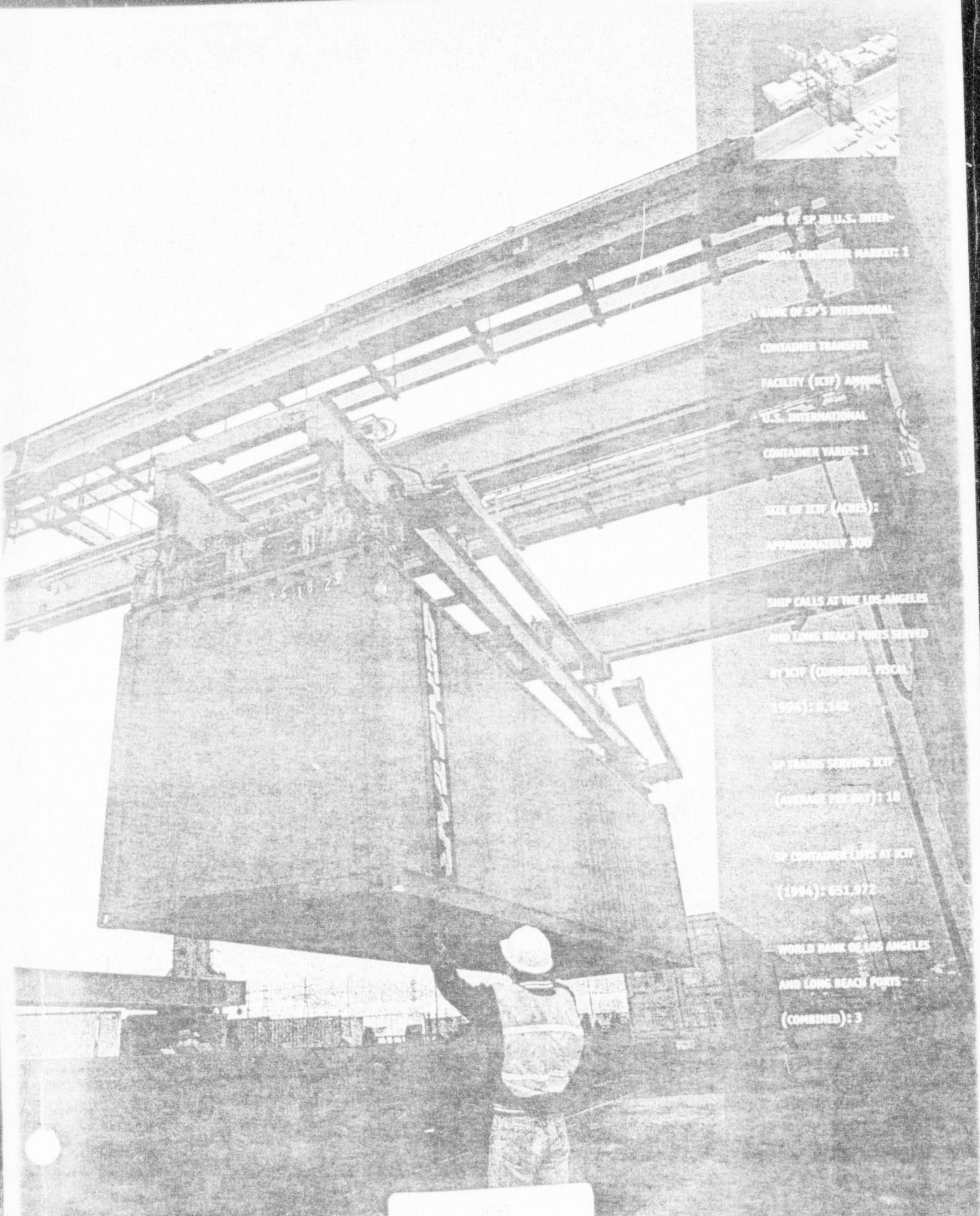
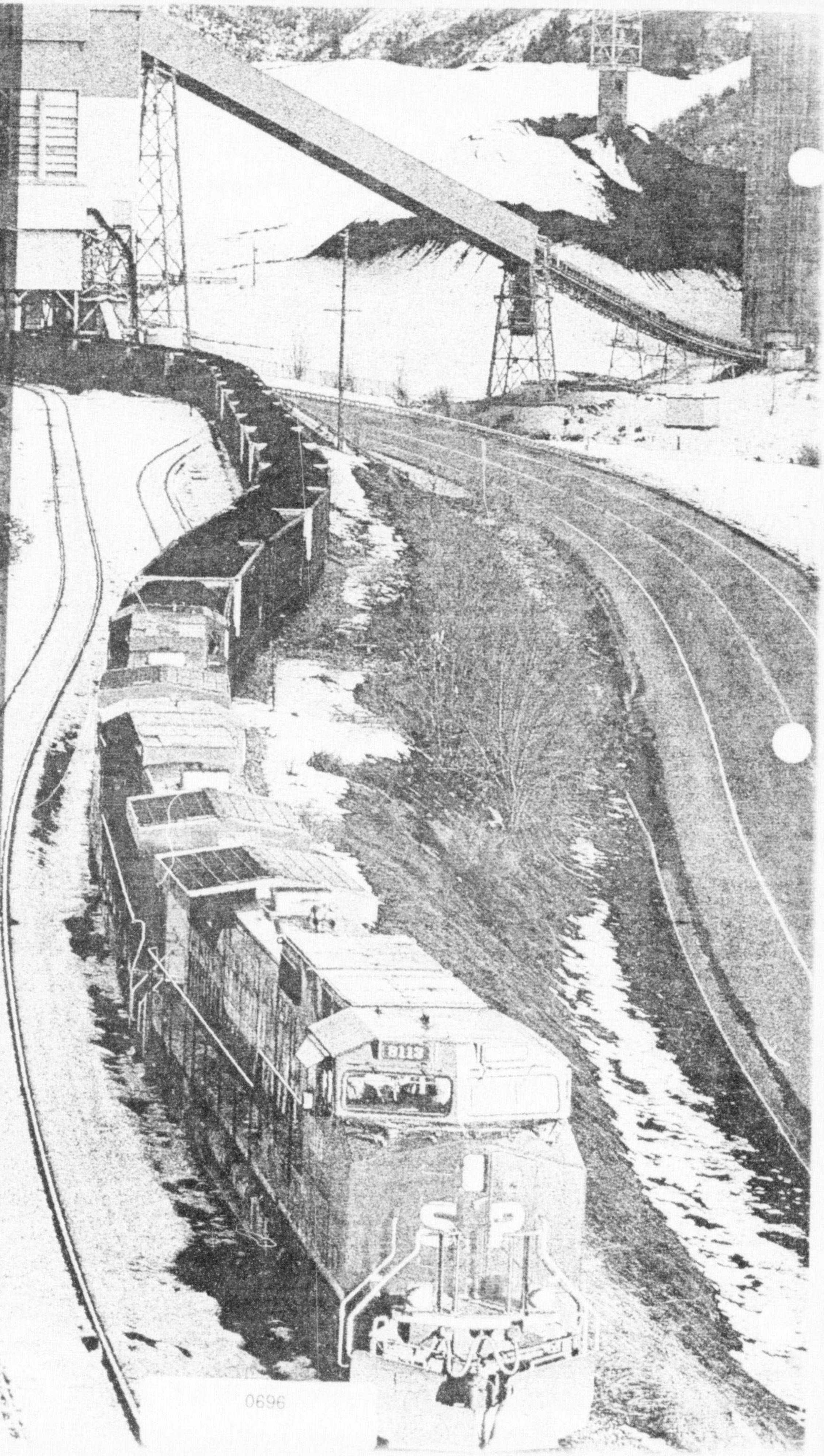
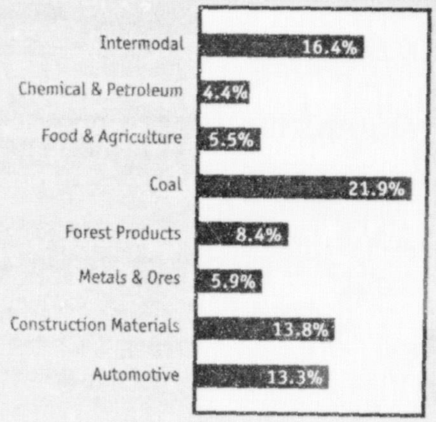

RANK OF SP IN U.S. INTER-
MODAL-CONTAINER MARKET: 1
RANK OF SP'S INTERMODAL
CONTAINER TRANSFER
FACILITY (ICTF) AMONG
U.S. INTERNATIONAL
CONTAINER YARDS: 1
SIZE OF ICTF (ACRES):
APPROXIMATELY 300
SHIP CALLS AT THE LOS ANGELES
AND LONG BEACH PORTS SERVED
BY ICTF (COMBINED, FISCAL
1994): 8,142
SP TRAINS SERVING ICTF
(AVERAGE PER DAY): 18
SP CONTAINER LIFTS AT ICTF
(1994): 651,972
WORLD RANK OF LOS ANGELES
AND LONG BEACH PORTS
(COMBINED): 3



IT WAS A MAJOR ACCOMPLISHMENT FOR 1994 OR ANY YEAR: INCREASING THE UTILIZATION OF EASTBOUND TRAINS CARRYING LOW-SULFUR UTAH AND COLORADO COAL TO MIDWESTERN UTILITIES AND MANUFACTURERS. MANY OF THE SAME TRAINS ARE RELOADED WITH IRON ORE FROM MINNESOTA FOR SHIPMENT TO A STEEL MILL IN UTAH. INSTEAD OF RETURNING EMPTY THIS BACK-HAUL HELPS SP RAISE REVENUES, INCREASE EQUIPMENT UTILIZATION, SATISFY CUSTOMERS, AND EXTEND ITS REACH TO PROFITABLE NEW MARKETS.

REVENUES INCREASED ACROSS THE BOARD
(increases in gross freight revenues by commodity 1994)



SP'S INTERMODAL LEADERSHIP MAKES IT A KEY FACILITATOR OF U.S. TRADE WITH THE PACIFIC RIM.

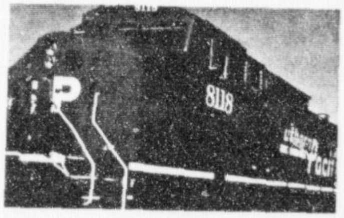
Southern Pacific in 1994 maintained its leadership in U.S. container transport, enabling it to increase intermodal revenues by 16%. SP also grew coal revenues by 22% because of its unique access to high-demand, clean-burning coal in Colorado and Utah; increased revenues in metals and ores due in part to its ability to serve the Arizona copper mines; and achieved solid growth in forest products and chemical and petroleum products. Passage of trade accords such as GATT and NAFTA increases the strength of SP's position on the Pacific Rim and along the U.S. border with Mexico. SP's growing truck/train intermodal business demonstrates its ability to capitalize on the continued shift by U.S. long-haul commercial transport from roads to rails.

SP's strong and unique franchise gives the Company expanding commercial opportunities in intermodal service, in moving raw materials for energy and manufacturing, and in trade with Mexico and the fast-growing economies of the Pacific Rim.

SP is increasing efficiency throughout its operations, enabling the railroad to continue its financial success and lay a firm foundation for improved customer service.

SP is rapidly building the most powerful, fuel-efficient locomotive fleet in its history. Beginning in 1993 through 1995 SP will have purchased more than 490 new or remanufactured locomotives and performed heavy overhauls or rebuilds on nearly 650 engines. SP also repairs 95% of "bad order" railcars within 24 hours and has cut to a new low the number of "slow order" track miles on its main line. To speed trains along its high-growth Sunset Corridor, SP is double-tracking line segments in Arizona and New Mexico using materials from low-volume double-track lines on other corridors. To accelerate its shift to scheduled operations, the Company consolidated its dispatch functions from three sites to one: the Transportation Service Center in Denver, Colorado. SP is also continuing to apply leading-edge information technology on its trains, along its track, and in its yards. These new tools are making SP more efficient and its employees even more productive.

SP IS RECYCLING TRACKS AND TIES TO ADDRESS VOLUME GROWTH IN THE SOUTHWEST.



MORE THAN 100 NEW 4400-HP LOCOMOTIVES JOINED THE SP FLEET IN 1994.

THE REMAKING OF A LOCOMOTIVE FLEET
KEY STATISTICS FOR 1994

- NEW & REMANUFACTURED: ↑248
- REBUILT/HEAVY OVERHAULED: ↑274
- TOTAL ROAD FLEET, YEAR END: →2064
- TIME PULLING TRAINS: ↑8%
- LOCOMOTIVES OUT OF SERVICE: ↓10%
- AVERAGE AGE: ↓12%

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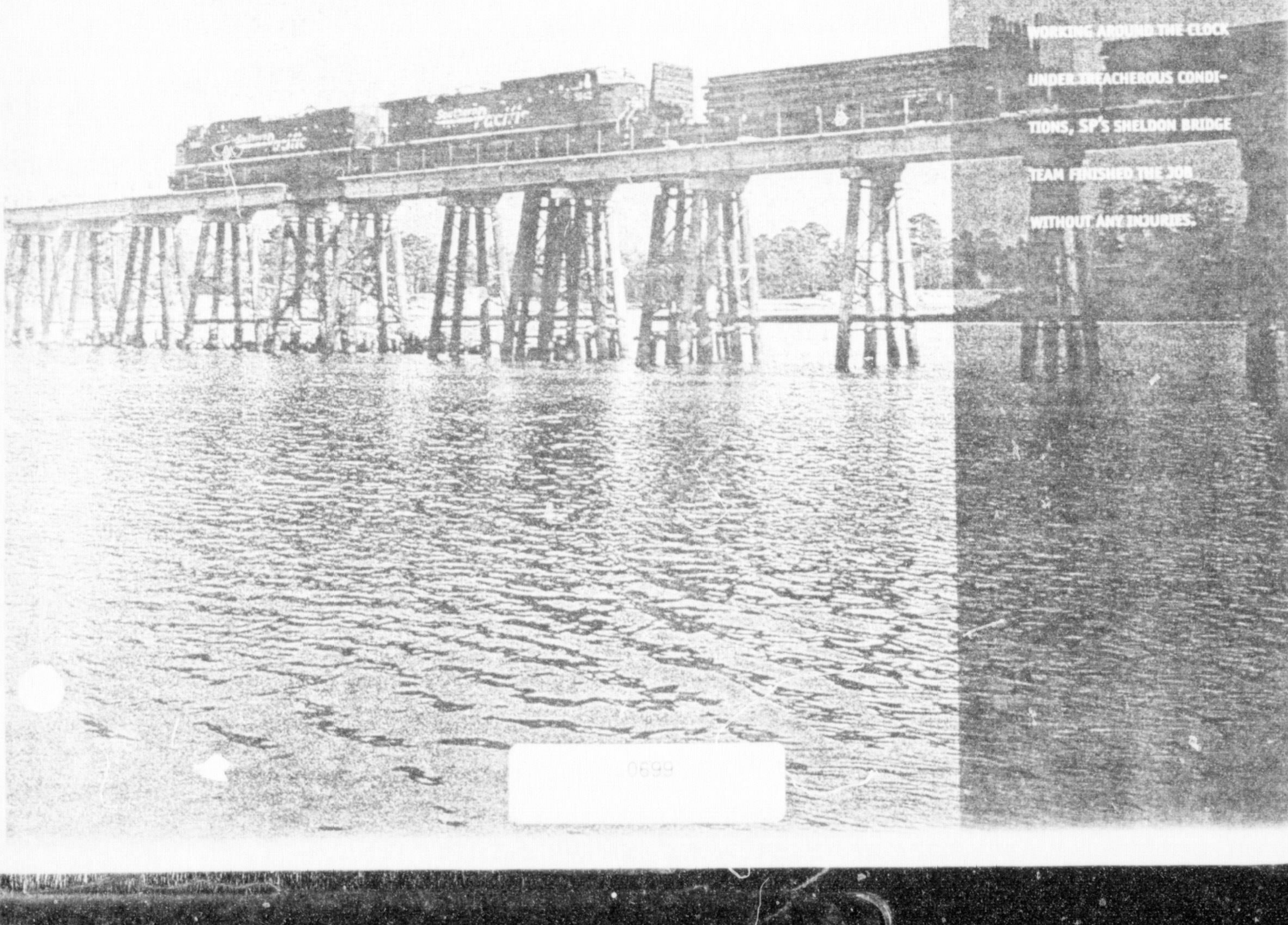
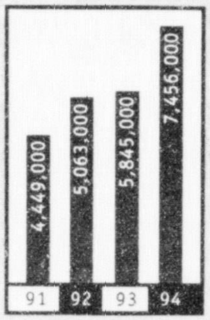
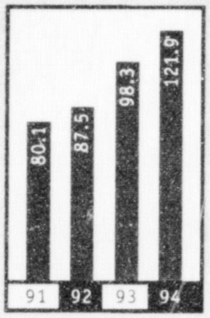
ON OCTOBER 18TH, 1994, THE STORM-SWOLLEN SAN JACINTO RIVER NEAR HOUSTON, TEXAS [illegible] TO REBUILD AND REOPEN THE BRIDGE LESS THAN THREE WEEKS LATER, RETURNING MORE THAN 20 TRAINS A DAY TO ONE OF SP'S BUSY MAIN LINES. DESPITE WORKING AROUND THE CLOCK UNDER TREACHEROUS CONDITIONS, SP'S SHELDON BRIDGE TEAM FINISHED THE JOB WITHOUT ANY INJURIES.





REVENUE TON-MILES
PER EMPLOYEE



CARLOADINGS
PER EMPLOYEE

Intermodal

Chemical and petroleum products

Food and agricultural products

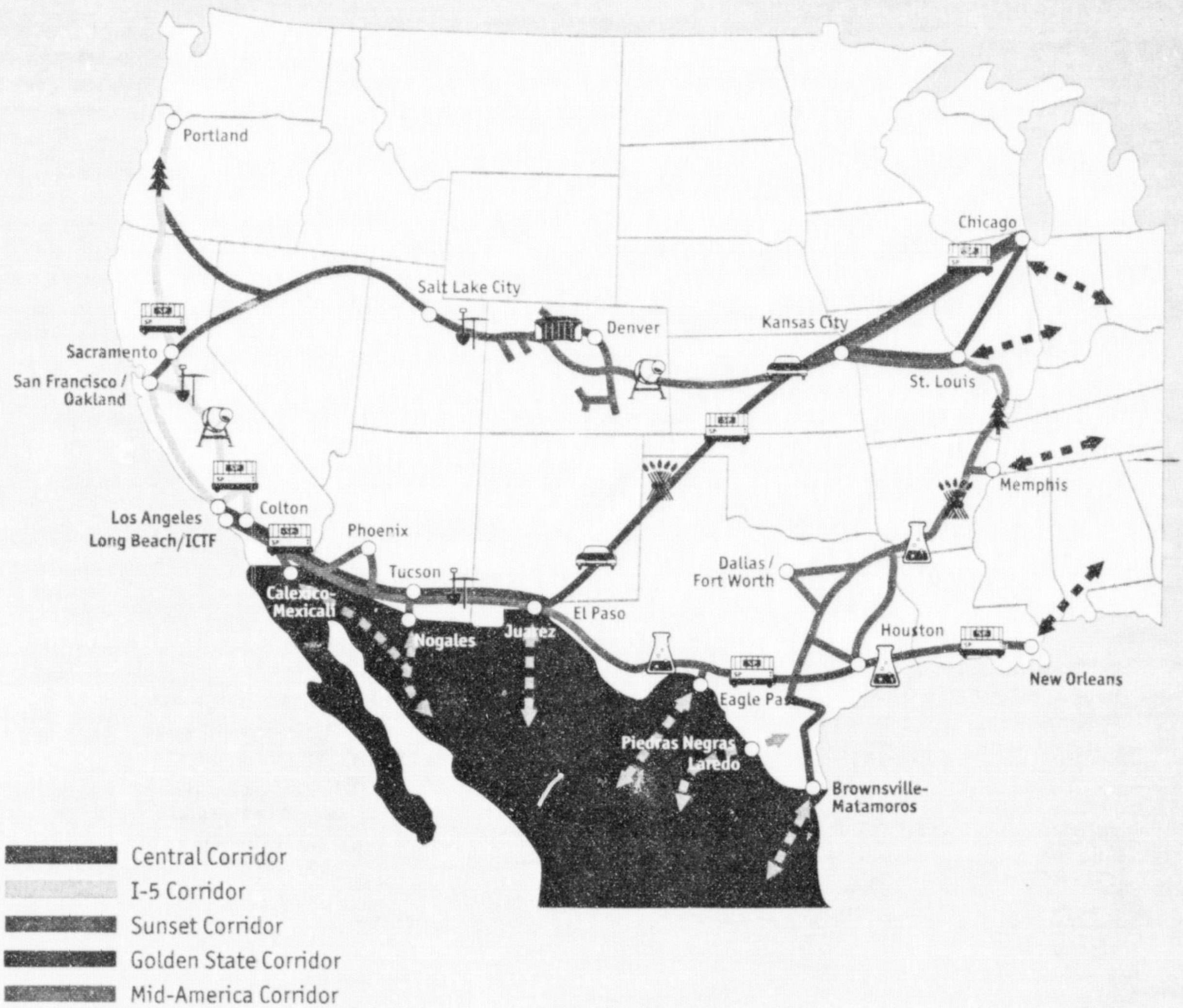
Coal

Forest products

Metals and ores

Construction materials and minerals

Automobiles



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Financial Information

The following selected consolidated financial data relating to the Company have been taken or derived from the Consolidated Financial Statements of the Company and other records of the Company. The Consolidated Statements of Operations and Changes in Stockholders' Equity (Deficit) and Statements of Cash Flows for each of the Company's fiscal years ended December 31, 1994, 1993, 1992, 1991 and 1990 and the Balance Sheets as of December 31, 1994, 1993, 1992, 1991 and 1990 have been audited by KPMG Peat Marwick LLP, independent certified public accountants. The selected financial data should be read in conjunction with the Consolidated Financial Statements and related notes and other financial information included elsewhere herein.

	Year Ended December 31,				
(dollars in millions, except as indicated)	1994	1993	1992	1991	1990
STATEMENT OF OPERATIONS DATA					
Operating revenues	$ 3,142.6	$ 2,918.6	$ 2,878.0	$ 2,785.6	$ 2,822.1
Operating expenses	2,796.9	2,815.4	2,769.1	2,694.1	2,678.1
Special charge (a)	—	—	—	259.9	—
Operating income (loss)	345.7	103.2	108.9	(168.4)	144.0
Other income (expense)(b)	221.0	(22.4)	90.2	37.2	65.8
Interest expense	158.2	156.0	143.3	152.0	183.0
Income (loss) before income taxes and cumulative effect of change in accounting charge/extraordinary item	408.5	(75.2)	55.8	(283.2)	26.8
Income tax expense (benefit)	160.7	(30.3)	22.7	(107.5)	9.9
Cumulative effect of change in accounting charge/extraordinary item (c)	(6.0)	(104.2)	—	—	12.8
NET INCOME (LOSS)	$ 241.8	$ (149.1)	$ 33.1	$ (175.7)	$ 29.7
Preferred dividends	$ —	$ 5.8	$ 9.0	$ 9.0	$ 9.0
Net income (loss) available to common stock	241.8	(154.9)	24.1	(184.7)	(33.7)(d)
PER SHARE DATA(d)					
Net income (loss) before cumulative effect of change in accounting charge/extraordinary item (dollars)	$ 1.63	$ (0.46)	$ 0.24	$ (1.85)	$ (0.47)
Net income (loss) (dollars)	1.59	(1.39)	0.24	(1.85)	(0.34)
Weighted average shares outstanding (thousands)	151,648	111,544	100,000	100,000	100,000
OTHER DATA					
Depreciation and amortization	$ 139.8	$ 133.2	$ 138.9	$ 124.9	$ 108.6
Capital expenditures (e)	300.5	311.2	340.7	305.1	387.8
BALANCE SHEET DATA AS OF PERIOD END					
Cash and short-term investments	$ 240.6	$ 65.5	$ 61.3	$ 52.8	$ 88.9
Total assets	4,152.1	3,434.0	3,204.5	3,355.0	3,650.7
Long-term debt (including current maturities)	1,148.8	1,475.0	1,329.0	1,411.2	1,591.0
Redeemable preference shares of a subsidiary (including current portion)	22.6	23.0	23.9	24.6	25.2
Preferred stock	—	—	75.0	75.0	75.0
Stockholders' equity (deficit) before common stock subject to repurchase	1,058.7	312.5	88.6	64.6	256.3
Stockholders' equity (deficit)	1,058.7	312.5	(76.9)	(100.9)	90.8(d)

(continued)

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The following discussion should be read in connection with the Consolidated Financial Statements, related Notes and other financial information included elsewhere herein.

Results of Operations

YEAR ENDED DECEMBER 31, 1994 COMPARED TO YEAR ENDED DECEMBER 31, 1993

The Company had net income of $241.8 million for 1994 (including a $6.0 million charge for the cumulative effect of a change in accounting for post-employment benefits under Statement of Financial Accounting Standards ("FAS") No. 112 adopted by the Company effective January 1, 1994) compared to a net loss of $149.1 million for 1993 (including a $104.2 million charge for the cumulative effect of a change in accounting for post-retirement benefits other than pensions under FAS No. 106 adopted by the Company effective January 1, 1993). The Company had operating income of $345.7 million for 1994 compared to $103.2 million for 1993. Operating income for 1993 was adversely affected by severe weather and flooding in certain western and midwestern states during the year, a significant decline in automotive shipments, a shortage of power due to a temporary reduction in the number of locomotives leased by the Company and a slower than anticipated recovery in certain segments of the economy. Operating income for 1994 showed the effects of substantial increases in traffic volume due to improvements in the economy and to the Company's programs to increase productivity.

Operating Revenues

In 1994, railroad operating revenues increased $218.7 million compared to 1993. Railroad freight operating revenues increased $206.8 million. Shipments of all commodities increased, with the most significant percentage increases occurring in intermodal, coal, construction materials and minerals, and automobiles. Other railroad revenues increased $11.9 million due primarily to increases in switching and demurrage revenue associated with increased traffic volume. For 1994, carloads increased 9.4% and revenue ton-miles increased 12.5% compared to 1993. The average net freight revenue per ton-mile for 1994 declined by 4.5% compared to 1993 due principally to an increase in traffic volume for commodities that generated lower revenue per ton-mile (e.g., coal and intermodal traffic), as well as to increases in revenue deductions and allowances that resulted in lower net freight revenue per ton-mile and carload.

The following table compares traffic volume (in carloads), gross freight revenue (before contract allowances and adjustments) and gross freight revenue per carload by commodity group for 1994 compared to 1993.

CARLOAD AND GROSS FREIGHT REVENUE COMPARISON

Years Ended December 31, 1994 and 1993

	Carloads			Gross Freight Revenues			Gross Freight Revenue Per Carload		
	1994	1993	% Change	1994	1993	% Change	1994	1993	% Change
	(in thousands)			(dollars in millions)			(dollars)		
Intermodal	728.1	607.6	19.8%	$ 851.9	$ 731.9	16.4%	$ 1,170	$ 1,205	(2.9)%
Chemical and petroleum products	342.7	344.2	(0.4)	614.9	589.2	4.4	1,794	1,712	4.8
Coal	303.2	263.4	15.1	299.3	245.6	21.9	987	932	5.9
Food and agricultural products	247.0	249.0	(0.8)	414.7	392.9	5.5	1,679	1,578	6.4
Forest products	226.2	221.4	2.2	432.0	398.4	8.4	1,910	1,799	6.2
Metals and ores	181.5	173.5	4.6	275.3	259.9	5.9	1,517	1,498	1.3
Construction materials and minerals	171.5	153.6	11.7	172.0	151.2	13.8	1,003	984	1.9
Automotive	73.4	65.1	12.7	188.7	166.6	13.3	2,571	2,562	0.4
TOTAL	2,273.6	2,077.8	9.4%	$ 3,248.8	$ 2,935.7	10.7%	$ 1,429	$ 1,413	1.1%

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(continued)

(dollars in millions, except as indicated)	Year Ended December 31, 1994	1993	1992	1991	1990
OPERATING DATA					
Total employees (at period end)	18,010	18,982	22,793	23,396	23,814
Total carloads (thousands)(f)	2,273.6	2,077.8	1,994.9	1,873.4	1,876.2
Route miles (period end)(g)	14,559	14,829	15,134	15,941	16,337
Revenue ton-miles (billions)(h)	139.1	123.6	115.4	104.1	101.6
Revenue per ton-mile (dollars)(i)	$ .021	$ .022	$ .023	$ .025	$ .026
Fuel consumption (millions of gallons)	436.0	408.9	390.3	360.2	354.5
Average fuel price per gallon (dollars)	$ .58	$ .62	$ .61	$ .63	$ .71
Revenue ton-miles per employee (thousands)(j)	7,456	5,845	5,063	4,449	4,266
Carloads per employee (j)	121.9	98.3	87.5	80.1	78.8
Revenues per employee (dollars in thousands)(j)	$ 168.4	$ 138.0	$ 126.3	$ 119.1	$ 118.5
Operating ratio (k)	89.0%	96.5%	96.2%	106.0%(a)	94.9%

(a) The special charge in 1991 consisted primarily of accruals for labor, environmental and legal costs. Excluding the special charge, operating income would have been $91.5 million, the operating ratio would have been 96.7%, net income (loss) would have been $(14.5) million and net income (loss) per share would have been $(0.24) for the year ended December 31, 1991.

(b) Consists primarily of gains from sales of transit corridors and other real estate assets and non-operating expenses. The 1994 amount also includes the write-off of deferred loan costs and early repayment premiums associated with the retirement of the $290 million Senior Secured Notes in December 1994. The 1993 amount includes the write-off of deferred loan costs and early repayment premiums associated with the retirement of certain indebtedness following the initial public offering and sale of 30,783,750 shares of common stock (the "IPO") and the issuance and sale of Senior Notes (the "Debt Offering") completed by the Company in August 1993.

(c) Includes the effects in 1994 of a $9.8 million pre-tax accrual of post-employment benefit costs pursuant to Statement of Financial Accounting Standards No. 112, the effects in 1993 of a $168.5 million pre-tax accrual of retiree health and welfare benefit costs pursuant to Statement of Financial Accounting Standards No. 106 and in 1990 a $12.8 million after-tax extraordinary gain. See "Financial Review."

(d) Prior to the consummation of the IPO, certain shares of the common stock were subject to repurchase at the option of the holders thereof. In 1990, the carrying value of common stock subject to repurchase increased $54.4 million which reduced both net income available to common stock and stockholders' equity (deficit). All shares of common stock formerly subject to repurchase are included in weighted average shares outstanding. See Note 8 to the Consolidated Financial Statements. The Company's commitment to repurchase common stock terminated upon completion of the IPO.

(e) Capital expenditures exclude capital leases. In addition, for purposes of this table and the Company's Consolidated Statement of Cash Flows included elsewhere herein, capital expenditures include railroad and non-railroad related expenditures, and, in 1993, expenditures for equipment, previously operated by the Company under operating leases, that was purchased with a portion of the proceeds of the IPO and the Debt Offering.

(f) Includes intermodal carloads and assumes two containers per intermodal carload.

(g) Route miles include first main track owned (including track leased to third parties) and trackage rights over lines owned by other railroads.

(h) Revenue ton-miles equal the product of the weight in tons of freight carried for hire and the distance in miles between origin and destination.

(i) Revenue per ton-mile equals net freight revenue divided by revenue ton-miles of freight traffic.

(j) For fiscal years 1990 through 1992, revenue ton-miles per employee, carloads per employee, and revenues per employee have been calculated on the basis of the number of employees at the end of each such period. However, the Company reduced the number of its employees from 22,793 at December 31, 1992 to 18,982 at December 31, 1993 and to 18,010 at December 31, 1994. Because of these substantial reductions in employees during 1994 and 1993, the Company does not believe that calculating these statistics on the basis of the number of employees at year end for these two years would accurately reflect the actual per employee data for 1994 and 1993. Accordingly, for 1994 and 1993 these data have been computed on the basis of the average number of employees during the year, which in turn was calculated as the arithmetic average of the number of employees at the end of each of the 12 months in each of those years.

(k) Operating ratio represents consolidated operating expenses as a percentage of consolidated operating revenues.

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- Intermodal carloads and revenue for 1994 increased over 1993 due to increased container-on-flatcar ("COFC") business with major steamship accounts, as well as the inclusion of additional revenue-empty car movements in the carload figures for 1994. The decline in revenue per carload was due primarily to the lower revenue per car associated with revenue-empty car movements.
- Chemical and petroleum products carloads remained relatively flat for 1994 compared to 1993, while revenue increased for 1994 compared to 1993. The revenue growth was due to increased shipments of environmental wastes, fertilizer, chlorine and caustic soda and organic chemicals, which yield a higher revenue per carload, partially offset by the change in the classification of certain plastics traffic.
- Coal carloads and revenue increased for 1994 due to continued demand for the low-sulfur high-BTU content coal produced by Company-served mines. This demand was from both existing utility customers and new utility customers and was enhanced by the customers' ability to blend the low-sulfur coal with higher sulfur coal in order to satisfy requirements of the Clean Air Act. The increase in revenue per carload was due primarily to increases in length of haul.
- Food and agricultural products revenue increased in 1994 compared to 1993 on declining carload volumes. Carloads declined in 1994 compared to 1993 due to the shutdown of a sugar beet processor in California and to reductions in grain traffic during the first half of 1994 caused by a smaller than usual crop harvest that resulted from the severe midwest flooding during 1993. The increases in revenue and revenue per carload were the result of increased length of haul and changes in the commodity mix.
- Carload volume for forest products increased in 1994 compared to 1993 due to increased traffic in lumber stock and particle board that was driven by increased construction activity and by increased wood chip and scrap paper traffic. Revenue per carload increases were due primarily to price increases in lumber products where strong demand in the California, Arizona and transcontinental markets helped support price increases as well as increased length of haul for particle board, wood chips and scrap paper.
- Carloads and revenue for metals and ores traffic increased for 1994 compared to 1993 due primarily to the startup of iron ore traffic between Minnesota and Utah in August 1994 and to increased ferrous metals shipments generated by a strong pipe market during the first half of 1994.
- Construction materials and minerals carloads and revenue increased for 1994 compared to 1993 due to increased traffic in sand and gravel, cement and miscellaneous building materials that resulted from increases in highway and building construction as well as increases in mineral traffic.
- Automotive carloads and revenue increased for 1994 compared to 1993 due to strong demand for trucks and automobiles associated with general economic growth.

Operating Expenses

Railroad operating expenses for 1994 decreased $16.9 million, or 0.6%, compared to 1993. The following table sets forth a comparison of the Company's railroad operating expenses during the years ended December 31, 1994 and 1993.

RAILROAD OPERATING EXPENSE COMPARISON

	Years Ended December 31, 1994 and 1993		
(dollars in millions)	1994	1993	% Change
Labor and fringe benefits	$ 1,085.1	$ 1,132.5	(4.2)%
Fuel	251.3	252.4	(0.4)
Materials and supplies	187.3	217.6	(13.9)
Equipment rental	328.0	331.0	(0.9)
Depreciation and amortization	139.8	133.2	5.0
Other	723.7	665.4	8.8
TOTAL	$ 2,715.2	$ 2,732.1	(0.6)%

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- Labor and fringe benefit costs decreased $47.4 million, or 4.2%, for 1994 compared to 1993. The Company reduced rail employment by approximately 5% during the year. The employment decline included a reduction of approximately 460 employees in the Company's operating departments, as well as a reduction of 275 employees due to the January 1, 1994, implementation of an outsourcing agreement for management information services functions. In addition, fringe benefit expenses in 1994 were reduced compared to 1993 by the elimination of an unemployment payroll tax in July 1993. Additional traffic volume during 1994 resulted in a 4.1% increase in train crew starts which reduced the impact of the employment decline. Expressed as a percentage of operating revenue, labor and fringe benefit expenses declined to 34.5% for 1994 compared to 38.8% for 1993.
- Fuel expenses decreased $1.1 million, or 0.4%, for 1994 compared to 1993. The decrease is a result of reduced cost per gallon (which includes handling and fuel hedging costs) from $.62 per gallon during 1993 to $.58 during 1994, partially offset by an increase in fuel consumption attributable to the increase in traffic volume. Included in the 1994 fuel expense is $14.0 million related to fuel hedging contracts compared to $9.6 million for 1993.
- Materials and supplies expense decreased $30.3 million, or 13.9%, for 1994 compared to 1993. The decrease was due to a combination of reduced maintenance of way and equipment repair expenses. The reduced maintenance of way expenses were due primarily to a $17.0 million credit attributable to increases in the capitalization of indirect costs and a change in the classification of such costs as a reduction in the materials and supplies category in 1994. In 1993, these capitalized costs were classified as a reduction in other expenses. Equipment related materials and supplies expenses decreased due to the 186 locomotive rebuilds capitalized (as a result of more extensive work performed) in 1994 compared to 61 in 1993, while 41 locomotive overhauls were expensed in 1994 compared to 158 in 1993.
- Equipment rental costs decreased $3.0 million, or 0.9%, for 1994 compared to 1993. The decrease included a $4.1 million decrease in car hire offset by a $1.1 million increase in locomotive and other lease costs. Included in the 1993 amount were increased rental costs associated with the midwest flooding. Partially offsetting the decreased expense were additional equipment rental costs during 1994 associated with increased traffic volume.
- Depreciation expense increased $6.6 million, or 5.0%, for 1994 compared to 1993 due to an increase in the depreciable property base, primarily locomotives.
- Other expenses increased $58.3 million, or 8.8%, for 1994 compared to 1993. This category of expense includes outside repairs and services, joint facility rent and maintenance costs, casualty costs and property and other taxes. Expenses in this category which increased significantly over the prior year were information system outsourcing costs, property taxes, excise taxes and joint facility rent expense and the capitalized costs referred to above. Expenses in this category which decreased significantly from the prior year included costs associated with the midwest flooding in 1993 and other professional services costs. Expenses for management information system outsourcing, implemented on January 1, 1994, were $41.6 million for 1994 (partially offset by decreased labor costs as discussed above). Property taxes in 1994 showed a $15.1 million increase over 1993 because the 1993 amount was reduced by the favorable settlement of disputed property taxes in California. Excise taxes increased $11.9 million over the prior year due to the enactment of an increase in the Federal excise tax on fuel in October 1993. Joint facility rent expense increased $4.5 million in 1994 over 1993 because the 1993 amount was reduced by the favorable settlement of joint facility agreements with another railroad. Joint facility maintenance costs and detour costs showed a decrease in 1994 due to costs incurred in 1993 associated with the midwest flooding. In addition, professional services expenses decreased $7.7 million in 1994 from 1993.

Other Income and Interest Expense

Other income was $221.0 million for 1994 compared to an expense of $22.4 million for 1993, an increase in income of $243.4 million. The increase was due primarily to increased gains on sales of property of $237.2 million, most of which resulted from the December 1994 sale of a transit corridor and other related properties located between downtown Los Angeles and the ports of Los Angeles and Long Beach (the "Alameda Corridor") for proceeds of $235 million. Gains on sales of property in 1994 were partially offset by a $12 million writedown in the carrying value of certain properties held for sale. Real estate rental income, net, increased $5.2 million due primarily to reduced expenses associated with real estate activities. Interest income increased $8.0 million due to the higher average cash balance outstanding during 1994. The remaining portion of other income was an expense of $82.3 million in 1994 compared to an expense of $75.2 million in 1993, an increased expense of $7.1 million. Included in the 1994 amount is an increase in expense of $10.7 million associated with the sale of accounts receivable and a reduced expense of $9.6 million associated with costs incurred attributable to real estate held for sale. In December 1994, the Company recorded expenses of $15.2 million for the write-off of deferred loan costs and for redemption premiums attributable to the repayment of the $290 million principal amount Senior Secured Notes. During 1993, the Company recorded expenses of $27.7 million for the write-off of deferred loan costs and for redemption premiums attributable to the repayment of its subordinated debentures. In addition, in November 1993, the Company received $27.1 million in cash from Southern Pacific Telecommunications Company ("SP Telecom") in full redemption of the SP Telecom preferred stock owned by the Company plus accrued dividends on the preferred stock, resulting in other income of $14.9 million.

Interest expense was $158.2 million for 1994 compared to $156.0 million for 1993, an increase of $2.2 million due primarily to a $5.2 million charge attributable to the Company's interest rate swap agreements.

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YEAR ENDED DECEMBER 31, 1993 COMPARED TO YEAR ENDED DECEMBER 31, 1992

The Company had a net loss of $149.1 million for 1993 compared to a net income of $33.1 million for 1992. The 1993 amount includes a $104.2 million after-tax charge for the cumulative effect of a change in accounting for post-retirement benefits other than pensions under FAS No. 106 adopted by the Company effective January 1, 1993. The Company had operating income of $103.2 million for 1993 compared to $108.9 million for 1992. Operating income for 1993 was adversely affected by severe weather and flooding in certain western states during the first quarter of the year and in certain midwestern states during the third and fourth quarters of the year. In addition, the Company experienced a significant decline in automotive shipments, a shortage of power due to a temporary reduction in the number of locomotives leased by the Company and a slower than anticipated recovery in certain segments of the economy. The Company addressed the power shortage by continuing to lease additional locomotives on a short-term basis. The Company estimates that the midwest floods in the second half of 1993, which caused delays, detours and additional repair costs, resulted in additional costs and revenue shortfalls of approximately $60 million to $65 million for 1993. The foregoing estimate is based on a number of assumptions and the actual amount of additional costs and revenue shortfalls is uncertain. Partially offsetting an increase in operating expenses for 1993 was reduced joint facility rent expense of approximately $10.0 million as a result of the negotiated settlement of a joint facility case, as well as reduced property tax expense of approximately $17.5 million due to revised state property tax assessments and to the favorable settlement of prior years' disputed property taxes in California.

Operating Revenues

In 1993, railroad operating revenues increased $27.4 million compared to 1992. Railroad freight operating revenues increased $39.1 million primarily due to increased intermodal and coal carloads partially offset by decreased automobile and food and agricultural carloads. Other railroad revenues (primarily passenger, switching and demurrage) decreased $11.7 million compared to 1992. Passenger revenues decreased because SPT discontinued operating commuter service in 1992, following the sale of the Company's peninsula corridor in the San Francisco Bay Area (the "Peninsula Corridor"). There was a similar decrease in commuter operating expense. Partially offsetting this decline were increased demurrage and other incidental revenues associated with increased traffic volume. For 1993, carloads increased 4.2% and revenue ton-miles increased 7.1% compared to 1992. The average freight revenue per ton-mile declined by 3.5% compared to 1992 due to continued competitive pressures on rates and changes in traffic to lower revenue per ton-mile commodities and routes. In 1993 lower than average revenue per ton-mile coal traffic carloads increased by 18.8%, while higher than average revenue per ton-mile automobile traffic carloads decreased by 29.4% principally due to a plant closing and the loss of a major contract, contributing to the decline in average freight revenue per ton-mile.

The following table compares traffic volume (in carloads), gross freight revenues (before contract allowances and adjustments) and gross freight revenues per carload by commodity group for 1993 compared to 1992:

CARLOAD AND GROSS FREIGHT REVENUE COMPARISON

Years Ended December 31, 1993 and 1992

	Carloads			Gross Freight Revenues			Gross Freight Revenue Per Carload		
	1993	1992	% Change	1993	1992	% Change	1993	1992	% Change
	(in thousands)			*(dollars in millions)*			*(dollars)*		
Intermodal	607.6	549.4	10.6%	$ 731.9	$ 670.5	9.2%	$ 1,205	$ 1,220	(1.3)%
Chemical and petroleum products	344.2	347.7	(1.0)	589.2	571.1	3.2	1,712	1,642	4.3
Coal	263.4	221.8	18.8	245.6	206.7	18.8	932	932	—
Food and agricultural products	249.0	250.2	(0.5)	392.9	401.0	(2.0)	1,578	1,603	(1.6)
Forest products	221.4	209.2	5.8	398.4	396.2	0.6	1,799	1,894	(5.0)
Metals and ores	173.5	174.8	(0.7)	259.9	261.0	(0.4)	1,498	1,494	0.3
Construction materials and minerals	153.6	149.5	2.7	151.2	148.9	1.5	984	996	(1.2)
Automotive	65.1	92.2	(29.4)	166.6	238.7	(30.2)	2,562	2,589	(1.1)
TOTAL	2,077.8	1,994.8	4.2%	$ 2,935.7	$ 2,894.1	1.4%	$ 1,413	$ 1,451	(2.6)%

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- Both segments of the intermodal business, container-on-flatcar ("COFC") and trailer-on-flatcar ("TOFC"), contributed to the increase in 1993 intermodal volume and revenue over 1992 levels. COFC growth primarily came from increased business with major steamship customers and increases in domestic doublestack business. TOFC volumes grew primarily as a result of increased business with motor carriers.
- Chemical and petroleum products carloads were down 1% in 1993 due to reduced demand by Company-served plastics shippers, a corresponding reduction in plastic feedstocks, reduced carloads of soda ash and crude oil and completion of an environmental waste contract in 1992. Revenue per carload increased due to an increase in long-haul traffic and yield improvement strategies, particularly in plastics.
- Coal carloads and revenue increased in 1993 due in large part to the United Mine Workers strike affecting eastern mine operations between June and December 1993, which increased demand for coal from Company-served mines. The strike was settled in December 1993. The increased coal carloads and revenues in 1993 were also due to strong summer demand by utilities and continued demand for western coal to be used in utility test burns. The Company expects that settlement of the coal strike, which was a significant factor in the increase in coal carloads and revenues in 1993, will result in reductions or eliminations of coal shipments for certain customers, but the Company cannot predict the effect of such settlement on total coal carloads in the future.
- Carload volume in forest products increased in 1993 through growth in shipments of paper products, while lumber product carloadings maintained 1992 levels primarily due to weak construction markets. Revenue for forest products grew at a slower rate than carloads due to a reduction in revenue per carload which was brought about by changes in product and market mix.
- Automobile traffic declined in 1993 as compared to 1992 because of the closing of a General Motors plant in California and the loss of a contract for transportation of finished automobiles.

Operating Expenses

Railroad operating expenses for 1993 increased $32.4 million, or 1.2%, compared to 1992. The Company estimates that approximately $50 million to $55 million of increased operating expenses were associated with the severe flooding that occurred in the midwest during the third and fourth quarters of 1993. The foregoing estimate is based on a number of assumptions and the actual amount of additional operating expenses is uncertain. Equipment rental costs and fuel costs also increased in 1993, while labor and fringe benefit costs and material and supply costs decreased in 1993 compared to 1992 as discussed below. Total 1993 operating expenses also included a $10.5 million charge primarily to cover the remaining costs of centralizing crew dispatching and calling and eliminating facilities no longer needed for operations.

The following table sets forth a comparison of the Company's operating expenses for 1993 and 1992:

RAILROAD OPERATING EXPENSE COMPARISON

	Years Ended December 31, 1993 and 1992		
(dollars in millions)	1993	1992	% Change
Labor and fringe benefits	$ 1,132.5	$ 1,167.0	(3.0)%
Fuel	252.4	236.9	6.5
Materials and supplies	217.6	244.7	(11.1)
Equipment rental	331.0	288.0	14.9
Depreciation and amortization	133.2	138.9	(4.1)
Other	665.4	624.2	6.6
TOTAL	$ 2,732.1	$ 2,699.7	1.2%

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- Labor and fringe benefit expenses decreased $34.5 million, or 3.0%, for 1993 compared to 1992. At December 31, 1993 Company employment had substantially declined compared to December 31, 1992, primarily due to a decline in roadway maintenance employees during the last four months of 1993 resulting in reduced labor costs for day-to-day repair and maintenance activities, as well as to a decline in transportation employees in December 1993 resulting from the November 1993 ratification of a United Transportation Union agreement. During 1993, train crew starts declined by 1.4% compared to 1992, even though adversely impacted by the midwest floods in the third and fourth quarters of 1993, contributing to the overall decline in labor costs. In addition, included in the expense reduction above is reduced payroll tax expense due to reduced employment and the elimination in 1993 of the railroad unemployment insurance repayment tax.
- Fuel expense increased $15.5 million, or 6.5%, due primarily to increased fuel consumption associated with increased traffic volume coupled with a 1.6% increase in the average cost per gallon of fuel in 1993.
- Material and supply expenses decreased $27.1 million, or 11.1%, for 1993 compared to 1992 due primarily to reduced running repairs on locomotives, reduced roadway repair and maintenance activity, the use of recycled and reconditioned second-hand materials, as well as to reduced purchases of material during the first quarter of 1993 in response to reduced revenues in that quarter compared to 1992. There was also a $5.0 million non-recurring inventory adjustment during 1993. During the year, the Company rebuilt or performed heavy repairs on 219 locomotives compared to heavy repairs on 159 locomotives in 1992. Costs associated with the rebuilding of 61 locomotives in 1993 were capitalized.
- Equipment rental costs increased $43.0 million, or 14.9%, due to a combination of the effects of the midwest floods causing increased equipment cycle time and increased short-term locomotive lease costs associated with increased traffic volume and a shortage of locomotives in certain areas. Included in the increase is a $18.9 million increase in net car hire, and a $12.9 million increase in locomotive lease costs over 1992.
- Depreciation and amortization expense decreased $5.7 million, or 4.1%, due primarily to reduced depreciation rates as well as to a reduced equipment depreciation base resulting from the Company's sale/leaseback transactions in 1992 and 1993.
- Other expenses increased $41.2 million, or 6.6%, for 1993 compared to 1992. This category of expense includes purchased repairs and services, joint facility rent and maintenance costs, casualty costs and property and other taxes. The 1993 increase is due primarily to detour fees and joint facility maintenance and operations costs associated with the midwest floods which were estimated to be approximately $27 million. The foregoing estimate is based on a number of assumptions and the actual amount of additional flood-related costs is uncertain. Also showing an increase for 1993 were casualty costs (due in part to the fact that 1992 casualty costs were reduced by insurance recoveries received with respect to claims accrued in 1992 and prior years), environmental cost accruals, data processing equipment rental costs as well as an increase in taxes on fuel beginning in the fourth quarter of 1993. Partially offsetting the expense increases in this category were reduced joint facility rent expense of approximately $10.0 million as a result of the negotiated settlement of a joint facility case earlier in the year, as well as reduced property tax expense of approximately $17.5 million due to revised state property tax assessments and to a favorable settlement of prior years' disputed property taxes in California.

Other Income and Interest Expense

Other income in total was an expense of $22.4 million in 1993 compared to income of $90.2 million in 1992, a decrease of $112.6 million. Gains on sales of property and real estate decreased $93.6 million to a total of $25.1 million in 1993. Rental income increased $3.7 million due in part to non-recurring rental income associated with a fiber optic conduit easement with SP Telecom. Interest income remained relatively stable with an increase of $0.3 million during 1993. The remaining portion of other income was an expense of $75.2 million in 1993 compared to an expense of $52.2 million in 1992, an increased expense of $23.0 million. This increase is due in part to the write-off of $17.0 million of deferred loan costs and a payment of $10.7 million for redemption premiums attributable to the repayment of certain subordinated debentures in connection with the recapitalization in August 1993. Expenses associated with the sale of accounts receivable increased $10.6 million in 1993 and were partially offset by reduced expenses associated with properties held for sale. In addition, in November 1993, the Company received $27.1 million in cash from SP Telecom in full redemption of the SP Telecom preferred stock owned by the Company plus accrued dividends on the preferred stock, resulting in other income of $14.9 million. Interest expense was $156.0 million in 1993 compared to $143.3 million in 1992, an increase of $12.6 million due primarily to a higher level of outstanding debt during 1993.

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Liquidity and Capital Resources

The Company's business is capital intensive and requires ongoing substantial expenditures for, among other things, improvements to roadway, structures and technology, acquisitions and repair of equipment, and maintenance of the rail system. In 1994, and for a number of years before that, the Company's railroad operations did not produce sufficient cash flows to meet its capital expenditures, debt service and other cash needs. As a result, the Company relied on proceeds from transit corridor, real estate and other asset sales, borrowings and other financings for these purposes.

The Company closed the initial public offering and sale of 30,783,750 shares of common stock (the "IPO") and the issuance and sale of $375 million principal amount Senior Notes (the "Debt Offering") in August 1993. In addition, the Company replaced its bank revolving credit facility with a new bank Credit Agreement under which it borrowed $175 million at that time. On March 2, 1994, the Company closed an offering of 25,000,000 shares of common stock (the "1994 Offering") for net proceeds of $503.6 million, which were used to repay $292 million of debt (including the $175 million drawn under the bank Credit Agreement) and for general corporate purposes. These measures provided the Company with significant cash and substantially improved the Company's liquidity. The Company anticipates that, for the next few years, cash flows generated by rail operations, although improved, will continue to be insufficient to meet all its cash needs including acquisition of equipment and other necessary capital expenditures. In order to satisfy these cash flow requirements, as well as to satisfy financial covenants in its credit facilities, the Company must continue to improve its operating results and obtain equipment financing while maintaining its bank credit facilities for use from time to time as required. In addition, in order to reduce the need for further borrowing, the Company expects to continue to sell real estate assets with substantial values that are not necessary to its transportation operations. However, the timing of such sales often is difficult to predict. Levels of asset sales may vary substantially from period to period, which in turn can cause significant variations in the Company's net income or loss, cash flows and liquidity.

On December 29, 1994, the Company closed the sale of its 26-mile Alameda Corridor to the ports of Los Angeles and Long Beach for $235 million for use as a consolidated freight corridor. The Company will continue to use the freight line which connects the ports with downtown rail yards along with other railroads. Proceeds from the sale were used, with other funds, to repay the $290 million principal amount Senior Secured Notes.

At December 31, 1994, the Company had cash, cash equivalents and short-term investments of $240.6 million. In addition, the Company had $300 million available under its revolving credit facility and $150 million available under a separate term loan facility.

Continued implementation of the Company's strategic plan will require the ongoing availability of additional sources of funding, including secured equipment and capital lease financing to upgrade the Company's locomotive and railcar fleet, as well as borrowings under the Company's bank credit facilities. The Company will remain leveraged to a significant extent and its debt service and capital lease obligations will continue to be substantial. Possible payment of $60 million to Union Pacific in connection with the St. Louis Southwestern Railway Company ("SSW") trackage rights case could add substantially to the Company's cash requirements for the near term.

Operating Activities

As shown in the Consolidated Statements of Cash Flows, cash provided by (used for) operating activities was $228.2 million, $(105.4) million and $107.3 million in 1994, 1993 and 1992, respectively. The improvement in 1994 was substantially due to improved operating results. The changes between periods are also due primarily to the net effect of changes in accounts receivable and payable between periods based on the timing of receipts and payments. The 1993 amount includes cash used in connection with the early buyback of equipment under operating leases and cash used to pay costs associated with the debt repayments during 1993. Included in operating cash flows are cash payments of $48.8 million, $55.4 million and $82.7 million in 1994, 1993 and 1992, respectively, for severance and relocation of employees previously accrued for in the special charges taken in 1988 and 1991. The Company also has made and will continue to make expenditures relating to the assessment and remediation of environmental conditions. The Company expects to fund its operations (including scheduled interest and capital lease payments) over the next twelve months with cash from operations, cash on hand, secured equipment financing, capital leases and, if necessary, borrowings under its bank credit facilities.

The Company had working capital deficits of $343.2 million and $562.0 million at December 31, 1994 and 1993, respectively. The improvement is due primarily to an increased amount of cash and cash equivalents on hand at December 31, 1994, attributable to the 1994 Offering coupled with improved operating results. In general, the deficit is caused by the capital intensive nature of the railroad business and the large number of one-year accruals funded out of future operations.

The Company received cash proceeds from sales and retirement of real estate and other property totalling $343.4 million in 1994, $53.8 million in 1993 and $362.4 million in 1992. The 1994 amount includes proceeds of $235.0 million from the sale of the Company's Alameda Corridor to the ports of Los Angeles and Long Beach. The 1992 amount includes $124.0 million from sales to the Peninsula Corridor Joint Powers Board (the "JPB"), $45.0 million from sales to the Metro Transit in Houston, Texas, $83.0 million from sales to the Los Angeles County Transportation Commission and $36.5 million from the sale/leaseback of certain locomotives and freight cars in June 1992. At December 31, 1994, certain properties remaining from the Company's acquisitions of Southern Pacific Transportation Company ("SPT") and The Denver and Rio Grande Western Railroad Company ("D&RGW") remained classified as real estate held for sale with an allocated cost for financial reporting purposes of $361.4 million. Assets categorized as real estate held for sale on the Company balance sheet constitute only a part of the properties and assets that the Company intends to seek to sell over the next several years. The Company has identified certain operating properties that it might sell in the future if it can do so without impacting its railroad operations. Management has not made a firm decision to remove any of these properties from its operating system. In order to enhance the value of certain properties and facilitate their disposition, the Company has in the past participated and may in the future participate with others in the development of such properties by contributing the property and funding to joint ventures or other entities, participating in sale and leaseback arrangements and engaging in other transactions that do not involve immediate cash proceeds. The Company is analyzing certain branchlines for possible sale, lease or abandonment. To the extent proceeds from such dispositions are less than the Company's basis in those properties, a non-cash financial statement loss would be recognized.

Capital Expenditures

Capital expenditures for railroad operations (exclusive of capital leases and equipment under operating leases purchased in 1993 with a portion of the proceeds of the IPO and the Debt Offering) were $299.0 million, $244.4 million, and $338.9 million for 1994, 1993 and 1992, respectively. During the three-year period, the Company spent $690.4 million for capital expenditures to upgrade its roadway and structures, including $19.0 million for the remodeling of the Company's Denver locomotive facility and $29.4 million for the acquisition of and improvements to an office building in Denver, Colorado, and spent $174.5 million for railroad equipment. Of these amounts for the three-year period, $70.3 million was financed by specific debt obligations. The Company expects 1995 capital expenditures for railroad operations to be approximately $324 million (exclusive of capital leases). The Company expects to fund 1995 capital expenditures with cash from operations, cash on hand, secured equipment financings and, if necessary, borrowing under its bank credit facilities.

In late 1993 and throughout 1994, the Company focused on upgrading its locomotive fleet. The Company acquired 150 new locomotives, 17 of which were delivered in the last quarter of 1993 with the balance delivered in 1994. Additionally, the Company has acquired 133 remanufactured locomotives of which 115 were delivered in 1994 and the balance in early 1995. These locomotives were financed by capital leases (for which the capitalized lease obligation was approximately $221 million). In 1994, the Company acquired through capital lease financing approximately 1,400 freight cars of which 700 were newly manufactured and 700 were remanufactured (for which the capitalized lease obligation was approximately $56 million). The Company also received approximately 1,600 additional reconditioned freight cars in 1994 on which it expects to complete capital lease financing in 1995. In addition, the Company acquired 350 used freight cars in 1994 under operating leases.

The Company has ordered an additional 206 AC-powered locomotives to be financed by capitalized lease financing that are scheduled to be delivered during the second and third quarters of 1995. In addition, the Company has ordered 920 new hopper cars and expects to receive approximately 1,500 reconditioned freight cars in 1995. The Company expects to finance these acquisitions through capitalized lease financing. The total expected capitalized lease obligation to be incurred in 1995, including the 1,600 reconditioned freight cars received in 1994 for which financing is scheduled to be arranged in 1995, is approximately $400 million.

Financing Activities

On August 17, 1993, the Company closed the IPO and the Debt Offering for net proceeds of $757.1 million. The proceeds were used to repay $481.2 million of debt and debt related costs, to purchase $99.1 million of equipment operated pursuant to operating leases, to redeem the Company's $75.0 million 12% preferred stock and for general corporate purposes. On March 2, 1994, the Company closed an additional offering of common stock for net proceeds of $503.6 million. The proceeds were used to repay $292 million of debt and for general corporate purposes.

In December 1994, using $235 million of the proceeds from the sale of the Alameda Corridor, together with other funds on hand, the Company retired the $290 million outstanding under the Senior Secured Notes. The repayment was accomplished by placing approximately $297 million of government securities in a defeasance trust in December 1994. In connection with the retirement of the Senior Secured Notes, the Company wrote-off in other expenses $9.4 million of unamortized debt issuance costs and paid a prepayment premium of $5.8 million and expensed in interest expense $5.2 million attributable to the Company's interest rate swap agreements.

In November 1994, the Company entered into a new $300 million three-year revolving credit agreement to replace its existing $200 million credit agreement. This agreement contains quarterly financial covenants including minimum tangible net worth, a maximum funded debt to net worth ratio and a minimum fixed charge coverage ratio. No borrowings have been made under the new facility.

In December 1994, the Company entered into a bank agreement permitting the Company to borrow up to $150 million as a term loan maturing in 1999. The agreement contains quarterly financial covenants identical to those contained in the revolving credit agreement. Any borrowing under the facility must be made by December 27, 1995. No borrowings have been made under this facility.

In order to accelerate realization on their accounts receivable, beginning in 1989 the Company's principal rail subsidiaries began selling certain net accounts receivable to ABS Commercial Paper, Inc. ("ABS"), an unaffiliated third party. ABS finances its purchases by the sale of its commercial paper, secured by the receivables it purchases, up to a maximum aggregate principal amount of $300.0 million at any time outstanding. The proceeds of issuance of the commercial paper are paid to the railroads for their receivables. Payment of the commercial paper is supported by certain banks that have agreed to provide liquidity on an as-needed basis. As of December 31, 1994, 1993 and 1992, the Company had sold $454.3 million, $391.7 million and $366.5 million of net outstanding receivables respectively, and had receivables relating to future proceeds from ABS for receivables sold of $111.2 million, $62.7 million and $39.7 million, respectively. The terms of the agreements are to expire on October 31, 1995. The Company is currently in the process of replacing the facility with another facility prior to the expiration date.

In connection with upgrading its locomotive fleet and acquiring new, remanufactured and reconditioned freight cars, the Company entered into capitalized lease obligations of $265.2 million in 1994. The Company's net equipment operating lease and rental expenses were $328.0 million, $331.0 million and $288.0 million for the years ended December 31, 1994, 1993 and 1992, respectively. Contingent rental and subleases rental were not significant.

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Effective January 1, 1994, the Company entered into an agreement with Integrated Systems Solutions Corporation ("ISSC") for the outsourcing of its management information services functions. Pursuant to the agreement, the Company is obligated to pay annual base charges of between $45 million and $50 million (which cover, among other things, payments for MIS equipment and personnel) over a ten-year period, subject to adjustments for cost of living increases and variations in the levels of service provided under the agreement.

The maturities of long-term debt at December 31, 1994, including capital lease obligations, from January 1995 though December 31, 1999 were $265.5 million. The total amount of mandatory redemptions and mandatory dividends of SSW's Series A and Series B Redeemable Preference Shares scheduled for payment from January 1, 1995 through December 31, 1999 are $21.6 million. The Company also has substantial future lease commitments relating to its locomotive and car fleet, and other substantial commitments. See Notes 9 and 12 to the Consolidated Financial Statements included elsewhere herein.

Other

In prior years, the Company has experienced increased costs due to the effect of inflation on the cost of compensation and benefits, and in the replacement of or additions to property and equipment. A portion of the increased labor costs directly affects expenses through increased operating costs. Fuel costs have fluctuated with market conditions and have directly affected operating results. Operating efficiencies have, however, partially offset this impact. Competition and other market factors may continue to restrict the Company's ability to recover all increases in costs through increases in the price of services. Certain of the wage agreements obtained in 1991, 1992 and 1993 have reduced the effects of inflation on operating costs but provide for cost of living increases beginning in 1995. A substantial portion of those agreements expire and are subject to renegotiation in 1995 (1998 with respect to the agreement covering the Western Lines).

To ensure stability of its fuel costs, the Company has entered into fuel hedging agreements covering approximately 95% of its estimated 1995 fuel needs at an average purchase price of $.49 per gallon (excluding handling costs). However, in the event that fuel prices decline below the average purchase price under the hedging agreements the Company will not receive any benefit from these fuel hedging agreements and may in fact pay more for fuel than it would have paid in the absence of such agreements.

The Company's Consolidated Financial Statements are prepared on the purchase accounting basis. The railroad subsidiaries report their financial position and results of operations on the historical cost basis. As a result, the Company reflects less depreciation expense than its combined railroad subsidiaries, as well as smaller gains on the sale of properties classified as real estate held for sale. See Note 1 to the Company's Consolidated Financial Statements included elsewhere herein.

Independent Auditors' Report

THE BOARD OF DIRECTORS
SOUTHERN PACIFIC RAIL CORPORATION:

We have audited the accompanying consolidated balance sheets of Southern Pacific Rail Corporation and Subsidiary Companies as of December 31, 1994 and 1993, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the three-year period ended December 31, 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Pacific Rail Corporation and Subsidiary Companies as of December 31, 1994 and 1993, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1994 in conformity with generally accepted accounting principles.

As discussed in Note 1 to the financial statements, effective January 1, 1993 the Company changed its methods of accounting for income taxes and post-retirement benefits other than pensions.

KPMG Peat Marwick LLP

KPMG PEAT MARWICK LLP
San Francisco, California
February 24, 1995

Management's Responsibility for Financial Reporting

The consolidated financial statements of Southern Pacific Rail Corporation have been prepared by management, which is responsible for their content and integrity. The statements present the results of operations, cash flows and financial position of the Company in conformity with generally accepted accounting principles and, accordingly, include amounts based on management's ongoing judgments and estimates. Information in other sections of the Annual Report is consistent with that included in the financial statements.

The Company's accounting systems are supported by internal accounting controls which are established to 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 accounting control should not exceed the benefits and that no system of internal controls can detect and prevent all errors and irregularities.

As part of their audit of the financial statements, the Company's independent auditors review and assess the effectiveness of selected internal accounting controls to establish a basis for reliance thereon in determining the nature, timing and extent of audit tests to be applied as they deem necessary to express an opinion on the fairness of the consolidated financial statements. In addition, the Company maintains a well-qualified internal audit department which evaluates, monitors, and reports to management on compliance with the Company's internal control policies and procedures.

The Board of Directors pursues its responsibility for the Company's financial statements through its Audit Committee, which is composed solely of directors who are not officers or employees of the Company. The independent auditors and the Company's internal auditors have direct access to the Audit Committee, with and without the presence of management representatives, to discuss the scope and results of their audit work and their comments on the adequacy of internal accounting controls and financial reporting.

Jerry R. Davis

JERRY R. DAVIS
President and Chief Executive Officer

Cannon Y. Harvey

CANNON Y. HARVEY
Executive Vice President—Finance and Law

Lawrence C. Yarberry

LAWRENCE C. YARBERRY
Vice President—Finance

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Consolidated Balance Sheets

Assets (in millions)	December 31, 1994	1993
CURRENT ASSETS		
Cash and cash equivalents	$ 145.6	$ 65.5
Short-term investments	95.0	—
Accounts and notes receivable, net of allowance for doubtful accounts of $8.1 in 1994 and $7.2 in 1993 (Note 2)	178.2	122.1
Accounts receivable sales proceeds receivable (Note 2)	111.2	62.7
Materials and supplies at cost	71.8	56.9
Other notes receivable	7.2	2.8
Other current assets	63.6	44.2
TOTAL CURRENT ASSETS	672.6	354.2
REAL ESTATE HELD FOR SALE (Note 3)	361.4	363.4
PROPERTY, at cost (Notes 3, 5, 9 and 12)		
Roadway and structures	2,204.4	2,103.0
Railroad equipment	1,013.4	702.2
Other property	309.0	287.1
TOTAL PROPERTY	3,526.8	3,092.3
Less accumulated depreciation and amortization	597.8	560.6
Property, net	2,929.0	2,531.7
OTHER ASSETS AND DEFERRED CHARGES		
Notes receivable and other investments	79.2	51.0
Other (Note 2)	109.9	133.7
TOTAL OTHER ASSETS	189.1	184.7
TOTAL ASSETS	$ 4,152.1	$ 3,434.0

See accompanying notes to consolidated financial statements.

(continued)

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Liabilities and Stockholders' Equity (in millions)	December 31, 1994	1993
CURRENT LIABILITIES		
Accounts and wages payable	$ 158.0	$ 125.3
Accrued payables		
Taxes	52.8	52.9
Interest	50.0	40.8
Vacation pay	66.3	67.1
Current portion of long-term debt (Note 5)	59.5	66.7
Redeemable preference shares of a subsidiary (Note 7)	1.9	1.8
Other current liabilities (Note 4)	627.3	561.6
TOTAL CURRENT LIABILITIES	1,015.8	916.2
LONG-TERM DEBT (Note 5)	1,089.3	1,408.3
DEFERRED INCOME TAXES (Note 6)	223.4	67.6
OTHER LIABILITIES (Notes 4 and 10)	744.2	708.2
REDEEMABLE PREFERENCE SHARES OF A SUBSIDIARY (Note 7)	20.7	21.2
COMMITMENTS AND CONTINGENCIES (Notes 6, 9, 10 and 12)		
STOCKHOLDERS' EQUITY		
Common stock, par value $.001 per share; 300,000,000 shares authorized; 155,826,120 and 130,783,750 shares issued and outstanding in 1994 and 1993, respectively (Note 8)	0.2	0.1
Additional paid-in capital (Note 8)	1,116.2	611.9
Accumulated deficit	(57.7)	(299.5)
TOTAL STOCKHOLDERS' EQUITY	1,058.7	312.5
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 4,152.1	$ 3,434.0

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations

(in millions, except per share amounts)	Year Ended December 31, 1994	1993	1992
OPERATING REVENUES			
Railroad	$ 3,056.4	$ 2,837.7	$ 2,810.3
Other	86.2	80.9	67.7
TOTAL	3,142.6	2,918.6	2,878.0
OPERATING EXPENSES			
Railroad			
Labor and fringe benefits (Note 10)	1,085.1	1,132.5	1,167.0
Fuel	251.3	252.4	236.9
Materials and supplies	187.3	217.6	244.7
Equipment rental	328.0	331.0	288.0
Depreciation and amortization (Note 3)	139.8	133.2	138.9
Other	723.7	665.4	624.2
TOTAL RAILROAD	2,715.2	2,732.1	2,699.7
Other	81.7	83.3	69.4
TOTAL	2,796.9	2,815.4	2,769.1
OPERATING INCOME	345.7	103.2	108.9
OTHER INCOME			
Gains from sales of property and real estate (Note 3)	262.4	25.1	118.7
Real estate and other rentals, net	25.5	20.3	16.6
Interest income	15.4	7.4	7.1
Other income (expense), net (Note 2)	(82.3)	(75.2)	(52.2)
TOTAL	221.0	(22.4)	90.2
INTEREST EXPENSE (Note 5)	158.2	156.0	143.3
INCOME (LOSS) BEFORE INCOME TAXES	408.5	(75.2)	55.8
INCOME TAX EXPENSE (BENEFIT) (NOTE 6)			
Current	3.7	—	0.1
Deferred	157.0	(30.3)	22.6
TOTAL	160.7	(30.3)	22.7
NET INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING	247.8	(44.9)	33.1
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING FOR POST-EMPLOYMENT BENEFITS IN 1994 AND POST-RETIREMENT BENEFITS OTHER THAN PENSIONS IN 1993 (Net of income tax benefits of \$3.8 and \$64.3, respectively) (Note 10)	(6.0)	(104.2)	—
NET INCOME (LOSS)	$ 241.8	$ (149.1)	$ 33.1
INCOME (LOSS) APPLICABLE TO COMMON STOCKHOLDERS	$ 241.8	$ (154.9)	$ 24.1
PRIMARY EARNINGS (LOSS) PER SHARE			
Net income (loss) before cumulative effect of change in accounting	$ 1.63	$ (0.54)	$ 0.34
Cumulative effect of change in accounting	$ (0.04)	$ (1.11)	$ —
NET INCOME (LOSS)	$ 1.59	$ (1.65)	$ 0.34
FULLY DILUTED EARNINGS (LOSS) PER SHARE			
Net income (loss) before cumulative effect of change in accounting	$ 1.63	$ (0.46)	$ 0.24
Cumulative effect of change in accounting	$ (0.04)	$ (0.93)	$ —
NET INCOME (LOSS)	$ 1.59	$ (1.39)	$ 0.24

See accompanying notes to consolidated financial statements.

Years Ended December 31, 1994, 1993 and 1992

(in millions, except per share amounts)	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Common Stock Subject to Repurchase	Total
BALANCES AT DECEMBER 31, 1991	100	$ 0.1	$ 221.2	$ (156.8)	$ (165.5)	$ (101.0)
Net income	—	—	—	33.1	—	33.1
Dividends on preferred stock ($120 per share)	—	—	—	(9.0)	—	(9.0)
BALANCES AT DECEMBER 31, 1992	100	0.1	221.2	(132.7)	(165.5)	(76.9)
Net loss	—	—	—	(149.1)	—	(149.1)
Dividends on preferred stock ($78 per share)	—	—	—	(5.8)	—	(5.8)
Common stock issued	31	—	390.7	—	165.5	556.2
Cancellation of notes receivable from The Anschutz Corporation	—	—	—	(11.9)	—	(11.9)
BALANCES AT DECEMBER 31, 1993	131	0.1	611.9	(299.5)	—	312.5
Net income	—	—	—	241.8	—	241.8
Common stock issued (Note 8)	25	0.1	503.5	—	—	503.6
Common stock issued to management	—	—	0.8	—	—	0.8
BALANCES AT DECEMBER 31, 1994	156	$ 0.2	$ 1,116.2	$ (57.7)	$ —	$ 1,058.7

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Cash Flows

(in millions)	Year Ended December 31, 1994	1993	1992
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$ 241.8	$ (149.1)	$ 33.1
Adjustments to net income (loss)			
Depreciation and amortization	139.8	133.2	138.9
Deferred income taxes	153.2	(94.6)	22.6
Gains from sales of property and real estate	(262.4)	(25.1)	(118.7)
Cumulative effect of change in accounting for post-employment benefits in 1994 and post-retirement benefits in 1993	9.8	168.5	—
Changes in:			
Receivables	(105.2)	(18.4)	60.5
Materials and supplies	(14.8)	(3.1)	1.2
Income taxes payable/receivable	(0.1)	(13.9)	1.2
Other current and noncurrent assets	5.3	23.5	10.5
Other current and noncurrent liabilities	60.8	(126.4)	(42.0)
TOTAL ADJUSTMENTS	(13.6)	43.7	74.2
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	228.2	(105.4)	107.3
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(300.5)	(311.2)	(340.7)
Property sold and retired	343.4	53.8	362.4
Increase in short-term investments (Note 1)	(95.0)	—	—
Change in notes receivable and other investments, net	(11.8)	(2.9)	(23.5)
NET CASH USED FOR INVESTING ACTIVITIES	(63.9)	(260.3)	(1.8)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of debt, net of costs	55.6	796.6	510.7
Debt and revolver drawdown (repayment), net	(641.5)	(734.5)	(596.6)
Proceeds from issuance of common stock, net of costs	503.6	390.7	—
Redemption of preferred stock	—	(75.0)	—
Dividends paid	—	(5.8)	(9.0)
Redeemable preference shares repayment	(1.9)	(2.1)	(2.1)
NET CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES	(84.2)	369.9	(97.0)
NET CHANGE IN CASH AND CASH EQUIVALENTS	80.1	4.2	8.5
CASH AND CASH EQUIVALENTS—BEGINNING OF THE PERIOD	65.5	61.3	52.8
CASH AND CASH EQUIVALENTS—END OF PERIOD (Note 1)	$ 145.6	$ 65.5	$ 61.3

See accompanying notes to consolidated financial statements.

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1. Summary of Significant Accounting Policies

Ownership, Principles of Consolidation and Basis of Presentation

Southern Pacific Rail Corporation ("SPRC") is the parent company of the Southern Pacific Transportation Company ("SPT") and Rio Grande Holding Company ("RGH"). SPRC together with its subsidiaries is referred to as the Company. Railroads owned include SPT, St. Louis Southwestern Railway Company ("SSW"), SPCSL Corporation ("SPCSL") and The Denver and Rio Grande Western Railroad Company ("D&RGW").

The consolidated financial statements are prepared on the purchase accounting basis and include the accounts of the Company and its subsidiaries on a consolidated basis. All significant intercompany balances and transactions have been eliminated in consolidation. The railroad subsidiaries report their financial position and results of operations on the historical cost basis, including reports to the Interstate Commerce Commission ("ICC").

Cash, Cash Equivalents, and Short-Term Investments

For statement of cash flows purposes, the Company considers commercial paper, municipal securities and certificates of deposit with original maturities when purchased of three months or less to be cash equivalents. Short-term investments consist primarily of commercial paper, municipal securities and certificates of deposit with original maturities beyond three months and less than twelve months. Such short-term investments are carried at cost, which approximates fair value due to the short period of time to maturity. Total cash, cash equivalents and short-term investments at December 31, 1994 were $240.6 million.

Investments

Investments in affiliated companies (those in which the Company has a 20% to 50% ownership interest) are accounted for by the equity method. Other investments are stated at cost which does not exceed market.

Real Estate Held for Sale

At the time of the acquisitions of D&RGW and SPT, the Company identified for sale certain real estate properties that were not essential to its transportation operations. These properties have been classified as Real Estate Held for Sale. Real estate properties held for sale are stated at the lower of cost or amounts expected to be realized upon sale. No properties have been added to this classification. In order to facilitate disposition of these properties, the Company may participate in joint ventures or other arrangements that do not result in immediate sales.

Property

Property accounting procedures followed by the Company and its railroad subsidiaries are prescribed by the ICC. In accordance with the Company's definition of unit of property, all costs associated with the installation of rail, ties, ballast and other track improvements are capitalized. Other costs are capitalized to the extent they increase asset values or extend useful lives. Retirements are generally recorded using a systemwide first-in, first-out basis. The cost of property and equipment (including removal and restoration costs) is depreciated on the straight line composite group method, generally based on estimated service lives. Pursuant to ICC regulation, periodic depreciation and cost studies are required and changes in service life estimates are subject to the review and approval of the ICC. Gains or losses from disposition of depreciable railroad operating property are credited or charged to accumulated depreciation except for significant disposal of property. Certain railroad properties that are not essential to transportation operations may be sold, some of which are included in real estate held for sale. Gains or losses resulting from sales of real estate no longer required for railroad operations are recognized as other income in the consolidated statement of operations.

Revenues

Freight revenues from rail transportation operations are recognized based on the percentage of completed service method. Other railroad revenues and other revenues are recognized as earned.

Retiree Welfare Benefits

Prior to January 1, 1993, the Company expensed retiree welfare benefits when paid. Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Post-retirement Benefits Other than Pensions" and recorded the estimate of its liability under Statement No. 106 of $168.5 million, which net of income taxes resulted in a charge to earnings of $104.2 million (see Note 10). Statement No. 106 requires that all employers sponsoring a retiree welfare plan use a single actuarial cost method as is required for pension plan accounting and that they disclose specific information about their plan in their financial statements.

Post-employment Benefits

In November 1992, the Financial Accounting Standards Board ("FAS") issued Statement No. 112 "Employers' Accounting for Post-employment Benefits." FAS 112 requires employers to recognize the obligation to provide benefits to former or inactive employees after employment but before retirement, if certain conditions are met. Effective January 1, 1994, the Company adopted FAS 112 and recorded a $9.8 million pre-tax charge ($6.0 million after tax). The Company's policy continues to be to fund the cost of post-employment benefits as the benefits are payable.

Income Taxes

The Company records income taxes using the liability method prescribed by Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities.

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A change in the tax laws or rates results in adjustment to the deferred tax liabilities and assets. The effect of such adjustments are included in income in the period in which the tax laws or rates are changed.

Earnings Per Share

Earnings per share are determined by dividing net income, after deduction of preferred stock dividends, by the weighted average number of shares of common stock outstanding. The weighted average number of shares of common stock outstanding in the calculation of primary earnings per share excludes the number of shares of common stock subject to repurchase. These shares are included in the calculation of fully diluted earnings per share. The following summarizes the weighted average number of shares used in these calculations:

	Shares at Year Ended December 31,		
(in thousands)	1994	1993	1992
Primary	151,648	93,575	71,250
Fully diluted	151,648	111,544	100,000

Reclassifications

Certain of the amounts previously reported have been reclassified to conform to the current consolidated financial statement presentation.

2. Sale of Receivables

Beginning in 1989, the Company began selling certain net receivables (including interline accounts), without recourse, to Rio Grande Receivables, Inc. ("RGR"), a subsidiary of SPRC. Also in 1989, RGR began selling the receivables purchased from the Company, with certain limited recourse provisions, to ABS Commercial Paper, Inc. ("ABS"), an unaffiliated third party, on a continuing basis for a period of up to five years subject to certain terms and conditions. The Company has agreed to service the receivables sold and is paid a fee for such services. The sale price for the receivables sold is based upon the face amount of the receivables and is reduced by discounts for expected defaults, servicing costs and anticipated collection periods. The Company retains a residual interest in the receivables should actual collections exceed the projected collections upon which the default discounts are calculated.

ABS finances its purchases by the sale of its commercial paper, secured by the receivables it purchases, up to a maximum aggregate principal amount of $300.0 million at any time outstanding. The ability of ABS to sell commercial paper is supported by certain banks which have agreed to provide liquidity to ABS on an as-needed basis. The liquidity banks must maintain a P-1 rating or there would need to be one or more replacement banks or a reduction in the maximum amount of commercial paper which ABS could issue.

As of December 31, 1994, 1993 and 1992, the Company had sold $454.3 million, $391.7 million and $366.5 million of net outstanding receivables to ABS, respectively, and had receivables from ABS for receivables sold of $111.2 million, $62.7 million and $39.7 million, of which $30.0 million were interest bearing at December 31, 1994, 1993 and 1992 and are included in other assets. Included in other income (expense), net, is approximately $(52.5) million in 1994, $(41.8) million in 1993 and $(31.1) million in 1992 of discounts and other expenses associated with the sales of accounts receivable. The initial term of the agreements expires on October 31, 1995. The Company is currently in the process of replacing the facility with another facility prior to the expiration date.

3. Property and Real Estate Held for Sale

The average depreciation rates for the Company's property and equipment for 1994 were approximately 5% for roadway and structures and 3% for equipment, including locomotives and freight cars.

The Company received cash proceeds from sales and retirements of real estate and property of $343.4 million, $53.8 million and $362.4 million in 1994, 1993 and 1992, respectively. The 1994 amount includes proceeds of $235.0 million for the sale of a transit corridor to the ports of Los Angeles and Long Beach (the "Alameda Corridor"). The 1992 amount includes $124.0 million from sales to the Peninsula Corridor Joint Powers Board ("JPB"), $45.0 million from sales to Metro Transit of Houston, Texas, $83.0 million from sales to the Los Angeles County Transportation Commission ("LACTC") and $36.5 million from the sale/leaseback of locomotives and freight cars in June 1992. The Company recorded expenditures of $13 million in 1994, $12 million in 1993 and $18 million in 1992 in costs relating to environmental conditions on properties held for sale.

The Company has granted the JPB options to purchase additional rights-of-way and land within five years after the closing of the sale of the Peninsula Main Line for $110 million of which approximately $79 million has not lapsed, been exercised or extinguished. The Company will retain exclusive freight rights on the sold properties.

4. Other Current Liabilities—and Other Liabilities

Other current liabilities include the following amounts:

	December 31,	
(in millions)	1994	1993
Reserves for casualty, freight-related claims and other (current portion)	$ 225.4	$ 165.3
Accrued repairs, equipment rentals and other payables	373.2	350.7
Post-retirement and post-employment benefit obligations	17.2	20.6
Reserve for employee separation and relocation (current portion)	11.5	25.0
TOTAL	$ 627.3	$ 561.6

Included in other non-current liabilities are $322.0 million and $329.0 million for casualty and freight-related claims and $-0-million and $35.3 million for employee separation and relocation at December 31, 1994 and 1993, respectively, in addition to $157.5 million and $148.8 million for post-retirement and post-employment benefits other than pensions at December 31, 1994 and 1993, respectively.

5. Long-Term Debt

Long-term debt is summarized as follows:

(in millions)	December 31, 1994	December 31, 1993
Equipment obligations (9.125–14.25%; due 1995 to 2007)	$ 324.5	$ 380.4
Mortgage bonds (8.2%; due 1995 to 2001)	34.7	39.6
SPT credit agreement (various; due 1996)	—	125.0
RGH credit facilities (4.688–6.0%; due 1995 to 1997)	—	117.0
SPT senior secured notes (10.5%; due 1999)	—	290.0
SPRC senior notes (9.375%; due 2005)	375.0	375.0
Other debt (4.0–7.613%; due 1995 to 2018)	93.0	88.1
Capitalized lease obligations (Note 9)	332.6	73.5
TOTAL	1,159.8	1,488.6
Less discount recorded in purchase accounting	(11.0)	(13.6)
Less current portion	(59.5)	(66.7)
TOTAL LONG-TERM	$ 1,089.3	$ 1,408.3

On March 2, 1994, the Company closed an offering of 25,000,000 shares of common stock for net proceeds of $503.6 million ("the 1994 Offering"). The proceeds were used to repay the $117 million outstanding under the RGH credit facilities, to repay the $175 million outstanding under the SPT Credit Agreement and for general corporate purposes.

In November 1994, the Company entered into a new $300 million three-year revolving credit agreement to replace its existing $200 million credit agreement. This agreement contains quarterly financial covenants including minimum tangible net worth, a maximum funded debt to net worth ratio and a minimum fixed charge coverage ratio. No borrowings have been made under the new facility.

In December 1994, the Company entered into a bank agreement permitting the Company to borrow up to $150 million as a term loan maturing in 1999. The agreement contains quarterly financial covenants identical to those contained in the revolving credit agreement. Any borrowing under the facility must be made by December 27, 1995. No borrowings have been made under this facility.

In December 1994, using proceeds from the sale of the Alameda Corridor of $235 million, together with other funds on hand, the Company retired the $290 million outstanding under the SPT Senior Secured Notes. The repayment was accomplished by placing approximately $297 million of government securities in a defeasance trust in December 1994. In connection with the retirement of the Senior Secured Notes, the Company wrote-off in other expenses $9.4 million of unamortized debt issuance costs and paid a prepayment premium of $5.8 million and expensed in interest expense $5.2 million attributable to the Company's interest rate swap agreements.

Contractual maturities of long-term debt (including capital lease obligations) during each of the five years subsequent to 1994 and thereafter are as follows:

(in millions)	
1995	$ 59.5
1996	53.0
1997	53.0
1998	45.6
1999	54.4
Thereafter	894.3
TOTAL	$ 1,159.8

Management estimates the fair value of the Company's debt at December 31, 1994 and 1993 was approximately $1,128 million and $1,581 million, respectively, based on interest rates for similar issues and financings.

At December 31, 1994, the Company was a party to interest rate swap agreements for which it pays a variable rate on an aggregate notional amount of $100 million, which is used to hedge its fixed interest rate exposure on certain debt and is accounted for as an adjustment of interest expense over the life of the debt. The approximate expense to terminate the swap at December 31, 1994, was $4 million.

A significant portion of railroad equipment and certain railroad property is subject to liens securing the mortgage bonds, equipment obligations or other debt.

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6. Income Taxes

The following summarizes income tax expense (benefit) for the years indicated:

(in millions)	Year Ended December 31, 1994	1993	1992
CURRENT			
Federal	$ 3.6	$ —	$ —
State	0.1	—	0.1
TOTAL	3.7	—	0.1
DEFERRED			
Federal	133.5	(25.1)	18.9
State	23.5	(5.2)	3.7
TOTAL	157.0	(30.3)	22.6
DEFERRED TAXES on cumulative effect of change in accounting for post-employment benefits in 1994 and post-retirement benefits other than pensions in 1993			
Federal	(3.3)	(54.6)	—
State	(.5)	(9.7)	—
TOTAL DEFERRED TAXES ON CUMULATIVE EFFECT	(3.8)	(64.3)	—
TOTAL INCOME TAX EXPENSE (BENEFIT)	$156.9	$ (94.6)	$ 22.7

Deferred tax expense in 1993 included $1.2 million related to the change in the Federal tax rate. Total income tax expense (benefit) from continuing operations differed from the amounts computed by applying the statutory Federal income tax rate to income before income taxes as a result of the following:

	Year Ended December 31, 1994	1993	1992
Statutory rate	35.0%	(35.0)%	34.0%
State income taxes (net of Federal income tax benefit)	4.4	(4.5)	4.5
Cumulative effect of Federal tax rate change (from 34% to 35%)	—	1.6	—
Other, net	(0.1)	(2.4)	2.2
EFFECTIVE RATE	39.3%	(40.3)%	40.7%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

(in millions)	December 31, 1994	1993
DEFERRED TAX ASSETS		
Accruals and reserves not deducted for tax purposes until paid	$ 382.2	$ 363.1
Net operating loss carryforwards	565.5	609.3
Capital lease obligations	135.5	29.9
Other	68.2	65.8
TOTAL GROSS DEFERRED TAX ASSETS	1,151.4	1,068.1
DEFERRED TAX LIABILITIES		
Differences in depreciation and cost capitalization methods (including deferred gains on property)	(1,373.6)	(1,119.5)
Other	(1.2)	(16.2)
TOTAL GROSS DEFERRED TAX LIABILITIES	(1,374.8)	(1,135.7)
NET DEFERRED TAX LIABILITY	$ (223.4)	$ (67.6)

The Company has analyzed the sources and expected reversal periods of its deferred tax assets and liabilities. The Company believes that the tax benefits attributable to deductible temporary differences and operating loss carryforwards will be realized by the recognition of future taxable amounts related to taxable temporary differences for which deferred tax liabilities have been recorded. Accordingly, the Company believes a valuation allowance for its deferred tax assets is not necessary.

The former parent of SPT has agreed to indemnify SPRC, SPT and its subsidiaries against any Federal income tax liability that may be imposed on the Company or its 80%-owned subsidiaries for tax periods ending on or prior to October 13, 1988 ("the Acquisition Date"). Years prior to 1984 are closed. SPRC agreed to pay or cause SPT and its subsidiaries to pay to the former parent any refund of Federal income taxes attributable to the 80%-owned subsidiaries received by SPRC, SPT or its subsidiaries after the Acquisition Date for any tax period ending on or prior to the Acquisition Date. Further, the former parent also agreed to indemnify SPRC, SPT and its subsidiaries, at least in part, for state, local and other taxes in respect of periods to and including the Acquisition Date, but only to the extent that such taxes are due or reportable for periods prior to the Acquisition Date.

The Federal income tax returns for the periods from October 14, 1988 through 1990 have been examined and are currently being considered by the Appeals Office of the Internal Revenue Service ("IRS") regarding various unagreed issues. The Company's consolidated Federal income tax returns are currently being examined for the years 1991 through 1993. Management believes adequate provision has been made for any potential adverse result.

The IRS's audit of RGH's returns for 1983 and the period ended October 31, 1984, led to the issuance of a Notice of Deficiency in October 1992 for 1980, 1983 and the period ended October 31, 1984. The audit of The Anschutz Corporation ("TAC"), of which RGH was a member from November 1, 1984, through October 13, 1988, also led to the issuance of a Notice of Deficiency for the 1979 and 1982 years as the result of the disallowance of net operating loss carryforward ("NOL") and investment tax credit carrybacks from the July 31, 1985 through July 31, 1987 periods. Both notices have been petitioned to the United States Tax Court. RGH does not expect a resolution of these cases in 1995. RGH's taxable periods from July 1, 1987 through October 13, 1988, included in the consolidated returns of TAC, are currently under IRS audit as part of the TAC audit. However, management believes adequate reserves have been provided to cover any anticipated deficiencies for these tax years.

As of December 31, 1994, the Company had approximately $1.4 billion of NOLs that expire in 2003 through 2008. The NOLs are subject to review and possible disallowance, in whole or in part, by the IRS upon audit of the Federal income tax returns of the Company.

Section 382 of the Internal Revenue Code of 1986, as amended, limits a corporation's utilization of its NOLs when certain changes in the ownership of the corporation's stock occur within a three-year period. Such a change has occurred with respect to the Company and therefore the Company will be permitted to deduct only a portion of its NOLs in each taxable year, commencing with the year ending December 31, 1994. The Company currently does not expect, however, that the limitation imposed under Section 382 will have a material adverse impact on the Company's ability to utilize its NOLs prior to their expiration. Nevertheless, the limitation could under certain circumstances delay the Company's utilization of its NOLs and thereby increase the current portion of the Company's Federal income taxes. Further, the limitation under certain circumstances could also cause a portion of the Company's NOLs to expire unutilized.

7. Redeemable Preference Shares of a Subsidiary

SSW, a 99.9%-owned subsidiary of SPT, originally issued $53.5 million ($48.5 million Series A and $5.0 million Series B) of SSW's non-voting redeemable preference shares. The current carrying amount on the balance sheets at December 31, 1994 and 1993 reflects the outstanding balances of the redeemable preference shares of $44.2 million and $46.0 million, respectively, less purchase accounting discounts of $21.6 million and $23.0 million, respectively.

The Series A shares are subject to mandatory redemption at face value over a 20-year period commencing in 1991, at which time mandatory dividends shall be declared and paid over the same period. The overall effective interest rate since the date of issue is approximately 2.0%. The Series B shares are subject to mandatory redemption at face value over a 15-year period commencing in 1989. Mandatory dividends shall be declared and paid over a 10-year period commencing in 1994. The overall effective interest rate since the date of issue is approximately 4.9%.

Mandatory redemptions and mandatory dividends of Series A and Series B shares scheduled for payment during each of the five years subsequent to 1994 are $4.2 million per year.

The Series A and Series B shares restrict certain dividend payments by SSW to its common and preferred shareholders. Under these provisions, at December 31, 1994, $53.2 million of SSW's historical cost basis retained income was not restricted. No estimate of the fair value of the preference shares was made by the Company.

8. Capital Transactions

On August 17, 1993, the Company closed the initial public offering and sale of 30,783,750 shares of common stock (the "IPO") and the issuance and sale of $375.0 million principal amount Senior Notes (the "Debt Offering") for net proceeds of $757.1 million. The proceeds were used to repay $481.2 million of debt and debt related costs, to purchase $99.1 million of equipment operated pursuant to operating leases, to redeem the Company's $75.0 million 12% preferred stock and for general corporate purposes. On March 2, 1994, the Company closed an offering of an additional 25,000,000 shares of common stock for net proceeds of $503.6 million. The proceeds were used primarily to repay $292 million of debt and for general corporate purposes.

The Board of Directors of the Company is authorized without further stockholder action to provide for the issuance from time to time of up to one million shares of preferred stock, in one or more series. Of such number of authorized shares, 75,000 shares of preferred stock designated as 12% cumulative Redeemable Exchangeable preferred stock ("preferred stock") were issued and outstanding as of December 31, 1992. The preferred stock ranked senior to the Company's common stock with respect to dividend rights and rights on liquidation. The preferred stock had a liquidation value of $1,000 per share and dividends on the preferred stock were cumulative at the annual rate of $120 per share. On August 17, 1993, as part of the IPO and the Debt Offering, the preferred stock was redeemed.

Prior to the IPO, the Company was obligated, pursuant to agreements entered into on October 13, 1988 and September 29, 1990, to repurchase up to 28,750,000 shares of its common stock from certain investors, at the election of the investors, if one or more nationally recognized independent experts determined that the Company was financially capable of doing so. Those shares were classified as Common Stock Subject to Repurchase in the accompanying financial statements. The Company's commitment to repurchase the shares of common stock terminated upon completion of the IPO.

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9. Leases

The Company leases certain freight cars, locomotives, data processing equipment and other property. Future minimum lease payments under noncancelable leases as of December 31, 1994, are summarized as follows:

(in millions)	Capital Leases	Operating Leases
1995	$ 24.3	$ 152.7
1996	44.5	140.2
1997	40.9	130.3
1998	39.8	121.8
1999	46.7	106.5
Thereafter	503.9	349.4
TOTAL MINIMUM PAYMENTS	700.1	$1,000.9
Less amount representing interest (at rates ranging from 7.2% to 13.1%)	(367.5)	
PRESENT VALUE OF MINIMUM LEASE PAYMENTS	$ 332.6	

Rental expense for noncancelable operating leases with terms over one year was $168.7 million, $156.5 million and $117.6 million for the years ended December 31, 1994, 1993 and 1992, respectively. Contingent rentals and sublease rentals were not significant.

In late 1993 and 1994, as part of a program to upgrade its locomotive fleet, the Company acquired 150 new locomotives, 17 of which were delivered in the last quarter of 1993 with the balance delivered in 1994. Additionally, the Company acquired 133 remanufactured locomotives of which 115 were delivered in 1994 and the balance in early 1995. These locomotives were financed by capital leases (for which the total capitalized lease obligation in 1994 is approx-imately $221 million). The Company acquired through capital lease financing approximately 1,400 freight cars of which 700 were newly manufactured and 700 were remanufactured for which the total capitalized lease obligation in 1994 was approximately $56 million. The Company also received approximately 1,600 additional reconditioned freight cars in 1994 on which it expects to complete capital lease financing in 1995. In addition, the Company acquired 350 used freight cars in 1994 under operating leases.

The Company has ordered an additional 206 AC-powered locomotives to be financed by capitalized lease financing that are scheduled to be delivered during the second and third quarters of 1995. In addition, the Company has ordered 920 new hopper cars and expects to receive approximately 1,500 reconditioned freight cars in 1995. The Company expects to finance these acquisitions through capitalized lease financing. The total expected capitalized lease obligation to be incurred in 1995, including the 1,600 reconditioned freight cars received in 1994 for which financing is to be arranged in 1995, is approximately $400 million.

In 1984, the Company entered into a long-term lease agreement with the ports of Los Angeles and Long Beach relating to the Company's Intermodal Container Transfer Facility (the "Facility"). Under the terms of the lease, the Company is obligated to make certain future minimum lease payments and is subject to additional contingent rentals which are based on the annual volume of container movement at the Facility. The minimum lease payments, ranging from approximately $3.9 million to $4.5 million for 1995 and 1996, respectively, are included in the table above. However, for each five-year period from 1997 through 2036, the amount of the annual minimum lease payments and contingent rentals will be determined by the ports based on independent appraisals of the fair rental value of the property and, therefore, no amounts are included in the above table for such years. The 1994 expense was $7.6 million.

The Company leases operating rights on track owned by other railroads and shares costs of transportation facilities and operations with other railroads. These include rights on Union Pacific lines between Kansas City and St. Louis and on Burlington Northern Railroad Company lines between Kansas City and Chicago. The Company has the right to terminate its usage with certain notice periods. Net rent expense for trackage rights was $6.4 million in 1994, $1.9 million in 1993 and $13.0 million in 1992. The 1993 amount includes the benefit of the negotiated settlement of a joint facility case of approximately $10 million.

The Company pays for the use of transportation equipment owned by others and receives income from others for the use of its equipment. It also shares the cost of other transportation facilities with other railroads. Rental expense and income from equipment and the operation of joint facilities are included in operating expenses on a net basis. Total net equipment lease, rent and car hire expense was $328 million, $331 million and $288 million for 1994, 1993 and 1992, respectively.

10. Employee Benefit and Compensation Plans

Pension Plan

The Company is a participating employer under the SPRC Pension Plan (the "SPRC Pension Plan"). The SPRC Pension Plan is a defined benefit noncontributory pension plan covering primarily employees not covered by a collective bargaining agreement. The SPRC Pension Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). Pension benefits for normal retirement are calculated under a formula which utilizes average compensation, years of benefit service and Railroad Retirement and Social Security pay levels. The Company's funding policy is to contribute each year an amount not less than the minimum required contribution under ERISA nor greater than the maximum tax deductible contribution. The assets of the SPRC Pension Plan consist of a variety of investments including U.S. Government and agency securities, corporate stocks and bonds and money market funds.

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