



South Dakota Department of Transportation

**Proposal to Purchase Mitchell to Rapid City (“MRC”)
Rail Line**

Prepared By

Watco Companies



Table of Contents

Watco's Customer First Foundation Principles	4
Watco Information	5
Lines to be Purchased	10
Purchase Price	10
Service Protections	11
Trackage Rights, Haulage Rights, and Interchange Rights	15
Current Grant Commitments	15
Future Grant Commitments	15
Loan Commitments	15
Other Financial Commitments	15
Lease and Sub-lease Agreements	15
Permits, Licenses, Excess Property Leases, and other Land Use Agreements	15
Approval of Sale	15
Environmental Liabilities	16
Condition of Sale	17

Watco's Customer First Foundation Principles

At Watco, our Customer First Foundation Principles are the overall guiding light and driver for our team members. Every day these principles are our guide, providing a clear path for what we do, the decisions we make and the manner in which we do our jobs.

Customer First Foundation Principles

Customer First - Safety Always!

Value Our Customers

- Earn their business every day by providing Safe, Accurate, and Timely Service
- Create solutions that deliver value for our Customers and Watco over the long term

Value Our People

- SAFE Service, ALWAYS
- Be Honest and Fair

Safely Improve Every Day

- Always do the right thing and always try to find a better way
- Build a tremendous future by making decisions that protect our Customer, Team, Community, and Environment

History and Background Information

Watco is a privately held company which specializes in providing fully customizable transportation, mechanical, terminal, port, and supply chain based solutions for Customers throughout the US, Mexico, Canada and Australia.

Founded in 1983, Watco is majority owned by the family of our Watco Founder, Dick Webb. Watco currently provides four main services to its Customers. They are broken out as follows.

Watco Transportation Services, (“WTS”) is the largest privately owned short line railroad holding company operating 42 short line railroads in the US and 2 in Australia. Watco Transportation operates and maintains more than 5,400 miles of track and 33 industrial contract switching locations.

Watco Terminal and Ports, (“WTPS”) currently owns and operates 86 terminal and port locations throughout North America. WTPS is a leader in bulk, break-bulk, and liquids rail/truck transloading, railroad switching, warehousing, liquid tank storage, and barge and vessel loading/unloading. Our ports and terminals handle more than 350 different products, including ethanol, crude oil, chemicals, dry bulk, food grade products, plastics, and waste materials in a safe, cost-effective, and environmentally responsible way.

Watco Mechanical Services, (“WMS”) operates at 29 locations with AAR certified tank car shops and AAR certified mechanical shops. Our mobile capabilities include eight locations serving anyone needing AAR certified tank car and mechanical repairs that are open to all Customers. We also operate five dedicated locations providing a mobile solution specific to each Customer.

Watco Supply Chain Services (“WSCS”) focuses primarily on developing the most cost-effective supply chain solutions for our Customers. WSCS’s provides Watco Customers with Truck, Rail, Intermodal, Maritime, and Customs Brokerage services on a global scale.

All combined Watco employs approximately 4,900 team members and produced approximately \$1,000M of revenue in 2018 by always trying to improve the quantity and caliber of our Customer Service and solutions.

Watco Leadership Personnel and Command Structure

Our Customers can be assured that the most experienced members from our Leadership team are present to ensure a safe, efficient operation. Conductors, engineers and track personnel are selected from our experienced teams in the Watco family of Short line Railroads. Management Team Members include:

Watco Executive Team

Rick Webb	Executive Chairman
Dan Smith	Chief Executive Officer
Rick Baden	President and Chief Financial Officer

Craig Richey	Executive Vice President, General Counsel
Stefan Loeb	Executive Vice President, Chief Commercial Officer
Rachael Peterson	Executive Vice President, Chief People Officer

Stefan Loeb – EVP, Chief Commercial Officer – As CCO, Stefan focuses on building and growing strong Customer relationships and leading the development of new commercial opportunities for Watco. Stefan’s emphasis on relationships has played a key role in the acquisitions of the Wisconsin and Southern Railroad, Ann Arbor Railroad, Blue Ridge Southern Railroad, and the Birmingham Terminal Railway, which were the largest railroad purchases in Watco history. Prior to joining Watco, Stefan spent nine years in the banking industry, working mostly with a portfolio centered on serving Customers in the short line and regional railroad industry as well as the rail supply industry. Stefan attended Indiana University-Bloomington where he received a bachelor’s degree in Business Finance from the Kelley School of Business.

Nick Coomes-EVP and Chief Operating Officer-Nick is responsible for overseeing the day-to-day operations of the transportation, terminal and port, and mechanical divisions, while ensuring that all operations are performed safely. Nick joined the Watco Team in January of 2014 as Vice President of operations support for Watco Terminal and Port Services. He most recently served as SVP of operations. Under Nick’s leadership, Watco saw the successful integration of the Kinder Morgan terminal acquisitions and the start-up of a new Watco service offering in the Houston deep-water stevedoring operations. Prior to joining Watco, Nick spent nine years at Dr Pepper Snapple where he held several positions, including director of engineering, where he led the scoping and execution of various marketing, packaging, and manufacturing related projects. Nick received a bachelor’s degree in Plastic Engineering and a master’s in Business Administration from Pittsburg State University in Pittsburg, KS.

Travis Herod –SVP Safety and Training – Travis is a Clayton College and State University Rail Training Program graduate. Travis has over 23 years of transportation experience; 8 years aviation transportation, 15 years railroad experience. He has been with the Watco Safety Team for 10 years and helped introduce accident and incident reduction programs. The programs have resulted in significant reduction in incidents and accidents and a better qualified and trained workforce ready to meet the demands of today’s rail industry. Travis is FRA certified Conductor and Locomotive Engineer, and Designated Supervisor of Locomotive Engineer under 49 CFR part 240. Recurrent training qualifications include SERTC Leadership and Management of Transportation Incidents, FEMA IS100 Incident Command Training, FEMA IS-700 National Incident Management training, FRA Hazardous Materials Transportation by Rail training. Travis currently serves as primary Locomotive Engineer, and Conductor Program Manager, and TSA Rail Security Coordinator for Watco Transportation Services.

Ron Spencer –Commercial Director – Ron is a University of Arkansas graduate with a degree in Transportation and Logistics Management. Ron has over 26 years of transportation experience; 11 years truck transportation with JB Hunt, Prime INC, and TMC. Two years as Director of Distribution and Logistics for BC Rogers Poultry before joining the Watco team. He has been with the Watco Team for 12 years and recently joined the Commercial team after 11 years leading the Customer Service team. In addition to his Commercial responsibilities Ron also coordinates all of Watco’s dimensional rail shipments and assists with Customer integration.

Parental Relationships and Guarantor Relationships

Watco is blessed to have outstanding strategic relationships that have helped grow the company at a 10+% compounded annual growth rate since its inception. Watco's strategic relationships that represent both its common and preferred equity partners are outlined in the following slide:



Watco's Strategic Relationships

<p style="text-align: center;">Oaktree Transportation Investment Fund "TIF"</p> <div style="display: flex; justify-content: center; gap: 10px;">    </div> <ul style="list-style-type: none"> • Oaktree has over \$120B of assets under management and \$2.5B investments in infrastructure • TIF is exclusively focused on long term North American transportation infrastructure • TIF partners have deep transportation experience 	<p style="text-align: center;">Kinder Morgan</p>  <ul style="list-style-type: none"> • Largest Pipeline Company and 3rd largest Energy Company in North America 	<p style="text-align: center;">Norfolk Southern</p>  <ul style="list-style-type: none"> • Largest Railroad in Eastern Half of the U.S. and 3rd largest in North America 	<p style="text-align: center;">Crowley Maritime</p>  <ul style="list-style-type: none"> • Second Largest Private Maritime Business in North America • Investment through SkyKnight Capital with 6 other Family Offices
--	---	--	--

Watco's ownership structure is as follows:

<u>Common Equity Owner</u>	<u>% Ownership</u>
Webb Family (Watco Management)	91%
Crowley Maritime (Skyknight)	6%
Kinder Morgan	2%
Norfolk Southern	1%

Business Goals

At Watco, we pride ourselves on creating value for our Customers while spending resources wisely. Watco is privately held and its capital is structured with a syndicate of banks who have provided the necessary capital to ensure stable operations and growth positioning. The five key components of the Watco's Financial Strategy are: 1) Revenue Growth; 2) Operating Efficiency; 3) Asset Utilization; 4) Risk Management; 5) Public and Private Partnerships.

Working toward these goals, we have implemented efficiency standards to measure our performance week-over-week in all areas of responsibility. These standards are measured and reviewed each week with local personnel where actual performance is compared to expectation. Any corrective action deemed necessary is implemented immediately. The measurement is driven by continually reducing consumption as it relates to a constant such as revenue moves or railcars switched.

At Watco, we believe communication is a critical component of our success. Our managers and team members communicate with our Customers daily to review ideas, concerns or issues. We feel that by improving our baseline communication with our Customers we will be able to improve our efficiencies more rapidly and effectively.

Line to be Purchased

Mitchell to Rapid City, SD ("MRC Line")

- Total Mileage: approximately 285.1
- Mitchell to Kadoka segment leased to MRC Regional Railroad Authority (through 2031)
- Operator: Dakota Southern Railway (through 2031 via sublease)
- Overhead trackage/haulage rights on Burlington Northern Sante Fe, LLC ("BNSF") Railway's lines to multiple interchange points for traffic originating/terminating on the MRC Line; trackage rights over BNSF line to access CHS Inc.'s grain elevator shuttle facility at Mitchell, SD; interchange rights with BNSF at Mitchell, SD
- Dakota Southern Railway Company holds a right of first refusal
- Class I and Class II purchasers require consent of BNSF Railway to maintain trackage/haulage/interchange rights
- Segments from Kadoka to Caputa and Caputa to Rapid City are railbanked.
- Maple Street Yard in Rapid City leased to American Colloid Company for car storage (through July 26, 2026)

Purchase Price

MRC Line \$13,000,000.00 to be paid as follows

\$ 5,000,000.00 in cash at closing, with the balance, after subtracting any monies owed to the State, to be paid in 5 equal installments on the anniversary date of closing the transaction.

The MRC Line purchase will include mainline tracks, sidings, extra width property facilities and any property which is currently subject to a lease by the State to a third party. In addition, the

purchase of the MRC Line purchase will include all contracts, improvements and other assets associated with the State’s ownership of the MRC Line. The purchase price includes the unpaid balance of \$4,348,600.00 that is owed to the State.

Service Protections

Expected operations improvements

Watco operates 42 shortline railroads in North America and has over 32 years of experience in the short line industry. We have relationships and business agreements with all of the Class I railroads. Our experience will allow us to evaluate current operations and determine the appropriate staffing, locomotive power, and management necessary to provide the service our Customers expect. We would work with the Dakota Southern Railroad, (“DSR”), who we have an outstanding relationship with, to insure all of Watco’s resources would be at DSR’s disposal to insure the best Customer Service is delivered in the safest and most value creating manner possible for all concerned.

Capital investment – Maintenance of Way Plan

Watco and DSR will develop the best plan possible to maintain and improve the track structure of the MRC Line. Our initial 3 year plan is broken out in detail below.

Annual Repair for the 1st 3 years of operation

Install 5,000 new and relay ties	\$ 400,000.00
Apply 15,000 tons of ballast	\$ 450,000.00
Tamping twice per year	\$ 800,000.00
Ditching / Undercutting	\$ 350,000.00
Crossing(s) Repair	\$ 80,000.00
Miscellaneous	<u>\$ 60,000.00</u>

Annual Total \$2,140,000.00

3 Year Total \$6,420,000.00

Post 3 Year plan calls for an average of \$2,000,000.00 to \$3,000,000.00 of track maintenance and capital spend annually.

Potential expansion

Watco has grown from one profit center, starting in 1983, to over 200 profit centers today in 4 countries and on 2 continents. We have found the best source of opportunity lies within our existing profit centers or at least within close proximity to them. Should Watco be successful in purchasing the MRC Line, we anticipate additional growth will be achieved not only through the expansion

of railroad services by working in conjunction with the DSR but by also bringing our WTPS, WMS and WSCS services to the lines for the benefit of our Customers, our communities, the State and Watco.

Projected industry development

The two best ways growth can occur, in a service-based business like Watco's, is for existing Customers to use more services or have new Customers start using Watco's services. Watco plans to work with the DSR to enhance its already good relationships with its Customers and the BNSF to insure rail service to can be maximized. In addition, Watco will work hand in hand with the DSR and the State to attract new industrial development to the lines. Watco has a 50-person commercial team and a 20-person business development team that will be assigned to grow business with new and existing Customers.

Identification of management headquarters

Watco plans to have its local operational headquarters in the Mitchell region and other satellite operational offices as needed. Watco will work with the DSR to grow its team member base as the need to provide additional services to our Customers grows. No job reductions in the State are anticipated.

Marketing plan

Watco's goal is to provide the best transportation services to its Customers in the safest and most efficient and economical manner possible. We want to operate in an environment that allows our team to improve and grow, passing on to future generations a company with an outstanding reputation for Customer service, safety, profitability and quality. Watco has a long history of success in establishing and promoting unit train and shuttle loader service throughout the grain belt and would look to bring the expertise to the South Dakota market. We would utilize our Customer relationships throughout North America to bring increase business to South Dakota.

As shown in the following slide, Watco has tremendous relationships with many of the same type of Customers that use the lines today since agricultural volumes represent almost 30% of our railroad carloads.

Rate or service modifications

Rate modifications would be coordinated with the DSR but are expected to be minimal except where they were beneficial to our Customers and ourselves. We would look at various items including increased locomotive power, increased team members, increased track capacity, and increased equipment to handle new and additional business.

Expected impact to existing shippers

Watco would expect all impacts to existing shippers to be positive. We will partner with our Customers and explore ideas for improvement. We are always prepared to invest in the future of

our Customers through collaboration, cooperation, and investment. If the State or any of our Customers would like a list of references from our existing Customer base, one will be provided.

Expected impact to communities

Watco continually works with the communities we operate in to be a successful partner. We have several examples of community projects our team members have participated in and developed over the years.

Experience operating short line railroads

WTS is the largest privately owned short line railroad holding company operating 42 short line railroads in the US and 2 in Australia. WTS operates and maintains more than 5,400 miles of track and 33 industrial contract switching locations. In 1985 Watco had the opportunity to purchase Union Pacific's first short line spin off running from Coffeyville, KS to Nevada, MO and has continually operated a portion of the line to this day. Watco continues to expand its short line railroad inventory with the most recent addition being the Savannah and Old Fort Railroad in Savannah, GA in September 2019.

Projected economic impact

Watco has historically grown new railroad profit centers at about 10% compounded annual growth rates for the first five years in operation. After that organic growth then slows to about 6% as shown on the slide below.

Watco Overview Organic Revenue Growth



- **Average Organic Revenue Growth: 2010 - 2018**
 - Freight Revenue **4.3%**
 - Non Freight Revenue **7.4%**
 - Combined Organic Revenue Growth **5.8%**



With this growth comes additional jobs and investments that benefit our Customers, our Team Members, our communities and the State. Watco believes the MRC Line has good growth opportunities that will benefit all the key stakeholders.

Trackage Rights, Haulage Rights, and Interchange Rights

Watco has enjoyed a long term and successful relationship with the BNSF for over 36 years. We are confident that we will be able to negotiate and secure any applicable rights as a result of the settlement agreement and related documents.

Current Grant Commitments

Watco will comply with all reporting and other requirements associated with any grants associated with the lines. If the reporting needs to improve or be made more frequently, Watco would be open to consider such requests.

Future Grant Commitments

Watco will comply with all reporting and other grant requirements in the event a grant is awarded on the MRC Line.

Loan Commitments

Watco is proposing to pay off the unpaid balance of \$4,348,600.00 that is owed to the State and or the Regional Railroad Authority with cash at closing. The unpaid balance of \$4,348,600.00 is included as part of Watco's proposed purchase price for the MRC Line.

Other Financial Commitments

Watco is proposing to pay off the unpaid balance of \$4,348,600.00 that is owed to the State and or the Regional Railroad Authority with cash at closing. The unpaid balance of \$4,348,600.00 is included as part of Watco's proposed purchase price for the MRC Line.

Lease and Sub-lease Agreements

Watco understands that any early termination of the operating leases or subleases will be a matter of private negotiation between Watco and the lessees or sub lessees and will not be the responsibility of the SDDOT.

Permits, Licenses, Excess Property Leases, and other Land Use Agreements

Watco understands that the SDDOT reserves the right to exclude any excess property from the sale of the Lines at any time prior to execution of a Line purchase agreement.

Approval of Sale

Upon approval of the sale Watco may file the appropriate legal notices as required by the STB and other regulatory agencies. Once filed it will take approximately 60 days to receive approval from the STB. Watco has filed hundreds of notices with the STB and has never experienced any significant issue in gaining approval of railroad operating authority. Depending upon our discussion with the DSR, no STB approval may be needed but no matter any STB approval should not take more than 60 days to obtain.

Environmental Liabilities

Watco Environmental Policy: <https://www.ehs.com/>

- Risk Protection – Watco has a risk/liability insurance plan that is second to none in the short line railroad industry. Currently Watco maintains an \$800,000,000 liability/accident insurance limit for damages/injuries that occur from Watco provided services. Watco maintains excellent relationships with their insurance providers and will only do business with “A” rated insurance providers.
- Comply with all external regulations, and conform to all internal policies;
- Improve Continuously via gap assessments, mitigation of potential impacts, and audits of, and corrective actions for, ongoing activities;
- Reduce Risk using engineering, administrative and PPE controls/measures;
- Raise Awareness among all Stakeholders via training, hazard analysis, behaviour-based observations, etc.;
- Utilize Proven Methods of Pollution Prevention (P²)--hazardous materials minimization, increased reuse and recycling, and standardized waste contracts;
- Report Promptly and Clean-Up thoroughly any release to the environment, utilizing root cause analyses to assess and implement preventative measures;
- Demonstrate Social Responsibility by courteous, safe, and environmentally-sensitive operations at all Watco assets.

Watco also uses Environmental Software Solution that provide interactive EHS dashboards to all Team Members which consist of:

- Track permits, applicable external regulations and internal policies
- Maintain permits and associated action items
- Report and track all spills and releases
- Perform audits and inspections, tracking action items to completion

- Generate action item reminders, reports, checklists, etc.
- Retain correspondence, sample analysis, evidence, etc.
- Provide Management with up-to-date metrics for improvement

Conditions of Sale

Watco affirms that we agree and can comply with all terms of the IFP conditions as outlined in the conditions of sale listed in Section 4. Watco is prepared to address any other contingencies required by the SDDOT.

1. Watco agrees that the SDDOT will have an ability to re-purchase the Lines in an abandonment proceeding or if Watco were to discontinue service for any reason.
2. Watco agrees that the SDDOT has preferred re-purchase rights if a sale is contemplated to another buyer.
3. Watco agrees with the SDDOT requirement that any assignee or successor to Watco must abide by the terms of the sale agreement.
4. Watco agrees with the SDDOT requirement that the sale of the line be considered “AS IS, WHERE IS”, as allowed by law.
5. Watco agrees with the provision requiring Watco to indemnify the SDDOT and hold the SDDOT harmless for any claims related to any acts or omissions after the closing of the sale.
6. Watco agrees to the provisions requiring Watco to fully protect any haulage, trackage, and interchange rights that apply to the line as a result of the SDDOT’s settlement with BNSF, and to fully comply with any other obligations that apply to Watco pursuant to that settlement agreement.
7. Watco understands the SDDOT will retain mineral rights as required by South Dakota law.
8. Watco agrees that the purchase will be subject to the right of highway authorities to maintain, construct, re-construct, sign, mark and repair all existing public highway crossings.
9. Watco understands that the SDDOT will reserve a right to crossings that have not yet been constructed but are identified in the SDDOT’s current Statewide Transportation Improvement Plan.
10. Watco agrees that the lines will be conveyed by quit claim deed and Watco will waive any title defects.

Watco is always ready for potential investment when the opportunity arises and we have the financial standing and relationships with major banks that allows us provide that investment. From infrastructure improvements to locomotive power we will be ready to support and grow with our Customers and the State of South Dakota.