



Strategic Plan

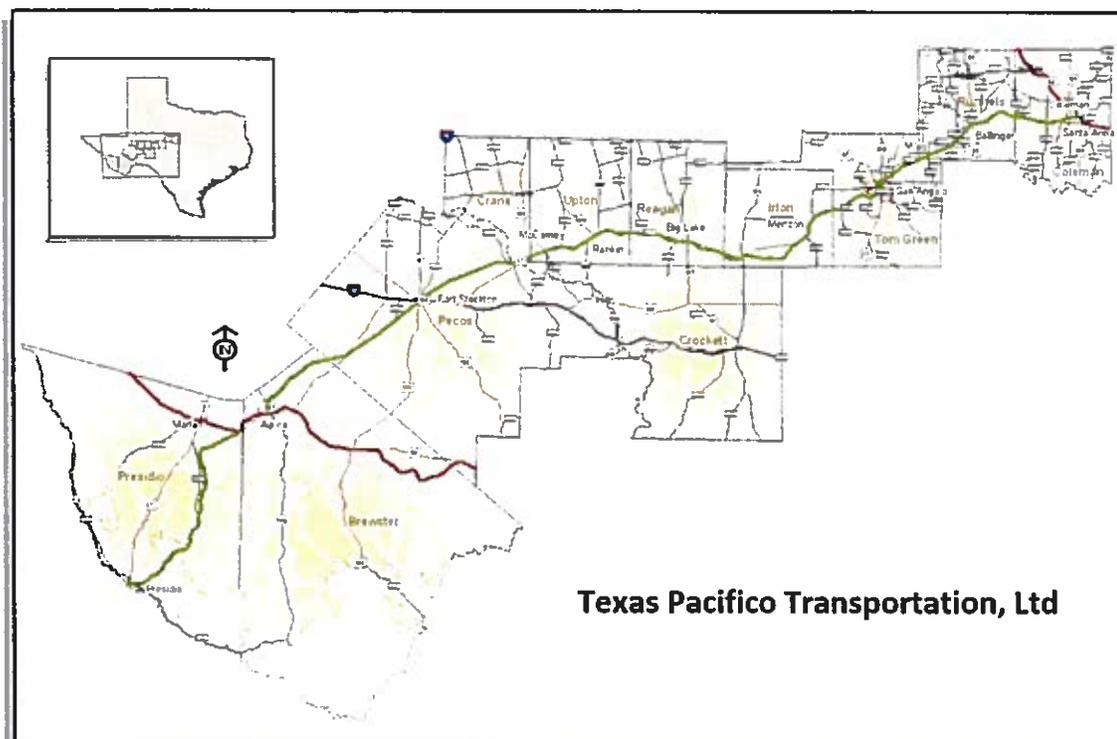
In Cooperation with the Texas Department of Transportation

June 2016

Background

On January 31, 2001, Texas Pacific Transportation, Ltd. (TXPF) entered into a Lease and Operating Agreement (LOA) with the Texas Department of Transportation (TxDOT) for the rail line between San Angelo Junction and Presidio, Texas, commonly known as the "South Orient Rail Line" (SORR). The LOA has an initial term of 40 years, with 5 renewal options of 10 years each, and grants TXPF exclusive operating rights over the line.

The line begins at San Angelo Junction, approximately 5 miles southwest of Coleman, at the connection to BNSF Railway's Lampasas Subdivision. The 373 miles of main line track travels in a generally southwesterly direction through Coleman, Runnels, Tom Green, Irion, Reagan, Upton, Crane, Crockett, Pecos, Brewster, and Presidio Counties to the U.S./Mexico border at Presidio, Texas. There are many communities located along the line which can benefit from having rail service available, including Talpa, Rowena, Ballinger, Miles, San Angelo, Mertzon, Barnhart, Rankin, McCamey, Fort Stockton, Belding, Alpine, and Presidio.



The rail line was in poor condition due to deferred maintenance by prior owners when the lease was executed and was designated as FRA¹ "Excepted Track". Excepted Track status restricts train speeds to 10 mph, limits hazardous materials movements to

¹ Federal Railroad Administration

5 carloads per train, and prohibits the movement of occupied passenger cars on the tracks. TXPF was faced with a proverbial “chicken and egg” scenario; the line needed major rehabilitation investments in order to attract business, but increased business was needed in order to generate revenue for major investments. The lease required TXPF to maintain the line in the condition it was in upon acquisition, but did not require any improvements beyond those conditions. TXPF provided service to the existing customers along the line at the 10 mph speed limitation and reinvested revenues into the infrastructure to keep it safely operable. Through 2010, TXPF experienced financial losses that averaged \$1 million annually.

On February 29, 2008, a fire completely destroyed the international rail bridge section located south of the levee at Presidio.



On March 1, 2009, a second fire partially destroyed and damaged the international rail bridge section located north of the levee. TXPF and TxDOT have been working cooperatively to develop an approved design for the replacement of the entire structure and acquiring the necessary permits to begin construction. The process has been complicated and delayed by the international nature of the structure and IBWC’s² improvements to the levee system which raised its height approximately 9 feet.

TXPF provided rail service to 12 shippers located along the line when the LOA was executed. Much of that freight was associated with the agricultural industry and seasonal in nature, with most rail activity occurring between mid-April and early August each year. Agricultural traffic volumes could be impacted by extreme weather conditions, such as floods or droughts, which negatively impacted operations and profitability. Strategic infrastructure investments were needed in order to improve operating efficiencies and attract new businesses to the rail line.

When TXPF executed the LOA, it assumed the prior interchange agreements between the South Orient Railroad Company, its predecessor, and the BNSF. The original Sale of Assets, Rights, and Obligations Agreement caps the rail line revenues for a 30 year period. For 15 years TXPF has had its revenues capped on BNSF traffic, representing 74% of the traffic it has moved. This agreement will expire at the end of 2021.

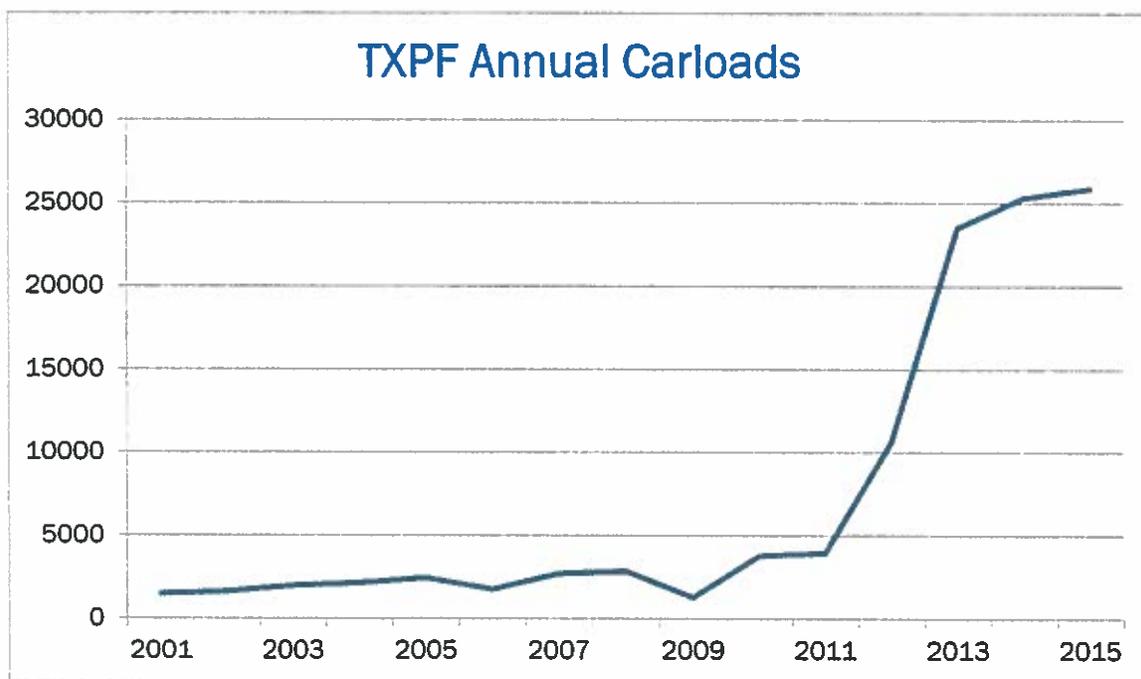
In 2009, TxDOT began a limited rehabilitation of the line from San Angelo Junction west to San Angelo using a combination of federal, state, and local funds with contributions from TXPF. TxDOT used a phased approach for this work and developed multiple

² International Boundary & Water Commission

projects over a period of 3 years in order to utilize federal funds in accordance with obligation requirements. The projects were completed in June 2012 and enabled the track to be raised to FRA Class 2, operable at 25 mph. TxDOT has continued a limited rehabilitation of the line westward from San Angelo and typically completes 1 project each year. This additional work is funded through a Texas Legislative appropriation and carload fees paid by TXPF. It helps sustain the safe operation of the line west from San Angelo at predominantly 25 mph speeds.

TXPF has reinvested all of its profits from land and track leases as well as freight operations revenues, whether capped or not through 2015. Either matching state investments, or through privately contracted rehabilitation projects, the rail line safety and operability has been greatly increased. Although there is still much to be done; the rail line capacity has been increased 500 percent.

TXPF interchanged an average of 2,031 loaded cars each year from 2001 through 2009. New customers began locating along the route as a result of increased petroleum mining in the region and the improving condition of the line. Traffic increased each year from 2010 through 2015, with 25,903 carloads interchanged in 2015 – an increase of over 1,100 percent versus the historical averages. The chart below provides a graphic representation of this carload information.



In 2011 car volumes increased due to the introduction of frac sand in the drilling process. TXPF successfully negotiated the location and construction of multimillion dollar transloading facilities along the line. Today there are eleven frac sand facilities, two crude oil transloading facilities and one chemical supplier allowing the development of the communities and the economy of the region. Most recently, Plains Marketing constructed a rail terminal in McCamey for inbound and outbound crude shipments.

This increase in traffic has resulted in a corresponding increase in revenues and TXPF is now operating at a profit. TXPF is reinvesting all profits back into the continued improvement of the line and is now providing service to Tinaja, 20 miles west of Alpine on a limited basis. Active customers that receive routine service are located as far west as Fort Stockton.

Challenges

Rail³ - East of San Angelo, the line is predominantly constructed of 85# and 90# jointed rail³ that was manufactured in the early 1900's. This rail is undersized for today's loadings and has significant wear from decades of train operations. TXPF and TxDOT have replaced 19.1 miles of severely worn rail with larger sizes⁴ of continuously welded rail (CWR) during their rehabilitation efforts. This is a 69 mile section of track, not including sidings.

From San Angelo to Sulphur Junction (located 11 miles east of Fort Stockton), the line is predominantly constructed of 112# and larger CWR that is generally in good condition. There are some sections of rail that should be replaced due to wear or other surface defects. This is a 156 mile section of track, not including sidings.

The line is constructed of 70# rail from Sulphur Junction to Alpine. Train speeds must be limited to 10 mph on this segment due to this undersized rail. This is a 75 mile section of track, not including sidings. TXPF operates over Union Pacific track for 11 miles from Alpine west to Paisano Junction, where the SORR diverges to the south.

The line is constructed of 90# rail from Paisano Junction to the international border at Presidio.

Crossties⁵ - East of San Angelo, TXPF and TxDOT have replaced over 100,000 crossties in the last several years. Tie conditions are in generally good condition for FRA Class 2 operations in this section of track. Selected defective tie replacements must continue as part of routine maintenance to sustain safe operations.

This can also prevent the need for major rehabilitation projects in the future.

From San Angelo to Sulphur Junction, crossties are in generally fair condition. TXPF has replaced 20,000 ties at strategic locations in order to maintain FRA Class 2 designation. TxDOT has begun a tie replacement program from San Angelo west, reaching Mertzon with the initial project. When the current project is completed, 24,500 ties will have been replaced in the first 35 miles west of San Angelo. Major tie replacement projects are needed toward Sulphur Junction to maintain 25 mph speeds.

³ Rail is identified by weight per linear yard of material

⁴ Current industry standard is 132# and higher for heavy haul lines. 115# & 119# rail is adequate for TXPF operations and has been used by TXPF & TxDOT at some locations.

⁵ Track is constructed with 3,240 ties per mile.

Routine maintenance in the rehabilitated section(s) must also continue to sustain safe operations.

Ties are in generally fair to poor condition from Sulphur Junction to Alpine. TXPF has strategically replaced 21,000 defective ties in this section of track to sustain safe train operations at 10 mph. A major tie replacement project is needed in this track segment to support increased train speeds and in conjunction with any rail replacements.

Ties are in generally fair condition from Sulphur Junction to the border at Presidio. In 2005, TxDOT replaced 45,000 ties in this section of track to support international traffic. Only 156 carloads were interchanged at the border prior to the international bridge fire in 2008.

Bridges – There are 336 bridge structures on the line, most of which are timber and were originally constructed prior to 1947. TXPF has an effective bridge management program and every year addresses specific bridge deficiencies as recommended by their consulting bridge engineer. TXPF has rehabilitated 35 bridges along the line within the last 18 months. TxDOT rehabilitated 29 bridges east of San Angelo while completing track work in that section and also replaced 3 other bridge structures.

Grade Crossings – There are 442 roadway-rail grade crossings on the rail line, both public (241) and private (180). Multiple tracks cross the same roadway at some locations where the main line and sidings both intersect the roadway. TXPF and TxDOT work cooperatively to address defective crossing conditions as funding is available for this work. TxDOT also includes grade crossing improvement in its rehabilitation projects and has reconstructed 140 crossings to date as part of its track improvement program.

Traffic – TXPF interchanges loaded cars of frac sand, crude oil, pipe, grain, steel, and a small number of miscellaneous commodities with the connecting railroads each year. In 2014, 96% of this traffic was related to the petroleum mining industry – frac sand, crude oil, or pipe. TXPF is interested in diversifying its commodity base through the international gateway or from new businesses locating in the region.

Funding – TXPF operated at a loss for the first 10 years of the lease agreement. Losses were absorbed by the parent company, Grupo Mexico, to enable TXPF to survive. Since 2011 TXPF has shown a profit and has continued to invest those profits on the rail line.

The rehabilitation of the line could require varying amounts of funding, depending on the immediate needs, customer developments, final objectives and future goals. A recent infrastructure assessment⁶ identified an additional \$147.7 million in total rehabilitation needs on the rail line. TXPF has reinvested all of its profits in the rail line, and TxDOT has had some success in securing state and federal funds for improvements. It is the philosophy of TXPF's parent company Grupo Mexico to be responsive to customer's needs and no investment will be left undone if the business

⁶ *Texas Pacifico Transportation – South Orient Rail Line Infrastructure Assessment*, January 2015, HNTB Corporation

justification is at hand. The table below shows TXPF's investments in the railroad through 2015.

Category	Amount,
Initial Lease Payment	\$3,500,000
10 years Losses & Limited Rehabilitation	\$10,820,367
Capital Expenditures 2012 - 2015	\$29,800,000
Total	\$44,120,367

TXPF has a \$30 million capital improvement program for 2016-17 that includes funding for the reconstruction of the Presidio international rail bridge, 13.5 miles of rail replacement, the construction of 2 new passing sidings, as well as tie replacements and other bridge work. TXPF is in the process of applying for a \$21 million FRA Railroad Rehabilitation and Improvement Financing (RRIF) to fund this improvement program.

Goals

TXPF's goals are to:

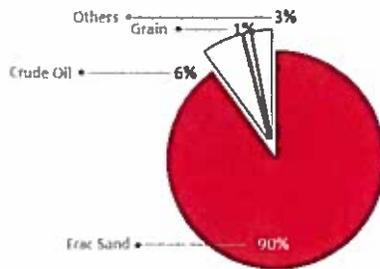
- 1) provide safe, efficient, and effective freight rail transportation services to the west Texas region, and
- 2) to become a competitive gateway for international rail movement.

TXPF has increased its employee base from 8 positions in early 2009 to 54 positions today. TXPF is locally headquartered in San Angelo and its employees are local residents in west Texas. TXPF is proud to call this area of the state "home" and to work cooperatively with state and local officials, as well as private sector interests, to continue to provide rail transportation services for the region and to create value for its employees and shareholders.

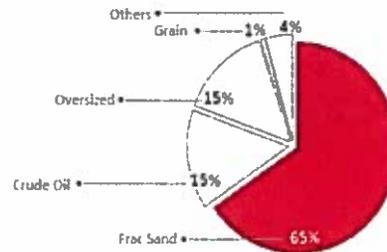
TXPF is seeking to diversify its commodity base and increase the variety of carloads interchanged so that profitability is not dependent on the energy sector. International freight rail opportunities can assist with this goal as the Presidio gateway is reopened and more of the line is rehabilitated, making the corridor competitive with trucks and other rail gateways.

In recent months TXPF has diversified the marketing mix increasing participation in others industries not related with oil and gas

Carloads 2014



Carloads February 2016



Next Steps

Infrastructure

TXPF will continue to make strategic investments in the infrastructure, as business cases develop and justify any such investment, in order to continue providing service to existing customers while seeking new rail transportation service opportunities in the region. Important areas of investment are:

- Rail and tie replacements between San Angelo Junction and San Angelo. This track segment will continue to have the highest tonnage movements as the connection to Dallas/Fort Worth and the central U.S. Continued capital investments are necessary to upgrade the track to current standards.
- Reconstruction of the Presidio international rail bridge.
- Bridge repairs and replacements as required by the Bridge Management Program.
- Tie replacements between San Angelo and Sulphur Junction to maintain 25 mph
- Rail and tie replacements between Sulphur Junction and Alpine. This track segment has the smallest rail size and will be limited to 10 mph until the rail is upgraded.
- Rail and tie replacements between Paisano Junction and Presidio.

TXPF will reconstruct the international rail bridge at Presidio in partnership with the connecting railroad, Ferromex, in accordance with its obligations under the LOA. TXPF acknowledges that the reconstruction of the international rail bridge can foster additional economic development opportunities in west Texas as well as provide an additional corridor for international rail freight.

Traffic

In spite of the depressed oil and gas market, TXPF has exceeded volume expectations, moving more carloads in 2016 year to date versus 2015.

TXPF will continue to seek new business opportunities that can increase traffic on the line, thereby increasing revenues, reducing truck traffic in the region, and providing economic development opportunities for the region through possible new businesses and job creation. In addition, TXPF will work cooperatively with local officials and economic development entities to provide effective rail service to existing businesses along the line and to attract new rail-oriented businesses to the region.

The reconstruction of the international rail bridge at Presidio is a key development in expanding the railroad's commodity base and economic development activities for the region. Marketing staff is engaged with businesses located in Mexico and the U.S. and developing business partnerships that could bring international rail traffic to the Presidio gateway. Opportunities for international trade exist in the state of Chihuahua, the Pacific Ports of Mexico, throughout Texas, and the central U.S., which are being actively pursued by TXPF.

The new bridge will provide the shortest distance between the states of Sinaloa and Chihuahua to Dallas/Fort Worth and beyond. Linking the most important emerging markets in Mexico and the United States.

Origin	Destination	Border	Mode	Total Dist. (Miles)	Dif vs Best Option
Chihuahua	Dallas, Tx	Presidio, Tx	FXE - TXPF	720	0%
Chihuahua	Dallas, Tx	El Paso, Tx	FXE - UP	871	21%
Chihuahua	Dallas, Tx	El Paso, Tx	Truck	880	22%
Chihuahua	Dallas, Tx	El Paso, Tx	FXE - BNSF	1148	59%

Origin	Destination	Border	Mode	Total Dist. (Miles)	Dif vs Best Option
Topolobampo	Dallas, Tx	Presidio, Tx	FXE - TXPF	1134	0%
Topolobampo	Dallas, Tx	El Paso, Tx	FXE - UP	1285	13%
Topolobampo	Dallas, Tx	Laredo	Truck	1347	19%
Topolobampo	Dallas, Tx	El Paso, Tx	FXE - BNSF	1562	38%

Funding

TXPF will continue to invest available revenue into rehabilitation of the infrastructure and other capital equipment needs to improve operations and maintain safe operations.

Freight from the Kansas City Southern and Union Pacific railroads is transported via Fort Worth and Western Railway to San Angelo Junction for interchange with TXPF. These railroads pay a division of the freight charges to the TXPF that is market rate. Due to the BNSF/South Orient Railroad Company agreement referenced previously, BNSF pays the TXPF a rate, on average, of approximately half the other mentioned Class 1s. This rating issue impairs the TXPF's ability to develop new business with the BNSF, makes it difficult for the other Class 1s to be competitive in TXPF destinations, and significantly limits the TXPF's annual revenues, and therefore, its reinvestment schedules.

TXPF will continue to work cooperatively with TxDOT in seeking federal, State, and private funds to enable additional rehabilitation as the market support the need for it. TXPF will also seek to maximize available funding through increased marketing efforts in both the U.S. and Mexico and through improved operating efficiencies whenever possible. Increased traffic volumes can maximize revenue and improve efficiencies with existing equipment and personnel.