VALUATION METHODS

In order to arrive at an indication of value, three fundamental and traditional approaches must be considered – the market, income, and cost approaches. The selection of one or more methods depends on the facts and circumstances of the valuation. Below is a summary of the three methods:

The **market approach** estimates value through analysis of recent sales of comparable assets. When using market transactions, the market approach estimates value through the analysis of actual purchases/sales of similar assets. Under this scenario, a comparison is made between the Subject Asset and purchases/sales of other assets. We considered this method but did not utilize it since we did not identify any comparable market transactions.

The **income approach** can be based either on the capitalization of the historical earnings of the asset or the present value of the future earnings or cash flow expected to be generated by the asset. If the historical earnings are used, the value may be based upon the most recent fiscal year's earnings or an average (possibly weighted) of earnings of multiple years. The earnings are then capitalized at a rate commensurate with the degree of risk associated with investing in the asset. If the discounted future earnings method is used, earnings or cash flow projections for a future period are discounted at a rate commensurate with the degree of risk associated with investing in the asset. This method was utilized.

The **cost approach** is predicated on the assumption that a prudent buyer would pay no more for an asset than it would to purchase the components of the asset at current market prices. This approach requires estimating the replacement cost-new of the asset and subtracting economic, physical and technological depreciation. This method was utilized.

Valuation of a Lease Agreement

The two major steps involved in the valuation of a lease are

1. Fair market value of the leased asset at the time of the valuation and,
2. The rate of economic return the asset commands in the market place

Fair Market Value of Leased Asset

In an appraisal review by John R. Garvin and Dr. Frank R. Stapleton valued as of December 31, 2004, the asset was appraised as follows:

Appraised Adjusted Corridor Value (real property)	$ 7,200,000
Appraised Value of the Track and Fixtures	17,000,000
Total Value Conclusion	$24,200,000

A review of the proposed lease agreement between the State of Ohio and the Ohio River Rail Road Company and its affiliates indicates that the lease is principally the use of the track and fixtures. Therefore, for purposes of this valuation, we are utilizing a cost of $17,000,000 for the Fair Market Value of the proposed leased asset. It is also our understanding that the State of Ohio intends to always own the real property.

Rate of Economic Return on an Asset

An interest in an asset should be considered an investment on which the holder will expect a return. Investors will only hold an asset if the expected return attached to the asset is high enough to justify the risk. The capitalization or discount rate is, in actuality, the "yield" that an asset would produce. The yield is comprised of two components, the safe (risk-free) rate of return and an additional factor of compensation for the relative degree of increased or decreased risk inherent in the asset. There are two primary criteria for the determination of capitalization or discount rates to be used when valuing an asset:

1. The capitalization or discount rate must be essentially the same as the rate of return (yield) that is currently being offered to attract capital or investment to the type of asset that is being valued.

2. The capitalization or discount rate must be consistent with the type of earnings that are to be capitalized or discounted.

It is important to note that capitalization and discount rates, though similar, are appropriate in differing situations. Capitalization rates are used as a divisor (or multiplier) to convert a defined stream of income to a present indicated value. A discount rate is used to convert a series of future income amounts into their present value. We utilized a discount rate.

Cost of Capital

A review of publicly traded railroads balance sheets indicates that the track and fixtures are the most significant balance sheet assets.

It is, therefore, assumed that the rate of return for the track and fixtures would be similar to that of the rate of return for a railroad company itself.

COST OF EQUITY

1. Build-Up or Summation Method – The build-up method to calculating the cost of equity is unique to the valuation analyst and relies on historical data along with other inputs to make forecasts into the future. These estimates seek to define the expected return on an investment or security. The starting point is the return that an investor could receive without any inherent risk. Additional risks are added to this number as they relate to the specific company being valued. BSE utilizes five steps in "building a cost of equity or discount rate for a specific company. The formula is as follows:

$$K_e = r_f + ERP + r_s + r_i + r_c$$

Where:
K_e = cost of equity
r_f = risk-free rate
ERP = equity risk (market) premium
r_s = size premium

r_i = industry premium
r_c = other risk factors

- Risk free rate of return – Generally BSE utilizes the 20-year U.S. Treasury Bond Yield as of the Valuation Date. This debt instrument is considered risk free and is a long-term investment.

- Market Risk Premium – this premium represents the extra return that a willing investor would expect to receive over that of the intermediate-term treasury security. This premium is based on large equity securities included in the S&P 500 from 1926 through the 2005. Specifically, BSE utilizes an adjusted premium from Stocks, Bonds, Bills, and Inflation: 2005 Yearbook (Valuation Edition) (SBBI Yearbook) published by Ibbotson Associates with monthly updates.

- Industry Risk Premium – This premium is the extra or less return that a willing investor would expect to receive due to the particular industry the company operates in. Specifically, BSE utilizes a premium from stocks, bonds, bills, and inflation: 2005 Yearbook (Valuation Edition) published by Ibbotson Association.

- Size Premium – This premium is the extra return that a willing investor would expect to receive over the large equity security by investing in smaller equity securities in the public markets. The equity and size premiums are measures of systematic risk. The systematic risk is the uncertainty of future returns because of the sensitivity of the return to the public markets as a whole. BSE utilizes a study published by Ibbotson & Associates (Standard & Poor's Corporate Value Consulting Risk Premium Study) for this premium.

2. Capital Asset Pricing Model (CAPM) – CAPM, by definition, is an "equilibrium asset pricing theory that shows that equilibrium rates of expected return on all risky assets are a function of their co-variance with the market portfolio". This method for determining a discount rate is based on the theory that investors in risky assets require a rate as compensation for the risk associated with holding that investment. Specifically, the formula for CAPM is as follows:

$$K_e = r_f + \beta(r_m) + r_s + r_c$$

Where:
K_e = cost of equity
R_f = risk-free rate
β = beta
r_m = market premium
r_s = size premium
r_c = other risk factors

In the actual calculation of CAPM, the key variable of the equation is Beta. Beta is the measure of the volatility of the subject security as compared to the market. Due to the unavailability of publicly traded guideline companies, a "market" beta for the industry was not available.

At first glance, the formula for the CAPM approach and the build-up approach toward calculating a company's cost of equity appear to be very similar; however, there are several differences. The primary difference is that CAPM features a beta-adjusted market premium. Additionally, all of the other risk factors that follow the adjusted market premium must take into account the components of beta. Due to the fact that size and industry specific risk is included in beta, these risk factors can differ between the CAPM approach and the build-up approach.

Due to the fact that the lessee is a much smaller company than the publicly traded comparables, BSE believes that it is *more appropriate to use a build-up approach* to establishing the asset's cost of equity as opposed to a CAPM approach. The calculation of the cost of equity, using the build-up approach, was completed as follows:

20 year treasury yield	5.07%
Supply side equity risk premium	6.14%
	11.21%
Risk premium for size	4.81%

Industry risk premium	(3.36%)
Cost of equity (K_e)	12.66%

COST OF DEBT

Tax affected interest rates based on current specific borrowing rates were used. The interest rate is tax-affected because the Company's interest expense is tax deductible. The calculation is as follows:

Interest expense (Prime)	7.75%
Tax rate (T)	40.00%
Kd = R X (1 – T)	
Kd =	4.70%

WEIGHTED AVERAGE COST OF CAPITAL

The weighting applied to both the cost of equity and the cost of debt is intended to be representative of a fixed capital structure that will be maintained for the duration of a company's existence. When determining the proper debt/equity weighting for a company's WACC, an assortment of appropriate approaches can be taken.

These respective percentages were applied to the two calculated rates as follows:

	Rate	Weight		Weighted Total
Ke =	12.66%	50%		6.33%
Kd =	4.65%	50%		2.35%
				8.68%
			Rounded	8.7%

We will utilize an 8.7% discount rate.

APPLICATION OF DISCOUNT RATE

Fair Market Value of Fixture and Tracks	$17,000,000
Discount Rate	8.7%
Expected yearly rate of return	$ 1,479,000

EXPECTED LIFE OF ASSET

The type of asset being valued, unlike a corporation, has a finite life. The term of the lease is 25 years, which we believe under most circumstances to be the economic and physical life of this asset.

The lease agreement requires the Panhandle Rail Line to maintain the track and fixtures so that at the end of the lease the track and fixtures are returned to the State of Ohio in much the same condition as they were originally leased. This maintenance of the asset which gives it a potential perpetual life must be calculated as an offset to the $1,479,000 yearly rate of return.

We have assumed that without maintenance the asset would be fully depreciated with no salvage value.

The maintenance offset is $680,000 a year or calculated as $17,000,000 divided by 25 yields $680,000 a year. Therefore, the expected lease payment can be calculated as follows:

Expected yearly rate of return	$1,479,000
Offset off economic and physical life	(680,000)
	$ 799,000

INDICATED VALUE – 25 YEAR LEASE

Based upon our analysis, we conclude that the fair market value of a proposed lease between the State of Ohio and the Columbus and Ohio River Rail Company is $799,000 per year.

LIMITING CONDITIONS

§1 BSE Partners LLC has no present or prospective interest in the asset that is the subject of this report, nor do we maintain any personal interest or bias with respect to the parties involved.

§2 BSE Partners LLC's compensation for this valuation is in no way contingent upon the value or the conclusion reported herein.

§3 This report may only be used for its stated purpose. It is intended and restricted for use by the management of the State of Ohio. The estimates of value presented in this report apply to this appraisal only and may not be used out of the context presented herein. Any other use of this report may lead the user to an incorrect conclusion for which BSE Partners LLC assumes no responsibility.

§4 BSE Partners LLC has assumed that the asset continues to operate.

§5 This report is not to be used, circulated, quoted or otherwise referred to in whole or in part for any other purpose or to any other party without the written consent of BSE Partners LLC.

§6 Possession of this report, or a copy thereof, does not carry with it the right of publication of all or part of it.

§7 BSE Partners LLC has no responsibility or obligation to update this report for events and circumstances occurring subsequent to the date of this report.

§8 BSE Partners LLC is not, by reason of performing this valuation and preparing this report, required to give expert testimony nor be in attendance in court or at any government hearing with reference to the matters contained here *unless* prior arrangements have been made with BSE Partners LLC regarding such additional engagements.

§9 In all matters that may be potentially challenged by a Court, the Internal Revenue Service, or others, BSE Partners LLC does not take responsibility for the degree of reasonableness of contrary positions that others may choose to take, nor the costs or fees that may be incurred in the defense of our recommendations against challenges.

§10 BSE Partners LLC does not purport to be a guarantor of value. It is important to note that asset valuations are based upon assumptions regarding future earning potential, and/or certain asset values, that may or may not materialize. In addition, unanticipated events and circumstances may occur. Therefore, the actual results achieved may differ materially from the estimated results. BSE Partners LLC makes no guarantees as to what values individual buyers and sellers may reach in an actual transaction.

§11 Information, estimates, and opinions contained in this report are obtained from sources considered reliable; however, BSE Partners LLC has not independently verified such information and assumes no liability for such sources.

§12 No investigation of titles to property or any claims on ownership of the property by any individuals or company has been undertaken. Unless otherwise stated in our report, titles are assumed to be clear and free of encumbrances and as provided to the appraiser. The owner's claims to the business and its assets are assumed to be valid. It is also assumed that any underlying assets will not operate in violation of any applicable government regulations, codes, ordinances, or statutes.

§13 BSE Partners LLC assumes that there is no hidden or unexpected conditions of the asset that would adversely affect value, other than as indicated in this report.

§14 BSE Partners LLC has not taken into account any and all future environmental considerations and potential liability in developing the opinion of value stated in this report.

§15 No opinion is intended to be expressed for matters that require legal or other specialized expertise, investigation, or knowledge beyond that customarily employed by appraisers valuing businesses.

§16 It should be specifically noted that the valuation assumes the asset will be competently managed and maintained by financially sound owners over the expected period of ownership. This appraisal does not entail an evaluation of management's effectiveness, nor is BSE Partners LLC responsible for future marketing efforts and other management or ownership actions upon which actual results will depend.

§17 Unless otherwise provided for in writing and agreed to by both parties in advance, the extent of the liability for the completeness or accuracy of the data, opinions, comments, recommendations, and/or conclusions shall not exceed the amount paid to the appraisers for professional fees and then, only to the party(s) for whom this report was originally prepared.

§18 This report is neither an offer to sell, nor a solicitation to buy securities, and/or equity in, or assets of, the subject company.