PIONEER RAILCORP

Consolidated Financial Report
December 31, 2017

Contents

Independent Auditor's Report

To the Board of Directors
Pioneer Railcorp

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Pioneer Railcorp and Subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pioneer Railcorp and Subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Peoria, Illinois
July 12, 2018

Pioneer Railcorp and Subsidiaries

Consolidated Balance Sheets
December 31, 2017 and 2016

	2017	2016
Assets		
Current assets:		
Cash	**$ 50,640**	$ 50,401
Trade receivables, less allowance for doubtful accounts of 2017 $209,306 and 2016 $199,186	**4,455,147**	3,700,792
Materials and supplies	**402,821**	397,637
Prepaid expenses and other assets	**1,014,233**	949,392
Prepayment of income tax	**76,500**	159,680
Total current assets	**5,999,341**	5,257,902
Property and equipment, net	**57,922,951**	55,437,299
Intangible assets, net	**475,161**	559,186
Goodwill	**559,255**	559,255
Total assets	**$ 64,956,708**	$ 61,813,642

See notes to consolidated financial statements.

	2017	2016
Liabilities and Equity		
Current liabilities:		
Notes payable and current maturities of long-term debt	**$ 1,101,302**	$ 1,114,967
Current maturities of salary continuation liability and option obligation	**392,203**	363,950
Accounts payable	**2,290,836**	1,040,290
Accrued expenses	**3,747,664**	2,884,632
Total current liabilities	**7,532,005**	5,403,839
Long-term liabilities:		
Line-of-credit	**14,384,446**	12,890,696
Long-term debt	**1,099,755**	1,219,197
Deferred revenue	**7,691,303**	7,288,501
Salary continuation liability and option obligation, net of current maturities	**2,702,680**	3,094,884
Interest rate swap	**68,003**	169,883
Deferred income taxes	**7,265,000**	11,232,000
Total long-term liabilities	**33,211,187**	35,895,161
Commitments and contingencies		
Equity:		
Pioneer Railcorp stockholders' equity:		
Common stock, Class A (voting), par value $0.001 per share, authorized 20,000,000 shares, issued 4,181,843 shares	**4,181**	4,181
In treasury 331,450 shares in 2017 and 2016	**(331)**	(331)
Outstanding 3,850,393 shares in 2017 and 2016	**3,850**	3,850
Common stock, Class B (nonvoting), no par value, authorized 20,000,000 shares	**-**	-
Additional paid-in capital	**448,847**	448,847
Affiliate's option to purchase Pioneer Class A common stock	**(117,392)**	(156,077)
Affiliate's investment in Pioneer Class A common stock (shares 2017 1,833,640 and 2016 1,808,640)	**(10,351,543)**	(10,183,858)
Retained earnings	**33,736,121**	29,973,430
Accumulated other comprehensive loss	**(41,495)**	(125,678)
Total Pioneer Railcorp stockholders' equity	**23,678,388**	19,960,514
Noncontrolling interest	**535,128**	554,128
Total equity	**24,213,516**	20,514,642
	$ 64,956,708	$ 61,813,642

Pioneer Railcorp and Subsidiaries

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2017 and 2016

	2017	2016
Railway operating revenue	**$ 22,821,642**	$ 23,227,004
Operating expenses:		
Wages and benefits	**9,315,306**	8,640,812
Fuel and travel	**1,208,401**	1,039,592
Transportation, car hire and joint facility expenses	**1,054,672**	915,360
Liability, property and vehicle insurance	**1,280,748**	1,297,018
Health and dental costs	**1,226,295**	1,413,816
Maintenance of way, materials and purchased services	**987,207**	1,036,093
Professional fees	**1,369,307**	731,316
Purchased switching services	**562,902**	563,949
Equipment maintenance	**591,196**	571,213
Real estate taxes	**336,244**	256,807
Licenses and fees	**351,319**	344,226
Other expenses	**722,184**	837,658
Depreciation and amortization	**4,105,395**	3,856,634
Gain on sale of property and equipment	**(87,747)**	(84,844)
	23,023,429	21,419,650
Operating (loss) income	**(201,787)**	1,807,354
Other income (expenses):		
Lease income	**837,489**	557,054
Interest expense	**(758,574)**	(731,959)
Sale of income tax credits	**-**	1,808,636
Gain on insurance proceeds	**188,393**	-
Other, net	**171,532**	325,905
	438,840	1,959,636
Income before provision for income taxes	**237,053**	3,766,990
Provision for income taxes	**(3,884,223)**	1,301,000
Net income	**4,121,276**	2,465,990
Less: noncontrolling interest in preferred stock dividends of consolidated subsidiaries	**(56,910)**	(59,475)
Net income attributable to Pioneer Railcorp	**4,064,366**	2,406,515
Other comprehensive income, net of tax expense (benefit):		
Unrealized gains (losses) on interest rate swap contracts	**19,683**	(60,568)
Reclassification adjustments for net settlements on interest rate swap contracts	**64,500**	89,791
Total other comprehensive income	**84,183**	29,223
Total comprehensive income	**$ 4,148,549**	$ 2,435,738
Basic earnings per Class A common share	**$ 1.06**	$ 0.63

See notes to consolidated financial statements.

Pioneer Railcorp and Subsidiaries

Consolidated Statements of Changes in Equity
Years Ended December 31, 2017 and 2016

	Common Stock Issued and Outstanding Class A (Voting)		Additional Paid-In Capital	Affiliate's Option to Purchase Pioneer Class A Common Stock	Affiliate's Investment in Pioneer Class A Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total
	Shares	Amount							
Balance at December 31, 2015	3,850,393	$ 3,850	$ 448,847	$ (194,762)	$ (10,018,673)	$ 27,771,090	$ (154,901)	$ 570,128	$ 18,425,579
Purchase of subsidiary shares from noncontrolling interest	-	-	-	-	-	-	-	(16,000)	(16,000)
Dividends on common stock, $0.10 per share	-	-	-	-	-	(204,175)	-	-	(204,175)
Exercise of affiliate's option to repurchase 25,000 shares of Pioneer common stock pursuant to stock repurchase agreement (Note 6)	-	-	-	38,685	(38,685)	-	-	-	-
Purchase of 25,000 shares of Pioneer Railcorp common stock by affiliate	-	-	-	-	(126,500)	-	-	-	(126,500)
Net income attributable to Pioneer Railcorp	-	-	-	-	-	2,406,515	-	-	2,406,515
Accumulated other comprehensive income	-	-	-	-	-	-	29,223	-	29,223
Balance at December 31, 2016	3,850,393	3,850	448,847	(156,077)	(10,183,858)	29,973,430	(125,678)	554,128	20,514,642
Purchase of subsidiary shares from noncontrolling interest	-	-	-	-	-	-	-	(19,000)	(19,000)
Dividends on common stock, $0.10 per share						(201,675)			(201,675)
Exercise of affiliate's option to repurchase 25,000 shares of Pioneer common stock pursuant to stock repurchase agreement (Note 6)	-	-	-	38,685	(38,685)	-	-	-	-
Purchase of 25,000 shares of Pioneer Railcorp common stock by affiliate	-	-	-	-	(129,000)	-	-	-	(129,000)
Redemption of Heartland Class B member units	-	-	-	-	-	(100,000)	-	-	(100,000)
Net income attributable to Pioneer Railcorp						4,064,366			4,064,366
Accumulated other comprehensive income	-	-	-	-	-	-	84,183	-	84,183
Balance at December 31, 2017	**3,850,393**	**$ 3,850**	**$ 448,847**	**$ (117,392)**	**$ (10,351,543)**	**$ 33,736,121**	**$ (41,495)**	**$ 535,128**	**$ 24,213,516**

See notes to consolidated financial statements.

Pioneer Railcorp and Subsidiaries

Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Net income	**$ 4,121,276**	$ 2,465,990
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**4,105,395**	3,856,632
Gain on sale of property and equipment	**(87,747)**	(84,844)
Deferred taxes	**(3,984,697)**	1,272,264
Provision for doubtful accounts	**36,276**	94,049
Changes in operating assets and liabilities:		
(Increase) decrease in assets:		
Trade receivables	**(790,631)**	508,349
Materials and supplies	**(5,184)**	61,213
Prepaid expenses and other assets	**(71,787)**	66,746
Prepayment of income taxes	**83,180**	363,885
Increase (decrease) in liabilities:		
Accounts payable	**1,250,546**	(972,438)
Accrued expenses	**863,032**	(941,296)
Deferred revenue	**402,802**	698,417
Net cash provided by operating activities	**5,922,461**	7,388,967
Cash flows from investing activities:		
Proceeds from sale of property and equipment	**100,586**	101,150
Purchase of property and equipment	**(6,512,915)**	(7,374,724)
Net cash used in investing activities	**(6,412,329)**	(7,273,574)
Cash flows from financing activities:		
Proceeds from line-of-credit	**26,586,964**	32,509,157
Proceeds from short-term notes payable	**1,080,542**	1,071,411
Proceeds from long-term debt	**266,919**	509,862
Principal payments on line-of-credit	**(25,093,214)**	(32,049,115)
Principal payments on short-term notes payable	**(1,074,109)**	(1,107,870)
Principal payments on long-term debt	**(406,459)**	(304,864)
Common stock dividend payments	**(201,675)**	(204,175)
Purchase of subsidiaries shares from noncontrolling interest	**(19,000)**	(16,000)
Preferred stock dividend payments to noncontrolling interest	**(56,910)**	(59,475)
Payments under salary continuation agreement	**(238,787)**	(221,585)
Payments under agreement to purchase common stock	**(125,164)**	(116,145)
Redemption of Heartland Class B member units	**(100,000)**	-
Purchase of common stock by affiliate	**(129,000)**	(126,500)
Net cash provided by (used in) financing activities	**490,107**	(115,299)

See notes to consolidated financial statements.

(Continued)

Pioneer Railcorp and Subsidiaries

Consolidated Statements of Cash Flows (Continued)
Years Ended December 31, 2017 and 2016

		2017		2016
Net increase in cash	**$**	**239**	$	94
Cash:				
Beginning of year		**50,401**		50,307
End of year	**$**	**50,640**	$	50,401
Supplemental disclosures of cash flow information:				
Cash payments for:				
Interest	**$**	**751,016**	$	729,678
Income taxes, net of refunds of 2017 ($43,175) and 2016 ($508,660)	**$**	**17,597**	$	(333,244)
Supplemental disclosure of noncash investing and financing activities:				
Change in fair value of interest rate swap, net of deferred taxes of 2017 $17,697 and 2016 $15,736	**$**	**84,183**	$	29,223

See notes to consolidated financial statements.

Note 1. Nature of Business and Summary of Significant Accounting Policies

Nature of business: Pioneer Railcorp (Pioneer) is the parent company of 17 short-line common carrier railroad operations, an equipment leasing company, two service companies and a contract services switching company. Pioneer Railcorp and its subsidiaries (the Company) operate in the following states: Alabama, Arkansas, Georgia, Illinois, Indiana, Iowa, Kansas, Michigan, Mississippi, Ohio, Pennsylvania and Tennessee.

The Company's subsidiaries and affiliates include the following:

Alabama & Florida Railroad Co. DBA Ripley & New Albany Railroad Co.
Decatur Junction Railway Co.
Elkhart & Western Railroad Co.
Fort Smith Railroad Co.
Gettysburg & Northern Railroad Company
Georgia Southern Railway Co.
Heartland Rail Investments, LLC
Indiana Southwestern Railway Co.
Kendallville Terminal Railway Co.
Keokuk Junction Railway Co. and its subsidiary, Keokuk Union Depot Company
Michigan Southern Railroad Company also DBA Napoleon, Defiance & Western Railway
Mississippi Central Railroad Co.
Pioneer Air, Inc.
Pioneer Industrial Railway Co.
Pioneer Railroad Equipment Co., Ltd.
Pioneer Railroad Services, Inc.
Rail Switching Services, Inc.
Alabama Railroad Co., Inc. also DBA Shawnee Terminal Railroad Co., Inc.
The Garden City Western Railway, Inc.
Vandalia Railroad Company

Pioneer Railroad Equipment Co., Ltd. holds title to a majority of the Company's operating equipment, and Pioneer Air, Inc. previously owned an airplane utilized by the Company for business purposes. Pioneer Railroad Services, Inc. provides management, administrative and agency services to the Company's subsidiary railroads. Rail Switching Services, Inc. performs contract switching services. Except as noted below, all other subsidiaries are short-line common carrier railroad operations.

Heartland Rail Investments, LLC (Heartland), is an Illinois limited liability company. See Notes 6 and 11 to the financial statements for a more complete description of Heartland and its activities.

A summary of the Company’s significant accounting policies is as follows:

Principles of consolidation: The accompanying financial statements include the accounts of Pioneer Railcorp and its consolidated subsidiaries, comprised of those entities in which Pioneer Railcorp has an investment of 50 percent or more, and Heartland, for which it has a controlling financial interest. All significant intercompany accounts and transactions have been eliminated.

Cash and cash equivalents: For the purposes of reporting cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. There were no cash equivalents as of December 31, 2017 and 2016.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Concentration of credit risk: Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and trade receivables. Periodically throughout the year, the Company has amounts on deposit with financial institutions that exceed the FDIC insurance limits. The Company has not experienced any loss as a result of those deposits and does not expect any in the future. The Company's trade receivables are concentrated with a major customer. Reference should be made to Note 9 for additional information regarding the major customer.

Trade receivables: Trade receivables are carried at original invoice amount less an estimate for uncollectible trade receivables. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. Provisions are made for estimated uncollectible trade receivables. Each month, management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Trade receivables are considered to be past due if any portion of the receivable balance is outstanding for more than 90 days. The Company generally does not charge interest on past due amounts.

Revenue recognition: Railroad shipping revenues are recognized when inbound shipments move onto the Company's tracks, or when outbound shipments move off the Company's tracks, which, due to the relatively short length of the hauls, is not materially different from the recognition of revenues as shipments progress. Industrial switching and other service revenues are recognized as such services are provided.

Revenue from the lease of railcars and locomotives held by subsidiaries, including Pioneer Railroad Equipment Co., Ltd., is included in railroad operating revenue and is recognized monthly as earned.

The Company also leases certain easements and rights of way to Company-owned property which is included in other income. This lease income is recognized monthly as earned.

Materials and supplies: Materials and supplies, which consist of various mechanical parts, track materials, locomotive supplies and diesel fuel, are stated at the lower of cost (determined by the average cost method) or net realizable value. Inventories are used on a daily basis for normal operations and maintenance.

Property and equipment: Property and equipment is stated at cost. Depreciation is generally computed on a straight-line basis over the following estimated useful lives:

	Years
Roadbed	20
Transportation equipment	10 - 15
Railcars	10 - 50
Buildings	20 - 40
Machinery and equipment	5 - 10
Office equipment	5 - 10

Leasehold improvements are depreciated over the lesser of the lease term or the life of the improvements.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Maintenance and repair expenditures, which keep the rail facilities in operating condition, are charged to operations as incurred. Expenditures considered to be renewals and betterments are capitalized if such expenditures improve the track conditions and benefit future operations with more efficient use of the rail facilities.

Capital projects primarily represent transportation equipment or roadbed modification projects which have either been purchased and the Company is in the process of modifying and upgrading prior to placing the assets into service, or roadbed modification projects which are not yet complete. As the assets have not yet been placed into service, the Company does not depreciate these assets.

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. The Company does not believe that any impairment existed as of December 31, 2017 or 2016.

Intangible assets: Intangible assets relate to track rights. The track rights are amortized on a straight-line basis over the remaining lease terms as more fully described in Note 3.

The Company evaluates the recoverability of identifiable intangible assets whenever events or changes in circumstances indicate that an intangible asset's carrying amount may not be recoverable. Such circumstances could include, but are not limited to, a significant decline in activity on the rail lines. To assess recovery, the Company measures the carrying amount of the asset against the estimated undiscounted future cash flows associated with it. Should the sum of the expected future net cash flows be less than the carrying value of the asset being evaluated, an impairment loss would be recognized. The impairment loss would be calculated as the amount by which the carrying value of the asset exceeds its fair value. The fair value is measured based on quoted market prices, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including the discounted value of estimated future cash flows. The evaluation of asset impairment requires the Company to make assumptions about future cash flows over the life of the asset being evaluated. These assumptions require significant judgment and actual results may differ from assumed and estimated amounts. The Company does not believe that any impairment existed as of December 31, 2017 or 2016.

Segment reporting: The Company's operations are principally in the rail transportation industry. Segment information is not presented since all of the Company's revenue is attributed to a single reportable segment.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Goodwill: The Company records as goodwill the excess of acquisition purchase price over the fair value of identifiable net assets acquired. The carrying value of goodwill is evaluated at each year-end and between annual evaluations if management believes indicators of impairment exist. Such indicators could include, but are not limited to (1) a significant adverse change in legal factors or in business climate, or (2) unanticipated competition. The Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If management concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, management conducts a two-step quantitative goodwill impairment test. The first step of the impairment test involves comparing the fair value of the applicable reporting unit with its carrying value. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, management performs the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill. The amount, by which the carrying value of the goodwill exceeds its implied fair value, if any, is recognized as an impairment loss. The Company's evaluation of goodwill completed during the years ended December 31, 2017 and 2016, resulted in no impairment losses.

Fair value of financial instruments: The carrying amounts of financial instruments, including cash and cash equivalents, trade receivables, accounts payable and accrued liabilities approximate fair value due to the short maturity of these instruments. The carrying amount of notes payable and long-term debt is estimated to approximate fair value because the interest rates fluctuate with market interest rates, or the fixed rates are based on estimated current rates offered to the Company for debt with similar terms and maturities. Interest rate swap contracts are reported at fair value in the consolidated balance sheets.

Derivative financial instruments: As part of the Company's asset/liability management, the Company uses interest rate swaps to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Derivatives that are used as part of the asset/liability management process are linked to specific assets or liabilities, or pools of assets or liabilities, and have high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period. Interest rate swap contracts are derivatives and are recognized on the balance sheet at their estimated fair value. On the date the derivative contract is entered into, the Company may designate the derivative as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability "cash flow" hedge. Changes in the fair value of a derivative that is highly effective, and that is designated and qualifies as a cash flow hedge, are recorded in accumulated other comprehensive income (loss), until earnings are affected by the variability of cash flows (*e.g.*, when periodic settlements on a variable-rate asset or liability are recorded in earnings).

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as cash-flow hedges to specific assets and liabilities on the balance sheet or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively.

The Company discontinues hedge accounting prospectively when *(a)* it is determined that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item (including forecasted transactions); *(b)* the derivative expires or is sold, terminated, or exercised; *(c)* the derivative is designated as a hedge instrument, because it is unlikely that a forecasted transaction will occur; or *(d)* management determines that designation of the derivative as a hedge instrument is no longer appropriate.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the derivative will continue to be carried on the balance sheet at its fair value, and gains and losses that were accumulated in other comprehensive income (loss) will be recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the derivative will be carried at its fair value on the balance sheet, with subsequent changes in its fair value recognized in current-period earnings.

Deferred revenue: From time to time, the Company, through its subsidiary railroads, enters into agreements with state agencies in the form of federal or state aid projects or grant agreements which are designed to aid the Company with labor, material and other costs relating to the rehabilitation and repair of track and bridge structures belonging to the Company. The track rehabilitation projects are required in order to improve the functionality of the track structure.

The Company records deferred revenue for any amounts related to track rehabilitation projects that are reimbursed by governmental entities, and capitalizes the same amount for the related track rehabilitation projects in the capital projects category of property and equipment. Commensurate with the completion of the projects, the Company begins depreciating the capitalized assets on a straight-line basis over their estimated useful lives, with deferred revenue being amortized to income over the same lives.

Earnings per common share: Basic earnings per Class A common share has been computed on the basis of the weighted-average number of common shares outstanding during each period presented.

Income taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties, if any, that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits, if any, are classified as additional income taxes in the consolidated statements of comprehensive income. The Company maintains no material uncertain tax positions for tax reporting purposes and accordingly, no liability is required to be recorded.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Involuntary conversions: When an involuntary conversion occurs, such as the destruction of property and equipment by means of an accident or a natural disaster, a gain or loss is recognized to the extent that the cost basis of the asset destroyed differs from any proceeds received or to be received as recovery for the loss (i.e. through insurance reimbursement). An asset relating to recovery is recognized only when realization of the claim for recovery of a loss recognized in the financial statements is deemed probable. Losses are accrued by a charge to income if the amount of the loss can be reasonably estimated. Gains are recognized in the financial statements when realization of recovery in excess of the cost basis of the asset destroyed is deemed probable.

Commitments and contingencies: During the preparation of the financial statements, management evaluates contingencies to determine whether it is probable, reasonably possible or remote that a liability has been incurred.

If the likelihood that a liability has been incurred is remote, the Company does not accrue for the commitment or loss. For unresolved contingencies with potentially material exposure that are deemed reasonably possible, management evaluates whether a potential loss or range of loss can be reasonably estimated. The Company records accruals for commitments and loss contingencies when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. In addition, legal fees are accrued for cases where a loss is probable and the related fees can be reasonably estimated. When it is reasonably possible that a liability has been incurred, the Company discloses the nature of the contingency and an estimate of the possible loss or range of loss or a statement that an estimate cannot be made. However, if the likelihood of a liability is remote, but it is at least reasonably possible that one or more future confirming events may materially change management's estimate within twelve months from the date of the financial statements, the Company discloses the nature of the contingency and an estimate of the possible loss or range of loss, unless an estimate cannot be determined.

Significant judgment is required to determine both the probability and the estimated amount of loss, and these assessments can involve a series of complex judgments about future events and may rely on estimates and assumptions that have been deemed reasonable by management. Management reviews these estimates and adjust the accruals and/or disclosures to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other new information. Such new information may change management’s estimates of (a) the likelihood (probable, reasonably possible, or remote) that a liability has been incurred, (b) whether it is at least reasonably possible that one or more future confirming events may materially change management's estimate within twelve months from the date of the financial statements and, (c) whether a liability or range of liability can be reasonably estimated. Changes in accounting estimates result from new information or subsequent developments and accordingly from better insight or improved judgment. The Company accounts for changes in an accounting estimates in (a) the period of the change if the change affects that period only, or (b) the period of the change and future periods if the change affects both.

Use of estimates in the preparation of the financial statements: The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Recent accounting standards: In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. The Company will also need to apply new guidance to determine whether revenue should be recognized over time or at a point in time. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 one year. ASU 2014-09, as deferred by ASU 2015-14, will be effective for the first interim period within annual reporting periods beginning after December 15, 2017, using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. The Company has not yet selected a transition method and is currently evaluating the impact of the pending adoption of ASU 2014-09 on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Under the new guidance in this ASU, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, *Revenue from Contracts with Customers*. Lessees will no longer be provided with a source of off-balance sheet financing. ASU 2016-02 is effective for public business entities for fiscal years beginning after December 15, 2018. Early application is permitted. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the effect that this standard will have on the financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which creates a new credit impairment standard for financial assets measured at amortized cost. The ASU requires financial assets measured at amortized cost (including trade receivables) to be presented at the net amount expected to be collected, through an allowance for credit losses that are expected to occur over the remaining life of the asset, rather than incurred losses. The measurement of credit losses for newly recognized financial assets (other than certain purchased assets) and subsequent changes in the allowance for credit losses are recorded in the statement of income as the amounts expected to be collected change. The ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. ASU 2016-13 will become effective for the Company as of January 1, 2021. Early adoption is permitted for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company does not intend to early adopt. The Company is currently evaluating the impact of adopting this new guidance on its financial statements.

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The ASU simplifies the measurement of goodwill impairment by eliminating the requirement that an entity compute the implied fair value of goodwill based on the fair values of its assets and liabilities to measure impairment. Instead, goodwill impairment will be measured as the difference between the fair value of the reporting unit and the carrying value of the reporting unit. The ASU also clarifies the treatment of the income tax effect of tax deductible goodwill when measuring goodwill impairment loss. The Company will be required to adopt ASU 2017-04 as of January 1, 2021. ASU 2017-04 must be applied prospectively with early adoption permitted. The Company is currently evaluating the impact of the adoption of this guidance on its financial statements.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The new guidance is intended to more closely align hedge accounting with entities' hedging strategies, simplify the application of hedge accounting, and increase the transparency of hedging programs. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The amendments in ASU 2017-12 are effective for the Company beginning on January 1, 2019. For cash flow and net investment hedges existing at the date of adoption, ASU 2017-12 must be applied through a cumulative-effect adjustment. The amended presentation and disclosure guidance is required only prospectively. The Company is currently evaluating the impact of the adoption of this guidance on its financial statements.

In February 2018, the FASB issued ASU 2018-02, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in this update allow for a reclassification of stranded tax effects resulting from the Tax Cuts and Jobs Act from accumulated other comprehensive loss to retained earnings. The amendments in the update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The adoption of this guidance, which will result in a reclassification of stranded tax effects of $8,174 from retained earnings to accumulated other comprehensive income (loss).

Note 2. Property and Equipment

Property and equipment consist of the following as of December 31, 2017 and 2016:

	2017	2016
Land	$ 4,482,662	$ 4,482,662
Roadbed	60,017,937	55,244,634
Transportation equipment	9,953,983	9,723,668
Railcars	7,336,734	7,443,738
Buildings	6,517,795	6,410,140
Machinery and equipment	5,185,945	4,609,768
Office equipment	866,880	858,295
Leasehold improvements	5,777,853	4,526,357
Capital projects	385,725	973,733
	100,525,514	94,272,995
Less accumulated depreciation	42,602,563	38,835,696
	$ 57,922,951	$ 55,437,299

The total depreciation expense was approximately $4,014,000 and $3,765,000 for the years ended December 31, 2017 and 2016, respectively.

Note 3. Intangible Assets

In September 2013, the Company's subsidiary, Mississippi Central Railroad Co., acquired rights to a 42 mile rail line lease from Corinth, Mississippi to Red Bay, Alabama. The lease expires on September 25, 2033. The Company determined the fair value of the rights to the rail line lease to be $490,000 as of the acquisition date and recorded that amount as a track rights intangible asset. The Company is amortizing the balance over the 20-year term of the lease agreement which represents management's estimated life of the intangible asset.

The remainder of the track rights intangible assets acquired in a December 2009 transaction are being amortized monthly through June 2019.

Intangible assets as of December 31, 2017 and 2016, consist of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		2017	
Track rights	$ 1,098,450	$ 623,289	$ 475,161
		2016	
Track rights	$ 1,098,450	$ 539,264	$ 559,186

Note 3. Intangible Assets (Continued)

The changes in the net carrying amount of intangible assets subject to amortization for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Balance, beginning	$ 559,186	$ 643,210
Additions	-	-
Amortization	(84,025)	(84,024)
Balance, ending	$ 475,161	$ 559,186

Estimated aggregate annual amortization expense in future years, on amortizable intangible assets, as of December 31, 2017, is as follows:

	Amount
Year Ending December 31,	
2018	$ 84,025
2019	54,261
2020	24,500
2021	24,500
2022	24,500
Thereafter	263,375
	$ 475,161

Note 4. Line-of-Credit, Pledged Assets, Notes Payable, Long-Term Debt and Derivative Financial Instruments

The Company has unsecured notes payable in the amount of $723,046 and $716,613 as of December 31, 2017 and 2016, respectively, for the financing of insurance premiums. The note outstanding at December 31, 2017, is payable in three quarterly installments of approximately $365,587, including interest at 2.995 percent through May 2018.

The Company's credit agreement with Wells Fargo provides a $20,000,000 line-of-credit. The line-of-credit, with a balance of $14,384,446 and $12,890,696 as of December 31, 2017 and 2016, respectively, bears interest at the one-month LIBOR rate plus a spread (effective rate of 3.375 percent at December 31, 2017) and requires monthly interest-only payments throughout the term of the agreement. The credit agreement, which expires April 30, 2019, contains a provision allowing the credit agreement maturity date to be extended annually. The agreement is collateralized by various assets and stock of each of the Company's subsidiaries, except for real estate and roadbed assets. The credit agreement contains certain restrictive loan covenants including a tangible net worth ratio, a funded debt to EBITDA ratio, and a minimum net income requirement. The Company did not meet a non-financial covenant requiring delivery of audited financial statements within 120 after fiscal year-end and did not meet the funded debt to EBITDA ratio for the year ended December 31, 2017; however, the Company obtained waivers from the bank for violation of these covenants.

Note 4. Line-of-Credit, Pledged Assets, Notes Payable, Long-Term Debt and Derivative Financial Instruments (Continued)

Long-term debt at December 31, 2017 and 2016, consists of the following:

	2017	2016
Unsecured noninterest bearing note payable, State of Iowa, due in annual installments of $6,868 through January 2025	$ 54,946	$ 61,814
Noninterest bearing note payable, Ford Credit, due in monthly installments of $782, final installment due November 2020, collateralized by a vehicle	27,368	36,750
Note payable, Kansas Department of Transportation, due in monthly installments of $1,029 including interest at 2% per annum, final installment due November 2024, collateralized by rails, ties, ballast, and other track materials in and near Garden City, Kansas	79,647	90,301
Note payable, Ohio Rail Development Commission, due in monthly principal only installments of $16,667 through April 2016 followed by monthly installments of $17,414 including interest at 2.17% per annum, final installment due April 2020, collateralized by rails, ties, and related track materials	475,063	671,431
Noninterest bearing note payable, State of Iowa, due in 10 annual installments of $22,880, commencing July 2017, with final installment due July 2026, collateralized by rails, ties, and related track materials	205,920	228,800
Note payable, Wells Fargo Equipment Finance, Inc., payable in 48 monthly installments of $8,205 including interest at 2.95% per annum through September 2020, collateralized by equipment	259,775	349,141
Note payable, Kansas Department of Transportation, due in 120 monthly installments of $1,277 including interest at 2% per annum, final installment due March 2026, collateralized by rails, ties, ballast, and other track materials in and near Garden City, Kansas	116,437	129,314
Note payable, Kansas Department of Transportation, due in 120 monthly installments of $2,456 including interest at 2% per annum, final installment due September 2027, collateralized by rails, ties, ballast, and other track materials in and near Garden City, Kansas	258,855	-
Noninterest bearing note payable, State of Mississippi, due in 10 annual installments of $50,000, final payment due and paid in October 2017, collateralized by track structure	-	50,000
	1,478,011	1,617,551
Less current portion	378,256	398,354
	$ 1,099,755	$ 1,219,197

Note 4. Line-of-Credit, Pledged Assets, Notes Payable, Long-Term Debt and Derivative Financial Instruments (Continued)

Aggregate maturities required on long-term debt as of December 31, 2017, are due in future years as follows:

	Amount
Year Ending December 31,	
2018	$ 378,256
2019	14,772,844
2020	231,061
2021	81,185
2022	82,223
Thereafter	316,888
	$ 15,862,457

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. Interest rate swaps are entered into to manage interest rate risk associated with the Company's variable-rate borrowings. The derivatives and hedging accounting guidance requires that the Company recognize all derivative instruments as either assets or liabilities at fair value in the consolidated balance sheets. In accordance with this guidance, the Company designates interest rate swaps on variable rate debt as cash flow hedges.

The effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Derivative instruments are negotiated contracts entered into with two issuing counterparties containing specific agreement terms, including the underlying instrument, amount, exercise price, and maturities.

Effective July 19, 2013, the Company entered into an interest rate swap contract with Wells Fargo for an original notional principal amount of $6,500,000 that reduces by $1,000,000 each year beginning in August 2015. The interest rate swap has an effective date beginning on August 1, 2014 and a maturity date of August 1, 2018. Under the swap contract, beginning on the effective date, the Company pays interest at a fixed rate of 1.88 percent and any differences between the fixed interest rate and a variable interest rate (one-month LIBOR) based on the notional amount is settled with the bank on a monthly basis. The swap contract is intended to reduce the Company's exposure to market risk associated with changes in interest rates by converting a portion of its variable-rate debt to fixed-rate debt. As of December 31, 2017 and 2016, the fair value of the interest rate swap contract was a liability of $4,190 and $45,928, respectively.

Note 4. Line-of-Credit, Pledged Assets, Notes Payable, Long-Term Debt and Derivative Financial Instruments (Continued)

Effective June 5, 2015, the Company entered into an interest rate swap contract with Wells Fargo for an original notional principal amount of $1,000,000 that increases by $1,000,000 in July 2016 and July 2017, and by $3,500,000 in July 2018. The interest rate swap has an effective date beginning on May 2, 2016 and a maturity date of May 1, 2020. Under the swap contract, beginning on the effective date, the Company pays interest at a fixed rate of 2.585 percent and any differences between the fixed interest rate and a variable interest rate (one-month LIBOR) based on the notional amount is settled with the bank on a monthly basis. The swap contract is intended to reduce the Company's exposure to market risk associated with changes in interest rates by converting a portion of its variable-rate debt to fixed-rate debt. As of December 31, 2017 and 2016, the fair value of the interest rate swap contract was a liability of $63,813 and $123,955, respectively.

As of December 31, the fair values of the Company’s derivative instrument liabilities related to interest rate swap contracts are summarized as follows:

	2017	2016
Designated as cash flow hedges:		
Fair value recorded as long-term asset	$ -	$ -
Fair value recorded as long-term liabilities	(68,003)	(169,883)
Total	$ (68,003)	$ (169,883)

As of December 31, the effect of interest rate contracts designated as cash flow hedges on the consolidated statements of income is summarized below. For interest rate contracts designated as cash flow hedges, the entire amount recognized in the consolidated statements of income represents the effective portion of the hedging relationship as there was no gain or loss related to an ineffective portion or amount excluded from the assessment of hedge effectiveness.

The following table presents the location and amount of gross gain (loss) reclassified from accumulated other comprehensive income to income (effective portion) during the years ended December 31, 2017 and 2016.

Location	Amount	
	2017	2016
Designated as cash flow hedges:		
Interest expense	$ 64,500	$ 89,791

Note 5. Income Tax Matters

The Company and all but one of its subsidiaries file a consolidated federal income tax return. The subsidiary not included in the consolidated federal income tax return files separate federal and state income tax returns.

The provision (benefit) for income taxes charged (credited) to operations for the years ended December 31, 2017 and 2016, was as follows:

	2017	2016
Current:		
Federal	$ (21,856)	$ (74,000)
State	122,633	103,000
	100,777	29,000
Deferred:		
Federal	(3,894,000)	1,212,000
State	(91,000)	60,000
	(3,985,000)	1,272,000
	$ (3,884,223)	$ 1,301,000

The income tax provision (benefit) differs from the amount of income tax determined by applying the federal income tax rate to pretax income from operations for the years ended December 31, 2017 and 2016, due to the following:

	2017		2016	
Computed "expected" U.S. tax expense	35.0	%	35.0	%
Increase (decrease) in income taxes resulting from:				
State income taxes, net of federal tax benefit	4.9		4.9	
Railroad tax credits	-		(0.2)	
Effective rates different than statutory	(1.0)		(1.0)	
Reduction of valuation allowance	-		(1.5)	
Revaluation of deferred taxes, Tax Cuts and Jobs Act of 2017	(1,690.1)		-	
Other	12.7		(2.1)	
	(1,638.5)	%	35.1	%

Note 5. Income Tax Matters (Continued)

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act tax reform legislation. This legislation makes significant changes in U.S. tax law including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks, and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 35 percent to 21 percent. As a result of the enacted law, the Company was required to revalue deferred tax assets and liabilities at the enacted rate. This revaluation resulted in a benefit of $4,006,439 to income tax expense in continuing operations and a corresponding reduction in the deferred tax liability. The other provisions of the Tax Cuts and Jobs Act did not have a material impact on the financial statements.

Deferred tax assets and liabilities consist of the following components as of December 31, 2017 and 2016:

	2017	2016
Deferred tax assets:		
Minimum tax and general business credit carryforwards	$ 1,169,000	$ 1,157,000
Interest rate swap	18,000	44,000
Federal NOL carryforwards	293,000	-
State NOL carryforwards	487,000	303,000
Deferred compensation	752,000	1,180,000
Heartland Rail investment basis	163,000	231,000
Other	574,000	491,000
Gross deferred tax assets	3,456,000	3,406,000
Deferred tax liabilities:		
Property and equipment	(10,483,000)	(14,305,000)
Prepaid expenses	(237,000)	(333,000)
Other	(1,000)	-
Gross deferred tax liabilities	(10,721,000)	(14,638,000)
Net deferred tax liabilities	$ (7,265,000)	$ (11,232,000)

The alternative minimum tax credit will carry forward with no expiration. General business credit carryforwards will expire after 2027. Federal NOL carryforwards will expire in 2038. State NOL carryforwards will expire at various times between 2019 and 2037.

The Company and one of its affiliates file income tax returns in the U.S. federal and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2014.

Note 6. Agreements with Former Chief Executive Officer and Another Major Related Party Stockholder

The Company's Board of Directors and the Company's former chief executive officer (CEO), upon the recommendations of an independent third-party consultant, agreed to the terms of a salary continuation agreement related to the CEO's retirement from the Company, effective March 21, 2006.

The former CEO passed away in September 2013; accordingly, per the terms of the agreement, the salary continuation agreement continues with his beneficiaries and another major related party stockholder.

The salary continuation agreement provides a monthly retirement benefit of $38,150 for 20 years commencing March 21, 2006. The Company recorded the approximate present value of this liability of $4,765,000 and corresponding charge to operations in its 2006 financial statements, discounted at the Company's 7.50 percent incremental borrowing rate then in effect. Interest expense is recorded with each monthly payment over the 20-year life of the agreement. Interest expense totaling approximately $219,000 and $236,000, respectively, was recognized during the years ended December 31, 2017 and 2016, related to these retirement benefits.

Future minimum payments due under the salary continuation agreement together with the present value of the minimum salary continuation payments as of December 31, 2017, are as follows:

	Amount
Year Ending December 31,	
2018	$ 457,800
2019	457,800
2020	457,800
2021	457,800
2022	457,800
Thereafter	1,449,700
Total minimum salary continuation payments	3,738,700
Less the amount representing interest	949,345
Present value of minimum salary continuation payments (of which $257,324 is included in current liabilities)	$ 2,789,355

Note 6. Agreements with Former Chief Executive Officer and Another Major Related Party Stockholder (Continued)

On March 21, 2006, Heartland entered into a stock purchase agreement with a major related party stockholder. Heartland obtained an option to purchase 853,690 shares of Pioneer's Class A common stock owned by the related party stockholder. The stock purchase agreement requires Heartland to pay the related party stockholder, or her beneficiaries, 168 equal monthly payments of approximately $12,768 from March 21, 2006 through February 21, 2020, for the right to purchase at various times, at various prices ranging from $4.15 to $5.48 per share and in various annual quantities, 853,690 shares of Pioneer's Class A common stock owned by the related party stockholder. Heartland recorded the present value of the stock purchase agreement of $1,333,979 as a liability in the 2006 financial statements, discounted at the Company's 7.50 percent incremental borrowing rate then in effect, and as a charge to the contra-equity account subsidiary's option to purchase Pioneer Class A common stock. Interest expense is recorded with each monthly payment over the 14-year life of the agreement. During the years ended December 31, 2017 and 2016, the Company recognized approximately $28,000 and $37,000, respectively, of interest expense related to these transactions.

The stock purchase agreement gives Heartland the option, but not an obligation, to purchase a scheduled number of shares of Pioneer Class A common stock from the related party stockholder, or her beneficiaries, each year. For any options not exercised as scheduled, Heartland has the option of exercising the right to purchase shares in a later year at predetermined higher share prices.

During the years ended December 31, 2017 and 2016, Heartland exercised options to purchase the following shares of Pioneer Class A common stock as follows:

	Number of Shares	Price Per Share	Aggregate Amount
March 2017	25,000	$ 5.16	$ 129,000
March 2016	25,000	$ 5.06	$ 126,500

The stock purchases described above were funded via cash transfers from Pioneer Railcorp. In the event of the death of the major related party stockholder, all provisions of the stock purchase agreement remain in effect to the stockholder's estate.

Future minimum payments due under the stock purchase agreement together with the present value of the minimum stock purchase payments as of December 31, 2017, are as follows:

	Amount
Year Ending December 31,	
2018	$ 153,220
2019	153,220
2020	25,537
Total minimum stock purchase payments	331,977
Less the amount representing interest	26,449
Present value of minimum stock purchase payments (of which $134,879 is included in current liabilities)	$ 305,528

Furthermore, see Note 11 regarding Heartland's investment in Pioneer's Class A common stock.

Note 7. Defined Contribution Retirement Plan

The Company has a defined contribution 401(k) plan covering substantially all employees. Employees are eligible to participate in the plan upon completion of one year of service and may elect to contribute, on a tax deferred basis, up to the lesser of 15 percent of their salary, or the Internal Revenue Service maximum deferral limit. The plan requires safe harbor matching contributions equal to 6 percent of eligible participant compensation. In addition to the Company matching contribution, the Company can, but did not in 2017 or 2016, make discretionary matching contributions outside of the safe harbor provisions. The Company contributed approximately $215,000 and $209,000 for the years ended December 31, 2017 and 2016, respectively.

Note 8. Lease Commitments and Total Rental Expense

The Company has lease agreements covering certain of its railroad properties. For leased railroad properties, the Company ordinarily assumes, upon the commencement date, all operating and financial responsibilities, including maintenance, payment of property taxes, and regulatory compliance. Payments on leased railroad properties are generally based upon a per car basis for traffic on the segment each year, or an annual stated amount reduced by a credit for the carload traffic each year. The leases expire between June 2019 and December 2024 and are generally subject to renewal options.

The Company has a land lease for the corporate office building. This lease, which was set to expire in September 2018, was renewed for an additional 5 year period in June 2018. The lease has annual rents equal to 10 percent of the appraised value of the land, payable in monthly installments, and with appraisal value reviews every five years following the origination date. The Company is responsible for costs of maintenance, utilities, taxes and insurance.

The total approximate minimum rental commitment as of December 31, 2017, required under noncancelable leases and excluding executory costs and per car rentals, is due in future years as follows:

	Amount
Year Ending December 31,	
2018	$ 149,000
2019	114,000
2020	104,000
2021	94,000
2022	81,000
Thereafter	116,000
	$ 658,000

The total rental expense under the leases was approximately $132,000 and $56,000 for the years ended December 31, 2017 and 2016, respectively.

Note 9. Major Customers

Major railroad customers with 10 percent or more of total railroad operating revenue for the years ended December 31, 2017 and 2016, and related accounts receivable as of December 31, 2017 and 2016, are as follows:

	Railroad Operating Revenue		Accounts Receivable	
	2017	2016	2017	2016
Customer A	$3,854,000	$4,309,000	$ 410,000	$ 320,000

Note 10. Noncontrolling Interest

Two of the Company's subsidiaries have preferred stock, owned by investors other than Pioneer Railcorp, outstanding as of December 31, 2017 and 2016. This stock is accounted for as a noncontrolling interest in subsidiaries, and dividends on the stock are accounted for as a current expense. Furthermore, Heartland Rail Investments, LLC's Class B units constitute a noncontrolling interest in that entity. There are no dividends applicable to those units.

Following is a summary of the noncontrolling interest in subsidiaries as of December 31, 2017 and 2016:

	2017	2016
Preferred stock of Alabama Railroad Co.:		
Par value - $1,000 per share		
Authorized - 700 shares		
Issued and outstanding 290 and 300 shares (cumulative 12% dividend; callable at Company's option at 150% of face value) at December 31, 2017 and 2016, respectively	$ 290,000	$ 300,000
Preferred stock of Alabama & Florida Railway Co., Inc.:		
Par value - $1,000 per share		
Authorized - 500 shares		
Issued and outstanding 245 and 254 shares (cumulative 9% dividend; callable at Company's option at 150% of face value) at December 31, 2017 and 2016, respectively	245,000	254,000
Class B units of Heartland Rail Investments, LLC	208	182
	$ 535,208	$ 554,182

Note 11. Investment in Heartland Rail Investments, LLC

Heartland entered into an operating agreement (the Agreement) with its Class A and Class B members originally effective March 21, 2006, which was amended and restated on May 4, 2017. The Class A member is Pioneer and the Class B members are officers and employees of the Company. Heartland's primary purpose is to purchase and own shares of Class A common stock of Pioneer and to provide opportunities for Class B members to participate, through the services they provide to Pioneer, in the future appreciation of the Class A common stock of Pioneer. Heartland is an investment vehicle for acquiring outstanding shares of Pioneer's Class A common stock from the former CEO and another major stockholder. The Agreement defines, among other things, Heartland's purpose and terms with its members including: initial capital accounts determination and maintenance thereafter, additional capital contributions of members, allocation of profits and losses, cash flow distributions and liquidation and dissolution distributions, transfer of ownership interests and withdrawals of members, voting and nonvoting units issued and rights, deadlock resolution actions in the event of material disagreements among voting members, covenants with respect to transactions with affiliates, information rights, advisory fees and other, and manager powers, authority and governance.

The term of Heartland shall continue perpetually, unless its existence is sooner terminated pursuant to terms as specified in the Agreement.

A dissolution of Heartland shall occur upon the occurrence of any of the following: (a) the sale, transfer or other disposition of all or substantially all of the assets of Heartland; or (b) an action to dissolve Heartland pursuant to terms of the Agreement; or (c) a change of control of Pioneer Railcorp (as defined in the Agreement).

As of December 31, 2017, a change of control of Pioneer Railcorp (as defined in the Agreement) would result in payment of $2,080,000 to the Class B members for redemption of outstanding units, calculated based on the maximum value of $10,000 per unit.

Pursuant to the Agreement, the Class A member has the sole ability to designate the manager of Heartland. All significant actions of Heartland are subject to the approval of the Class A member.

Pursuant to the Agreement, the Class B members voting as a separate class alone shall be entitled to vote the shares of Class A common stock of Pioneer Railcorp owned by Heartland. Also, the Class B members, in conjunction with the Class A members holding a majority of Class A units, have the rights to approve changes or modifications of the Agreement, except for ministerial amendments to exhibits made by the manager as directed by the Agreement.

Authorized, issued and outstanding membership units of Heartland are summarized as follows as of December 31, 2017 and 2016:

		Issued and Outstanding	
	Authorized	2017	2016
Class A units	12,000,000	11,705,540	11,436,088
Class B units	1,500	208	182

Note 11. Investment in Heartland Rail Investments, LLC (Continued)

Allocation of net profit and loss: Pursuant to the Agreement, the net profit of Heartland is allocated to its members (a) first, to the extent of any negative capital accounts; (b) second, to Class A members to the extent of all prior losses allocated in excess of all prior profits allocated; (c) third, to Class A members based on their average capital account balance multiplied by the short-term rate in effect under Internal Revenue Code of 1986, as amended, Section 1274; and (d) fourth, to Class B members.

Pursuant to the Agreement, the net loss of Heartland is allocated to its members (a) first, in proportion to and to the extent of positive account balances; and (b) second, to members in accordance with the members' respective units owned.

Cash flow, liquidation and dissolution distribution rights: Pursuant to the Agreement, Heartland's cash flow shall be first applied to the payment of expenses and debt service and then to the maintenance of adequate reserves determined by the manager.

Any cash remaining after the payment of expenses and debt service may be distributed to members for payment of income tax on their allocation of income. This tax distribution shall not exceed the maximum rate for a member as if the member were an Illinois resident.

Any remaining funds may be distributed as follows: (a) first, a fixed return equal to Class A units in an amount equal to 5 percent of the total Class A investment (there shall only be one fixed return payment per year and there shall be no right to cumulate the fixed return and receive it in a future year); (b) second, to Class A members until the total of all distributions equals the Class A investment; (c) third, 20 percent to Class A members and 80 percent to Class B members (amount distributed to a Class B member shall not exceed $10,000 per Class B unit owned by the member); and (d) fourth, any remaining funds shall be distributed to Class A members. The distribution methodology in this paragraph shall also be used in a liquidating distribution in redemption of the Class A units and the Class B units upon dissolution of Heartland.

The Agreement contains an interpretive Section 5.03 specifically stating the distribution provisions are intended to provide the Class A members with a first priority such that the entire Class A investment is returned before any Class B distribution.

Redemption: Pursuant to the Agreement, a redemption can only be made in the event that (a) Heartland is dissolved; (b) a Class B member retires at age 60 or older; (c) an involuntary transfer of member units has occurred; or (d) upon the death of a Class B member. In the event of an involuntary transfer of member units, Heartland shall have the option to purchase all of the units subject to the involuntary transfer. In the event of death of a Class B member or retirement of a Class B member at age 60 or order, Heartland shall have an obligation to purchase all of the Class B member units owned by the Class B member.

If the event of termination of employment of a Class B member from the Company other than by death or retirement at age 60 or older, such Class B member shall thereupon forfeit all Class B units held by such Class B member without payment therefore; provided, however, in the event such termination of employment occurs following a change of control (as defined in the operating agreement) of Pioneer Railcorp, such Class B member shall not forfeit such Class B units and the dissolution provisions of the operating agreement shall control.

Valuation of the Class B units shall be determined in accordance with the operating agreement. Notwithstanding any valuation calculation, the Class B units will have a maximum value not to exceed $10,000 per unit unless an increase thereof is approved by the Class A members.

Note 11. Investment in Heartland Rail Investments, LLC (Continued)

As of December 31, 2017, the redemption obligation for Class B members who have attained retirement age of 60 but have yet elected to retire, calculated based on the maximum value of $10,000 per unit, is $430,000. No provision has been made in the accompanying financial statements for this obligation as the financial instruments were not deemed to be mandatorily redeemable as of December 31, 2017.

Note 12. Commitments and Contingencies

Litigation and claims: In the course of its business, the Company's subsidiaries experience crossing accidents, employee injuries, delinquent or disputed accounts and other incidents which give rise to claims that may result in litigation. Management vigorously pursues settlement of such claims, but at any one time, some such incidents, which could result in lawsuits by and against the Company and its subsidiary railroads, remain unresolved. Management believes it has valid claims for, or good defenses to, these actions.

Management considers such claims to be a routine part of the Company's business and, as of the date of this statement, management believes that no incidents not otherwise considered have the potential to result in a liability that would materially affect the Company's consolidated financial position or results of operations.

Self-insurance: The Company self-insures a portion of the risks associated with medical expenses incurred by its employees and their dependents. Under the terms of the self-insurance agreement, the Company is responsible annually for the first $100,000 in 2017 and 2016 of qualifying medical expenses per person, limited to an aggregate excess amount computed under the terms of the insurance contract using specified participant rates. An insurance contract with an insurance company covers individual claims in excess of $100,000 in 2017 and 2016 on an annual basis. The expenses under the Company's self-insured medical plan for the years ended December 31, 2017 and 2016, were approximately $1,292,000 and $1,448,000, respectively. The Company has recorded a liability of approximately $170,000 and $170,000 at December 31, 2017 and 2016, respectively, for claims incurred but not reported.

Note 13. Earnings Per Share – Class A Common Stock

Following is information about the computation of the earnings per share (EPS) data for the years ended December 31, 2017 and 2016:

	Income (Numerator)	Average Shares Outstanding (Denominator)	Per Share Amount
		2017	
Earnings per share:			
Net income available to common stockholders	$ 4,064,366	3,850,393	$ 1.06
		2016	
Earnings per share:			
Net income available to common stockholders	$ 2,406,515	3,850,393	$ 0.63

There were no items of a dilutive nature applicable to the 2017 or 2016 calculations.

Note 14. Class A Common Stock Repurchases

The Company's Board of Directors approved a plan to repurchase up to 1,000,000 shares of the Company's Class A common stock from stockholders. No repurchases were made in 2017 or 2016 under this plan. The Class A common stock acquired by repurchase is accounted for as treasury stock in the Company's consolidated balance sheets and statements of changes in equity. As such, treasury shares held reduce the number of shares of Class A common stock outstanding as of December 31, 2017 and 2016, and the value of the treasury stock reduces equity.

Reference should also be made to Note 6 for stock repurchase agreements with the former CEO and another major stockholder.

Note 15. Fair Value Disclosures

The following information is designed to enable the reader of the financial statements to assess the inputs used to develop fair value measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lower priority to unobservable inputs (Level 3). If the inputs used in the determination of the fair value measurement fall within different levels of the hierarchy, the categorization is based on the lower level input that is significant to the fair value measurement. Assets and liabilities carried at fair value are categorized based on the inputs to the valuation techniques as follows:

Level 1: Inputs that are quoted prices (unadjusted) for identical assets or liabilities in active markets that the Company has the ability to access as of the measurement date.

Level 2: Inputs that are significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Inputs that are unobservable inputs that reflect a Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lower level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

The table below presents the balances of liabilities measured at fair value, by level within the hierarchy, as of December 31, 2017 and 2016.

	Level 1	Level 2	Level 3	Total
		2017		
Liabilities:				
Interest rate swaps	$ -	$ 68,003	$ -	$ 68,003
		2016		
Liabilities:				
Interest rate swaps	$ -	$ 169,883	$ -	$ 169,883

Note 15. Fair Value Disclosures (Continued)

Following is a description of the valuation methodology used for liabilities measured at fair value. There have been no changes in the methodologies used as of December 31, 2017 and 2016.

The Company's interest rate swaps are pay-fixed, receive-variable interest rate swaps based on the LIBOR swap rate. The LIBOR swap rate is observable at commonly quoted intervals for the full term of the swaps and therefore the swaps are considered Level 2 items. For any interest rate swaps in an asset position, the credit standing of the counterparty is analyzed and factored into the fair value measurement of the asset. FASB issued accounting guidance states that the fair value measurement of a liability must reflect the nonperformance risk of the entity. Therefore, the impact of the Company's creditworthiness has also been factored into the fair value measurement of the interest rate swaps in a liability position. The valuation methodologies used for interest rate swaps (measured at fair value) are that these swaps are valued by means of a mathematical model that calculates the present value of the anticipated cash flows from the transaction using mid-market prices and other economic data and assumptions.

Note 16. Contractual Termination and Change in Control Benefits

The Company has an employment agreement with the Company's Chief Executive Officer (CEO) that expires December 31, 2020. Under the terms of the agreement, the CEO would be entitled to benefits if certain conditions are met. The CEO is entitled to 3 years of his current salary if the Company 1) asks, forces or requires the CEO to accept a lesser salary or lesser position(s) or; 2) terminates the CEO's employment, excluding certain conditions. The CEO is also entitled to 3 years of his current salary if the Company and the CEO do not enter into a new agreement upon expiration of the existing agreement. The CEO is entitled to 2.99 years of his current salary upon a change in control, as defined in the agreement. The cost of benefits for events that would trigger compensation of 3 or 2.99 years of salary is recognized as a liability and a loss when it is probable that the CEO will be entitled to benefits and the amount can be reasonably estimated. No liability or loss has been recognized related to the cost of events that would trigger 3 or 2.99 years of salary as the Company's management does not consider it probable that the CEO will be entitled to benefits under those contract terms. The CEO is also entitled to 1 year of salary upon his decision to retire during the term of the agreement. The benefit cost related to the CEO's decision to retire is recognized as a liability and a loss once the CEO has earned the right to receive the benefit. Accordingly, the Company recognized a liability of $797,431 related to this benefit cost in accrued expenses in the accompanying consolidated balance sheet at December 31, 2017.

The Company has employment agreements with certain key employees that would compensate the employees upon certain conditions involving terminations of their employment without cause or upon change in control as defined by the agreements. The agreements were entered into as these key employees are trusted and valued members of the Company's management team and the Company desires to provide these employees with retention and severance benefits to ensure that the Company continues to receive the value of employee contributions to the Company's business, including through a time of a "change of control". A liability and related expense are recognized when it is probable that employee(s) will be entitled to benefits and the amount can be reasonable estimated. No liability or loss has been recognized related to these agreements as the Company's management does not consider it probable that employees will be entitled to benefits under the contract terms.

Under various scenarios outlined in the agreement, the employee is entitled to one year, two years or three years of retention and severance benefits with a maximum contingent liability at December 31, 2017 of $4,089,000.

Note 17. Shareholder Litigation

On June 5, 2017, a group of Company shareholders filed a Petition for Declaratory Judgment and Injunctive Relief in the Iowa District Court for Scott County. The plaintiffs assert claims arising from Heartland, a subsidiary of the Company, voting its shares of Company common stock, and from events occurring at the 2017 annual meeting of the Company's shareholders. Plaintiffs allege that Heartland's voting of its Company shares at the annual shareholder meeting violates Section 490.721 of the Iowa Business Corporations Act. Plaintiffs also seek the following remedies, among others: declaratory and injunctive relief concerning the validity of the May 5, 2017 election of the Company board of directors at the annual shareholders meeting and whether the board elected at that meeting may lawfully act for the Company; declaratory and injunctive relief regarding whether the Company may count the votes of Heartland; and declaratory and injunctive relief regarding accepting shareholders' nominations for directors at shareholders' meetings.

The parties are engaging in discovery. A bench trial is scheduled to begin on all matters on November 13, 2018.

Plaintiffs seek only declaratory and injunctive relief and have not asserted a claim for monetary damages. The outcome of this lawsuit is uncertain; however, since no monetary damages have been claimed by the Plaintiff, it is not probable that there will be a material adverse effect on the Company's financial position, results of operations or cash flows. Accordingly, no provision has been made in the accompanying financial statements for any losses attributable to this matter. The Company believes it has meritorious defenses and is vigorously defending this litigation.

Note 18. Subsequent Events

The Company has evaluated events occurring subsequent to December 31, 2017, as to their potential impact to the financial statements through July 12, 2018, which is the date the financial statements were available to be issued.

On February 9, 2018, the Bipartisan Budget Act of 2018 was signed into law. This law included a retroactive extension of the Internal Revenue Code (IRC) Section 45G short line railroad maintenance tax credit through January 1, 2018. The retroactive extension of this legislation provided for 45G tax credit for qualifying maintenance expenditures incurred and paid for in 2017. The legislation also provided a 90-day safe harbor period from the date of enactment to facilitate executing agreements pertaining to the sale or assignment of the 45G tax credits.

The Company evaluated its ability to utilize the retroactively applied credits against its 2017 taxable income and determined that selling or assigning the credits as provided for in Section 45G of the IRC to be the appropriate measure. Accordingly, in February 2018 the Company entered into agreements for the sale and assignment of the railroad maintenance tax credits that generated approximately $1,791,000 of cash proceeds. For financial statement reporting purposes, this amount will be recognized in the 2018 financial statements since the legislation was not effective until 2018. Based on the dating of the sale and assignment agreements, substantially all the amount will be recognized for income tax reporting purposes as income in the 2018 income tax returns.