BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri Gas Utility, Inc. for Authority to Issue up to and Including $88,000,000 of Long-Term Indebtedness in one or More Tranches after the Closing of the Merger Between Missouri Gas Utility and Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas, and to, Among Other Things, Encumber the Operating Assets of the Consolidated Entity.	)	**Case No. GO-2012-0102**

STAFF RECOMMENDATION

COMES NOW the Commission Staff ("Staff"), and submits its Memorandum in this case recommending conditional approval of Missouri Gas Utility, Inc.'s Energy ("MGE") Application for Authority to Issue Up to and Including $88,000,000 of Long-Term Indebtedness. In support thereof Staff states:

1. Staff has reviewed MGU's filing, as described in the attached Staff Memorandum.

2. Based on Staff's review Staff recommends the Commission grant conditional approval pending receipt of definite terms of the transaction. Specifically Staff recommends approval with the following conditions:

A. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction, including, but not limited to, MGU's capital structure for ratemaking purposes, and that the Commission reserves the right to consider the ratemaking treatment of these financing transactions and their effect on cost of capital in any later proceeding.

B. That the Company shall file with the Commission a record of projects financed with proceeds in excess of the "Bridge Loan"— i.e. in the event that incremental debt is offered under the "Term Loan" facility.

C. That the Company shall pursue best efforts to secure a fixed-rate term loan to refinance the $43 million Bridge Loan in the event it does not have cash flow to support the request of $88 million.

D. That the Company shall file with the Commission all final terms and conditions of the proposed financing, including, but not limited to, the aggregate proceeds received, price information, and estimated expenses.

WHEREFORE Staff recommends the Commission conditionally approve MGU's application and order the above recommended conditions.

Respectfully submitted,

/s/ Lera L. Shemwell
Lera L. Shemwell
Deputy General Counsel
Missouri Bar No. 43792

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-7431(Telephone)
(573) 751-9285 (Fax)
lera.shemwell@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 9th day of December, 2011.

/s/ Lera L. Shemwell

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GO-2012-0102, Missouri Gas Utility, Inc.

FROM: Zephania Marevangepo, Financial Analysis Department

/s/ Zephania Marevangepo 12/09/11	/s/ Lera Shemwell 12/09/11
Financial Analysis Department	Staff Counsel's Office

SUBJECT: Staff Recommendation to conditionally approve MGU's amended request to encumber its Missouri regulated gas distribution assets in an amount not to exceed $88,000,000 through no more than two proposed financing transactions.

DATE: December 9, 2011

Missouri Gas Utility, Inc.

1. (a) **Type of Issue:** Long-Term Debt .

(b) **Amount:** Up to $43,000,000 "Bridge Loan" to be executed upon the merger of Missouri Gas Utility, Inc. (MGU) and Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas (SMNG) with a term of eighteen (18) months, and $88,000,000 "Term Loan" to be executed in the future and will refinance the existing Bridge Loan and recapitalize the MGU capital structure for a twenty (20) year term).

(c) **Interest Rate (s):**
(1) "Bridge Loan"- LIBOR + 250bps/ Base Rate + 150 bps[1].
(2) "Term Loan"- shall be grid-based and tied to Debt to EBITDA as shown below:

Debt to EBITDA > = 7.0x	LIBOR + 275 bps / Base Rate + 175 bps
Debt to EBITDA < 7.0x > = 6.75x	LIBOR + 250bps / Base Rate + 150bps
Debt to EBITDA < 6.75x > = 6.5x	LIBOR + 225 bps / Base Rate + 125 bps
Debt to EBITDA < 6.5x	LIBOR + 200 bps / Base Rate + 100 bps

2. **Proposed Date of Transaction:** January 3, 2012 or as soon thereafter as possible.

---

[1] MGU Application, HC Appendix 4: Base Rate option is defined as higher of (a) the CoBank/ UMB Bank prime, (b) the Federal Funds Rate plus 50 bps, or LIBOR plus 100 bps.

3. (a) **Statement of purpose of the Transaction:**

(1) “Bridge Loan” proceeds shall be used to refinance MGU debt, SMNG debt and finance expansion and improvement of service and facilities.

(2) “Term Loan” proceeds shall be used to refinance the “Bridge Loan” and to recapitalize MGU’s capital structure.

(b) **From a financial perspective, does Staff deem this purpose reasonable?**

Yes _X_ No

4. **Type of Transaction**:

(a) The “Bridge Loan” shall be used as temporary financing. The expected execution date of the transaction is January 3, 2012 and the expected maturity date of the loan is June 30, 2013.

(b) The “Term Loan” shall be long-term permanent financing. The loan may be issued between June 1, 2012 and June 30, 2013 and shall have a 20-year term.

5. **Copies of executed instruments defining terms of the proposed transaction:**

(a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.

_X_ (b) If such instruments have not been executed at the time of filing, a commitment to provide the terms and conditions of the instruments when they are available has been made.

(c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

6. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the proposed transaction reviewed:**
Yes _X_ No

7. **Capital expenditure schedule reviewed:**
Yes No _X

8. **Recommendation of the Staff:**

___ Grant by session order (see Comments)

_X_ Grant Conditional Approval pending receipt of definite terms of transaction (see Comments)

___ Require additional and/or revised data before approval can be granted (see Comments)

___ Formal hearing required (see Comments)

___ Recommend dismissal (see Comments)

Background:

MGU's Application for Commission authority to encumber its Missouri utility assets, arises in part from the Commission's order, filed on September 28, 2011 in the merger case- File No. GM-2011-0354, which approved the Unanimous Stipulation and Agreement addressing the proposed merger of SMNG and MGU, with MGU as the surviving entity.

MGU, a Colorado corporation, is a wholly owned subsidiary of Summit Utilities, Inc.; and IIF CNG Investment LLC (IIF) is the ultimate owner of both entities. After completion of the merger, MGU will operate natural gas distribution and transmission systems in northern, central and south central Missouri.

Request:

Although the caption of MGU's Application indicates it requesting Commission "authority to issue up to and including $88,000,000 of long-term indebtedness in one or more tranches after the closing of the merger between Missouri Gas Utility and Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas, *and* to, among other things, encumber the operating assets of the consolidated entity," through communications with Staff, MGU has clarified that it is only seeking Commission authority to put a lien on or encumber its Missouri utility assets in the amount of $88,000,000. MGU is not seeking Commission authority to issue two separate debt financing transactions pursuant to Section 393.200, RSMo and 4 CSR 240-3.220 because MGU is not a Missouri corporation.

MGU plans to issue up to $43,000,000 for a term up to 18 months (Bridge Loan) and subsequently up to $88,000,000 in long-term indebtedness (Term Loan), the first $43,000,000 of which would replace the Bridge Loan. The first debt issuance of approximately $43,000,000, which will serve as temporary financing (Bridge Loan), is expected be issued by January 3, 2012 and mature on June 30, 2013. The second issuance of approximately $88,000,000 which will serve as indirect fixed interest rate, long-term financing (Term Loan), is expected to be issued at least by the maturity of the Bridge Loan term, but preferably by June 1, 2012 and mature on June 30, 2032, and will refinance the Bridge Loan.

Loan Provider(s) and Uses of Proceeds:

The "Bridge Loan" will be equally provided by CoBank and UMB Bank. The loan proceeds are to be used to refinance MGU's $10,120,000 Variable Rate Demand Revenue Bonds (Series 2009B) and SMNG's $28,000,000 senior secured term loan, provided by CoBank, as well as to finance the expansion and improvement of service and facilities.

MGU intends to continue to install service lines to new customers in all its service territories in 2012, which will be financed primarily by these funds and by cash on hand. However, MGU has represented to Staff that external capital will be available if needed. The Company believes that it will install service lines and provide service to an additional 800 to 1200 customers during 2012.

The "Term Loan" is to be provided by CoBank, UMB Bank and other financial institutions to be selected by CoBank in consultation with MGU, Summit Utilities, and IIF—MGU's sole equity investor. The loan proceeds will be used to refinance the "Bridge Loan" and recapitalize MGU's capital structure

Recapitalization and its Impact:

MGU's 2011 merged pro-forma financial statements show a ratio of approximately 74 percent equity and 26 percent debt. MGU, as part of the proposed transactions, plans to recapitalize its capital structure to reduce the amount of equity and increase the amount of debt in its capital structure.

IIF has demonstrated a willingness to commit significant capital to the SMNG and MGU systems. Both systems have undergone significant expansion and the merged systems are expected to continue to expand. The amount of equity capital currently invested in MGU and SMNG serves to demonstrate IIF's willingness to commit equity capital as necessary to support the ongoing operations and expansion initiatives of both MGU and SMNG. Upon issuance of up to $88 million of long-term debt notes however, the original $43 million of short-term loans issued upon the merger date will be retired, and the resulting $45 million of net cash will thus be available as a return of capital to IIF to reduce their outstanding equity position and migrate the debt/equity ratio toward the targeted 60%/40% level. MGU has represented to Staff that it expects to retain approximately $15 million of the $45 million in debt proceeds for working capital and growth purposes, with the remaining $30 million being used to reduce IIF's equity investment in the merged system. After the recapitalization, the equity-to-capitalization ratio would be approximately 42% ($65 million / $153 million).

Appendix 7 of MGU's finance application shows MGU's projected recapitalized capital structures over a four-year period—2012 through 2015—with a debt-to-capitalization ratio of approximately 55 to 60 percent and an equity-to-capitalization ratio of approximately 45 to 40 percent. MGU's proposed recapitalization results in a capital structure consistent with that of a company with "Aggressive" financial risk.[2]

Credit Worthiness and Financial Covenants:

According to S&P the FFO to debt ratio is a primary consideration in determining the likelihood of default, in the long-term. Summit Utilities, Inc. (MGU's parent and guarantor) and

[2] Based on S&P's Benchmarks contained in a May 27, 2009 article, "Criteria Methodology: Business Risk/Financial Risk Matrix Expanded."

MGU's current FFO to debt ratios for 2010 were 3.53 percent and -2.09 percent. The projected 5-year averages of this ratio (2011-2015) are 7.52 percent and 6.31 percent. S&P's minimum benchmark for a "highly leveraged" company is 12 percent (please refer to footnote 3). While S&P made it clear that these benchmarks are mere guidelines, Summit Utilities, Inc. and MGU's actual and projected financial metrics are indicative of a "highly leveraged" company. Assuming Summit and/ or MGU were assigned a business risk profile of "strong," which is only one notch lower than more established natural gas distribution companies, both entities' indicative credit rating would be 3 notches below investment grade at 'BB-'.

Despite MGU's "highly leveraged" financial risk profile, CoBank and UMB bank are willing to extend long-term loan access to MGU at a fairly low interest rate[3], on condition that MGU comply with three primary financial loan covenants cited in the "Term Loan" term sheet (Appendix 4HC to MGU's finance application): (1) Debt to Capitalization Ratio < = 65 percent, (2) Debt to EBITDA Ratio < = 8.0x and (3) Debt Service Coverage Ratio > = 1.40x.

The 18-month Bridge Loan's covenants do not contain the same hurdles required by the 20-year term loan. However, MGU has represented to Staff that it expects to be able to meet the more stringent covenants required to secure permanent financing within the next six months. MGU anticipates this can be achieved through the opportunity to generate full year revenue streams during 2012 of customers added in 2011 as well as to realize the full benefit of the cost saving synergies associated with the SMNG/MGU merger. However, MGU has also assured Staff that the lenders are willing to provide long-term, fixed rate capital in the event that it may not be able to meet the more stringent covenants.

Conclusion:

Staff recognizes that while MGU's actual and projected financial ratios show significant possible financial strain, IIF has demonstrated a commitment to provide capital to ensure that MGU and SMNG continue to provide quality and reliable services and expand into new service territories. Although MGU has communicated to Staff that it has no definitive plans to further expand its operations in Missouri, its ability to do so with a reasonable amount of equity investment may depend on the continued investment of IIF.

Staff recommends approval of this application with the following conditions:

RECOMMENDED CONDITIONS:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction, including, but not limited to, MGU's capital structure for ratemaking purposes, and that the Commission reserves the right

[3] Conference call, November 16, 2011. MGU represented to Staff that it expects to secure an "indirect fixed interest rate" of approximately 5.5 percent on the "Term Loan". MGU will secure an "indirect fixed interest rate" by swapping the floating rate on its "Term Loan" with a fixed rate from CoBank.

to consider the ratemaking treatment of these financing transactions and their effect on cost of capital in any later proceeding.

2. That the Company shall file with the Commission a record of projects financed with proceeds in excess of the "Bridge Loan"— i.e. in the event that incremental debt is offered under the "Term Loan" facility.

3. That the Company shall pursue best efforts to secure a fixed-rate term loan to refinance the $43 million Bridge Loan in the event it does not have cash flow to support the request of $88 million.

4. That the Company shall file with the Commission all final terms and conditions of the proposed financing, including, but not limited to, the aggregate proceeds received, price information, and estimated expenses.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri Gas Utility, Inc. for Authority to Issue up to and Including $88,000,000 of Long-Term Indebtedness in one or More Tranches after the Closing of the Merger Between Missouri Gas Utility and Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas, and to, Among Other Things, Encumber the Operating Assets of the Consolidated Entity)	File No. GO-2012-0102

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.

Zephania Marevangepo

Subscribed and sworn to before me this 9th day of December, 2011.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

D Suzie Mankin
Notary Public