

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of	)	
The Raytown Water Company for an Order	)	<u>Case No. WF-2012-0413</u>
Authorizing Issuance of Water Facilities	)	
Refunding and Improvement Bonds Series 2012	)	

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through its attorney, and states, for its *Staff Recommendation*, to the Missouri Public Service Commission ("Commission"), as follows.

1. On June 12, 2012, The Raytown Water Company ("Raytown" or "Company") filed with the Commission an *Application for Order Authorizing the Issuance of Water Facilities Refunding and Improvement Bonds* ("*Application*").

2. In the *Application*, Raytown is seeking authority to borrow a principal sum not to exceed \$1,015,000 from the Missouri Environmental Improvement and Energy Resources Authority, which will issue Water Facilities Refunding and Improvements Bond Series 2012 (2012 EI ERA Bonds) to obtain the proceeds to lend to Raytown for improvements that are to be used to replace a water main with a larger water main.

3. On June 25, 2012, the Commission issued an *Order* which directed Staff to file a recommendation regarding the Company's financing application no later than August 27, 2012. This pleading complies with that *Order*.

4. Staff recommends that this *Application* be approved with conditions as defined in Appendix A, attached and incorporated by reference herein, which is a Memorandum prepared by Shana Atkinson, Utility Regulatory Auditor III, in the Commission's Financial Analysis Department.

WHEREFORE, Staff respectfully submits this *Staff Recommendation* to the Commission for its information and consideration, and recommends that the *Application* be approved with conditions as set out in Appendix A of this *Staff Recommendation*.

Respectfully submitted,

/s/ Rachel M. Lewis

Rachel M. Lewis
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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record on this 27th day of August, 2012.

/s/ Rachel M. Lewis

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WF-2012-0413, Raytown Water Company

FROM: Shana Atkinson, Financial Analysis Department

/s/ Shana Atkinson 08/27/12
Project Coordinator / Date

/s/ Rachel Lewis 08/27/12
Staff Counsel's Office / Date

SUBJECT: Staff Recommendation to conditionally approve the Application of Raytown Water Company for authority to borrow a principal sum not to exceed \$1,015,000 from the Missouri Environmental Improvement and Energy Resources Authority ("Authority"), which will issue Water Facilities Refunding and Improvement Bonds Series 2012 ("2012 EI ERA Bonds") to obtain the proceeds to lend to Raytown Water Company.

DATE: August 27, 2012

Raytown Water Company

1. (a) **Type of Issue:** Loan Agreement, Promissory Note and Deed of Trust and Security Agreement in Conjunction with Water Facilities Refunding and Improvement Bonds Series 2012 to be issued by the Authority.

(b) **Amount:** Not to exceed \$1,015,000.

(c) **Rate:** The interest rate on the loan will not exceed 3.25 percent.
2. **Proposed Date of Transaction:** As soon as approval from the Commission is received.
3. (a) **Statement of Purpose of the Transaction:** The Applicant proposes to apply the proceeds from the loan (a) for the replacement of a water main with a larger water main in the Applicant's service territory inside of Raytown, Missouri to be installed at the same time the City of Raytown upgrades its infrastructure; (b) to fund any debt service reserve fund that may be required, and (c) to pay the costs and expenses of the issuance of the Bonds.

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

Yes X No
4. **Type of Transaction:** The Applicant will enter a Loan Agreement with the Authority and the Authority will issue and sell for cash a principal amount not to exceed \$1,015,000 of tax-exempt EI ERA Bonds. The Loan Agreement will bear the same terms as the EI ERA Bonds. The Loan Agreement will be secured by a mortgage from the Applicant.
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.

- ☒ (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 ☒ No

7. **Capital expenditure schedule reviewed:**

Yes ☒ No

8. **Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:**

Yes ☒ No

9. **Recommendation of the Staff:**

- ☐ Grant by session order (see Comments)
- ☒ Conditional Approval granted 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)

COMMENTS:

Raytown Water Company (“Raytown”, “Applicant”, or “Company”) is a Missouri water corporation with its principal place of business at 9820 East 63rd Street, Raytown, Missouri 64133. The Applicant is in the business of the retail sale of water as a public utility in portions of the cities of Raytown and Kansas City, in Jackson County, Missouri.

Raytown has filed an Application requesting that the Commission authorize the issuance of EIERA Bonds. Although EIERA Bonds will need to be issued as part of the overall process to procure the \$1,015,000 of funds requested in Raytown’s Application, Raytown is not the entity that will actually issue the EIERA Bonds. The Authority is the entity that will issue the EIERA Bonds and then the Authority lends these proceeds to Raytown bearing the same terms as the EIERA Bonds. The EIERA Bonds are to be issued as an Additional Obligation under, subject to and secured by the lien of, a Deed of Trust, Mortgage and Security Agreement pursuant to the Bond Trust Indenture and Loan Agreement among Raytown, the Mortgage Trustee (UMB Bank), and the Authority. Therefore, Staff recommends the Commission only authorize Raytown to enter a loan with the Authority. This loan will allow the Company to borrow up to \$1,015,000 in aggregate principal amount from the Authority, in conjunction with its request of the Authority to issue EIERA Bonds. The Authority will issue EIERA Bonds to investors and then lend these proceeds to Raytown by executing the loan documents. In response to Staff Data Request No. 0005, Raytown Water Company specified to Staff that Raytown will not have custody of the funds until construction of the water main begins. If there is any lag time between when the proceeds are released and there is a draw in support of the project, UMB Bank will hold those proceeds until they are drawn down. The Authority is authorized to issue EIERA Bonds and loan the proceeds to a corporation for the purpose of acquisition, construction, reconstruction, enlargement, improvement, furnishing, equipping, maintaining, repairing, operating, or leasing, of any facility constituting a “project” under Section 260.005 through 260.125, RSMo (Supp. 2011).

The EIERA Bonds are tax-exempt, which makes the cost of the bonds lower than if they were traditional taxable bonds because the investor does not require a higher return to offset the taxes normally due on investment income. According to the Application the interest rate on the EIERA Bonds is not to exceed 3.25%.

Raytown filed its Application pursuant to Section 393.200 RSMo (Supp. 2011). Staff has historically applied the “standard of not detrimental to the public interest” in such instances. Staff’s primary concerns are whether the proposed transaction will impair the Company’s ability to attract capital, and whether the funds are ultimately used for system investment. Although Staff’s analysis focuses on the possible impact on the Company’s creditworthiness, Staff’s recommendation is not intended to be an endorsement of Raytown’s capacity and/or willingness to meet its obligations. Additionally, Staff did not conduct an audit or cost review with regard to the proposed capital expenditures. Raytown provided a Preliminary Opinion of Probable Construction Cost for the water main replacement in response to Staff Data Request No. 0003, and this preliminary opinion estimated the construction of the water main to cost \$900,000. In Raytown’s response to Staff Data Request No. 0004, Raytown indicated that the final bid for the construction will not be awarded until October 2012. Staff has relied on the Company’s representation that the funds authorized under this financing will be used for Raytown’s regulated water utility operations.

Staff evaluated the potential impact of Raytown's proposed financing on its financial risk by analyzing the three financial ratios in which benchmarks were published in the May 27, 2009, Standard and Poor's (S&P) article, "Criteria Methodology: Business Risk/Financial Risk Matrix Expanded" (see Attachment 1). These three ratios are the Funds From Operations (FFO) to Total Debt ratio, the Total Debt to Total Capital ratio and the Total Debt to EBITDA (earnings before interest, taxes, depreciation, and amortization) ratio. S&P's scale classifies a company's Business Risk Profile ("BRP") according to the following categories: "Excellent," "Strong," "Satisfactory," "Fair," "Weak," and "Vulnerable." The BRPs are evaluated along with a company's Financial Risk Profile (FRP) of "Minimal," "Modest," "Intermediate," "Significant," "Aggressive," and "Highly Leveraged" to estimate a possible credit rating.

Attached and incorporated herein by reference is Attachment 2, which shows the results for Staff's calculations for each of the three ratios using the financial information Raytown provided in Exhibit D, attached to its Application. Staff calculated the three ratios using the actual financial information for the year ending December 31, 2011, and the pro forma financial information as of December 31, 2011, taking into account the proposed financing and the use of the proceeds. Staff compared the results of its calculations to the benchmark guidelines for at least a 'BBB-' credit rating for a company with a BRP of "Strong." Because Raytown is not rated by S&P, it does not have an assigned BRP. However, it would be reasonable to assume that Raytown's BRP would be no less than "Strong" because, to Staff's knowledge, S&P has not assigned a BRP weaker than "Strong" for any Missouri regulated utility company whose principal regulated operations are confined to Missouri.

Before evaluating the pro-forma impact of the proposed financing, it is important for Staff to assess the current actual financial ratios as of the date of the financial statements Raytown provided with its Application. Staff's analysis is provided in Attachment 2. Staff's analysis indicates that Raytown's ratios are within the FRP range of "Minimal," according to S&P's benchmarks for the three ratios FFO to Total Debt, Total Debt to Total Capital and Total Debt/EBITDA. Assuming Raytown has a "Strong" BRP, the ratios are consistent with the benchmark for an 'AA' credit rating under S&P's matrix.

After the pro forma adjustments, the FFO to Total Debt and Total Debt/EBITDA ratios for Raytown are within the FRP range of "Significant," and the Total Debt to Total Capital ratio is within the FRP range of "Modest". Continuing with the assumption that Raytown has a "Strong" BRP, this would be consistent with a credit rating within the range of an 'A' to 'BBB' credit rating under S&P's matrix.

Staff recommends the Commission approve the Application with the conditions below because Staff concludes that the proposed transaction will not impair the Company's ability to attract capital and UMB Bank will only release funds for the purposes specified in the Application.

OTHER ISSUES:

Staff has verified that the Company has filed its annual report and is not delinquent on any assessment. Staff's Budget and Fiscal Services Unit has reviewed the circumstances in this finance case and determines that it is appropriate to condition the approval of the Company's financing on the submission of appropriate journal entries to determine if the fee schedule should apply, as set forth in Section 386.300 RSMo (Supp. 2011), in accordance with 4 CSR 240-3.615(1)(F).

RECOMMENDED CONDITIONS:

Staff recommends that this Application be approved with the following conditions:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, which includes, but is not limited to, the capital structure, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions, and their effect on cost of capital, in any later proceeding.
2. That the Company file with the Commission all final terms and conditions of the proposed financing, which shall include, but not be limited to, the executed Loan Agreement, the Promissory Note, the Deed of Trust and Security Agreement, the Water Facilities Refunding and Improvement Bonds and the Bond Trust Indenture.
3. That the Company submit a verified report to the Commission's Budget and Fiscal Services Unit documenting the issuance of the note, the use of any associated proceeds, and the applicability and measure of fees under Section 386.300.2. RSMo (Supp. 2011).
4. That nothing in the Commission's order approving this Application shall be considered as the Commission providing authority for the issuance of the EI ERA Bonds. The Commission is providing authority for The Raytown Water Company to take all necessary steps to execute the proposed loan transaction with the Missouri Environmental Improvement and Energy Resources Authority, not the authority for the issuance of the EI ERA Bonds.
5. That all future funds acquired through issuance of securities under this application shall be used exclusively for the benefit of Raytown Water Company's regulated operations.
6. If there is any delay in the use of proceeds more than three (3) months after the Commission Approves this Application, the Company will promptly notify the Commission of the delay and the reason for the delay.

OF THE STATE OF MISSOURI

In the Matter of the Application of)
The Raytown Water Company for an) File No. WF-2012-0413
Order Authorizing Issuance of Water)
Facilities Refunding and Improvement)
Bonds Series 2012)

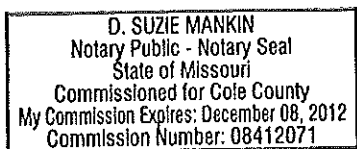
AFFIDAVIT OF SHANA ATKINSON

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Shana Atkinson, of lawful age, on her oath states: that she 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 her; that she has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of her knowledge and belief.

Shana Atkinson
SHANA ATKINSON

Subscribed and sworn to before me this 27th day of August, 2012.



D. Suzellankin
Notary Public

May 27, 2009

Criteria | Corporates | General:

Criteria Methodology: Business Risk/Financial Risk Matrix Expanded

Primary Credit Analysts:

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Criteria Methodology: Business Risk/Financial Risk Matrix Expanded

(Editor's Note: We are republishing this criteria following our periodic review completed on Dec. 8, 2010. In the original version of this article published on May 26, 2009, certain rating outcomes in the table 1 matrix were misspelled. A corrected version follows.

Table 1 supersedes tables 1, 2, and 3 in the following articles:

- "Business And Financial Risks In The Global Telecommunication, Cable, And Satellite Broadcast Industry," published Jan. 27, 2009;
- "Key Credit Factors: Business And Financial Risks In The U.S. For-Profit Health Care Facilities Industry," published Jan. 21, 2009;
- "Key Credit Factors: Methodology And Assumptions On Risks In The Packaging Industry," published Dec. 4, 2008;
- "Business And Financial Risks In The Investor-Owned Utilities Industry," published Nov. 26, 2008;
- "Business And Financial Risks In The Global Building Products And Materials Industry," published Nov. 19, 2008;
- "Business And Financial Risks In The Commodity And Specialty Chemical Industry," published Nov. 20, 2008;
- "Business And Financial Risks In The Oil And Gas Exploration And Production Industry," published Nov. 10, 2008;
- "Key Credit Factors: Business And Financial Risks In The U.S. Trucking Industry," published Nov. 4, 2008;
- "Business And Financial Risks In The U.S. Gaming Industry," published Sept. 25, 2008;
- "Key Credit Factors: Business And Financial Risks In The Retail Industry," published Sept. 18, 2008; and
- "Business And Financial Risks In The Restaurant Industry," published Dec. 4, 2008.

Table 1 also supersedes only table 1 in "Business And Financial Risks In The Global High Technology Industry," published Sept. 18, 2008.)

Standard & Poor's Ratings Services is refining its methodology for corporate ratings related to its business risk/financial risk matrix, which we published as part of "2008 Corporate Ratings Criteria" on April 15, 2008, on RatingsDirect at www.ratingsdirect.com and Standard & Poor's Web site at www.standardandpoors.com.

This article amends and supersedes the criteria as published in Corporate Ratings Criteria, page 21, and the articles listed in the "Related Articles" section at the end of this report.

This article is part of a broad series of measures announced last year to enhance our governance, analytics,

dissemination of information, and investor education initiatives. These initiatives are aimed at augmenting our independence, strengthening the rating process, and increasing our transparency to better serve the global markets.

We introduced the business risk/financial risk matrix four years ago. The relationships depicted in the matrix represent an essential element of our corporate analytical methodology.

We are now expanding the matrix, by adding one category to both business and financial risks (see table 1). As a result, the matrix allows for greater differentiation regarding companies rated lower than investment grade (i.e., 'BB' and below).

Table 1

Business And Financial Risk Profile Matrix						
Business Risk Profile	--Financial Risk Profile--					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	CCC+

These rating outcomes are shown for guidance purposes only. Actual rating should be within one notch of indicated rating outcomes.

The rating outcomes refer to issuer credit ratings. The ratings indicated in each cell of the matrix are the midpoints of a range of likely rating possibilities. This range would ordinarily span one notch above and below the indicated rating.

Business Risk/Financial Risk Framework

Our corporate analytical methodology organizes the analytical process according to a common framework, and it divides the task into several categories so that all salient issues are considered. The first categories involve fundamental business analysis; the financial analysis categories follow.

Our ratings analysis starts with the assessment of the business and competitive profile of the company. Two companies with identical financial metrics can be rated very differently, to the extent that their business challenges and prospects differ. The categories underlying our business and financial risk assessments are:

Business risk

- Country risk
- Industry risk
- Competitive position
- Profitability/Peer group comparisons

Financial risk

- Accounting
- Financial governance and policies/risk tolerance
- Cash flow adequacy

- Capital structure/asset protection
- Liquidity/short-term factors

We do not have any predetermined weights for these categories. The significance of specific factors varies from situation to situation.

Updated Matrix

We developed the matrix to make explicit the rating outcomes that are typical for various business risk/financial risk combinations. It illustrates the relationship of business and financial risk profiles to the issuer credit rating.

We tend to weight business risk slightly more than financial risk when differentiating among investment-grade ratings. Conversely, we place slightly more weight on financial risk for speculative-grade issuers (see table 1, again). There also is a subtle compounding effect when both business risk and financial risk are aligned at extremes (i.e., excellent/minimal and vulnerable/highly leveraged.)

The new, more granular version of the matrix represents a refinement--not any change in rating criteria or standards--and, consequently, holds no implications for any changes to existing ratings. However, the expanded matrix should enhance the transparency of the analytical process.

Financial Benchmarks

Table 2

Financial Risk Indicative Ratios (Corporates)			
	FFO/Debt (%)	Debt/EBITDA (x)	Debt/Capital (%)
Minimal	greater than 60	less than 1.5	less than 25
Modest	45-60	1.5-2	25-35
Intermediate	30-45	2-3	35-45
Significant	20-30	3-4	45-50
Aggressive	12-20	4-5	50-60
Highly Leveraged	less than 12	greater than 5	greater than 60

How To Use The Matrix--And Its Limitations

The rating matrix indicative outcomes are what we typically observe--but are not meant to be precise indications or guarantees of future rating opinions. Positive and negative nuances in our analysis may lead to a notch higher or lower than the outcomes indicated in the various cells of the matrix.

In certain situations there may be specific, overarching risks that are outside the standard framework, e.g., a liquidity crisis, major litigation, or large acquisition. This often is the case regarding credits at the lowest end of the credit spectrum--i.e., the 'CCC' category and lower. These ratings, by definition, reflect some impending crisis or acute vulnerability, and the balanced approach that underlies the matrix framework just does not lend itself to such situations.

Similarly, some matrix cells are blank because the underlying combinations are highly unusual--and presumably

would involve complicated factors and analysis.

The following hypothetical example illustrates how the tables can be used to better understand our rating process (see tables 1 and 2).

We believe that Company ABC has a satisfactory business risk profile, typical of a low investment-grade industrial issuer. If we believed its financial risk were intermediate, the expected rating outcome should be within one notch of 'BBB'. ABC's ratios of cash flow to debt (35%) and debt leverage (total debt to EBITDA of 2.5x) are indeed characteristic of intermediate financial risk.

It might be possible for Company ABC to be upgraded to the 'A' category by, for example, reducing its debt burden to the point that financial risk is viewed as minimal. Funds from operations (FFO) to debt of more than 60% and debt to EBITDA of only 1.5x would, in most cases, indicate minimal.

Conversely, ABC may choose to become more financially aggressive--perhaps it decides to reward shareholders by borrowing to repurchase its stock. It is possible that the company may fall into the 'BB' category if we view its financial risk as significant. FFO to debt of 20% and debt to EBITDA 4x would, in our view, typify the significant financial risk category.

Still, it is essential to realize that the financial benchmarks are guidelines, neither gospel nor guarantees. They can vary in nonstandard cases: For example, if a company's financial measures exhibit very little volatility, benchmarks may be somewhat more relaxed.

Moreover, our assessment of financial risk is not as simplistic as looking at a few ratios. It encompasses:

- a view of accounting and disclosure practices;
- a view of corporate governance, financial policies, and risk tolerance;
- the degree of capital intensity, flexibility regarding capital expenditures and other cash needs, including acquisitions and shareholder distributions; and
- various aspects of liquidity--including the risk of refinancing near-term maturities.

The matrix addresses a company's standalone credit profile, and does not take account of external influences, which would pertain in the case of government-related entities or subsidiaries that in our view may benefit or suffer from affiliation with a stronger or weaker group. The matrix refers only to local-currency ratings, rather than foreign-currency ratings, which incorporate additional transfer and convertibility risks. Finally, the matrix does not apply to project finance or corporate securitizations.

Related Articles

Industrials' Business Risk/Financial Risk Matrix--A Fundamental Perspective On Corporate Ratings, April 7, 2005

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The Raytown Water Company

WF-2012-0413

Selected Pro Forma Financial Ratios for Raytown Water Company

<u>RATIO ANALYSIS</u>	<u>Ratios as of 12-31-11</u>	<u>Pro-Forma Ratios</u>	<u>S&P Benchmark Bounds for Highly Leveraged Financial Risk</u>
Debt/EBITDA	1.32 x	3.45 x	5.00 x
Funds from Operations to Total Debt:	69.16%	26.02%	12.00%
Total Debt to Total Capital:	11.67%	25.64%	60.00%

Source: Standard & Poor's RatingsDirect, "Criteria Methodology: Business Risk/Financial Risk Matrix Expanded", May 27, 2009.