BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of McDonald County Telephone Company for Authority to Create a Lien on its Property Devoted to the Public Service for the Purpose of Obtaining a Loan to be Used to Construct Additional Facilities)	Case No. TO-2009-0025

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission and for its recommendation states:

1. On June 14, 2008, McDonald County Telephone Company filed an application with the Missouri Public Service Commission. It asks for authority to pledge certain of its assets as collateral so that it may obtain a loan to finance construction needed for it to serve its customers. The loan, ballooning in 2009, is renewable.

2. Section 392.300.1 RSMo 2000 provides that no telecommunications company shall mortgage or encumber the whole or any part of its franchise, facilities or system, necessary or useful in the performance of its duties to the public, without having first secured from the Commission an order authorizing it to do so.

Section 392.310.1 RSMo provides that a telecommunications company may, when authorized by order of the Commission, issue notes payable at periods of more than twelve months after the date thereof, when necessary for the acquisition of property, the construction, completion, extension or improvement of its facilities or maintenance of its services within the state.

3. The applicable standard is whether this transaction is detrimental to the public interest. See, *In the Matter of the Application of Le-Ru Telephone Company*, 9 Mo. P.S.C. 3d 331, 334 (2000).

4. In the attached Memorandum, labeled Appendix A, the Staff states that the new construction will have a positive impact for the Company and for its customers, and that the proposed financing transaction will not impact the Company's credit worthiness.

WHEREFORE, the Staff recommends that the Commission approve McDonald County Telephone Company's application and direct the Company to submit journal entries to the Budget and Fiscal Services Department.

Respectfully submitted,

/s/ William K. Haas
William K. Haas
Deputy General Counsel
Missouri Bar No. 28701

Attorney for the Staff of the
Missouri Public Service Commission
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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 12th day of September 2008.

/s/ William K. Haas

Memorandum

To: Official Case File
Case No. TO-2009-0025, McDonald County Telephone Company

From: Myron Couch, Telecommunications Department
Ron Bible, Financial Analysis Department

Subject: Recommendation to approve an application for authority to issue a note secured by a lien

Date: September 11, 2008

Telecommunications Department

On July 22, 2008, I traveled to the McDonald County Telephone Company headquarters in Pineville, Missouri. The purpose of the visit was to see the construction of the new administrative/customer service facility. I observed the new building when completed will triple the size of the existing facility. The new facility on that day appeared to be within a few months of being complete.

I visited with James Cox, the Outside Plant Manager, and took a tour of the old and new facilities. The old building appeared cramped and in need of renovation. The new building, which was attached to the old, was spacious and modern. On previous visits to this company, Staff had observed that the old building did not offer sufficient space for the employees, administrative staff and the Customer Service Representatives, who meet with walk-in customers. Mr. Cox pointed out the various areas of the new facility and how they were constructed to better meet the demands of the business. Presently, the owner operators, Ross and Vicky Jo Babbitt, of the Company share a very small office with their respective desks butted together. In the new building they will each have an office to allow each of them to conduct their respective duties without interruption from the other.

After a tour of the building, the existing central offices and outside plant, I had the opportunity to sit down and visit with the Babbitts to talk about the construction and the loan. I inquired if there would be any change that would impact the provisioning of telephone service. They indicated that the only impact would be better efficiency in the way they would continue to offer service.

I inquired if the loan would have any impact on the Universal Service Funds (USF) the Company was presently receiving. The information I received in answer to my data request, concerning this issue, shows that the expenses for the new building changes the ratio of loop investment to total plant in service and results in a decrease of USF funding of $12,700. I have checked and found the Company to be compliant in its PSC assessment, its Missouri USF assessment, its Relay Missouri payments and it is current in its submission of Quarterly Quality of Service Reports, all of which demonstrate the Company is meeting Quality of Service Objectives.

Staff of the Telephone Department recommends the Commission approve the loan application by the Company under Case No. TO-2009-0025. Our Staff is convinced that the new construction will have a positive impact for the Company and for their customers.

Financial Analysis Department

Standard and Poor's (S&P) Corporate Ratings Matrix assigns Business Risk Profile (BRP) to utility companies as Excellent, Strong, Satisfactory, Weak, and Vulnerable; as well as a Financial Risk Profile (FRP) of Minimal, Modest, Intermediate, Aggressive, and Highly Leveraged. Please see Attachment A for a more complete explanation. McDonald Telephone Company is not currently rated by S&P, however, Staff can use the basic criteria S&P uses to evaluate the potential impact the proposed transaction would have on McDonald's credit worthiness if it were rated by S&P.

Staff reviewed the pro-forma financial statements provided by the Company in its Application and calculated the three key financial ratios used by S&P in its Corporate Ratings Matrix. The three key financial ratios are Funds From Operations (FFO) Interest Coverage, FFO as a Percentage of Average Total Debt, and Total Debt to Total Capital. Staff compared the ratios to S&P's Corporate Ratings Matrix on a current basis and then on a proforma basis. Staff determined that McDonald's pro-forma FFO Interest Coverage of 31.57 times is within the FRP range of Minimal. This means that even with the additional debt related to this transaction, the Company has a minimal amount of interest to pay relative to its cash flow. The FFO as a Percentage of Average Total Debt is 38.78 percent is also categorized as Minimal. In other words, the Company has a minimal amount of debt relative to its funds flow. Finally, Total Debt to Total Capital is 6.55 percent which, once again, is categorized as Minimal by S&P. This means that the Company has a minimum amount debt relative to its total capital. In fact, according to the financial statements provided by the Company in its Application, the Company currently has 98.38 percent equity and only 1.62 percent debt. After the transaction, the financial statement indicates they will have 93.45 percent equity and only 6.55 percent debt.

Staff determined that McDonald's pro-forma financial ratios are consistent with at least an investment grade credit rating.

Recommendation

Staff recommends that the Commission approve the Application submitted by Company in this case subject to the following conditions:

1. That the Company shall submit to the Commission any information concerning deviations from the stated use of the funds or any information that would

materially change the pro-forma capitalization and financial ratios associated with this Application.

2. That the Application is approved for the purposes stated in the Application and not for operating expenses.

3. That nothing in the Commission's order is to be considered a finding by the Commission of the value of this transaction for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

4. That the Company shall submit journal entries to the Budget and Fiscal Services Department for it to calculate the fee due under Section 386.300.2 RSMo.

Attachments: A Standard and Poor's Ratings Direct Report
B Pro-Forma Financial Ratios

Attachment A

STANDARD
&POOR'S

RatingsDirect®

November 30, 2007

U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix

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U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix

The electric, gas, and water utility ratings ranking lists published today by Standard & Poor's U.S. Utilities & Infrastructure Ratings practice are categorized under the business risk/financial risk matrix used by the Corporate Ratings group. This is designed to present our rating conclusions in a clear and standardized manner across all corporate sectors. Incorporating utility ratings into a shared framework to communicate the fundamental credit analysis of a company furthers the goals of transparency and comparability in the ratings process. Table 1 shows the matrix.

Table 1

Business Risk/Financial Risk

	Financial Risk Profile				
Business Risk Profile	**Minimal**	**Modest**	**Intermediate**	**Aggressive**	**Highly leveraged**
Excellent	AAA	AA	A	BBB	BB
Strong	AA	A	A-	BBB-	BB-
Satisfactory	A	BBB+	BBB	BB+	B+
Weak	BBB	BBB-	BB+	BB-	B
Vulnerable	BB	B+	B+	B	B-

The utilities rating methodology remains unchanged, and the use of the corporate risk matrix has not resulted in any changes to ratings or outlooks. The same five factors that we analyzed to produce a business risk score in the familiar 10-point scale are used in determining whether a utility possesses an "Excellent," "Strong," "Satisfactory," "Weak," or "Vulnerable" business risk profile:

- Regulation,
- Markets,
- Operations,
- Competitiveness, and
- Management.

Regulated utilities and holding companies that are utility-focused virtually always fall in the upper range ("Excellent" or "Strong") of business risk profiles. The defining characteristics of most utilities--a legally defined service territory generally free of significant competition, the provision of an essential or near-essential service, and the presence of regulators that have an abiding interest in supporting a healthy utility financial profile--underpin the business risk profiles of the electric, gas, and water utilities.

As the matrix concisely illustrates, the business risk profile loosely determines the level of financial risk appropriate for any given rating. Financial risk is analyzed both qualitatively and quantitatively, mainly with financial ratios and other metrics that are calculated after various analytical adjustments are performed on financial statements prepared under GAAP. Financial risk is assessed for utilities using, in part, the indicative ratio ranges in table 2.

Table 2

Financial Risk Indicative Ratios - U.S. Utilities

(Fully adjusted, historically demonstrated, and expected to consistently continue)

	Cash flow		Debt leverage
	(FFO/debt) (%)	(FFO/interest) (x)	(Total debt/capital) (%)
Modest	40 - 60	4.0 - 6.0	25 - 40
Intermediate	25 - 45	3.0 - 4.5	35 - 50
Aggressive	10 - 30	2.0 - 3.5	45 - 60
Highly leveraged	Below 15	2.5 or less	Over 50

The indicative ranges for utilities differ somewhat from the guidelines used for their unregulated counterparts because of several factors that distinguish the financial policy and profile of regulated entities. Utilities tend to finance with long-maturity capital and fixed rates. Financial performance is typically more uniform over time, avoiding the volatility of unregulated industrial entities. Also, utilities fare comparatively well in many of the less-quantitative aspects of financial risk. Financial flexibility is generally quite robust, given good access to capital, ample short-term liquidity, and the like. Utilities that exhibit such favorable credit characteristics will often see ratings based on the more accommodative end of the indicative ratio ranges, especially when the company's business risk profile is solidly within its category. Conversely, a utility that follows an atypical financial policy or manages its balance sheet less conservatively, or falls along the lower end of its business risk designation, would have to demonstrate an ability to achieve financial metrics along the more stringent end of the ratio ranges to reach a given rating.

Note that even after we assign a company a business risk and financial risk, the committee does not arrive by rote at a rating based on the matrix. The matrix is a guide--it is not intended to convey precision in the ratings process or reduce the decision to plotting intersections on a graph. Many small positives and negatives that affect credit quality can lead a committee to a different conclusion than what is indicated in the matrix. Most outcomes will fall within one notch on either side of the indicated rating. Larger exceptions for utilities would typically involve the influence of related unregulated entities or extraordinary disruptions in the regulatory environment.

We will use the matrix, the ranking list, and individual company reports to communicate the relative position of a company within its business risk peer group and the other factors that produce the ratings.

ATTACHMENT: B

MO PSC CASE NO. TO-2009-0025

Selected Pro Forma Financial Ratios
for McDonald County Telephone

RATIO ANALYSIS	Ratios as of 12-31-07	Pro-Forma Ratios	S&P Benchmark Bounds for Investment Grade Credit Rating[1]
Funds From Operations Interest Coverage:	35.55 x	31.57 x	2.0 x
Funds from Operations to Total Debt:	174.68%	38.78%	10 %
Total Debt to Total Capital:	1.62%	6.55%	60 %

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AFFIDAVIT OF RONALD BIBLE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Ronald Bible, 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.

Ronald L Bible

Ronald Bible

Subscribed and sworn to before me this 11th day of September, 2008.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn

Notary Public

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AFFIDAVIT OF Myron E. Couch

STATE OF MISSOURI)
) ss:
COUNTY OF COLE)

Myron E. Couch, employee of the Missouri Public Service Commission, being of lawful age and after being duly sworn, states that he has participated in preparing the accompanying document and that the facts therein are true and correct to the best of his knowledge and belief.

Myron E. Couch

Myron E. Couch

Subscribed and affirmed before me this 12th day of September 2008.
I am commissioned as a notary public within the County of Callaway,
State of Missouri and my commission expires on 9-21-10

NOTARY PUBLIC SEAL OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L. Sundermeyer

NOTARY PUBLIC