

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. IF-2005-0506, Green Hills Telephone Corporation

FROM: Matt Barnes, Regulatory Auditor III - Financial Analysis Department
Dan Redel, Director - Budget and Fiscal Services
Larry Henderson, Technical Specialist II – Telecommunications Department

/s/ Matt Barnes 9/9/05

/s/ William K. Haas 9/9/05

Project Coordinator / Date

General Counsel's Office / Date

SUBJECT: Staff Recommendation for Approval to Execute and Deliver a Loan Agreement, Promissory Note, a Restated Mortgage, Security Agreement and Financing Statement for a total sum not to exceed \$22,704,000.

DATE: September 9, 2005

1. (a) **Type of Issue:** Loan Agreement, Mortgage, Security Agreement and Financing Statement
 - (b) **Amount:** Up to \$22,704,000 for nineteen (19) years
 - (c) **Rate:** According to the Loan Agreement dated February 17, 2005, Section 3.1(b)(i): "The portion of the Telecommunications Loan specified in Schedule 1 hereto will bear interest at the Cost-of-Money Interest Rate determined by the Government pursuant to 7 U.S.C. 935(d)(2)(A) of the Act and its implementing regulations, as amended from time to time (7 C.F.R. 1735.31(c)) and the portion of the Telecommunications Loan specified in Schedule 1 hereto will bear interest at the rate of five percent (5.00%) per annum."
 - (d) **Other Provisions:** Section 5.12 of the Loan Agreement states, "From the date of this Agreement until the date specified in Schedule 1, the Borrower will maintain a Times Interest Earned Ratio (TIER) of at least 1.0. Thereafter, starting on the date specified in Schedule 1 (hereinafter called the "TIER Commencement Date") the Borrower shall maintain the TIER level(s) as specified in Schedule 1." Schedule 1 indicates that as of December 31, 2008 (TIER Commencement Date), the TIER shall be at least 1.50.
2. **Proposed Date of Transaction:** As soon as Commission approval is granted.
 - (a) **Statement of Purpose of the Issue:** The general terms and conditions to be contained in the note and loan agreement provide for a loan in a total amount up to \$22,704,000 with a repayment term and interest rate as set forth in the loan agreement. The loan schedule calls for an initial loan draw of \$1,500,000 on

September 30, 2005, and subsequent loan draws of \$3,500,000 on June 30, 2006, \$2,500,000 on March 31, 2007, \$1,500,000 on September 30, 2007, and \$500,000 on March 31, 2008.

(b) **From a financial perspective, does Staff deem this purpose reasonable?**
Yes X No

3. **Type of Transaction:** The Applicant proposes to borrow certain sums, not to exceed \$22,704,000 from the Rural Utilities Service (RUS) in order to fund capital improvements.

4. **Copies of executed instruments defining terms of the proposed securities:**

- ___ (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 statement of the general terms and conditions to be contained in the instruments which are proposed to be executed.
- ___ (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**
Yes X No

6. **Pro-forma Balance Sheet, Cash Flow and Income Statement reviewed:**
Yes X No

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

8. **Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:**
Yes X No

9. **Recommendation of the Staff:**

- X Grant by session order (see Comments)
- ___ Conditional Approval granted pending receipt of definite terms of issuance (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:

Green Hills Telephone Corporation (Green Hills or Company), a member-owned cooperative states in their Application:

Green Hills Telephone Corporation is engaged generally in the rendering of telecommunications service to approximately 3200 customers subject to the jurisdiction of the Commission in thirteen (13) exchanges located in the Missouri counties of Caldwell, Carroll, Davies, Linn, Livingston and Ray. The Company has filed an Application with the Missouri Public Service Commission (Commission) to obtain approval to issue a Note and to execute a Loan Agreement, Mortgage, Security Agreement and Financing Statement in an amount not to exceed \$22,704,000.

The borrowing will be used by Applicant for the construction, completion, extension and improvement of its facilities within the state; specifically, the proceeds of the loan will be used to complete a project designed to provide digital loops and broadband capability to all existing and new customers by the end of 2015.

Total Debt to Total Capital Ratio

This financing will not cause a significant change in the Company's consolidated pro forma capital structure. The Company's actual Total Debt to Total Capital Ratio as of December 31, 2004, is 25.96 percent and will increase to 28.80 percent with the initial loan draw on September 30, 2005. After the subsequent loan draw on June 30, 2006, the Total Debt to Total Capital Ratio will increase to 36.23 percent. For 2007 through 2009 the Company's Total Debt to Total Capital Ratio will be 42.75 percent, 41.27 percent, and 38.68 percent respectively (See Attachments A-1 and A-2).

Times Interest Earned Ratio (TIER)

RUS requires Green Hills to maintain a minimum TIER coverage of 1.00 as one of the covenants in the loan agreement until December 31, 2008. As of January 1, 2009, the loan covenants require Green Hills to maintain a minimum TIER coverage of 1.50. The TIER coverage calculation consists of Total Net Income plus Interest Expense payable in such year, divided by Interest Expense payable for such year. The historical TIER coverage for 2000 through 2004 for Green Hills was 7.99 times, 10.28 times, 6.93 times, 11.70 times and 7.70 times, respectively (see Attachment B-1 and B-2). On a pro forma basis for 2005 through 2009, the TIER coverage is 7.20 times, 4.37 times, 2.71 times, 2.86 times and 3.62 times, respectively (see Attachments B-1 and B-2).

Debt Service Coverage (DSC)

The DSC ratio is not a requirement as part of the covenants contained in the loan agreement, but Staff believes this ratio provides a more reliable estimate of the cash flow needed to service the principal and interest on the loan. The DSC ratio calculation consists of total net income plus depreciation and amortization expense and interest on long-term debt payable for such year, divided by principal and interest on long-term debt payable in such year. Staff is accustomed to seeing a minimum DSC ratio of 1.25 times and believes this minimum ratio is enough to meet the cash flow needed to service the principal and interest on the loan. The historical DSC ratios for the years 2000 through 2005 are 4.73 times, 4.94 times, 4.00 times, 5.22 times and 4.08 times, respectively. On a pro forma basis for 2005 through 2009, the DSC ratios are 4.14 times, 4.45 times, 3.37 times, 3.37 times and 3.73 times respectively (See Attachments C-1 and C-2).

Universal Service Fund (USF)

The Company provided Staff pro forma USF support indicating the dollar amount anticipated to be received after completion and in-service of the Plant. The Plant is expected to be completed and in-service sometime in 2008. The Company anticipates USF to increase ** ** and ** ** for 2008 and 2009 respectively. If the Company were to lose USF support for this particular project, the Company's pro forma Net Income would decrease from ** ** to ** ** for 2008. For 2009 the Company's pro forma Net Income would decrease from ** ** to ** **.

Capital Credits

Green Hills is a member-owned cooperative. The Company refunds certain dollar amounts to their patrons once a year. The Company anticipates a refund to its customers of ** ** for 2005 through 2008 and ** ** for 2009.

Telecommunications Facilities Analysis

Following its review of Green Hills Telephone Corporation's proposed plans, the Telecommunications Department Staff believes that the use of the funds for these purposes is reasonable. Based on Staff's review, the transaction is not detrimental to the public interest. Staff recommends that the Commission approve Green Hills Telephone Company's Application for authority to borrow funds to finance construction of the projects proposed in the Application. Installation of telecommunications equipment is subject to guidelines established by the Commission rules, the National Electric Code (NEC), the National Electric Safety Code (NESC) and Rural Utilities Service (RUS) standards.

STANDARD OF REVIEW

The applicable standard is whether or not this transaction is not detrimental to the public interest. See *In the Matter of the Application of Le-Ru Telephone Company for Authority to Borrow an Amount not to Exceed \$9,164,700 from the Rural Utilities Service, the Rural Telephone Bank and the Federal Financing Bank and the in Connection therewith to Execute an Amending Telephone Loan Contract Amendment, Promissory Notes, and a Restated Mortgage, Security Agreement and Financing Statement*, 9 Mo. P.S.C. 3d 229, 231 (August 15, 2000).

RECOMMENDATION

Green Hills has been approved to borrow **up to** \$22,704,000 from RUS. As part of that process, Green Hills also needs Commission approval. However, Green Hills submitted pro forma financial statements to Staff indicating they will borrow only \$9,500,000. Staff's calculations were based on the pro forma financial statements submitted by Green Hills with its Application, which only contemplated the anticipated \$9,500,000. If Green Hills had provided pro forma financial statements that contemplated the full amount approved by RUS, then the financial ratios would have been more strained. If Green Hills needs to borrow more than \$9,500,000 from RUS, Staff recommends that the Commission condition its approval of this Application to require Green Hills to submit another application for this additional amount.

Based upon its separate review, Staff recommends that the Commission approve the Application submitted by Green Hills as not detrimental to the public interest in this case subject to the following conditions:

1. That the Commission reserves the right to consider the ratemaking treatment to be afforded these transactions and the resulting cost of capital in a later proceeding.
2. That the Company shall submit an Application for Commission approval if Green Hills needs to borrow more than \$9,500,000 from RUS.
3. Within thirty (30) days after execution of draw down, the Company shall file a report with the Commission's Budget and Fiscal Services Department reflecting the amount of the draw down and use of the proceeds so that the fee schedule may be applied.
4. Finding that the money, property and labor to be procured by said transaction is reasonably required for the purposes specified above, and that no part of the proceeds shall be reasonably chargeable to operating expenses or to income.
5. Granting such further relief in this matter as the Commission may deem necessary.

MO PSC CASE NO. IF-2005-0506
OFFICIAL CASE FILE MEMORANDUM
Page 6 of 6

Attachments:	A-1, A-2	Historical and Pro Forma Capitalization
	B-1, B-2	Historical and Pro Forma TIER Coverage Ratios
	C-1, C-2	Historical and Pro Forma DSC Ratios

Green Hills Telephone Corporation
IF-2005-0506

Historical Capital Structure

Capital Component	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Common Equity	**									
Preferred Stock										
Long-Term Debt										
Short-Term Debt										
Total										**

Capital Structure	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Common Equity	54.04%	55.35%	58.47%	61.76%	66.15%	69.11%	73.41%	75.48%	75.24%	74.04%
Preferred Stock	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Long-Term Debt	45.96%	44.65%	41.53%	38.24%	33.85%	30.89%	26.59%	24.52%	24.76%	25.96%
Short-Term Debt	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Green Hills Telephone Corporation's Application Appendix 6 and response to Staff Data Request 2, 3, and 4.

* Includes Current Portion of Long-Term Debt.

NP

Green Hills Telephone Corporation
IF-2005-0506

Pro-Forma Capital Structure

Capital Component	2005	2006	2007	2008	2009
Common Equity	**				
Preferred Stock					
Long-Term Debt					
Short-Term Debt					
Total					**

Capital Structure	2005	2006	2007	2008	2009
Common Equity	71.20%	63.77%	57.25%	58.73%	61.32%
Preferred Stock	0.00%	0.00%	0.00%	0.00%	0.00%
Long-Term Debt	28.80%	36.23%	42.75%	41.27%	38.68%
Short-Term Debt	0.00%	0.00%	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Green Hills Telephone Corporation's Application Appendix 6 and response to Staff Data Request 2, 3, and 4.

NP

Green Hills Telephone Corporation
IF-2005-0506

Historical TIER Coverage Ratio

TIER Coverage Ratio	2000	2001	2002	2003	2004
Net Income + Interest on long-term debt divided by interest on LTD	**				**
TIER Coverage Ratio	7.99 x	10.28 x	6.93 x	11.70 x	7.70 x

Source: Green Hills Telephone Corporation's Application Appendix 6 and response to Staff Data Request 2, 3, and 4.

NP

Green Hills Telephone Corporation
IF-2005-0506

Pro-Forma TIER Coverage Ratio

<u>TIER Coverage Ratio</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Net Income + Interest on long-term debt divided by interest on LTD	**				**
TIER Coverage Ratio	7.20 x	4.37 x	2.71 x	2.86 x	3.62 x

Source: Green Hills Telephone Corporation's Application Appendix 6 and response to Staff Data Request 2, 3, and 4.

NP

Historical DSC Coverage Ratio

Debt Service Coverage Ratio	2000	2001	2002	2003	2004
Net Income + depreciation & amortization + Interest on long-term debt + principal payment + divided by Total Principal and Interest	**				**
Debt Service Coverage Ratio	4.73 x	4.94 x	4.00 x	5.22 x	4.08 x

Source: Green Hills Telephone Corporation's Application Appendix 6 and response to Staff Data Request 2, 3, and 4.

NP

Green Hills Telephone Corporation
IF-2005-0506

Pro-Forma DSC Coverage Ratio

<u>Debt Service Coverage Ratio</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Net Income +					
depreciation & amortization +					
Interest on long-term debt +					
principal payment +					
Divided by Total Principal and Interest					
payment					
Debt Service Coverage Ratio	4.14 x	4.45 x	3.37 x	3.37 x	3.73 x

Source: Green Hills Telephone Corporation's Application Appendix 6 and response to Staff Data Request 2, 3, and 4.

NP