

Exhibit No. _____
Issue: Cost of Capital (Debt)
Witness: Michael E. Thaman, Sr.
Type of Exhibit: Direct Testimony
Sponsoring Party: Raccoon Creek
Case No.: SR-2016-0202
Date: September 30, 2016

Missouri Public Service Commission

Direct Testimony

of

Michael E. Thaman, Sr.

On Behalf of

Raccoon Creek Utility Operating Company, Inc.

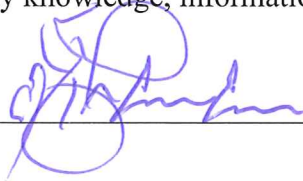
September 30, 2016

AFFIDAVIT

STATE OF Missouri)
COUNTY OF St. Louis)

SS

I, Michael E. Thaman, Sr., state that the answers to the questions posed in the attached Direct Testimony are true to the best of my knowledge, information and belief.



Subscribed and sworn to before me this 29th day of September, 2016.


Notary Public

My Commission Expires:

Kathleen M. Fellner
State of Missouri - St. Louis County
Notary Public Commission #12833887
My Commission Expires 4/18/2020

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**DIRECT TESTIMONY OF
MICHAEL E. THAMAN, SR.**

WITNESS INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael E. Thaman, Sr. My business address is Warson Capital Partners, LLC, 7733 Forsyth Boulevard, Suite 1450, St. Louis, MO 63105.

Q. PLEASE DESCRIBE YOUR FORMAL EDUCATION.

A. I received a Bachelor of Science with a major in Accounting from the University of Missouri – Columbia in 1971.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. My professional experience includes the following:

a. 1971 – 1981: Practice as a Certified Public Accountant with the St. Louis office of KPMG, an international accounting firm.

b. 1981 – 1991: Executive Vice President and Chief Financial Officer of Landmark Bancshares Corporation, a \$2.5 billion banking organization based in St. Louis, now part of Regions Bank.

c. 1992 – 1994: CEO of NationsMart Corporation, a consumer services company which completed an IPO in 1993.

d. 1994 – present: Co-Founder and CEO of Warson Capital Partners, LLC, an investment banking and private equity firm based in St. Louis providing debt and equity capital to emerging growth companies in a wide range of industries.

1 **Q. WHAT EXPERIENCE DO YOU HAVE IN REGARD TO THE FINANCING OF**
2 **BUSINESSES?**

3 A. My experience with respect to financing businesses began in the mid-1970s as a
4 member of management at the international accounting firm KPMG working with
5 clients who were having difficulty in arranging financing for a variety of reasons
6 including distressed or “turnaround” situations. In that capacity, I pursued
7 financing from both traditional and nontraditional sources. As CFO of Landmark
8 Bancshares Corporation for eleven years, I (i) lead the process of raising more
9 than \$100 million of private and public debt and equity financing to fuel growth of
10 the company, ultimately listing the company on the New York Stock Exchange;
11 and (ii) served on our community banks’ executive loan committees participating
12 in the analysis and approval process for loan proposals from clients in a variety
13 of industries including a few public utilities. I often worked with clients whose
14 loan proposals were rejected, usually for lack of traditional credit worthiness, to
15 identify and pursue alternative sources of financing. As co-founder and CEO of
16 Warson Capital Partners for 22 years, I have represented more than 100 client
17 companies in raising debt and/or equity financing in both local and national
18 markets. Many of these clients have been start-up situations, early-stage
19 emerging growth companies, and in some cases “turnaround” situations, most
20 requiring nontraditional financing.

PURPOSE

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. I will discuss the general non-availability of traditional financing for sewer utilities in the condition of Raccoon Creek Utility Operating Company, Inc. (Raccoon Creek), and the reasons therefore, as well as the reasonableness of the debt rate being charged to Raccoon Creek.

COST OF CAPITAL (DEBT)

Q. WHAT DOCUMENTS HAVE YOU REVIEWED IN PREPARATION FOR YOUR TESTIMONY?

A. I have reviewed the Direct Testimony of Josiah Cox; historical financial statements of Raccoon Creek as of and for the period from inception to December 31, 2015, and as of and for the six months ended June 30, 2016; a file created by Raccoon Creek entitled "Raccoon Creek Credit Risk Profile with Contingent Liabilities"; Missouri Department of Natural Resources (MDNR) documents with respect to the Missouri Clean Water Law and related civil penalties; Construction Loan and Security Agreement Between Raccoon Creek Utility Operating Company, Inc. and Fresh Start Venture LLC; "Small Utility Return on Equity/Rate of Return Methodology" prepared by the financial Analysis Department of the Utility Services Division of the Missouri Public Service Commission dated September 2010; Missouri Office of the Public Counsel "Small Utility Rate Case Tutorial" prepared by Ted Robertson, CPA; "Water & Sewer Operating Revenue, Expenses, and Statistics" for "WPC&WSS&Villages" for the calendar year January 1 – December 31, 2013; "West 16th Sewer Company-W/O

1 Additions Case No. SM-2015-0014 Test Year Ended 12/31/13 Updated to
2 6/30/14 Plant in Service”; “SR-2016-0065 Raccoon Creek Rate Base Worksheet
3 Source: SR-2016-0202 EMS”; “Raccoon Creek Utility Operating Company, Inc.
4 Weighted Cost of Capital for Raccoon Creek Utility Operating Company, Inc.”
5 and related schedules; “Report and OrderFile No. WR-2016-0064 et al. in the
6 Matter of the Water Rate Request of Hillcrest Utility Operating Company, Inc.

7 **Q. WHAT DO YOU UNDERSTAND IS RACCOON CREEK’S ACTUAL COST OF**
8 **DEBT?**

9 A. Fourteen percent (14%).

10 **Q. DOES THAT DEBT COST SURPRISE YOU?**

11 A. No, given the true risk profile of Raccoon Creek and the resulting nature of the
12 debt.

13 **Q. WHY NOT?**

14 A. In my opinion, the risk profile of small utilities in the condition of Raccoon Creek,
15 particularly with respect to financial position, results of operations, out-of-
16 compliance status, and the potential for unknown contingent liabilities
17 (“Distressed Utilities”), is such that traditional bank financing is not available. Any
18 lender to Distressed Utilities would be entering into a financing arrangement with
19 significant high-risk characteristics, completely outside of traditional bank capital
20 markets. There is no bond rating, stated, adjusted or otherwise, that could apply
21 to this risk profile. As a result, very few sources of financing would be available.

22 **Q. WHAT TYPES FINANCING MIGHT BE AVAILABLE TO RACCOON CREEK?**

1 A. Financing for distressed public utilities such as Raccoon Creek is very difficult to
2 source. The few sources that may be available would be specialized
3 infrastructure venture investors, high-net-worth private investors, and mezzanine
4 financing firms who would likely: (i) be familiar with small utilities and particularly
5 Distressed Utilities, the risks that may be associated therewith, the cost and the
6 time required to eliminate or mitigate such risks, and the management team and
7 its ability to address those risks; and (ii) be willing to take the risk of a loan with
8 significant high-risk characteristics in exchange for a commensurate rate of
9 interest. Such commensurate rate of interest would be determined by such
10 sources of financing based on their own assessment of risk, a process that is
11 highly subjective because of the many unknowns, financial and otherwise,
12 associated with Distressed Utilities. Given that there exists no established
13 market for this type of financing, Distressed Utilities are fortunate when they do
14 locate a source of financing, but find themselves with very little negotiating
15 position.

16 **Q. WHAT IS THE INTEREST RATE FOR THESE TYPES OF FINANCING?**

17 A. Based on my experience, lenders to companies with risk profiles similar to that of
18 Raccoon Creek could expect returns in the range of fifteen (15%) to twenty-one
19 percent (21%) for such loans.

20 **Q. DOES THE INDIVIDUAL FINANCIAL WHEREWITHAL OF AN ENTITY'S**
21 **PRESIDENT, SUCH AS MR. COX, IMPACT THIS SITUATION?**

22 A. Given that an entity's president such as Mr. Cox typically is not directly involved
23 in, nor a personal signatory to, financing arrangements such as that for Raccoon

1 Creek, a lender would look only to the characteristics of the business and its risk
2 profile without regard to the president's financial position.

3 **Q. DO YOU HAVE AN OPINION AS TO THE REASONABLENESS OF THE 14%**
4 **INTEREST RATE ASSOCIATED WITH RACCOON CREEK'S FINANCING?**

5 A. Yes. Based on the risk profile of Raccoon Creek and the very few alternatives
6 available for debt financing, I believe the fourteen percent (14%) interest rate
7 associated with Raccoon Creek's financing is reasonable.

8 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

9 A. Yes.