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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AUXIER WATER
COMPANY, INC. FOR AUTHORIZATION OF
ITS PROPOSED SALE AND CONVEYANCE
OF ALL OF ITS WATER DISTRIBUTION
SYSTEM AND CUSTOMER DEPOSITS TO
THE CITY OF PRESTONSBURG,
KENTUCKY

CASE NO. 2007-00488

**AUXIER WATER COMPANY'S
RESPONSES TO COMMISSION STAFF'S SECOND DATA REQUEST**

Bruce F. Clark
STITES & HARBISON, PLLC
421 West Main Street
P.O. Box 634
Frankfort, KY 40602-0634
Telephone: (502) 223-3477
COUNSEL FOR APPLICANT, AUXIER
WATER COMPANY, INC.

February 14, 2008

REQUEST:

1. Provide all letters, analyses, notes, memoranda, studies, and related documents that Applicants prepared or commissioned the preparation of that were used to negotiate the purchase price of \$2,650,000.

RESPONSE:

1. Attached are two valuations prepared for Auxier Water Company. The first valuation (Auxier Exhibit 1), dated May 27, 2005, is an assessment of the replacement cost prepared by Bocook Engineering, Inc. of \$4,347,750. The second valuation (Auxier Exhibit 2), dated January 11, 2006, is a business valuation of Auxier Water Company prepared by River Hill Capital, LLC of \$3,611,000. Also attached (Auxier Exhibit 3) is a cost-based valuation, dated June 2006, performed by the Kentucky Rural Water Association of \$2,401,417.

Justification of Sale and Selling Price – Auxier Water Company is a privately-owned water utility that has served the public by providing safe and reliable water service for many years. The principal owner is Mr. Philip Ward, who is on-call 24 hours/day, 7 days/week. The stress on Mr. Ward has become excessive, and he has determined that it would be in his best interests, and in the best interests of Auxier's customers, to sell the utility to the City of Prestonsburg. Such sale would provide Auxier's customers with access to a larger staff, greater facilities, and more reliable water service.

Mr. Ward and his co-owner, Mr. Forrest Music, wanted to obtain a fair price for the water

Witness: Philip L. Ward

company, as would the owner of any business. To determine what a “fair price” would be, Auxier retained the services of the Bocook Engineering Company, and further hired River Hill Capital to value the business. Their valuations came in substantially above the agreed-upon sales price of \$2.65 million.

The selling price in the Auxier/Prestonsburg Agreement is based on proper valuation principles, and is significantly less than the price paid by the City of Nicholasville for the Spears water system (approved by the Commission in 2002). Moreover, the Contract between Auxier and Prestonsburg was written to protect the Auxier customers from future rate increases. Finally, the cost savings and efficiencies created through the operation of the Auxier system by Prestonsburg will allow the selling price to be satisfied without any rate increases being imposed on Auxier’s customers.

REQUEST:

2. At page 8, the Acquisition Contract provides “[u]pon the City’s retirement of its Acquisition Debt, and the interest thereon, from the water revenues received from water users in the Service Territory of Auxier, it will continue to furnish such water service at the City’s Outside Rates (Exhibit B), or as the same may be adjusted from time to time.” Does Prestonsburg agree to commit that all revenues received from the water users in Auxier’s present service territory will be used solely for the retirement of the Acquisition Debt? If Prestonsburg objects to making this commitment, explain in detail the basis for its objection.

RESPONSE:

2. *See* Response of Prestonsburg to Staff’s Second Data Request No. 2.

REQUEST:

3. In its response to Item 2 of the Commission Staff's First Data Request, Prestonsburg provided a Conditional Loan Commitment from the Kentucky Infrastructure Authority ("KIA") dated December 13, 2007. KIA has committed to a loan that shall not exceed \$2.7 million that will have a 20-year term and an interest rate of 0.7 percent per annum. Provide an amortization schedule for the proposed KIA loan.

RESPONSE:

3. *See* Response of Prestonsburg to Staff's Second Data Request No. 3.

REQUEST:

4. a. Provide an analysis of the revenues Prestonsburg would receive over the 20-year KIA loan term that compares Auxier remaining a wholesale water customer and the customers currently served by Auxier becoming retail customers of Prestonsburg.
- b. For the same 20-year period as Item 4(a), provide the projected annual operational costs for Prestonsburg to provide retail water service to Auxier water customers.
- c. Provide all workpapers, assumptions, and calculations used in the responses to Items 4(a) and 4(b).

RESPONSE:

4. a. *See* Response of Prestonsburg to Staff's Second Data Request No. 4(a).
- b. *See* Response of Prestonsburg to Staff's Second Data Request No. 4(b).
- c. *See* Response of Prestonsburg to Staff's Second Data Request No. 4(c).

REQUEST:

5. In Case No. 2001-00325,¹ the Commission ordered: “No portion of the rates charged to Spears Water’s existing customers and to future customers in the area now served by Spears Water shall be used to recover the difference between the purchase price for the Spears Water system and the net unrecovered value of the system at the time of transfer.” Explain why the Commission should not condition its approval of the proposed transaction upon restricting Prestonsburg to assessing Auxier’s current rates to Auxier’s customers until the net unrecovered value of the Auxier system at the time of the transfer is paid by those customers at which time the customers’ rates will become the City’s Outside Water Rates.

RESPONSE:

5. *See* Response of Prestonsburg to Staff’s Second Data Request No. 5.

¹ Case No. 2001-00325, The Joint Application of the Spears Water Company, Inc. and the City of Nicholasville for Approval of an Asset Purchase Agreement (Ky. PSC Mar 7, 2002) at 5.

REQUEST:

6. Explain in detail why customers of Auxier should not be charged Prestonsburg's current rates upon completing the proposed transaction.

RESPONSE:

6. *See* Response of Prestonsburg to Staff's Second Data Request No. 6.

REQUEST:

7. a. Provide a copy of the most recent cost-of-service study that Prestonsburg has performed or commissioned for its water operations.
- b. In the event that no cost-of-service study is available, provide all analyses that are the basis for Prestonsburg's present water service rates. Include all workpapers, assumptions, and calculations used to arrive at Prestonsburg's rates.

RESPONSE:

7. a. *See* Response of Prestonsburg to Staff's Second Data Request No. 7(a).
- b. *See* Response of Prestonsburg to Staff's Second Data Request No. 7(b).

REQUEST:

8. Provide in detail an explanation of the method and basis that will be used to determine future adjustments to Prestonsburg's water service rates.

RESPONSE:

8. *See* Response of Prestonsburg to Staff's Second Data Request No. 8.



Bocook Engineering, Inc.

Consulting Engineers

312 Tenth Street • Paintsville, Ky. 41240

(606) 789-5961 • Fax: (606) 789-7671

May 27, 2005

Mr. Philip Ward
Auxier Water Company
392 John CC Mayo Ave
Auxier, Kentucky 41602

Re: Preliminary System Replacement Cost 2005

Dear Phil:

At your request, we have conducted a Replacement Cost Analysis for Auxier Water Company. This is a preliminary analysis covering major physical items and engineering costs. Some items not covered in this analysis include, but are not limited to:

1. Cost of easements
2. Governmental, Highway or Railroad permit fees
3. Office facilities
4. Mobile Equipment
5. Operating materials on hand such as pipe, valves, meters
6. Value of Customer Base

Enclosed is a map of the existing Auxier Water Company pipeline system upon which the analysis is based, as well as a spreadsheet listing quantities and unit costs used in the evaluation.

Results of the assessment indicate that at this time the replacement cost of the Auxier Water Company to be \$4,347,750.

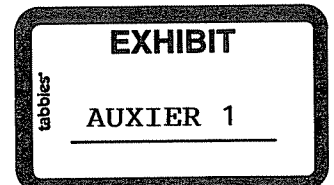
Sincerely,

Dewey L. Bocook, Jr., P.E., P.L.S.

Xc: File

1759/Word/Preliminary System Replacement Estimate 2005

"a better world tomorrow. through engineering today"



Auxier Water Company
Replacement Cost Estimate
May 2005

WO# 1759

Description	Quantity	Unit Price	Cost	Accumulated Total
2" Gate Valve	44	\$ 400.00	\$ 17,600	\$ 17,600
3" Gate Valve	14	\$ 475.00	\$ 6,650	\$ 24,250
4" Gate Valve	48	\$ 550.00	\$ 26,400	\$ 50,650
6" Gate Valve	64	\$ 600.00	\$ 38,400	\$ 89,050
8" Gate Valve	1	\$ 800.00	\$ 800	\$ 89,850
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5/8x3/4 Residential	950	\$ 800.00	\$ 760,000	\$ 871,550
2" CL 200 SDR21	45,300	\$ 7.00	\$ 317,100	\$ 1,188,650
3" CL 200 SDR21	29,300	\$ 8.00	\$ 234,400	\$ 1,423,050
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8" CL 200 SDR21	350	\$ 20.00	\$ 7,000	\$ 3,169,800
4" River Crossing PE	5	\$ 10,000.00	\$ 50,000	\$ 3,219,800
6" River Crossing PE	5	\$ 12,500.00	\$ 62,500	\$ 3,282,300
Railrod Crossing	4	\$ 20,000.00	\$ 80,000	\$ 3,362,300
4" Road Bore 4 lanes	2	\$ 25,000.00	\$ 50,000	\$ 3,412,300
6" Road Bore 4 lanes	4	\$ 25,000.00	\$ 100,000	\$ 3,512,300
2" Road Bore 2 lanes	6	\$ 7,500.00	\$ 45,000	\$ 3,557,300
4" Road Bore 2 lanes	10	\$ 7,500.00	\$ 75,000	\$ 3,632,300
6" Road Bore 2 lanes	17	\$ 10,000.00	\$ 170,000	\$ 3,802,300
Leak Detection Meters	11	\$ 800.00	\$ 8,800	\$ 3,811,100
Fire Hydrants	26	\$ 2,500.00	\$ 65,000	\$ 3,876,100
50,000 gal Storage Tk	1	\$ 30,000.00	\$ 30,000	\$ 3,906,100
Flush Hydrants	4	\$ 800.00	\$ 3,200	\$ 3,909,300
Flush Valve Assy	22	\$ 475.00	\$ 10,450	\$ 3,919,750
4" Fire Flow Meter Assy	2	\$ 10,000.00	\$ 20,000	\$ 3,939,750
3" Fire Flow Meter Assy	1	\$ 8,000.00	\$ 8,000	\$ 3,947,750
Engineering Cost	1	\$ 400,000.00	\$ 400,000	\$ 4,347,750

RIVER
HILL
CAPITAL, LLC

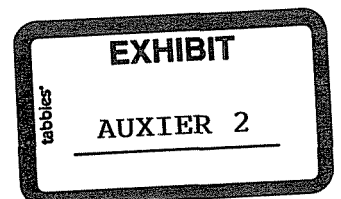
January 11, 2006

Auxier Water Company, Inc.
392 John Centre Mayo Ave.
Auxier, KY 41602

Attention: Mr. Philip Ward, President

You have asked us to provide our opinion of the approximate, current realistically - attainable value of 100% of the common stock of Auxier Water Company, Inc. (referred to herein as "AWC" or the "Company"). For purposes of rendering this opinion, we have equated the "realistically-attainable value" with the "investment value" as that term is typically defined in publications written by acknowledged experts in the valuation of closely-held securities. Shannon Pratt, Robert Reilly and Robert Schweihs, in their book entitled *Valuing A Business*, pp.30-31, defined investment value as "the specific value of an investment to a particular investor or class of investors based on individual investment requirements; distinguished from market value which is impersonal and detached". There can be many valid reasons or unique conditions that will result in the investment value differing materially from the estimated market value of a company. According to the 2005 Edition of *Business Valuation and Taxes*, p. 15, by Shannon Pratt and David Laro, those reasons or conditions may include:

- (1) the respective economic needs and abilities of the investors,
- (2) differences in risk aversion or tolerance,
- (3) motivation of the parties,



- (4) business strategies and business plans,
- (5) synergies and relationships,
- (6) strengths and weaknesses of the target business,
- (7) form of the organization of the target business.

In the case of AWC, a privately-owned water utility that holds an exclusive license to provide drinking water in a water district that was established and is regulated by the Kentucky Public Service Commission, we believe there is a relatively small number of prospective buyers that would be interested in acquiring AWC, that could obtain regulatory approval and that could realize the maximum economic benefits from an acquisition of AWC. The two targeted buyers to which the investment value of AWC is the most relevant measure of value, in our opinion, are those water systems owned and operated by the adjacent cities of Prestonsburg and Paintsville, Kentucky. These city systems now provide wholesale water to AWC's distribution system and/or own and operate sanitary sewer systems that service many of AWC's customers. (We understand that these systems rely on AWC to provide information on the connection of its customers, the size of service or the water usage by those customers, so that they know how much to charge for waste water discharged into their sewers.) In addition, we believe there are other investor-owned water systems that operate in Eastern Kentucky who have, or could obtain, PSC approval to operate AWC and that might benefit as owners for one or more of the reasons or conditions listed above.

In making our determination of value, we relied on: (i) the Company's internally-prepared income statements and balance sheet for the nine months ended September 30, 2005 and an estimate of full year results using information provided by AWC management and its accountant, (ii) the *Annual Report* of AWC as filed with the Public Service Commission of the

Auxier Water Company, Inc.

January 11, 2006

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Commonwealth of Kentucky for the year ended December 31, 2004, (iii) a copy of the *Water Contract*, dated February 11, 1998 between AWC and the Prestonsburg City Utility Commission ("PCUC"), (iv) a copy of the *Water Line Acquisition and Joint Development Agreement* dated February 11, 1998, between AWC and PCUC, (v) a copy of a study *Preliminary System Replacement Cost 2005* dated May 27, 2005, prepared by Bocook Engineering, Inc. Paintsville, Ky., and (vi) other supplementary operating or financial information provided by AWC or its legal counsel during meetings or phone calls that took place between October 31, 2005 and December 15, 2005. While we believe the information provided us to be reliable, we have not made an independent verification of its accuracy or completeness.

River Hill Capital has no present or prospective interest in the stock or assets that are subject to this opinion and has no bias toward any of the parties involved. The analysis and preparation of our opinion was performed by Gerald R. Martin. A copy of his professional resume is attached as Exhibit C.

To estimate the current realistically-attainable or investment value of AWC we considered two approaches: the discounted present value of projected free cash flows and the estimated current replacement value of the Company's assets (primarily the water system).

In order to estimate the value of AWC stock using the discounted present value of the projected free cash flow, we first assumed that the two municipally-owned water and sewer systems that currently provide wholesale water and/or sewer services to neighboring water districts and to AWC's customers are the most likely strategic buyers. We believe that the municipal water and sewer utilities of either Prestonsburg or Paintsville, Kentucky could benefit in several ways from owning AWC. We understand that either one could increase the income it now realizes from the charges it makes for sewer services currently provided to AWC customers

Auxier Water Company, Inc.

January 11, 2006

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and either one could realize substantial savings in personnel and administrative overhead because both already have employees on their payrolls who perform many of the services, billing and managerial tasks that AWC now pays an outside company to perform. Both are believed to have the financial resources or borrowing capacity to raise the funds needed to acquire AWC, to expand the system or to make system improvements that would allow AWC to grow more rapidly and deliver water more efficiently. Furthermore, we understand that AWC has not raised its rates since 1988, other than to pass through the approximate 2% per year increase in the cost of wholesale water as charged by Prestonsburg during the last several years. Management of AWC believes that it is reasonable to assume that if a municipal water system became the owner and was not subject to regulation by the Kentucky Public Service Commission; AWC would be able to implement a minimum annual rate increase of 4% per year. We consider this increase to be reasonable in light of: (i) the lack of any rate increases in some 17 years, (ii) the expected increases in the costs of purchasing water and the power needed to provide elevated service to many of its customers, (iii) the normal inflationary increases in the cost of labor and supplies used by AWC that the Company's owners have absorbed rather than passed through, (iv) the growth in population, tourism and water usage expected from the recent completion of a new state penitentiary, a new thoroughbred racetrack (that may offer other types of gambling in the near future), and the 1,500 acre Jenny Wiley State Resort Park (all of three of which are located within AWC's service area), (v) other commercial and residential developments that are planned or anticipated in Auxier because of the completion of city sewers and (vi) the need to provide a more reasonable rate of return on the additional invested capital and new rate base to an owner willing to acquire and operate AWC. We have also assumed that the 4% annual rate increases

Auxier Water Company, Inc.

January 11, 2006

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would allow AWC to use 1% of the annual water sales to fund a new "Water System Replacement Reserve" that would be in addition to projected annual capital expenditures.

The financial model we developed to project future free cash flow and to calculate discounted present value of the investment to an assumed strategic buyer is attached as Exhibit A. The historic financial information and many of the assumptions used in this model were provided by, or developed in cooperation with, the President of AWC and the Company's legal and accounting advisors. A discount factor of 9% was applied to projected free cash flows to arrive at the present value of those flows which provided the indicated price which an investor might pay to acquire AWC. To establish this rate, we looked at the latest available rates of return reported by nine U.S., investor-owned water companies. The weighted average rate of return on equity of this group for 2004 was reported to be 8.52% and the five year weighted average return on equity was 9.18%. Therefore, we believe that a 9.0% rate offers a reasonable return on investment for acquiring a water utility like AWC that has both a legal and natural monopoly to offer water services in its district and in which it owns and operates the only distribution system. This return rate is supported by what we believe would be the assumed cost of raising long term capital by a prospective buyer that could issue tax-free municipal bonds to finance the purchase of AWC, plus an additional amount to provide a fair return on capital and for the risk and uncertainty of such an investment. Using quotes from a Louisville brokerage firm, we find that the average current yield on 20-year term, insured, municipal bonds issued by several Kentucky counties is approximately 4.5%. We added an additional 4.5% (to arrive at the 9% total discount factor) in order to provide a reasonable return on invested capital and for the risk and uncertainty of the investment. These assumptions, and several others we relied upon, are detailed in the footnotes to Exhibit A. This approach provided an indicated current enterprise value of

Auxier Water Company, Inc.

January 11, 2006

Page 6

\$3,611,000 and a value for 100% of the equity ownership of \$3,323,000, after subtracting \$288,000 to repay the \$194,000 net deficit in working capital and the \$94,000 of long term liabilities reported at September 30, 2005.

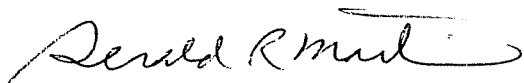
We also reviewed an analysis of AWC's system replacement cost done by Bocock Engineering at the request of AWC. This report (attached as Exhibit B) concluded that on May 27, 2005, the replacement cost of assets was \$4,347,750. Since this was an appraisal of substantially all the tangible assets (ignoring exclusive operating rights and the value of contracts) of the Company not the stock, we then deducted the deficit in net working capital (\$194,000) and the total long-term liabilities (\$94,000) to arrive at an indicated value of approximately \$4.0 million using this approach.

Although the net replacement cost of the Company's distribution system suggests a higher value, we believe an investor would make an offer based primarily on the potential rate of return the investment could be expected to provide it. Therefore, we have placed the greatest weight on the discounted present value of projected free cash flow approach. It is our opinion that the current realistically-attainable or investment value of a 100% holding of the common stock of AWC as of this date is approximately \$3,300,000.

We appreciate this opportunity to be of service to you and will be pleased to provide whatever amplification of our opinion you may require.

Sincerely,

RIVER HILL CAPITAL, LLC



Gerald R. Martin
Vice President

EXHIBIT A

AUXIER WATER CO.

Proforma Cash Flow Projection and Estimated Present Value of Free Cash Flow

Assumption	2004	2005	2006	2007	2008	2009	2010	Terminal
	Actual	Estimated(4)	Proj.	Proj.	Proj.	Proj.	Proj.	Value (9)
1. Water Revenue								
1a. Water purchased (000 gal.)	75,321	75,500	77,010	78,550	80,121	81,724	83,358	
1b. Water sold (000 gal.)	65,133	69,460	70,849	72,266	73,712	75,186	76,689	
1c. Metered water ratio	0.865	0.92	0.92	0.92	0.92	0.92	0.92	
1e. Ave. \$ per gal. sold	\$ 0.0071	\$ 0.0071	\$ 0.0074	\$ 0.0077	\$ 0.0080	\$ 0.0083	\$ 0.0086	
1d. Water sales (\$ 000)	\$ 464	\$ 493	\$ 523	\$ 555	\$ 589	\$ 624	\$ 662	
2. Utility Operating Expenses (\$000)								
2a. Cost of purchased water	182	185	194	204	215	225	237	
2b. Ave. cost per gal. of water	\$ 0.0024	\$ 0.0025	\$ 0.0025	\$ 0.0026	\$ 0.0027	\$ 0.0028	\$ 0.0028	
2c. Materials & supplies	17	13	13	14	14	15	15	
2d. Insurance	12	10	10	11	11	11	12	
2e. Other oper. exp.	240	245	100	103	106	109	113	
2.f Total Operating Exp.	\$ 451	\$ 453	\$ 318	\$ 332	\$ 346	\$ 361	\$ 376	
3. Gross Profit (\$000)	\$ 13	\$ 40	\$ 205	\$ 223	\$ 243	\$ 264	\$ 286	
4. Net Int. Exp. (\$000)	\$ 10	\$ 6						
5. Depreciation Exp. (\$000)	\$ 42	\$ 36	\$ 36	\$ 36	\$ 36	\$ 36	\$ 36	
6. Taxes - Other than Income	\$ 17	\$ 7						
7. Earnings (loss) before taxes	\$ (56)	\$ (9)	\$ 169	\$ 187	\$ 207	\$ 228	\$ 250	
8. Capital Expenditures								
8a. Misc. capital expenditures	\$ 26	\$ 14	\$ 15	\$ 16	\$ 17	\$ 18	\$ 19	
8b. Water system replace. reserve			\$ 5	\$ 6	\$ 6	\$ 6	\$ 7	
9. Increase in Working Capital	\$ -	\$ 4	\$ 4	\$ 4	\$ 4	\$ 5	\$ 5	
10. Free Cash Flow (\$000)	\$ (40)	\$ 9	\$ 181	\$ 198	\$ 216	\$ 236	\$ 256	4,274
11. Discount Factor	9%		0.917	0.842	0.772	0.708	0.650	0.650
12. Discounted Present Value of Free Cash Flow (\$000) at 12/31/05 (2)		\$	\$ 166	\$ 167	\$ 167	\$ 167	\$ 167	\$ 2,778
13. Cumulative Discounted Present Value of Free Cash Flow (\$000)		\$	\$ 166	\$ 332	\$ 499	\$ 666	\$ 833	\$ 3,611
14. Net Working Capital Deficit and Long Term Liabilities (\$000)(8)								\$ (288)
15. Indicated Value of Equity Net of Debt at 12/31/05 (\$000) (9)								\$ 3,323

FOOTNOTES AND ASSUMPTIONS

- (1) Annual water purchased in 2005 is estimated based on results for the first 11 months of 2005. Projections assume water purchases (gallons) in '06 to '10 will increase 2% per year, based on expected growth in demand from residential and commercial customers, and the cost per gallon will increase 3% per year, which is consistent with the 2% to 3% annual increases charged by AWC's wholesale water supplier the last few years.
- (2) Assumes that purchaser would increase water rates 3% per year to cover rising expenses and provide a more reasonable return on increased rate base and an additional 1% per year to fund a reserve for water main and system replacements, bringing the projected total annual increase to 4%.
- (3) Actual water losses, operating exp. and capital expend. in 2004 and 2005 were abnormally high due to two extraordinary events. In 2004 the city of Paintsville installed new sewers in Auxier and a contractor damaged several AWC water lines while laying new pipe resulting in water losses. Also, heavy rains in May 2004 caused substantial erosion and several AWC lines were washed out or damaged causing major water loss and substantial increases in repairs exp. in '04 and '05. Results in 2005 assume a water loss of 8% (a .92 metered water ratio), which reflects AWC's typical ratio over many years. Capital expend. are also expected to return to a more normal level in 2005 and are assumed to increase 6% per year from 2006 to 2010.
- (4) Estimated 2005 results assume approximately the same amount of water purchased as 2004, an improved metered water sold ratio (.92), and operating expenses were estimated based on the actual amounts paid through the 9 months ended 9/30/05.
- (5) Other operating expenses in 2006 under new ownership of another water utility with operations in the same area as AWC were estimated at \$100k by management of AWC. Materials & supplies, Insur. and Other operating expenses are projected to increase at 3% per year from 2007 to '10, the approx. rate of inflation.
- (6) Discounted to net present value at the assumed required return rate of 9% based on the approximate 5 year ave. rate of return reported by nine U.S., publicly-held, investor-owned water companies at year end 2003. Those are: American Water Works, Philadelphia Suburban, Cal. Water Service, American States Water, SJW Corp., Middlesex Water, Conn. Water Service, Southwest Water and Consumers Water.
- (7) Assumed long term growth rate in free cash flow after 2010 in perpetuity of: 3%
- (8) Assumes that AWC pays off all liabilities, net of current assets, at closing of the transaction from the proceeds of the sale of AWC stock or assets.
- (9) Terminal Value estimated at end of 5 years assuming a required return rate of 9% less an 3% assumed long term growth rate equals a discount rate of 6% which provides a terminal value multiple = $1/.06 = 16.6$

Bocook Engineering, Inc.

Consulting Engineers

312 Tenth Street • Paintsville, Ky. 41240

(606) 789-5961 • Fax: (606) 789-7671



May 27, 2005

Mr. Philip Ward
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392 John CC Mayo Ave
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Sincerely,

A handwritten signature in black ink, appearing to read 'Dewey L. Bocook, Jr.' The signature is fluid and cursive, with a large, sweeping initial 'D'.

Dewey L. Bocook, Jr., P.E., P.L.S.

Xc: File
1759/Word/Preliminary System Replacement Estimate 2005

**Auxier Water Company
Replacement Cost Estimate
May 2005**

WO# 1759

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4" River Crossing PE	5	\$ 10,000.00	\$ 50,000	\$ 3,219,800
6" River Crossing PE	5	\$ 12,500.00	\$ 62,500	\$ 3,282,300
Railrod Crossing	4	\$ 20,000.00	\$ 80,000	\$ 3,362,300
4" Road Bore 4 lanes	2	\$ 25,000.00	\$ 50,000	\$ 3,412,300
6" Road Bore 4 lanes	4	\$ 25,000.00	\$ 100,000	\$ 3,512,300
2" Road Bore 2 lanes	6	\$ 7,500.00	\$ 45,000	\$ 3,557,300
4" Road Bore 2 lanes	10	\$ 7,500.00	\$ 75,000	\$ 3,632,300
6" Road Bore 2 lanes	17	\$ 10,000.00	\$ 170,000	\$ 3,802,300
Leak Detection Meters	11	\$ 800.00	\$ 8,800	\$ 3,811,100
Fire Hydrants	26	\$ 2,500.00	\$ 65,000	\$ 3,876,100
50,000 gal Storage Tk	1	\$ 30,000.00	\$ 30,000	\$ 3,906,100
Flush Hydrants	4	\$ 800.00	\$ 3,200	\$ 3,909,300
Flush Valve Assy	22	\$ 475.00	\$ 10,450	\$ 3,919,750
4" Fire Flow Meter Assy	2	\$ 10,000.00	\$ 20,000	\$ 3,939,750
3" Fire Flow Meter Assy	1	\$ 8,000.00	\$ 8,000	\$ 3,947,750
Engineering Cost	1	\$ 400,000.00	\$ 400,000	\$ 4,347,750

EXHIBIT C

GERALD R. MARTIN

Vice President
River Hill Capital, LLC
2904 Eastpoint Parkway
Louisville, Kentucky 40223-4186
(502) 326-4922
E-mail: gerald@riverhillcapital.com

Home Address:
516 Briar Hill Road
Louisville, KY 40206
(502) 893-0892

River Hill Capital, LLC was organized in June 1996 to develop, establish or expand strategic and managerial relationships with a select group of privately-held or smaller publicly-held companies. The principals of River Hill provide financial or operational advisory services and may invest in or otherwise acquire equity ownership in these promising companies. In June 1996, Mr. Martin co-founded River Hill Capital and by December 1996 assumed full-time responsibilities with River Hill.

Until December 1996, Mr. Martin was a stockholder and registered principal of J.J.B. Hilliard, W.L. Lyons, Inc. He worked exclusively in the Investment Banking Department after joining the firm in 1973 and was co-manager of that department for ten years. Hilliard Lyons is a member of the New York Stock Exchange.

From 1979 to November 1996, Mr. Martin was Senior Vice President of Investment Banking. This department was responsible for mergers and acquisitions, private placements of securities, public offerings of securities, securities valuation and financial consulting services for public, private and closely-held companies, government organizations and individuals.

Mr. Martin had primary responsibility for many of Hilliard Lyons' engagements as exclusive agent, co-agent or financial advisor in approximately 50 merger or acquisition transactions involving purchase prices ranging from \$2 million to \$800 million.

Mr. Martin has had experience as a financial consultant or advisor to several local government agencies and non-profit organizations. This includes two engagements completed on behalf of the Mayor's office of the City of Louisville: in 1984 a study of the financial results and long-range plan of the Louisville Water Company and in 1987 a comprehensive study of the financial operations and outlook for Louisville's municipal transit system (TARC).

In December 1996, he completed fifteen years of volunteer service as Vice Chairman of the Board of Commissioners of the Housing Authority of Louisville. He was the first President of Louisville Housing Services, Inc., a non-profit corporation that finances and develops home ownership for low income families, provides funding for a program that grants scholarships to students in public housing and provides free job skills training to public housing residents.

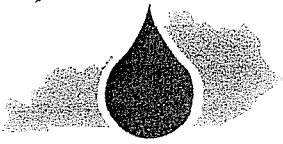
GERALD R. MARTIN

Mr. Martin received his BS degree in Business from the University of Dayton in 1968. He graduated from U.S. Navy Officer's Candidate School, Newport, RI, and was commissioned a Reserve Officer in 1969. After serving for two years as a Combat Information Center Officer aboard an aircraft carrier operating with the U.S. Seventh Fleet in the Pacific and Vietnam, he received his MBA degree from Wright State University, Dayton, Ohio in 1972. Prior to joining Hilliard Lyons, Mr. Martin was Corporate Trust and Trust Operations Officer at the First National Bank, Dayton, Ohio.

In December 2003, Mr. Martin was appointed by the Mayor of Metro Louisville to the Board of Directors of the Louisville Water Company, a 150 year old, city-owned water utility with over \$100 million in annual revenue. Mr. Martin is a Director of the Begley Company (d.b.a. Concord Custom Cleaners), Lexington, Kentucky, a privately-owned, 130-store dry cleaning and laundry chain purchased from Rite Aid in a leveraged buyout.

Mr. Martin has been, since 1997, financial advisor to the CEO and ESOP trustees of Omni Visions, Inc. and a member of the Board's Compensation Committee. Omni Visions, Inc. is based in Nashville, Tennessee and is one of the largest for-profit providers of therapeutic foster care services in Tennessee and North Carolina. Mr. Martin has been financial advisor to, and was the first outside member of the Board of Directors of, Summit Energy Services, Inc., Louisville. Summit provides energy management services to Fortune 500 clients throughout the United States and has experienced very rapid and profitable growth as energy costs have increased.

Professional memberships include the CFA (Chartered Financial Analysts) Society of Louisville and he is a Fellow of the Financial Analysts Federation. A native of Detroit, he was born in 1946, is married and has two children.



Kentucky Rural Water Association

Helping water and wastewater utilities help themselves

June 21, 2006

Phillip Ward, Water Manager
Auxier Water Company, Inc.
P. O. Box 134
Auxier, KY 41602

Dear Mr. Ward: *Ph*

Please find enclosed a Valuation of Auxier Water Company prepared by the Kentucky Rural Water Association. We thank you for the opportunity to work with you and the staff of Prestonsburg Utilities Commission in trying to determine a fair price for Prestonsburg's potential purchase of the distribution system assets and customer-base in Auxier.

This valuation represents our best estimation of the current value of Auxier's assets from the perspective of the purchase by a municipally-owned public utility. We hope that this Valuation will allow both parties to reach an agreement that will be benefit all of the parties, Auxier, Prestonsburg, and, most importantly, the current water customers in Auxier.

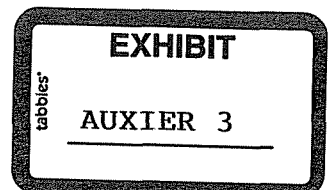
If you have any questions about any of the information contained in this report or need any further assistance in this matter, or any other, please contact us at your convenience.

Sincerely,

Andy Lange
Assistant Director

AL:bs

Enclosure



Valuation of Auxier Water Company, Inc.

Prepared by: **Kentucky Rural Water Association**

June 2006

Background

The Kentucky Rural Water Association ("KRWA") appreciates the opportunity to work with the Auxier Water Company, Inc. ("Auxier") and the Prestonsburg City's Utilities Commission ("Prestonsburg") to help the utilities reach a mutually acceptable agreement on the purchase of the distribution assets of Auxier by Prestonsburg. We recognize from the start that both the seller and the potential buyer are serious about the negotiations for this transaction. We also understand that both parties want what is best in their own interests. In the case of Auxier, the interests are more personal in nature along with a keen sense of doing what is best for their neighbors and water customers of over 40 years. Prestonsburg, on the other hand, being a publicly owned utility is naturally more concerned about how the purchase will affect their existing customers and in developing a plan to serve the potential new customers in Auxier efficiently and fairly.

On June 5, 2006, a meeting was held with Phillip Ward, owner of Auxier, David Ellis, superintendent and Eddie Campbell, chief financial officer of Prestonsburg, Bob McGlothlin, water superintendent of the Big Sandy Water District, and Andy Lange, assistant director, Carryn Lee, financial analyst, and Barry Back, circuit rider, representing KRWA.

This meeting began with a general discussion between the interested parties and served to inform the evaluation team from KRWA in regards to the intentions of both parties and to gain a better understanding of the utility's current operations, interconnections, and agreements. After these initial discussions, Mr. Ward took Mr. McGlothlin and Mr. Back on a *driving tour of approximately one-third of Auxier's 40-mile distribution system*. Mr. Lange and Ms. Lee remained with Mr. Ellis and Mr. Campbell to continue discussions with the potential buyers.

Previous Valuations

Prior to the meeting, copies of two independent valuations commissioned by Auxier were reviewed by the members of the KRWA evaluation team. The first valuation, an opinion of "current realistically attainable value," was performed by River Hill Capital, LLC ("River Hill") in Louisville, Kentucky. The other valuation, a "replacement cost analysis," was performed by Bocock Engineering, Inc. ("Bocock") in Paintsville, Kentucky. River Hill's report estimates the value of Auxier at approximately **\$3,300,000**. Bocock Engineering estimated the replacement cost of Auxier at **\$3,947,750**.

River Hill's valuation approach seems to best fit a situation where one retail business is being purchased by an investor with the intentions of continuing the retail operations and relying on an acceptable rate of return on the investment. Several of the assumptions used in projecting future revenue levels appear to us to be overly optimistic based on the past growth rates in the number of customers and revenues. According to Kentucky Public Service Commission ("PSC") annual reports submitted by Auxier over the past 15 years, the customer base has increased by 2.6% annually and revenue has increased by 2.25%.

Several of the other factors cited by River Hill as incentives for the purchase of Auxier are specious or exaggerated. The penitentiary, Jenny Wiley State Resort Park, and the thoroughbred racetrack can not be expected to attract substantial new economic activities as claimed in the assumptions and opinions offered by River Hill.

User rates in Auxier are already higher than state and regional averages. Realistically, Prestonsburg would likely need to lower water rates to bring the Auxier customers more into line with their existing municipal customers. Because Prestonsburg, as a potential buyer, would probably lower user rates the revenue projections used by River Hill appear to be overly optimistic.

Bocock Engineering has provided Auxier with a schedule of assets and estimated the replacement cost for these assets as of May 2005. By itself, replacement cost is not an acceptable standard method for determining the value of a utility. Normally, accumulated depreciation must be subtracted from the replacement cost to reflect a more realistic value. In addition, Bocock included engineering costs in the estimate for Auxier. Engineering costs have no bearing on the value of a utility that has already been built and therefore should not be included in the

total. Assuming that the cost estimates provided by Bocoock are accurate, the replacement cost would be just under \$4 million.

KRWA Valuation

In our research of accepted methodologies for the valuation of utilities for the purpose of sale, we have encountered three primary approaches. These are 1) **Comparative**, 2) **Income** or Capitalization, and 3) **Cost** (Replacement Cost-New less Depreciation). The Comparative method is probably the most realistic and accurate because it uses real-world examples, but it relies on having enough similar transactions in a state or region to make valid comparisons. Income or Capitalization methods seem to be used most often when a transaction involves one privately-owned utility being sold to another privately-owned utility. The Cost method is generally the simplest method to use because it is easily quantifiable through accurate price estimates and properly audited accounts.

We have chosen to use the **Cost** method for our valuation because we have very limited examples of appropriate **Comparative** sales in Kentucky. The **Income** method does not seem to be the best fit in this case because the potential sale involves a private and a public utility. In addition, there already exists a recent and acceptable replacement cost estimate prepared by Bocoock to combine with accumulated depreciation data contained in Auxier's 2004 PSC Annual Report, extrapolated to reflect 2005 levels of depreciation. We have also added a 10% premium to the value of Auxier's assets due to the above average condition of the distribution assets, according to our assessment.

VALUATION

Replacement Cost Estimate (Bocoock) (see Appendix)	\$3,947,750
Accumulated Depreciation (44.7%) (see Depreciation Worksheet)	<u>-\$1,764,644</u>
Cost-based Valuation	\$2,183,106
10% premium	<u>+\$218,311</u>
Total Cost-based Valuation	\$2,401,417

APPENDIX A

Auxier Water Company Replacement Cost Estimate May 2005

Description	Quantity	Unit Price	Cost	Accumulated Total
2" Gate Valve	44	\$400.00	\$17,600	\$17,600
3" Gate Valve	14	\$475.00	\$6,650	\$24,250
4" Gate Valve	48	\$550.00	\$26,400	\$50,650
6" Gate Valve	64	\$600.00	\$38,400	\$89,050
8" Gate Valve	1	\$800.00	\$800	\$89,850
2" Water Meter/Box Assy	7	\$2,000.00	-\$14,000	\$103,850
1" Water Meter/Box Assy	5	\$1,300.00	\$6,500	\$110,350
1.5 Water Meter	1	\$1,200.00	\$1,200	\$111,550
5/8 x 3/4 Residential	950	\$800.00	\$760,000	\$871,550
2" CL 200 SDR21	45,300	\$7.00	\$317,100	\$1,188,650
3" CL 200 SDR21	29,300	\$8.00	\$234,400	\$1,423,050
4" CL 200 SDR21	72,950	\$10.00	\$729,500	\$2,152,550
6" CL 200 SDR21	67,350	\$15.00	\$1,010,250	\$3,162,800
8" CL 200 SDR21	350	\$20.00	\$7,000	\$3,169,800
4" River Crossing PE	5	\$10,000.00	\$50,000	\$3,219,800
6" River Crossing PE	5	\$12,500.00	\$62,500	\$3,282,300
Railroad Crossing	4	\$20,000.00	\$80,000	\$3,362,300
4" Road Bore 4 lanes	2	\$25,000.00	\$50,000	\$3,412,300
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Flush Valve Assy	22	\$475.00	\$10,450	\$3,919,750
4" Fire Flow Meter Assy	2	\$10,000.00	\$20,000	\$3,939,750
3" Fire Flow Meter Assy	1	\$8,000.00	\$8,000	\$3,947,750

Depreciation Worksheet

Utility Plant Account	BALANCE		2004	Added in 2005	2005
	General Plant	Transmission & Distribution	Accumulated Depreciation		Accumulated Depreciation
Land & Land Rights	2,261				
Structures & Improve.	56,712		28,808		
Water Treatment Equip.	9,040		9,038		
Mains		828,070	315,597	29,959	345,556
Meters & Installations		104,802	67,730	3,273	71,003
Hydrants		8,300	4,156	212	4,368
Office Furn. & Equip.	26,243		24,749		
Transporation Equip.	71,981		65,387		
Power Equip.	5,000		4,999		
Communications	705		451		
Totals	\$171,942	\$941,172	\$520,915		
			\$387,483	\$33,444	\$420,927

Accumulated Depreciation of Transmission and Distribution System

$$\$420,927 / \$941,172 = .447 \text{ or } 44.7\%$$