



Response to the Office of Utilities Regulation Consultative Document

on

“ Estimate of the Weighted Average Cost of Capital

for Cable and Wireless Jamaica”

(Document No: TEL 2008/05:Con/01)

March 24, 2009

Table Of Contents

1.0 Introduction.....	2
2.0 Weaknesses of the OUR's Proposal.....	2
3.0 Cost of Debt.....	3
3.1 Tax Adjustment.....	4
3.2 Debt-to-value Ratio.....	5
4.0 Cost of Equity.....	5
4.1 Beta Estimates.....	6
4.2 Equity Market Risk Premium (EMRP).....	6
4.3 Small Company Premium.....	7
5.0 Use of Real WACC Inappropriate.....	8
6.0 Divisional WACC.....	11
7.0 Conclusion.....	11

1.0 Introduction

Cable and Wireless Jamaica (LIME) values the opportunity to respond the Office of Utilities Regulation's (OUR's) Consultative Document entitled "Estimate of the Weighted Average Cost of Capital for Cable and Wireless Jamaica". (Document No: TEL 2008/05:Con/01)(the Consultative Document).

The cost of capital represents the minimum rate of return that LIME is allowed to recover in setting the prices of its regulated services. In practice the cost of capital is calculated as a weighted average cost of capital (WACC). In an industry where LIME continues to invest multimillions of dollars in its infrastructure and technology, the OUR has a duty to ensure that the Company's shareholders receive a WACC that is appropriate.

2.0 Weaknesses of the OUR's Proposal

Estimating the WACC of a company requires the calculation of the following components, namely:

- a) The cost of debt
- b) The cost of equity
- c) The debt to value ratio
- d) The equity to value ratio

This may be represented by the formula

$$\text{WACC} = w_d * k_d (1-T) + w_e * k_e$$

Where,

w_d = Debt/(Debt + Equity) = the fraction of debt in the capital structure

k_d = the forward-looking cost of debt

w_e = Equity/(Debt + Equity) = the fraction of equity in the capital structure

k_e = the forward-looking cost of equity.

T = Corporate tax rate, reflecting the tax benefit of debt

Whereas, LIME accepts the general approach taken by the OUR to calculate its WACC, it disagrees with a number of the estimates and approaches proposed, on the basis that they are inappropriate and as a consequence, result in a proposed WACC that does not represent a fair return on LIME's investments.

It is LIME's considered position that the OUR's proposal is off the mark in the following respects:

- a) The cost of debt is underestimated
- b) The currency and sovereign risk estimates are understated
- c) Although benchmarking LIME against the largest top ten global western companies, there was no provision for a small company premium
- d) The tax rate has been overestimated
- e) The debt value ratio is not an appropriate proxy for LIME
- f) The use of historical betas are internationally accepted and more often used than predictive betas
- g) The equity market risk premium has been understated
- h) The suggestion to apply a real WACC to LIME is based on a misunderstanding.

- i) The use of a divisional WACC is too subjective and undermines the overall approach to calculating the WACC, since it cannot be supported by capital market information.

The subsequent sub-headings clearly outline the evidence and reasons for LIME's position as well as its recommendations.

3.0 Cost of Debt

Contrary to the OUR's proposal, LIME's forward-looking cost of debt should be estimated from its observed long-term cost of funding. This will fully incorporate the market dynamics (i.e. inflation, GDP growth) inherent within Jamaica and the company's specific fundamentals.

In the Consultative Document, the OUR assessed the cost of debt for LIME from the short-term US dollar denominated bridging facility put in place with Citibank before the syndication. There are three principal reasons why this is inappropriate. First, this facility is short-term in nature and does not reflect the long-term risk inherent within LIME, and hence it is not forward-looking. Second, this facility is also guaranteed by C&W plc (i.e. a UK listed company with GBP6.3 billion in revenues) and does not reflect the risks specific to LIME. Third, the yield on this debt of 6.6% (1 month LIBOR +2%) is below the yield on a 10-year US dollar-linked Jamaica Government bond of 8.5%, which would imply that LIME is less risky than the Government of Jamaica ("GOJ") – a manifestly erroneous result.

More correctly, LIME's cost of debt should be made up of the following components:

k_d (US\$) = Risk free rate + Sovereign risk + Company spread

k_d (J\$) = Risk free rate + Sovereign risk + Company spread + Currency risk

In assessing the risk free rate, the best proxy to be used is the yield on a US Government issued debt instrument, which closely matches the Company's investment horizon. LIME proposes that the yield on a 10- year government bond be used, as this is often the most actively traded and long dated government bond issued.

Sovereign risk is measured by the spread between GOJ global US dollar denominated bonds and similar US Government issues. US Government 10-year bonds currently yield 3.82%¹ while the equivalent 10-year US dollar Government of Jamaica (GOJ) bond currently yield 8.50%. This measures the sovereign risk to be 4.68% (i.e. 8.50% minus 3.82%) which is higher than the OUR's measure of 3.13%. See data in Table 1.

Currency risk is measured by the spread between GOJ global US dollar bonds and similar GOJ Jamaican dollar issues. Higher interest rates on Jamaican dollar debt compensate providers of capital for the greater risk of currency devaluation. Table 1 below² shows inflation expectations in Jamaica are strong for a continued period highlighted by the differential in the yields getting larger as bond maturities are longer. The currency risk of a 10-year GOJ bond was accessed by Citibank to be 9.20% which compares to the OUR's measure of 7.10%.

¹ As at August19, 2008

² Data from Citibank as at March 2008

LIME's Response to OUR's Consultation Document on

'Estimate of the Weighted Average Cost of Capital for Cable & Wireless Jamaica'

Document No. TEL 2008/05: Con /01

March 24, 2009

Table 1

GOVT BOND YIELD - JULY 08		90-dys	180-dys	1-yr	2-yrs	3-yrs	5-yrs	10-yrs
Sovereign Risk	US\$ Yield Curve	1.78	1.97	2.07	2.30	2.57	3.06	3.82
	J\$ Yield Curve (US\$ linked)	6.25	6.50	6.95	7.25	7.40	7.80	8.50
	<i>Difference</i>	4.47	4.53	4.88	4.95	4.83	4.74	4.68
Currency Risk	J\$ Yield Curve (US\$ linked)	6.25	6.50	6.95	7.25	7.40	7.80	8.50
	J\$ Yield Curve	14.75	15.00	15.60	15.95	16.25	16.70	17.70
	<i>Difference</i>	8.50	8.50	8.65	8.70	8.85	8.90	9.20

Based on historical lending spreads CWJ could borrow at approximately 2% above the GOJ borrowing rate³. This implies a total US dollar linked pre-tax cost of debt of 10.50% (i.e. 8.50%+2%) and a Jamaican dollar pre-tax cost of debt of 19.70% (i.e. 17.70%+2%). However, the OUR assesses LIME's US dollar pre-tax cost of debt to be 6.60% and Jamaican dollar pre-tax cost of debt to be 13.73%⁴ which is a rate lower than that of the GOJ and, again, incorrectly implies that LIME is less risky than the GOJ. See data in Table 1. This result is manifestly erroneous and suggests that the OUR's approach to determining LIME's cost of debt ought to be modified.

In relation to the cost of debt, while a rate of interest (i.e. the risk-free rate plus debt margin) is charged in the market, most businesses pay a lower effective rate for debt because of the utilisation of the tax shield advantages of debt finance (profits are taxed after interest payments, so that for each Jamaican dollar spent on debt service, 33.33% of this value is returned to the Company in the form of reduced tax charges, assuming the Company is liable to corporation tax on marginal profit at the standard rate). This is taken into account in the WACC formula by multiplying the cost of debt by (1 - T). This implies a total US dollar post-tax cost of debt of 7.04% (i.e. 10.50% [1 - 0.33]) and a Jamaican dollar post-tax cost of debt of 13.20% (i.e. 19.70% [1 - 0.33]).

3.1 Tax Adjustment

LIME agrees with the tax adjustment methodology applied by the OUR in principle but would apply the Jamaican corporate tax rate of 33.33% in both adjustments in the formulas below:

$$ATWACC = w_d * k_d (1-T) + w_e * k_e \quad \dots\dots\dots (3)$$

$$Pre-Tax WACC = ATWACC / (1 - T) \dots\dots\dots (4)$$

LIME does not agree with the OUR's proposal to apply an estimation of a Global Corporate Tax Rate of 35.25% in formula (3). This however, is not a reflection of LIME's true long-term corporate tax charge, since the Company is not aware of any intention of the government in the foreseeable future to increase the corporate tax rate from 33.33% nor has the OUR provided any information to support the proposed tax rate of 35.25%. As such, LIME recommends that the existing and foreseeable tax rate of 33.33% be used.

³ Section 3.0 - OUR Consultation Document and C&W plc Treasury dept.

⁴ OUR consultation document, section 3.4

3.2 Debt-to-value Ratio

The OUR is correct in stating that it is standard practice to use a notional/optimal debt-to-value ratio in computing the WACC and not the actual debt-to-value ratio specific to a given company. It is however, more appropriate to assess this ratio using market values rather than book values, as market values adequately reflect the return that capital owners expect.

LIME recommends using a sample of telecoms companies in developing countries, specifically Latin American companies as a proxy. This is so because the top 10 global telecom companies from the largest developed Western economies cannot reasonably be considered an appropriate proxy for LIME. Again, the OUR's primary objective should be to find companies in that are truly comparable with LIME.

When a more appropriate sample of Latin American companies is used, we observe a target leverage of 0.6x EBITDA or 12% of debt/value ratio assuming an average EBITDA valuation multiple of 5.4x as shown from the Table 2 below⁵.

Table 2

Company	Net Debt / EBITDA	Value / EBITDA	Net Debt / Value
Axtel	1.2x	5.2x	23%
Brasil Telecom	0.1x	7.9x	1%
CTC	0.6x	3.6x	17%
GVT	0.1x	8.8x	1%
Telecom Arg.	0.2x	2.8x	7%
Telesp Fixed	0.4x	5.2x	8%
Telemar ON	0.6x	4.1x	15%
Telmex	1.2x	5.3x	23%
AVERAGE	0.6x	5.4x	12%

Based on the foregoing, the OUR's proposal to use a debt weighting (debt/value) of 45.06% is mis-specified. The appropriate value is 12.00%.

4.0 Cost of Equity

LIME agrees that the most effective way to assess the cost of equity is through the capital asset pricing model (CAPM).

LIME's cost of equity is made up of the following components:

$$k_e (US\$) = \text{Risk free rate} + \text{Sovereign risk} + (\text{Beta} \times \text{EMRP}) + \text{SCP}$$

$$k_e (J\$) = \text{Risk free rate} + \text{Sovereign risk} + \text{Currency risk} + (\text{Beta} \times \text{EMRP}) + \text{SCP}$$

Each component will now be reviewed and recommendations made to the OUR.

⁵ Merrill Lynch – Global Telecoms Report August 2008
LIME's Response to OUR's Consultation Document on
'Estimate of the Weighted Average Cost of Capital for Cable & Wireless Jamaica'
Document No. TEL 2008/05: Con /01
March 24, 2009

4.1 Beta Estimates

LIME agrees with the OUR that historical betas are regularly used to calculate the cost of equity. In fact, LIME's current cost of equity was computed using a historic beta and presently most telecommunications companies employ historical betas for this purpose. The same is true for investment services such as Bloomberg, Merrill Lynch, Value Line and Price Waterhouse Coopers. Given that LIME has not undergone any major structural change nor has there been a change in the regulatory regime under which it operates, it is appropriate to use a sample of historic betas to inform an estimate for LIME's beta, since these will have a high correlation with future realized betas. As such, LIME recommends that the OUR continue to use historic betas to compute its cost of equity. This approach is more commonplace and its computation transparent when compared to predictive betas.

The OUR has assessed the equity beta for LIME using as a proxy the top 10 global Telco's from the largest developed western economies. This sample of companies is not comparable to LIME. Below, in Table 3, is a comparable set of peers, which consists of a sample of large telecoms companies in developing Latin American countries. The historic weighted average re-levered (asset) beta estimated from this group is 1.10 compared to the OUR's 0.71 predictive beta.

Table 3

Company	Market cap <i>£m</i>	Net debt / (cash) <i>£m</i>	Levered Beta ¹ <i>5 year</i>	Marginal tax rate <i>%</i>	Market gearing ² <i>%</i>	Unlevered Beta ³ <i>5 year</i>	Re-levered Beta
Tele Norte Leste Part	4,952	1,861	1.01	15%	27.3%	0.76	
Telmex	12,516	4,202	0.92	30%	25.1%	0.75	
Brasil Telecom Participacoes	3,965	376	0.99	15%	8.7%	0.92	
America Movil	43,885	4,378	1.18	30%	9.1%	1.11	
Millicom	4,234	457	1.69	30%	9.7%	1.57	
CTC Chile	701	340	1.05	17%	32.6%	0.75	
Telesp	7,369	762	0.82	15%	9.4%	0.75	
Mean	77,622		1.09			0.94	1.03
Weighted Mean			1.11			1.01	1.10

Source **Factset, Worldwide Corporate Tax Guide (Ernst & Young)**

Notes

1 Weekly Beta (5 year)

2 Book Value of Net Debt / (Market Value of Equity + Book Value of Net Debt)

3 $bu = bg / (1 + (1-t)(D/E))$ where *bu* - unlevered beta; *bg* - levered beta; *t* - marginal tax rate; *D* - net debt; *E* - market c

4.2 Equity Market Risk Premium (EMRP)

According to a study conducted by Price Waterhouse Coopers (PWC) on behalf of C&W Barbados (information relating to this report is to be treated as confidential), the realised excess return over the risk free rate for the past 75 to 100 years have ranged from 4.5% to 7.5%, with an average of 6.0%. Based on the results of this study, we conclude that 6.0% is an appropriate estimate.

As contained in Table 4 below, other reputable sources present a range for EMRP from 3.4% to 7.4%. It is therefore recommended that the OUR use 6.0% instead of 4.1% for the EMRP.

Table 4

Source	Method	Market	Period	EMRP Estimate
Morningstar (formerly Ibbotson) "Stocks, Bonds, Bills, and Inflation Yearbook 2007", Valuation edition	Realised equity returns in excess of the risk free rate (in US dollar terms)	US	1970-2005	4.75%
	Realised equity returns in excess of the risk free rate (in US dollar terms)	Canada	1970-2005	3.88%
	Realised equity returns in excess of the risk free rate (in US dollar terms)	UK	1970-2005	5.54%
	Realised equity returns in excess of the risk free rate	US	1926-2006	7.1%
Duke University Fuqua business school (2007).	Survey of US CFOs	US	2007	3.4%
Dimson, Marsh, and Staunton, "Global Investment Returns Yearbook 2006".	Arithmetic average premium over bonds	US	1900-2005	6.5%
	Arithmetic average premium over bills	US	1900-2005	7.4%
	Arithmetic average premium over bonds	UK	1900-2005	5.3%
	Arithmetic average premium over bills	UK	1900-2005	6.1%
	Arithmetic average premium over bonds	World	1900-2005	5.1%
	Arithmetic average premium over bills	World	1900-2005	6.1%

LIME's independent estimation is consistent with PWC findings in its report on the WACC estimation for C&W Barbados. For example Table 4 above lists EMRP from a number of reputable sources and covers a range from 3.4% to 7.4%. The range of studies and conclusions presented above are more far reaching and comprehensive than those presented by the OUR. It would therefore be prudent for the OUR to use 6.0% instead of 4.1%.

4.3 Small Company Premium

While CWJ may be a large company in Jamaica, it is a small company in global and even Latin American markets. Therefore a Small Company Risk premium is recommended for inclusion in the calculation of the cost of equity.

Small Company Risk premia relate to the findings of Fama and French who suggested that the CAPM may be mis-specified with respect to size (It is noteworthy that UK regulators (for example, OFWAT and the Competition Commission) have adopted such premia in setting prices. This premium can be applied as an adjustment to the cost of capital dependent on the relative size of the company in question.

Table 5 below⁶ shows the standard premia that are applied to different size companies.

⁶ Presented in the PWC report on C&W Barbados
LIME's Response to OUR's Consultation Document on
'Estimate of the Weighted Average Cost of Capital for Cable & Wireless Jamaica'
Document No. TEL 2008/05: Con /01
March 24, 2009

Table 5

	Market cap of smallest company (in US\$m)	Market cap of largest company (in US\$m)	Size Premium (Return in Excess of CAPM)
Mid Cap	1,947	7,777	0.97%
Low Cap	627	1,946	1.76%
Micro Cap	2	627	3.88%

Source: Morningstar "Stocks, Bonds, Bills, and Inflation Yearbook 2007", Valuation edition

CWJ's market capitalisation at August 2008 I was US\$397m and therefore fall into the micro cap segment. The Small Company Premium to be applied is 3.88%.

5.0 Use of Real WACC Inappropriate

The OUR has taken the view that "... CWJ's accounting procedures are based on current cost accounting. That is, the value of CWJ's assets is adjusted annually, to reflect changes in inflation and technological progress. The book value of each asset is adjusted, up or down, to reflect the value of a "modern equivalent asset" at current prices. Thus, inflation is already taken into account in the current cost accounting procedures. It follows therefore that the applicable cost of capital is the real weighted average cost of capital. This avoids double counting the inflation effect"⁷. Unfortunately, the OUR's view is not completely accurate.

For regulatory purposes, LIME's book value changes year-on-year by applying a combination of the AUS Telephone Plant Index (formerly known as Turner Index) and a currency adjuster. Neither of these adjustments account for the full impact of Jamaican inflation as illustrated by the formula below.

Currency changes between the Jamaican and US dollar are influenced primarily by the differential in each country's inflation rates rather than total Jamaican inflation. In economics theory this is called Purchasing Power Parity ("PPP"). Relative PPP relates the inflation rate in each country to the change in the market exchange rate.

$$FX_t = (1 + \text{Jamaica inflation rate}) / (1 + \text{US inflation rate}) \times FX_{t-1}$$

Tables 8 and 9 below show that the inflation differential between Jamaica and the US matches the Jamaican dollar devaluation over the same 8-year period.

⁷ OUR consultation document, section 3.29
LIME's Response to OUR's Consultation Document on
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Document No. TEL 2008/05: Con /01
March 24, 2009

Table 6⁸

Jamaica INFLATION										
	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Jan	2.20	0.30	0.08	0.03	0.84	(0.31)	0.59	0.40	0.17	0.37
Feb	1.80	0.20	(0.02)	0.44	0.56	(0.58)	(0.05)	1.03	0.39	(1.10)
Mar	1.20	0.50	0.08	0.97	0.49	0.47	0.03	0.83	0.68	0.48
Apr	1.50	0.70	1.14	1.88	0.41	1.57	0.50	0.41	0.55	(0.22)
May	2.40	0.70	0.40	2.23	0.64	1.86	0.28	0.58	0.36	0.91
June	2.00	0.50	1.27	1.48	0.81	2.46	0.86	1.61	0.41	1.29
July	2.80	1.10	1.36	1.58	0.97	1.53	1.53	0.66	0.28	1.20
Aug		0.90	0.31	0.06	1.31	1.41	0.37	0.37	0.56	1.14
Sep		1.60	0.75	2.61	0.63	1.55	0.45	0.21	0.59	0.27
Oct		1.40	(0.08)	0.59	3.30	1.64	0.73	0.25	0.64	0.80
Nov		3.20	(0.18)	0.29	2.42	0.93	1.24	0.22	0.38	0.99
Dec		2.50	0.50	0.07	0.60	0.78	0.50	0.11	0.26	0.48
Total	13.90	13.60	5.61	12.23	12.98	13.31	7.03	6.68	5.27	6.61
		1.136	1.056	1.122	1.130	1.133	1.070	1.067	1.053	J Inflation
		1.029	1.032	1.034	1.027	1.023	1.016	1.028	1.034	US Inflation
	1.66	1.51	1.47	1.36	1.23	1.11	1.06	1.02	1.02	Cumul PPP Adj.

Table 7⁹

Devaluation (%)										
	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Jan	1.59	0.60	0.63	0.40	0.18	3.94	0.32	0.53	1.76	1.29
Feb	(0.52)	(0.00)	0.57	0.06	0.36	1.43	(0.04)	0.02	(0.14)	1.04
Mar	(0.40)	0.37	0.21	(0.59)	0.10	4.65	0.17	(0.22)	0.12	0.66
Apr	0.37	0.42	0.20	0.17	(0.41)	1.88	0.63	(0.02)	0.09	0.50
May	0.25	0.20	0.15	0.10	0.28	3.70	0.90	0.35	0.26	0.60
June	0.53	0.53	0.47	0.22	0.48	(0.69)	0.35	(0.02)	0.52	0.70
July	0.39	0.45	(0.07)	0.62	0.95	0.25	0.29	(0.11)	0.45	1.85
Aug		1.36	(0.04)	0.01	0.17	0.39	0.74	0.07	1.19	0.08
Sep		0.83	0.14	1.05	(0.03)	0.54	0.53	0.31	3.73	0.70
Oct		1.10	0.67	1.83	(0.01)	1.22	0.35	3.53	(0.18)	0.63
Nov		0.24	0.63	0.99	0.15	0.35	0.95	(0.65)	1.59	1.42
Dec		(1.03)	0.34	(0.14)	(0.57)	(0.05)	2.12	0.32	0.18	1.47
Total	2.22	5.07	3.91	4.72	1.66	17.63	7.30	4.09	9.57	10.92
		5.1%	3.9%	4.7%	1.7%	17.6%	7.3%	4.1%	9.6%	Annual J\$ Deval
	1.67	1.59	1.53	1.46	1.44	1.22	1.14	1.10	1.10	Cumulative Deval

The AUS index, a measure of North American technological progress, has grown on average 1.8% pa since 2000. Some asset categories have increased and some asset category have decreased as shown in the Table 10 below. The highest annual change is 19.7% and the lowest -43.3% which demonstrates that the Index is not a proxy for US inflation.

⁸ Source: Citibank 19 August 2008

⁹ Source: Citibank 19 August 2008

Table 8

ASSET CLASS	Percentage Movement						Average % Change
	00/01	01/02	02/03	03/04	04/05	05/06	
BURIED CABLE - METALLIC	4.8%	0.4%	0.4%	4.9%	6.7%	19.7%	6.1%
UNDERGROUND CABLE - METALLIC	5.0%	1.0%	0.3%	5.0%	6.4%	17.7%	5.9%
AERIAL CABLE - METALLIC	4.8%	2.1%	1.5%	5.0%	6.2%	13.5%	5.5%
INTRA BUILDING CABLE - METALLIC	4.8%	2.1%	1.5%	5.0%	5.9%	13.2%	5.4%
SUBMARINE CABLE - METALLIC	4.4%	2.1%	1.5%	4.6%	4.7%	10.0%	4.5%
AERIAL WIRE	4.0%	2.8%	2.4%	4.7%	5.0%	6.2%	4.2%
AIRCRAFT	5.1%	3.1%	1.9%	4.9%	5.4%	3.9%	4.1%
CONDUIT SYSTEMS	4.3%	3.1%	3.7%	3.3%	4.9%	4.4%	3.9%
BUILDINGS	3.1%	3.6%	2.1%	5.7%	4.4%	3.8%	3.8%
TOTAL PLANT	3.3%	1.6%	1.6%	3.6%	4.5%	8.1%	3.8%
AERIAL CABLE - FIBER	4.2%	4.0%	1.0%	4.8%	3.6%	2.6%	3.4%
UNDERGROUND CABLE - FIBER	5.1%	2.4%	1.2%	4.7%	3.4%	3.3%	3.3%
INTRA BUILDING CABLE - FIBER	4.1%	3.0%	1.9%	3.8%	4.5%	2.6%	3.3%
ELECTRO MECHANICAL SWITCHING	1.7%	4.6%	3.6%	3.2%	3.1%	2.5%	3.1%
BURIED CABLE - FIBER	3.9%	2.5%	1.2%	3.7%	4.7%	2.2%	3.1%
POLES	3.1%	3.9%	2.7%	3.0%	3.8%	1.4%	3.0%
SUBMARINE CABLE - FIBER	4.0%	3.1%	1.5%	3.7%	3.5%	2.1%	3.0%
SPECIAL PURPOSE VEHICLES	1.0%	0.0%	2.0%	1.0%	5.9%	4.9%	2.5%
OPERATOR SYSTEMS	0.8%	3.3%	2.8%	2.3%	2.7%	1.5%	2.2%
FURNITURE	0.9%	0.9%	0.9%	0.6%	4.0%	3.3%	1.8%
GARAGE WORK EQUIPMENT	1.1%	0.8%	0.3%	0.5%	3.7%	3.8%	1.7%
CIRCUIT EQUIPMENT - DIGITAL	0.0%	2.8%	2.7%	0.0%	2.6%	0.0%	1.4%
OTHER WORK EQUIPMENT	0.8%	1.1%	0.0%	0.7%	1.1%	0.7%	0.7%
OFFICE EQUIPMENT	0.6%	1.3%	-0.6%	0.6%	-0.6%	1.9%	0.5%
RADIO SYSTEMS - DIGITAL	0.8%	1.6%	-2.3%	0.0%	1.6%	0.8%	0.4%
CIRCUIT EQUIPMENT - ANALOG	0.7%	-0.7%	0.0%	0.0%	1.4%	-0.7%	0.1%
RADIO SYSTEMS - ANALOG	0.0%	-1.0%	0.0%	0.0%	0.0%	-1.1%	-0.3%
ANALOG ELECTRONIC SWITCHING	0.0%	-2.1%	0.0%	0.0%	0.5%	-1.6%	-0.5%
PUBLIC TELEPHONE TERM EQ	0.0%	-1.6%	0.0%	0.0%	0.0%	-1.6%	-0.5%
MOTOR VEHICLES	0.4%	-2.2%	-2.2%	1.5%	1.5%	-3.7%	-0.8%
DIGITAL ELECTRONIC SWITCHING	-12.0%	4.5%	-8.7%	4.8%	0.0%	0.0%	-1.9%
GENERAL PURPOSE COMPUTERS	-25.0%	-22.2%	-14.3%	-43.3%	-2.9%	-9.1%	-19.5%
Overall Average	1.2%	1.0%	0.3%	1.3%	3.2%	3.6%	1.8%

Therefore, LIME's annual adjustments to book value using the AUS Index and a currency adjuster do not reflect the full impact of inflation, but instead reflect the impact of exchange rate changes or the inflation differential (in the case of the currency adjustment) and technological changes (in the case of the AUS Index). As the currency adjustment (in LIME's book value calculation) accounts for changes in the exchange rate (not inflation), the correct measure of LIME's WACC for regulatory price changes should be based on a nominal Jamaican dollar WACC. The OUR's proposal to use a real pre-tax US dollar WACC is misguided and would penalise CWJ by not compensating the Company for the risk associated with inflation. On the other hand, LIME's has calculated its nominal J\$ pre-tax WACC to be 39.58% and its nominal J\$ post-tax WACC to be 26.39 %.

Moreover LIME's Cost of Capital is appropriately expressed as a nominal Jamaican dollar WACC because:

- 1) LIME's prices are denominated in Jamaican dollars
- 2) LIME's prices are regulated in Jamaican dollars
- 3) The order, in which the WACC is transformed, say from real to nominal versus nominal to real, can lead to errors in the estimate of the WACC.

Hence, LIME proposes that a nominal Jamaican dollar WACC be used and not a real WACC as proposed by the OUR.

6.0 Divisional WACC

While computing a company's WACC is complex, attempting to calculate its divisional WACC is even more so. LIME is an integrated company, making it reasonable to employ a single beta at the company level and hence a single WACC. The OUR has made no attempt to provide any evidence to the contrary but instead seeks to rely on the "heuristic (subjective) approach as developed by the Boston Consulting Group (BCG) in 1995", without any attempt to validate its many assumptions.

As discussed, the computation of the WACC and hence its robustness, rely on publicly available capital market information that can be validated and which LIME has referenced in this response, checked and interrogated. This is to be contrasted with the OUR's attempt to compute divisional WACCs for LIME using a subjective approach in the absence of capital market information on the Company's divisions.

LIME's company divisions (and those of comparable companies) as described by the OUR are not traded on the stock market and therefore do not have a share price. As such it is almost impossible to evaluate the systemic risk of a "share price" that does not exist. Most regulators do not use divisional WACCs because the variables required cannot be observed in the capital market and as such there is no objective basis on which to arrive at or to defend divisional WACCs. This is further compounded by the potential harm to the business of mis-specified divisional WACCs.

Since LIME is 'one' vertically integrated entity facing the capital markets, a single WACC is appropriate. LIME does not support divisional WACCs for all the reasons aforementioned.

7.0 Conclusion

The OUR's proposal to use a real pre-tax US dollar WACC of 8.94% is based on an erroneous understanding of LIME's asset valuation. At section 5 of this response, LIME clarifies that its annual asset revaluation does not account for the totality of inflation in the Jamaican market but rather only accounts for the differential between the inflation rates in the US and Jamaican markets as reflected in the currency movements. Therefore the WACC that ought to be applied to LIME, in its entirety, is the nominal Jamaican dollar WACC.

The OUR has indicated its intention to apply a pre-tax WACC and LIME is not opposed to the use of a pre-tax WACC. The nominal pre-tax WACC arrived at by LIME, using the data provided by PWC and other financial services is 39.58%.