



LIME'S RESPONSE
TO
THE OUR'S PROPOSAL FOR AN ESTIMATE OF THE WEIGHTED
AVERAGE COST OF CAPITAL FOR TELECOMMUNICATIONS
CARRIERS IN JAMAICA

January 2010

Introduction

LIME welcomes the opportunity to provide feedback on the OUR's second consultation document "Estimate of the Weighted Average Cost of Capital for Telecommunications Carriers in Jamaica".

After a careful review of the two commissioned reports prepared by NERA Economic Consulting (hereafter NERA) on LIME's behalf, LIME is forced to conclude that the WACC proposal put forward by the Office lacks the academic rigor, transparency and forward looking features appropriate for a Telecommunications Carrier in Jamaica. LIME is of the view that were the OUR's proposal to be implemented it would unreasonably compromise the financial viability of a Telecommunication Carrier such as LIME.

WACC Recommended by LIME

Fixed-line WACC

The WACC that the OUR will set via this consultation will only apply to LIME's regulated fixed-line business for the foreseeable future. As such, LIME confines its recommendation (via this medium) to a WACC for a global telecommunications operator primarily involved in providing fixed-line services.

In keeping with NERA's expert advice (which has been shared with the Office), LIME recommends that the OUR's WACC Determination comply with the parameters outlined in Table 1 below.

Table 1 – NERA WACC for LIME

Parameter	NERA Range
Risk-free Rate	4.6%
Equity Risk Premium	5.9%
Asset Beta	0.52 - 0.56
Gearing	36%
Equity Beta	0.81 – 0.87
Country Risk Premium	7.2%
Currency Risk Premium	9.5%
Small Company Premium on Equity	0.8 – 1.5%
USD Cost of Equity	17.3 – 18.4%
JMD Cost of Equity	26.8 – 27.9%
Debt Premium	1.7 – 2.4%
USD Cost of Debt	13.4 – 14.1%
JMD Cost of Debt	22.9 – 23.6%
Tax Rate	33.3%
Nominal Pre-tax USD WACC	21.5 – 22.8%
Nominal Vanilla USD WACC	15.9 – 16.9%
Nominally Fully Post-tax USD WACC	14.3 – 15.2%
Nominal Pre-tax JMD WACC	34.0 – 35.3%
Nominal Vanilla JMD WACC	25.4 – 26.4%
Nominally Fully Post-tax JMD WACC	22.7 – 23.6%

Source: NERA

Divisional WACC

LIME acknowledges that there is some theoretical basis for the OUR's seeking to implement a divisional WACC, but nevertheless cautions against pursuing this approach. Two key reasons are;

- 1) the fact that it is not a popular approach among Regulators in general
- 2) the inherent difficulty of estimating a WACC for divisions of a company that are not publicly traded on the stock market.

Further, in the event that a divisional WACC is being introduced, it is more appropriate to estimate different betas for the interconnection and retail businesses, as opposed to the approach of trying to decompose the beta for a vertically integrated telecom into an interconnection and retail beta. The former approach is far more transparent, objective, reasonable and robust. Table 2 below depicts the values being recommended to the OUR (without prejudice to LIME’s preference that a divisional WACC not be implemented).

Table 2 – NERA Divisional WACC (%)

Common Parameters	Jamaican Telecom (JMD)
Risk-free Rate	4.6%
Equity Risk Premium	5.9%
Gearing	36%
Country Risk Premium	7.2%
Currency Risk Premium	9.5%
Small Company Premium on Equity	0.8 – 1.5%
Debt Premium	1.17 – 2.4%
Cost of Debt	22.9 – 23.6%
Tax rate	33.3%
Network Interconnection	
Asset Beta	0.49
Equity Beta	0.76
Cost of Equity	26.6 – 27.3%
Nominal Pre-tax WACC	33.8 – 34.7%
Nominal Vanilla WACC	25.3 – 26.0%
Nominally Fully Post-tax WACC	22.5 – 23.1%
Retail	
Asset Beta	0.62
Equity Beta	0.97
Cost of Equity	27.8 – 28.5%
Nominal Pre-tax WACC	34.9 -35.9%
Nominal Vanilla WACC	26.0 – 26.7%
Nominally Fully Post-tax WACC	23.3 – 23.9%

Source: NERA

LIME cannot overemphasize the fact that the application of a divisional WACC is subject to a high degree of regulatory judgment and as such, the OUR needs to ensure that it does not specify a WACC for interconnection services that is too low. Otherwise, LIME's financial viability would be significantly compromised in the context of a weak Jamaican economy that is forecasted to deteriorate before beginning to recover.

Conclusion

The role of the Regulator in specifying a WACC for a regulated entity, such as LIME, has far-reaching implications for its financial performance and ultimate viability. As such, the process must be undertaken in compliance with well established technical and theoretical frameworks and in a very transparent manner. The OUR's proposal lacks the technical rigor needed and simply puts the onus on network operators to prove that it is inadequate. LIME has no doubt that it has done this by means of the two reports prepared by NERA on its behalf. Both reports have been submitted to the OUR and are entitled, **Cost of Capital for LIME – A Review of OUR's Proposals** and **Cost of Capital for a Global Telecommunications Provider and for LIME**. The latter report has been submitted to the Office under confidential cover.

LIME anticipates the OUR's full and comprehensive response to the issues highlighted in its complete submission. LIME also reasonably expects that the OUR's response will not compromise any of its commercially sensitive information.

END DOCUMENT