

**CABLE AND WIRELESS (JAMAICA) LTD.
COMMENTS ON**

**Estimate of the Weighted Average Cost of Capital for
Telecommunications Carriers**

(Consultation Document 2020/TEL/011/CON.002)

22 July 2020

I. INTRODUCTION

1. Cable & Wireless (Jamaica) Ltd. (“**C&WJ**”) welcomes the opportunity to respond to the Office of Utilities Regulation’s (“**OUR**”) Consultation Document, *Estimates of the Weighted Average Cost of Capital for Telecommunications Carriers*, dated 24 June 2020. This proceeding will have significant implications for the industry, as the estimates of a WACC for fixed and mobile licensees are critical inputs to establishing cost-based interconnection rates.
2. Please direct any questions you may have to Charles Douglas at charles.douglas@cwj.com.

II. C&WJ’S RESPONSE TO OUR QUESTION 1: “DO YOU AGREE WITH THE APPROACH TO ESTIMATE SEPARATE WACCs FOR FIXED LINE AND MOBILE?”

3. No, we do not agree with the approach to estimate separate WACCs for fixed wireline and mobile wireless operators in Jamaica. There is no economic basis for the cost of capital for fixed and mobile networks to be different. First, the scope of operators’ service offerings in Jamaica include both a mix of wireline/wireless and fixed/mobile services. With Digicel having deployed a wireline fibre network, technology convergence for telecommunications is a reality in Jamaica today, and the companies sourcing capital in Jamaica for investment will be viewed as having similar service portfolios.
4. Second, the near future will witness even greater convergence as technologies become increasingly seamless. The ability of consumers to transition between fixed services, Wi-Fi and mobile

services is no longer a perk, but a competitive advantage, if not a requirement for operators. Thus, even if there were some risk difference between investing in a mobile and a fixed network, the entities deploying networks in Jamaica today are no longer distinguished along the lines of the two technologies.

5. Thirdly, the means of delivering mobile services involves increasing amounts of fixed infrastructure. In many countries, the rapidly escalating capacity required to provide high-quality mobile broadband services is leading to decreasing cell radii (implying more fibre backhaul) and an escalating off-loading of traffic to fixed fibre networks. Thus, although the access networks are distinguishable, little else is, and there is no logical reason why a technological difference in access networks would lead to a difference in cost of capital. Indeed, given the uncertainty concerning fixed broadband take up, it could be argued that the cost of capital of fixed access networks is increasing and will be higher than that of mobile access networks. Furthermore, given the emphasis placed in the Consultation Document on establishing a forward-looking estimate of the WACC, we believe it is appropriate to establish a single estimate of the WACC for all telecommunications operators in Jamaica, in order to promote efficiency and provide a level playing field.

III. C&WJ'S RESPONSE TO OUR QUESTION 2: "DO YOU AGREE THAT A GEARING RATIO OF 35.54% FOR FIXED AND A GEARING RATIO OF 35.72 FOR MOBILE IS REASONABLE? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES."

6. Flow approves of the optimal gearing approach, and while Flow objects in principle to the calculation of separate optimal gearing ratios for fixed and mobile, we assent in practice with the OUR's gearing ratio estimates for fixed and mobile. Both estimated ratios are comparable and at levels we believe are appropriate.
7. For comparison, it is worth noting that a WACC study completed by regulators in the five ECTEL states and Curacao estimated a single gearing ratio for all telecommunications providers comparable to the two fixed and mobile ratios the OUR has estimated.

IV. C&WJ'S RESPONSE TO OUR QUESTION 3: "DO YOU AGREE THAT A RISK-FREE RATE OF 2.26% FOR BOTH SEGMENTS (FIXED AND MOBILE) IS REASONABLE? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION."

8. Yes, Flow agrees with the OUR's approach to estimating a risk-free rate and that an estimate of 2.26% for *both* segments (fixed and mobile) is a reasonable input to the OUR's WACC calculations.

V. C&WJ'S RESPONSE TO OUR QUESTION 4: "DO YOU AGREE THAT A COUNTRY RISK PREMIUM (CRP) OF 3.42% FOR JAMAICA IS REASONABLE? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES."

9. Yes, Flow agree with the OUR's methodology and CRP estimate. We believe an estimated CRP of 3.42% for Jamaica is reasonable.

VI. C&WJ'S RESPONSE TO OUR QUESTION 5: "DO YOU AGREE THAT A DEBT PREMIUM OF 1.59% FOR JAMAICA TELECOM SECTOR IS REASONABLE? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES."

10. Yes, Flow agrees with the OUR's approach to estimating a debt premium and that an estimated debt premium of 1.59% for the telecom sector as a whole is appropriate.

VII. C&WJ'S RESPONSE TO OUR QUESTION 6: DO YOU AGREE WITH THE APPROACH TO ESTIMATING BETA? DO YOU AGREE THAT A BETA OF 0.697 FOR FIXED AND A BETA OF 0.918 FOR MOBILE ARE REASONALBE? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES.

11. Please see our answers to Questions 1 and 2, above. As articulated in these answers, there is a trend towards technology convergence in Jamaica and elsewhere, which we believe explains the observed disappearance of significant differences between the WACC inputs for mobile and fixed networks. There is also a great deal of regulatory precedent in using a single beta for both fixed and mobile networks. Part of this regulatory precedent is due to the fact that it is very difficult to find reasonable data on pure play fixed network players. As a result, we believe the distinction between fixed and mobile betas is artificial and inappropriate, especially in the case of

Jamaica where operators operate both fixed *and* mobile networks. We propose the OUR use a single measure of beta and base its estimate on the average of the fixed and mobile beta developed recently by ECTEL, or 0.606 (average of 0.664 and 0.547).

12. We believe the estimates by ECTEL are the best and most appropriate benchmark among those listed in Exhibit 9. The five ECTEL markets are the only countries listed in the same (Caribbean) region as Jamaica, as well as the only markets with the same operators as Jamaica (Flow and Digicel).

VIII. C&WJ'S RESPONSE TO OUR QUESTION 7: DO YOU AGREE WITH THE APPROACH TO ESTIMATING THE MRP? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES."

13. No, we do not agree with the OUR's approach to estimating the MRP. The OUR has chosen to apply the same historical approach to estimating the MRP as it applied in its 2016 WACC study, an approach which the OUR conceded at that time was "likely to overestimate the actual premium rather than underestimate it." The decision to establish an inflated estimate of the true WACC is not without costs, and can act to distort economic efficiency and competition.
14. If the OUR chooses to apply this MRP estimate, then we urge the OUR to select the lower bound estimate of 4.66% (instead of the average of 4.66% - 6.26%) in order to counteract this overestimation bias.

IX. C&WJ'S RESPONSE TO OUR QUESTION 8: "DO YOU AGREE WITH THE VALUES, 4.76% AND 2.32% TO BE USED FOR EXPECTED INFLATION FOR JAMAICA AND THE UNITED STATES OF AMERICA, RESPECTIVELY? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES."

15. Yes, Flow agrees with the OUR's estimates of expected inflation for Jamaica and the USA, and the reliance on IMF projections to derive these expected inflation estimates.

X. C&WJ'S RESPONSE TO OUR QUESTION 9: "DO YOU AGREE WITH THE ESTIMATED WACC FOR FIXED CARRIERS (10.75%) AND MOBILE CARRIERS (12.63%)? PLEASE JUSTIFY YOUR POSITION AND PROVIDE SUPPORTING INFORMATION AND REFERENCES."

16. We do not agree with the estimated WACC for fixed and mobile networks for all of the reasons articulated in our comments above. Instead, we believe a single estimated WACC applicable to all operators is appropriate. We also believe that, based on our responses to the above questions, adjustment should be made to the following WACC inputs:

- Market Risk Premium. The mark risk premium selected should be on the lower end of the historic approach to estimation, i.e., 4.66%, and
- Beta. The beta should be equivalent for mobile and fixed networks and based on the average of the fixed and mobile beta developed recently by ECTEL, or 0.606.

17. After making these adjustments, we believe a pre-tax WACC for fixed and mobile in Jamaica of 9.50% and 9.49%, respectively, is appropriate.

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