



Estimating the Cost of Capital: Further Consultation on Beta Values

Report on Consultation and Decision

August 2008

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1 INTRODUCTION

In December 2006, the Malta Communications Authority (hereafter “the Authority” or “MCA”) published a consultation and proposed decision on estimating the cost of capital (hereafter “the Proposed Decision”). This Proposed Decision addressed the theoretical background for estimating the cost of capital and asked for the views of respondents on a number of specific aspects related to the MCA’s proposed methodology and approach in estimating the cost of capital (hereafter ‘WACC’).

The consultation period for the aforementioned Proposed Decision ended on 9 February 2007, with two operators submitting their formal feedback. This feedback, together with the MCA’s reaction was the subject of a decision and further Consultation (hereafter ‘Further Consultation’) which was published on 2 April 2008.

In this decision and further consultation the MCA consulted further on feasible methods to be used for establishing the Beta values required for the calculation of WACC. The MCA proposed also a range for the Beta values for the calculation of the WACC for mobile and fixed-line telephony companies respectively.

The consultation period for this section of the decision and further consultation ended on 9 May 2008, with no respondents submitting their feedback within the consultative period.

2 SUMMARY OF FURTHER CONSULTATION ON BETA VALUES

The Decision featured a range of techniques to calculate the betas for SMPs. These included:

- Market information (for publicly traded companies); and
- Betas of comparable companies; and
- Betas used by other regulators

The MCA recognised that beta estimates using local stock exchange market information for the last two years do not necessarily provide a suitable estimate of the systematic risk of a particular company. As a result the beta estimates for both publicly traded and private companies would need to be estimated by reference to benchmark data from comparable companies and used by other regulators.

Data published by the IRG in February 2007, shown in Figure 1 and Figure 2 hereunder, provides an indication of the betas used in different IRG countries.

Figure 1.

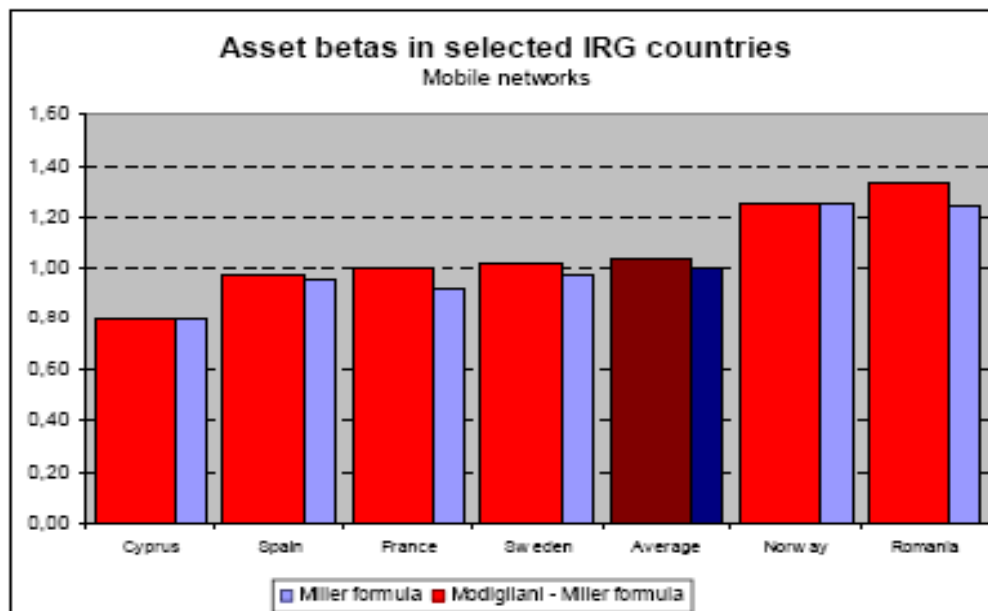
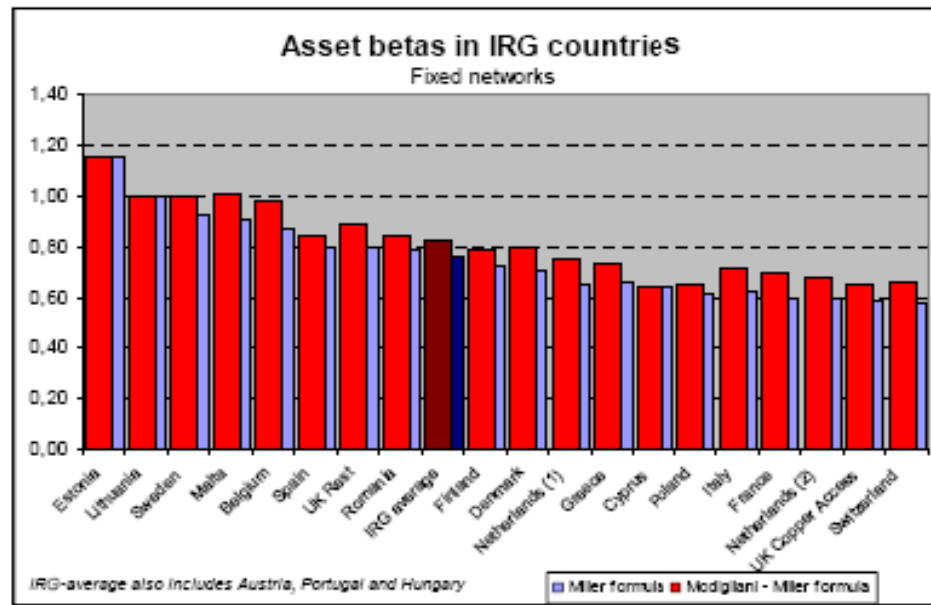


Figure 2.



The asset betas vary significantly between countries, reflecting the difficulties in estimating betas. The asset betas for mobile companies range from 0.8 in Cyprus to 1.3 in Romania with a simple average in the region of 1.0. In the case of fixed networks the betas range from just above 0.6 in Cyprus to just below 1.2 in Estonia, with a simple average in the region of 0.8.

The MCA also noted that systematic risk is influenced by various factors which may not necessarily be comparable between companies, and this together with other factors such as the availability of data and estimation techniques used, gives rise to the wide range of beta estimates in the IRG countries. Despite this, the MCA was of the view that an indication of the beta estimate for Maltese telecom companies can be obtained from this data.

Therefore, taking into account the local scenario the MCA proposed the use of a range of ungeared beta estimates in calculating the cost of capital of telecom companies in Malta.

Proposed Decision:

Proposed ranges of asset betas in estimating their cost of equity:

- ***Fixed and Cable companies: 0.8 for the low estimate and 1.0 for the high estimate***
- ***Mobile companies: 1.0 for the low estimate and 1.05 for the high estimate.***

3 MCA'S DECISION ON THE RANGE OF BETA VALUES

Given that no respondent submitted any feedback during the consultative period, the MCA is hereby confirming the proposed decision shown in the Further Consultation.

This decision on the extended consultation on Beta values will not impact the WACC estimates for Mobile and Fixed telephony reported in Appendix I of the Decision (April 2008), namely an average pre-tax WACC rate of 13.9% and 15.1% for fixed-line and cable companies, and mobile companies respectively. This is because these WACC estimates were already based on the proposed ranges of Beta values.

In line with the Further Consultation of April 2008 on the estimation of Beta values, the resulting WACC rates should be applied for regulatory accounting periods ending on or after 31 December 2007.

Going forward, the MCA will request operators with SMP status to submit revised WACC rates on an annual basis following the approach outlined in the Decision and Further Consultation of April 2008 and this Decision on Beta values.

The MCA reserves the right to review and modify the methodology and / or the parameters established in this decision notice, when the need arises in accordance with the normal consultation process.

Ing. Philip Micallef

Chairman
Malta Communications Authority
August 2008