



Decision and Order

**Definition of the Weighted Average Cost of Capital (WACC) for
Qatar Telecom (QTel) Q.S.C.**

**Supreme Council of Information and Communication Technology
(ictQATAR)**

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1 Executive summary

1. This Decision and Order (**Order**) is issued by the General Secretariat of Supreme Council of Information and Communications Technology (**ictQATAR**) and is directed to Qatar Telecom (Qtel) Q.S.C. (**Qtel**)¹.
2. Cost of Capital (**CoC**) is a measure of the financial return that investors seek for the risk they are taking on by investing in the company. From a regulatory point of view, the CoC is the allowed rate of return, usually determined as the Weighted Average Cost of Capital (**WACC**). The WACC is a percentage value that is applied to capital investments in Qtel's business.
3. If the WACC is recovered (in addition to depreciation and OPEX) then the cost of investing in the business is fully covered and both equity and debt investors have their financial needs satisfied from a regulatory point of view.
4. The underlying considerations for the calculation of the WACC are taken from a regulatory point of view. ictQATAR recognizes that financial institutions perform WACC calculations for Qtel, which may have different assumptions and goals and hence produce different values. Amongst others, the regulatory objectives are to: provide sufficient return to encourage investments, refer to capital market performance where it is possible, consider adequately the risk of the regulated industry, and to ensure that retail and wholesale products are priced efficiently.
5. ictQATAR had two rounds of consultation with the industry.
6. According to the information acquired during the consultation, the WACC range is between 13% (value proposed by Qtel) and 6.2% (value proposed by QNBN). Vodafone Qatar proposed WACC is in the middle of that range (7.97% - 10.5%).
7. ictQATAR estimate after CD2 was between 9.3% (Group) and 9.6% (Domestic).
8. The variance of the values is an indication of how difficult it is to estimate the WACC, which is highly influenced by several parameters, including the scenario chosen and the timeframe considered.
9. Determining the WACC is a crucial step for a Regulator. A WACC value that is set too low, can discourage new investment and result in prices that are below efficient costs. Conversely, to set a WACC value too high, can encourage overinvestment and result in prices that are too high.
10. In particular, to set a too low WACC, for instance, might artificially lower the prices of the Wholesale Services, encouraging the *buy* approach and discouraging - at the same time - investment in new infrastructures.
11. In this context, ictQATAR's primary concern is to mitigate the risk of mistakes with negative impacts on the willingness to invest of the SPs or on the level of the prices.
12. ictQATAR therefore determines that the WACC value is set at 10.75% (nominal, pre-tax).
13. This is a "single rate" WACC, applicable to all of Qtel's products for regulatory purposes. ictQATAR currently sees no sufficient merit to define multiple WACCs for various parts of Qtel's business (e.g. fixed/mobile/access/core).
14. This WACC is calculated on a "forward looking basis" as much as possible and is specified to be valid for the next four years at the minimum.
15. The WACC is also based on historical parameters. So this WACC should be used by Qtel in specific regulatory instructions and financial calculations, especially in Qtel's Regulatory Accounting System (**RAS**) starting from the RAS 2010.

¹ Qtel has been rebranded "ooredoo" 25 February 2013.

2 Legal Basis and Policy Objectives

16. The State of Qatar has empowered and authorized the Supreme Council of Information and Communication Technology (**ictQATAR**) to liberalize and regulate the telecommunications sector under Decree Law 34 of 2006 and the Telecommunications Law (**Telecommunications Law**), and Executive By-Law 1 of 2009 for the Telecommunications Law (**By-Law**). These laws establish the objectives and legal framework for ictQATAR to create the appropriate legal and regulatory conditions for the development of sustainable competition in the telecommunications sector so that, amongst other things, telecommunications may become a factor for promoting social and economic development.
17. Under the Telecommunications Law and By-Law, ictQATAR has specific objectives and powers to ensure the prices and charges of Dominant Service Providers (**DSPs**) are cost-based and appropriately applied to products and services offered at a wholesale or retail level. Service Providers (**SP**) are also subject to any related regulations, rules, orders, notices, decisions and instructions, as well as telecommunications licenses issued to them. Together this comprises the Applicable Regulatory Framework (**ARF**) that applies to licensed telecommunications service providers.
18. ictQATAR has mandated objectives and goals to achieve under the Telecommunications Law. Article 2 outlines the main objectives that apply for the purposes of this Order:
 - Article 2 (2) enhancing the telecommunications sector's performance in the State of Qatar through encouraging competition and fostering use of telecommunications;
 - Article 2 (5) encouraging sustainable investment in the telecommunications sector;
 - Article 2 (9) establishing a fair regime that meets the requirements of the competitive market place through the implementation of interconnection between service providers and all procedures related thereto;
 - Article 2 (12) ensuring that the regulation of the telecommunications sector remains in line with international rules; and
 - Article 2 (13) ensuring the orderly development and regulation of the telecommunications sector.
19. Article 19(1) of the Telecommunications Law requires ictQATAR to undertake functions and duties in respect of interconnection and access to promote appropriate, **effective and low cost interconnection**² between telecommunications networks, promote access to facilities of other service providers to ensure interoperability and promote the growth of competitive telecommunications services markets.
20. Article 29 of the Telecommunications Law requires tariffs to be based on the cost of efficient service provision without any excessive charges which may result from dominance. Under this Article 29, ictQATAR may issue decisions to amend tariffs where it finds they are not in line with the cost of service provision.
21. On 31 October 2011, QTel was issued with the Notice and Orders,³ designating it as a DSP in retail and wholesale Relevant Markets in the telecommunications sector in Qatar. The implications and operation of the designation Notice and Orders are that QTel will be subject to specific provisions, obligations and remedies in the ARF that apply to DSPs. QTel may also be made subject to additional obligations and remedies, if required.
22. One of QTel's obligations as a DSP is the requirement to establish a Regulatory Accounting System

² Emphasis added

³ ICTRA 2011/10/31

(RAS)⁴. The RAS is an essential part of identifying the cost of service provision for the purpose of ensuring the charges do not contain any excessive charges (Article 29 of the Telecommunications Law) or are below cost.

23. The WACC, as a key contributor to the cost base, appreciably determines retail and wholesale charges. This requires a WACC value that ensures that the DSP achieves a fair return on capital employed (at the WACC value) and the goals of low and efficient prices and increased competition are adhered to.

Also the WACC level should not discriminate against the SP seeking access to the services of a DSP. So, the Access Seeker that buys services from the DSP, should not pay too much and so have its own business impeded. A fair WACC value satisfies both the DSP network-builder and the buyer of services from that network.

3 Establishing the Weighted Average Cost of Capital (WACC)

24. The Cost of Capital (**CoC**) is a measure of how much, on average, it costs a firm to raise the capital required to finance its activities. Given the telecoms industry's high levels of capital investment, this rate is a key input in its regulatory process.
25. The WACC has an impact on any cost-oriented prices (set by regulators), such as e.g. call termination charges. Typically models consider three types of costs:
 - Operational expenditures (OPEX);
 - Depreciation of the asset base;
 - Cost of Capital (**CoC**) = WACC rate * Capital Employed

3.1 Definition

26. The WACC is usually calculated on a post-tax basis so that regulated prices provide the company with sufficient revenue to also meet its tax liabilities:

$$WACC_{Pre-tax} = WACC_{Post-tax} / (1-t) = (g * RD + (1-g) * RE) / (1 - t)$$

Where:

- **g** is the gearing ratio $D/(D+E)$ with the D is the net financial debt and E is the value of equity;
- **RD** and **RE** are respectively the cost of debt and the cost of equity. The cost of equity is higher in order to reward the equity investors for bearing a higher level of risk. Payments to equity investors are not contractually defined and they are received only *after* debt payments have been made;
- **t** is the corporate tax rate.

3.2 Consultation Process

27. Due to the importance of the WACC for consumers and competition, DSP and other SPs, ictQATAR has reached the conclusions in these Orders after an interactive consultation process with the telecommunications industry in Qatar. The first round of consultation (**CD1**, ICTRA 2011/06/06 issued on 06 June 2011 set out the general methodology and principles. It also set out the need for the WACC and the process to be followed. ictQATAR received replies from Qtel and Vodafone Qatar Q.S.C (**Vodafone**).
28. The second round of consultation (**CD2**, ICTRA 2012/12/06 issued on 6 December 2012) summarized the responses to the CD1. The CD2 examined in more detail the key issue areas and

⁴ Legal Basis is fully detailed in RAS Orders ICTRA 2013/03/31-B, that established Qtel RAS Obligations

also gave due consideration to the respondents' views given in the first round. CD2 set out estimation methods for a range of values that ictQATAR proposed to consider for the definition of the WACC rate.

ictQATAR received replies to CD2 from QTel, Vodafone and Qatar National Broadband Network Co. (Q.NBN).

29. The process and methodology used in both of these WACC consultation documents reflects international best practice used in WACC determinations. ictQATAR mitigated the risk of mistakes in setting the WACC taking into account the most relevant regulatory objectives, such as the relevance to favor the investments in infrastructures in Qatar.
30. QTel shall adopt this WACC – inter alia - for the purposes of Regulatory Accounting starting from the FY 2010. The same WACC value will be used in other regulatory assessments and cost studies.
31. Key aspects of the consultation process and the calculations in the FRD are:
 - SPs proposed different values during the consultations. In particular:
 - QTel range: 15.7% (CD1) - 13% (CD2)
 - Vodafone Qatar: 7.97% (Group) – 10.2% (Domestic)
 - QNBN: 6.2% (Fixed Assets) – 7.4% (All Other Infrastructures)
 - IctQATAR (CD2) estimated a minimum of 8.4% (Qatari Scenario) and a maximum of 9.6% (Group Scenario).
 - The tax rate is considered as zero, which has a small impact;
32. ictQATAR carefully considered all the estimates provided by the SPs. The wider objectives of ictQATAR need to be considered when selecting the final value.

3.3 Setting the WACC value

33. After having carefully examined all submitted comments during this consultation process, ictQATAR appreciated, that no “absolutely right” WACC can be calculated, as the variance of the WACCs calculated by the SPs and by ictQATAR demonstrated.

After having carefully considered all the submissions from the consultation process, ictQatar concluded that no “absolutely right” WACC can be calculated, this is substantiated by the variance presented in the figures submitted by the SPs.

34. ictQATAR considers that a single WACC rate remains more appropriate for the forthcoming regulatory period.
35. The WACC is influencing charges substantially. Charges by the DSP to end customers for retail products and charges by the DSP to other SPs for wholesale products. This influences the profitability of the DSP, the profitability of other SPs, the investments, competition and consumer welfare. Therefore, a balance has to be struck between these – conflicting - goals. The final WACC needs, necessarily to be considered as fair and balanced. Article 19(1) of the Telecommunications Law explicitly requires low cost interconnection. Access Seeker (for wholesale products) are typically interested in a low WACC and hence low charges for wholesale costs.
36. On the other side, according to the article 2(5) of the Telecommunication Law, ictQATAR has to encourage sustainable investment in the telecommunication sector. ictQATAR does not see a clear rationale to select a value on the upper or lower end of the ranges calculated or proposed by the SPs during the consultation. Therefore ictQATAR considers a value “in the middle” as the fairest regulatory option available.
37. ictQATAR sets the nominal WACC rate for QTel at 10.75%. As QTel is currently tax-exempt this WACC rate is the same for pre-tax and post-tax.

Comparing the WACC with WACCs of similar countries, ictQATAR believes that a fair value has been chosen.

4 Order to QTel to implement the WACC

38. ictQATAR instructs QTel to apply the WACC value in the RAS with immediate effect, starting from the FY 2010. This value shall be used unless directed otherwise by ictQATAR.
39. The WACC shall also be used in other analyses and cost studies, which may be specified by ictQATAR from time to time.

5 Duration of this Order and review process

40. Periods between revisions of the WACC should be as long as possible in order to provide the industry with regulatory certainty. WACC rates set by regulators are typically applied for periods between one and 5-years.
41. The WACC is based on a forward-looking approach. Hence, the WACC value shall apply for at least 4 years. A review of the WACC is not planned prior to 2017.
42. In case of a substantial change in market conditions, ictQATAR reserves the right to revise this WACC rate at any time, but will not consider itself obliged to do so. In practice, e.g. a risk-free rate which is substantially above or below the set value and for a durable period may trigger such a revision.

Alternatively, the SPs may address ictQATAR with a substantiated request for a revision of the WACC, if they believe that market conditions have sufficiently changed. The request has to be supported with a reliable and detailed justification and has to be corroborated with facts and figures. The decision and sole discretion as whether to take action in these matters thus continues to rest with ictQATAR.



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For the Supreme Council of Information and Communication Technology (ictQATAR)
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