

## **DECISION**

**Cost of capital rate of MEO – Serviços de Comunicações e Multimédia, S.A.**

**(Financial year of 2019)**

**ANACOM**

**2019**

## 1. Background

The cost of capital rate is reflected in the rate of return that is appropriate to compensate the opportunity cost of the investment.

In the context of the regulation of the electronic communications market, this is sought by determination of the cost of capital rate that: (i) ensures the correct incentives to investment; (ii) ensures that there are no market distortion, through discriminatory and anti-competitive practices; (iii) eliminates possible barriers to the entry of new competitors; and (iv) protects consumers from excessive prices. Here, it is considered essential to define a methodology that enables calculating, without any accounting and/or analytical constraints, the appropriate cost of capital rate to remunerate the investments of regulated companies.

The National Communications Authority (ANACOM) has, since 2010, been establishing a methodology to calculate the cost of capital rate of MEO - Serviços de Comunicações e Multimédia, S.A. (Hereinafter also referred to as MEO), and to determine the cost of capital rate to be considered by this operator for regulatory purposes. Following the critical review of the parameters applicable to the financial year of 2018, by Determination of 09.05.2019, ANACOM updated the methodology for calculation of the cost of capital rate to be considered in this regard, with the methodology for calculation of all the rest of the parameters to be considered in the calculation of the cost of capital rate having remained unchanged.

In this context, and in order to determine the cost of capital rate to be used by MEO in its Analytical Accounting System (SCA), applicable to the 2016 financial year, and which appropriately reflects the obtaining of a reasonable profit, considering the risk incurred in the investments made, ANACOM awarded to Mazars, S.A. (hereinafter Mazars) the critical review of the current methodology and updating of the data required for calculating each parameter of the cost of capital rate, the subject matter of this document which is integral part of the report "*Determination of the cost of capital rate of MEO – Serviços de Comunicações e Multimédia, S.A. – applicable to the financial year of 2019*", drawn up by Mazars (attached herewith).

It should be stressed that ANACOM decided, on 04.07.2019, to submit the draft decision on MEO's cost of capital rate (financial year of 2019) to the general procedure of public

consultation, pursuant to article 8 of Law number 5/2004, of 10 February, in its current wording (Electronic Communications Law – LCE) and to the procedure of prior hearing of stakeholders, pursuant to articles 121 and 122 of the Code of Administrative Procedure (CPA), having established, in both cases, the deadline of 20 business days for the stakeholders to express an opinion, with ANACOM having drawn up the report on these procedures, which is an integral part of this measure, and approved a draft final decision.

The draft final decision was notified on 22.08.2019 to the European Commission, BEREC and the NRAs of the other Member States, pursuant to number 1 of article 57 of the LCE and also in accordance with the provisions in article 7 of the Framework Directive.

Following this, the European Commission issued a statement on the draft final decision, not having presented any comments.

## **2. Cost of capital rate**

Since ANACOM 's determination of 2010, referred to above, the methodology to be used by MEO in calculating the cost of capital rate to be considered in its Analytical Accounting System is defined by this Authority, with the methodology also being established for various parameters considered, as well as the information sources to be used.

### **2.1. Methodology**

The methodology used in MEO's Analytical Accounting System for calculating the cost of capital is based on the weighted average cost of capital (CMPC), in the variant of the formula of the nominal weighted average cost of capital before taxes (pre-tax), and using the capital asset pricing model (CAPM) to calculate the cost of equity.

Furthermore, it is also important to note that, for the parameters calculated by a methodology based on a benchmark, using comparable companies, in the criteria used in the choice of these companies, the following was taken into account: (i) the income *per capita* of the respective countries; (ii) the supply of similar products; (iii) the position in the market; (iv) the growth rate; and (v) the value of the company.

In this respect, it should be stressed that the review of the methodology to calculate the cost of capital rate, carried out by Mazars (see annex), did not detect the need for any change in relation to ANACOM's last decision on this matter.

It is important to note that, despite ANACOM having understood that the absence of methodological changes to the calculation of this value exempted the procedures of consultation of the stakeholders and notification of the European Commission (EC), concerning the updating of the fixed termination costing model incorporated in the market analysis 1, the EC stated that *“The Commission recognises the difference between the methodological changes notified by ANACOM in the past and the mere updating of the data in case in question. However, the Commission considers that any new calculation of the CMPC should be subject to the consultation procedures referred to in articles 6 and 7 of the Framework Directive, regardless of the whether the new value of the CMPC is the result of a methodological change or simply an updating of the data used in the calculation. Consequently, the Commission urges ANACOM to consult the stakeholders and the Commission before endorsing any measure related to the CMPC in the future, whether as an autonomous decision or as part of a market analysis or decision on corrective measures.”*.

In view of the above, ANACOM believes that it should not be exempt from the public consultation procedures and hearing of the stakeholders prior to the notification of this measures to the EC.

It is highlighted that, in any case, the conduct of the present administrative act only involves the application of the methodology in force which – as noted above – was not changed in this respect.

In terms of future predictability, ANACOM believes that it can be expected that the current methodology for calculating the cost of capital rate for regulatory purposes could, in the medium term, be subject to considerable review, namely due to anticipating that the efforts of harmonisation in this area promoted by the European instances can be incorporated in the domestic procedures of the different Member States.

## 2.2. Definition of the cost of capital rate

The prior adoption of a clear methodology and consequent *à priori* definition of the value of the cost of capital rate promotes regulatory predictability and transparency in the markets.

Thus, and considering the value of the parameters obtained, detailed in the consultant's annex attached to this document, ANACOM believes that the **cost of capital rate**, applicable to the financial year of 2019, should be **7.4021%** (see Table 8).

**Table 1. Cost of capital rate (2019)**

| Parameters                         |                |
|------------------------------------|----------------|
| Risk-free interest rate            | 2.45%          |
| Beta                               | 0.762          |
| Risk premium                       | 6.54%          |
| <i>Gearing</i>                     | 39.53%         |
| Debt premium                       | 1.608%         |
| Tax rate                           | 22.50%         |
| Cost of equity                     | 7.43%          |
| <b>Cost of capital rate (2019)</b> | <b>7.4021%</b> |

## 3. Conclusion

In view of the methodology in force and the calculation presented and detailed in the annex, it is determined that, in the context of the results of 2019 of MEO's analytical accounting system, the **cost of capital rate of 7.4021%** should be used.