April 16, 2021

Steven Ingram
208 S. Akard St.
18th Floor
Dallas, TX 75202

Re: Response to Comments on the 2021 Capitalization Rate Study, Large Telecommunications

Dear Mr. Ingram:

The department would like to thank you for taking the time to review our study and for providing additional information for us to consider. The following information was provided: your submission email received April 8, 2021, which explained the items for consideration along with the attached Diversified Communications Cost of Capital Study prepared by Duff & Phelps.

The comments primarily pertained to:

- The choice of guideline companies
- The capital structure, and
- The Capital Asset Pricing Model used to estimate the cost of equity

These comments were like the comments provided for tax year 2020. We put considerable time and effort in analyzing various sources of data, adjusting our study where appropriate and responding to those comments for the prior year. Our responses for the prior year can be found at the following link:

> https://mtrevenue.gov/wp-content/uploads/2020/04/2020-Capitalization-Rate-Study-Response-to-ATT-Comments.pdf

For the current tax year, our focus was on what has changed from the prior year to warrant any further adjustments for tax year 2021. Ultimately our conclusion was, there is no material change from the prior year to warrant any further adjustment to our selection of guideline companies and as a result our capital structure. However, we did decide to shift some weight off the Capital Asset Pricing Model when selecting our equity rate. We ultimately placed equal weight on the Capital Asset Pricing Model and the Dividend Discount Model. This resulted in us adjusting our Weighted Average Cost of Capital from 5.75% to 5.95%.

More detail of the analysis conducted, information reviewed, and conclusions reached follows.

Guideline Companies

Consistent with comments provided for tax year 2020, we were asked to consider the additional lines of business AT&T now operates in after the acquisition of Time Warner Inc. More specifically, it was recommended we include additional guideline companies (representing a diversified entertainment company) in our study to recognize the additional lines of business AT&T now operates in.

Considerable analysis was completed for tax yar 2020 due to this request. Ultimately, for tax year 2020, it was determined that companies in the Computers/Peripherals industry as well as companies in the Internet industry are not comparable companies for determining a cost of capital for a telecommunications company providing two way transmission of voice, image or data. Further, the department concluded that the additional business segments represented by Time Warner did not make up a large enough portion of the consolidated unit to warrant inclusion of pure play entertainment companies in our study.

As a test to see if an adjustment was warranted for tax year 2021, we reviewed AT&T's 10-K, specifically the revenue and EBITDA breakouts by segment, to see what has changed since the prior year. The following exhibits were produced based on this review:

Exhibit 1

AT&T % Revenues by Segment

From: AT&T Inc., Year End 2020, SEC 10-K

Segment	2020	2019	2018
Communications	80.8%	78.6%	84.2%
WarnerMedia	17.7%	19.5%	12.1%
Latin America	3.3%	3.8%	4.5%
Corporate and other	1.1%	1.0%	1.3%
Eliminations and consolidations	-3.0%	-2.9%	-2.0%
Total	**100.0%**	**100.0%**	**100.0%**

Exhibit 2

AT&T % EBITDA by Segment

From: AT&T Inc., Year End 2020, SEC 10-K

Segment	2020	2019	2018
Communications	80.3%	76.3%	83.6%
WarnerMedia	21.6%	25.2%	18.3%
Latin America	-1.9%	-1.5%	-1.8%
Total	**100.0%**	**100.0%**	**100.0%**

Based on this review, we concluded there is no material change from the prior year and thus no adjustment to guideline companies is warranted for the current tax year.

Capital Structure

It was also requested our capital structure be adjusted from 60% equity and 40% debt to 75% equity and 25% debt. The primary support for this request, seems to be the Diversified Communications Cost of Capital Study prepared by Duff & Phelps. The difference in capital structure between the department's study and the Duff & Phelps study is primarily a result of the differences in guideline companies.

Consistent with our decision not to adjust our guideline companies we determined no adjustments was warranted to our capital structure as our capital structure is based on the capital structures utilized by the guideline companies.

Equity Rate Selection

It was requested less weight be placed on the Capital Asset Pricing Model when selecting the Cost of Equity.

Although the department would like more guideline company information to be available for the Dividend Discount Model (only 3 of the 5 guideline companies have the required information for the model) we ultimately did move weight from the Capital Asset Pricing Model to the Dividend Discount Model, resulting in equal weight being placed on each model.

This resulted in an increase to the selected Cost of Equity and a corresponding increase to the Weighted Average Cost of Capital. The adjustment is demonstrated below:

Exhibit 3
Initial Weighted Average Cost of Capital

Weighted Average Cost of Capital (WACC)					
Source of Capital	**Capital Structure**	**Cost of Capital**	**Marginal Tax Rate**	**After-tax Cost of Capital**	**Weighted Cost**
Equity	60.00%	7.93%		7.93%	4.76%
Debt	40.00%	3.16%	24.00%	2.40%	0.96%
WACC	**100.00%**				**5.72%**
WACC (Rounded)					**5.75%**

Exhibit 4
Adjusted Weighted Average Cost of Capital

Weighted Average Cost of Capital (WACC)					
Source of Capital	**Capital Structure**	**Cost of Capital**	**Marginal Tax Rate**	**After-tax Cost of Capital**	**Weighted Cost**
Equity	60.00%	8.26%		8.26%	4.96%
Debt	40.00%	3.16%	24.00%	2.40%	0.96%
WACC	**100.00%**				**5.92%**
WACC (Rounded)					**5.95%**

Again, I would like to thank you for your comments and the additional information you provided for our consideration. I look forward to any further discussion we may have throughout the 2021 appraisal season.

Our final 2021 Capitalization Rate Study for Large Telecommunications can be found at:

https://mtrevenue.gov/publications/cap-rate-studies/

Sincerely,

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