

April 16, 2021

Bwembya Chikolwa  
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Mailstop: (Broomfield, 23-506)

Re: Response to Comments on the 2021 Capitalization Rate Study for,  
Medium and Small Telecommunication

Dear Mr. Chikolwa

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 5, 2021 with attached comments. As well as a Cost of Capital Study prepared by Duff & Phelps for Wireline Carriers received via email on March 16, 2021.

The following summarizes the main areas identified for further consideration:

- Cost of Debt
- Cost of Equity
- Arguments Against Direct Capitalization
- Tax Rate

The department did adjust the debt rating and corresponding Cost of Debt as well as the weighting used when selecting the Cost of Equity. This resulted in our Weighted Average Cost of Capital being increased from 6.05% to 6.50%.

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

## Cost of Debt

Analysis was provided and a debt rating of B was recommended along with a cost of debt of 7.92%.

Like the prior year we decided to use interest coverage ratios to determine a synthetic debt rating for each guideline company. A bond rating was then selected using both the Mood'y ratings and synthetic ratings. We concluded to a debt rating of between B and Ba and a corresponding cost of debt of 7.23%.

## Cost of Equity

Comments and recommendations were provided about the various methods and models for estimating the Cost of Equity. Ultimately, it was requested we adjust our weighting used in selecting the Cost of Equity and a rating of 8.77% was recommended.

We did adjust our weighting utilized in selecting the Cost of Equity. 10% weight was moved off the Capital Asset Pricing Models on to the Dividend Discount Models. At this time, we determined no more

weight than this should be placed on the Dividend Discount Models as only 2 of the 6 guideline companies have enough information to be able to complete the model.

We concluded to a Cost of Equity of 8.68%.

## Direct Capitalization Approach

Comments were provided detailing the weakness of the Direct Capitalization Approach.

As the comments pertain to the usage of direct capitalization in general and not the methodologies utilized to estimate the Direct Capitalization Rate. No adjustments were deemed necessary to the study. However, these comments along with other considerations are part of the reconciliation process an appraiser must consider when selecting which Approaches to Value should receive weight when concluding on a market value.

## Income Tax Rate

It was recommended we increase the tax rate used to tax affect the cost of debt as the rate we used is less than the average paid by most companies.

As a result of this request we reviewed the financial statements of the guideline companies to determine what the combined marginal tax rate has been over the recent past. Exhibit 1 provides the result of our analysis.

**Exhibit 1**  
**Guideline Company Combined Marginal Income Tax Rate**

*From: GPC 10-k's*

GPC Ticker	2020			2019			2018		
	Federal Rate	State Rate	Combined Marginal	Federal Rate	State Rate	Combined Marginal	Federal Rate	State Rate	Combined Marginal
ATUS	21.0%	10.2%	31.2%	21.0%	-3.3%	17.7%	21.0%	44.9%	65.9%
CNSL	21.0%	1.6%	22.6%	21.0%	10.6%	31.6%	21.0%	5.2%	26.2%
LUMN	21.0%	-10.8%	10.2%	21.0%	-1.6%	19.4%	21.0%	-1.5%	19.5%
TDS	21.0%	4.0%	25.0%	21.0%	5.5%	26.5%	21.0%	4.9%	25.9%
USM	21.0%	3.4%	24.4%	21.0%	3.4%	24.4%	21.0%	4.0%	25.0%
WOW	21.2%	0.9%	22.1%	21.1%	5.5%	26.6%	21.0%	7.8%	28.8%
<b>Average</b>	<b>21.0%</b>	<b>1.5%</b>	<b>22.6%</b>	<b>21.0%</b>	<b>3.3%</b>	<b>24.4%</b>	<b>21.0%</b>	<b>10.9%</b>	<b>31.9%</b>
<b>Median</b>	<b>21.0%</b>	<b>2.5%</b>	<b>23.5%</b>	<b>21.0%</b>	<b>4.5%</b>	<b>25.5%</b>	<b>21.0%</b>	<b>5.1%</b>	<b>26.1%</b>
<b>Trimmed Avg</b>	<b>21.0%</b>	<b>2.5%</b>	<b>23.5%</b>	<b>21.0%</b>	<b>3.2%</b>	<b>24.2%</b>	<b>21.0%</b>	<b>5.5%</b>	<b>26.5%</b>
High	21.2%	10.2%	31.2%	21.1%	10.6%	31.6%	21.0%	44.9%	65.9%
Low	21.0%	-10.8%	10.2%	21.0%	-3.3%	17.7%	21.0%	-1.5%	19.5%

Based on our review, we concluded that our tax rate is reasonable, and no adjustments was made to the tax rate used to tax affect our Cost of Debt.

## Overall Weighted Average Cost of Capital

Exhibit 2 and 3 demonstrate the overall impact to our study for the adjustments made.

**Exhibit 2**

**Initial Weighted Average Cost of Capital**

<b>Weighted Average Cost of Capital (WACC)</b>					
<b>Source of Capital</b>	<b>Capital Structure</b>	<b>Cost of Capital</b>	<b>Marginal Tax Rate</b>	<b>After-tax Cost of Capital</b>	<b>Weighted Cost</b>
Equity	30.00%	8.49%		8.49%	2.55%
Debt	70.00%	6.54%	24.00%	4.97%	3.48%
<b>WACC</b>	<b>100.00%</b>				<b>6.03%</b>
<b>WACC (Rounded)</b>					<b>6.05%</b>

**Exhibit 3**

**Revised Weighted Average Cost of Capital**

<b>Weighted Average Cost of Capital (WACC)</b>					
<b>Source of Capital</b>	<b>Capital Structure</b>	<b>Cost of Capital</b>	<b>Marginal Tax Rate</b>	<b>After-tax Cost of Capital</b>	<b>Weighted Cost</b>
Equity	30.00%	8.68%		8.68%	2.60%
Debt	70.00%	7.23%	24.00%	5.49%	3.85%
<b>WACC</b>	<b>100.00%</b>				<b>6.45%</b>
<b>WACC (Rounded)</b>					<b>6.50%</b>

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 small and Medium Telecommunications can be found at:

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

Sincerely,



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