APPENDIX 5.9V

(referred to in paragraphs 2.348 and 5.164)

Effects of a price control to 2001/02 on Vodafone

1. To allow it to comment on our proposed method of assessing the impact of any price control on its finances, we put to Vodafone an illustrative price control, calculated prior to our formulating our conclusions ('the illustrative price control') using a hypothetical controlled price for incoming calls in 1999/2000 of 11.72 ppm, falling by RPI–10 to 10.14 ppm by 2001/02. We reviewed the impact on Vodafone's forecast business performance; the results are shown in Appendix 5.8V.[1]

2. In this appendix, we review the impact of the price control eventually proposed. This was for a maximum termination charge for successful incoming calls of 11.70 ppm in 1999/2000 prices, falling by RPI–9 to 2001/02. However, this included an adjustment of 0.32 ppm to reflect our view that Vodafone should no longer charge for unsuccessful calls (ie unanswered calls and diverted calls before they are answered)—an adjustment we expect to be revenue neutral. For comparability with the earlier analysis, we disregard this adjustment and consider the effect of a price control based on 11.38 ppm for all calls, falling by RPI–9 to 2001/02. Assuming an inflation rate of 3 per cent, this gives out-turn average charges for incoming calls in 2000/01 and 2001/02 of 10.70 and 10.06 ppm respectively.

3. Table 1 shows the effect over the three years to 2001/02 of both the illustrative control and the control actually proposed, compared with the business plan of Vodafone. We estimated that our recommended control would have the following effects:

(a) a reduction in Vodafone's incoming calls revenues over the three years by £199 million, or [✄] per cent of its cumulative forecast total revenues, or [✄] per cent of its cumulative forecast incoming calls revenues;

(b) a cumulative reduction in Vodafone's cash flows over the three years by £138 million, or [✄] per cent of its total forecast cash flows; and

(c) a reduction in its cumulative forecast profits before tax by [✄] per cent, assuming that Vodafone does not take action to reduce its expenditure budgets.

[1]Appendix 5.8V does not form part of the Cellnet report.

TABLE 1 **Summary of forecast results of a price control on Vodafone's forecast to 2001/02***

Comparisons with the company's forecast	*Proposed*	*Illustrative*
		£ million
Cumulative reduction in incoming calls revenues in the three years to 2001/02	199	[✂]
Cumulative reductions in cash flows†	138	
		per cent
Cumulative reduction in revenue as percentage of total forecast revenue	*Figures omitted. See note on page iv.*	
Cumulative reduction in revenue as percentage of forecast incoming calls revenue		
Cumulative reduction in forecast profit before tax‡		
Cumulative reduction in cash flows as percentage of forecast cumulative cash flows§		
Cumulative cash flow reduction over three years compared with equivalent cumulative marketing and incentives		
Cumulative cash flow reduction over three years compared with equivalent cumulative marketing, incentives and capital expenditure		
Debt as percentage of equity and debt at March 2002¶		
Debt as percentage of equity and debt at March 1999¶		

Source: MMC and submissions from Vodafone.

*The proposed price control reflects an incoming calls average tariff of 11.38 ppm for 1999/2000 reducing by RPI–9 to 2001/02. The illustrative control assumed an incoming calls average tariff of 11.72 ppm for 1999/2000 reducing by RPI–10 to 2001/02, which we put to Vodafone before formulating our final proposal.

†The reduction in cash flows is after taking account of reduced tax payable on reduced profits, and interest on additional borrowings that may be necessary.

‡The reduction in profit may not arise in practice because Vodafone may take action to reduce its expenditure budgets.

§Cash flows are calculated as profits after tax plus depreciation.

¶Debt issues do not apply to Vodafone Limited from its UK mobile phone activity.

4. Vodafone told us that a cash flow reduction of £138 million over three years would be unwelcome but that it would not jeopardize Vodafone's ability to finance its functions. Vodafone also said that its capital expenditure forecasts were set to meet its forecast for traffic growth. Accordingly, if the volume growth were not achievable, it could reduce or rephase its capital expenditure levels to reduce its forecast cash requirements, subject to a six-month period to make such adjustments.