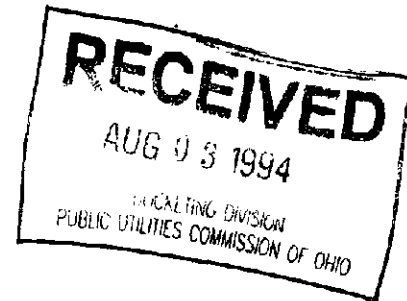BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)
The Ohio Bell Telephone Company) Case No. 93-487-TP-ALT
for an Increase in Electric Rates in its)
Service Area.)

Prepared
Testimony of
Stephen R. Chaney
Performance Analysis Department

Staff Exhibit _____

1. Q. Please state, for the record, your name, position, and background.

A. My name is Stephen R. Chaney. I am employed as a Financial Analyst in the Performance Analysis Division, Utilities Department of the Public Utilities Commission of Ohio, 180 East Broad Street, Columbus, Ohio, 43266-0573.

I have received a Bachelor of Science Degree in Civil Engineering from Purdue University in December, 1978, and a Master's Degree in City and Regional Planning from Ohio State University in December, 1981. I have been employed by the Public Utilities Commission of Ohio since January, 1982.

2. Q. What is the purpose of your testimony in this proceeding?

A. It is the purpose of my testimony in this proceeding to update the cost of capital determination contained in the Staff Report of Investigation and to respond to objections to the Staff Report of Investigation that relate to the rate of return issue. In the body of my testimony, I will address objections of the Applicant number 2 a through e, objections of the OCC numbers 50 through 55, objections of the IXC Coalition numbers 1 through 3, objection of Time Warner Access number 2, objection of the American Association of Retired People number 6, and objection of the Legal Aid Society of Dayton number 41.

1   3. Q. Does your testimony address any issues regarding the embedded costs of

2   long-term debt and preferred stock?

3

4   A. No, objections regarding embedded costs were not filed.

5

6   4. Q. Does your recommendation in this testimony contain a recommended

7   point within the rate of return range.

8

9   A. No. The purpose of my recommendation is to present an accurate

10   estimate of the Applicant's cost of capital. The Staff's analysis was

11   conducted solely with regard to cost of capital issues. The Staff believes

12   that all points within the range are reasonable estimates of the

13   Applicant's cost of capital, and any decision as to what rate of return

14   should be granted, within the range, must necessarily be based on factors

15   other than cost of capital.

16

17   5. Q. How did the Staff determine its recommendation of a fair and reasonable

18   rate of return for the Applicant?

19

20   A. The Staff calculated the rate of return based on a cost of capital approach.

21   This methodology takes into account the amounts and costs of long-term

22   debt, preferred stock, and common equity. The cost of capital as

23   determined by the Staff appears in Table 1, below.

TABLE 1

Staff's Overall Rate of Return Recommendation
Ameritech and Subsidiaries
December 31, 1993
(Dollars in Thousands)

	Amount	% of Total	% Cost	% Weighted Cost
Long-Term Debt	$ 3,811,423	32.70%	7.37%	2.41%
Common Equity	7,844,635	67.30%	12.09-13.11%	8.14-8.82%
Total	$ 11,656,058	100.00%		10.55-11.23%

6. Q. How were the costs and amounts of long-term debt and preferred stock determined?

A. The Costs and amounts of long-term debt and preferred stock were determined from an update to December 31, 1993 of Applicant's Schedules D-3 and D-4 of the Standard Filing Requirements. Both the amount and annual interest cost for long-term debt, as of December 31, 1993, are $3,811,423,250 and $280,975,624, respectively. This results in an embedded cost of long-term debt of 7.37%. The Applicant has no balance of preferred equity as of December 31, 1993.

7. Q. How was the amount of common equity determined?

A. The amount of common equity is the balance from December 31, 1993 of $7,844,635,000.

8. Q. How did the Staff determine the common equity investor's required return?

A. The Staff used the discounted cash flow (DCF) methodology to determine the cost of equity capital (required return) to Ameritech and Subsidiaries. The DCF method recognizes that investors must be compensated for foregoing the present use of income. Investors purchase stock with the expectation of receipt of future dividends. The price an investor is willing to pay is equal to the present value of expected future dividends.

$$(1) \quad P_o = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \ldots + \frac{D_t}{(1+k)^t} = \sum_{t=1}^{\infty} \frac{D_t}{(1+k)^t}$$

Where:

P_o = current price of the stock

D_t = expected dividends in the year t

K   = discount rate (required return)

If the expected dividend growth rate can be represented by g then equation (1) becomes:

$$(2) \quad k = \frac{D_1}{P_o} + g$$

Where:

k = discount rate (required return) or cost of capital

g = expected growth rate in dividends

That is, the cost of capital (stockholders' required return) is the sum of the dividend yield and the expected growth rate.

4

As D_1 is not known ahead of time, $D_1 = D_0(1+g)$ is substituted:

$$k = \frac{D_0(1+g)}{P_0} + g$$

9. Q. Why did the Staff use the discounted cash flow (DCF) methodology to determine the cost of equity capital?

A. The Staff views the DCF approach as an appropriate basis for the determination of the cost of capital because it is consistent with the Staff's effort to promote economic efficiency in a regulated environment. The Staff believes that regulatory authorities must function as a substitute for competitive market forces and believes that achievement of economic efficiency is beneficial to both the utility company and the consumers.

The DCF approach is consistent with economic efficiency because it equates the "required" return of the equity investor (or cost of capital to the company) to what can be earned on new additional investment in the competitive marketplace.

Consider an investor who has purchased and holds one share of public utility stock. He has done so because his "required" return for his saving sacrifice is equal to the expected return he will receive by holding the stock.

If the investor observes that the expected return from the public utility stock is less than: (1) the expected return from shares of unregulated

5

1 companies of comparable risk, and/or (2) the return that can be earned

2 on new direct (physical) investment of comparable risk, then he will sell

3 his share of the public utility stock and either purchase the shares of the

4 unregulated companies or engage in direct investment.

5

6 Assume now that many investors act in the same rational way. The

7 selling of the public utility stock will reduce its price and therefore

8 increase the expected return up to the point where it is equal to the

9 return of the comparable unregulated companies and/or to the return of

10 the new additional direct investment.

11

12 The exact opposite movement will occur if the expected return from a

13 public utility stock is higher than the expected return from stock of

14 comparable unregulated companies.

15

16 Therefore, the "required" return or cost of capital derived by using the

17 DCF approach is equal to the cost of equity capital of unregulated

18 companies of comparable risk and the return on additional direct

19 investments of comparable risk. It is thus consistent with the principles

20 of economic efficienty and commensurate with returns on investment

21 in other enterprises bearing corresponding risks.

22

23 10. Q. How did the Staff apply the DCF methodology to arrive at a cost of equity

24 recommendation in the case of the Applicant?

25

26 A. The Staff used a discounted cash flow (DCF) analysis to estimate the cost

27 of common equity to the Applicant. The Staff's customary and preferred

6

method of analysis is to apply the DCF methodology to the Applicant's common stock, or, if the Applicant is a subsidiary, to that of the parent company. A secondary method of analysis, applying the DCF methodology to a comparable group of companies, is also often employed.

In the present case, efforts to establish reasonable and meaningful estimates of the Applicant's cost of equity through a DCF analysis of Ameritech's common stock were not, at the time of the Staff Report, successful. The update of the Ameritech-only DCF is more meaningful. Although aspects remain problematic. The "classic" DCF model utilizes a company's retention ratio and earned return on equity to compute a sustainable growth rate, a specification usually referred to as the "B times R" approach. The five-year "BxR" for Ameritech is 5.36%. The July 1993 to June 1994 average of Ameritech's stock price, together with the dividend over the period produces a dividend yield of 4.70%, which, when combined with the "BxR" growth rate, results in a cost of equity estimate of 10.31%. Value Line projects earnings per share forward to the 1997-99 time frame at $4.15, while 1994 earnings per share are expected to be $2.55. Using the midpoint of 1998, this implies a 12.18% compound annual growth rate and a 17.45% estimate of the cost of equity. The equivalent estimate in the Staff Report is 9.66%. The Staff believes this illustrates the problem of relying, in certain situations, upon earnings estimates by financial analysts, particularly when applied to a single company. For groups of companies, however, the earnings estimates are less volatile, as statistical distortions are likely to be offsetting, at least to some degree.

A group of telephone companies with a substantial orientation towards provision of local service would be useful in cost of equity analysis. The Staff utilized the Telecommunications CompuStat data base to screen for a group of companies for a comparable DCF analysis. The selection criteria required companies to be located in the continental United States, have publicly traded common stock, and have local service operating revenues. An additional selection criterion was that Value Line information be available for the company. Besides Ameritech, fifteen companies met these criteria, and Value Line reports were examined for these companies. From this examination, the Staff concluded that the business activities or market situation of four of these companies indicated that their inclusion in a comparable group would be inappropriate. The excluded companies were Century Telephone, Lincoln Telecommunications, Sprint Corporation, and Telephone & Data Systems.

The basic selection criteria being a substantial orientation towards local service, the Staff believes this to be an adequate method for comparable group selection. However, additional explicit criteria can be applied, with the resultant selection of the same group. These criteria are, a Standard & Poor's senior debt rating of BBB+ or better, total operating revenues and sales of greater than $200 million, a ratio of local service operating revenues to total telephone operating revenues between twenty and sixty percent, and local service operating revenues greater than toll service operating revenues. No comparable group is perfect, but the Staff believes that the selected group of Ameritech and eleven

1 other companies represents the best tradeoff between similarity to

2 Ameritech and an adequate group size for purposes of analysis.

3

4 A number of financial estimates and statistics, drawn from the Value

5 Line reports and the CompuStat data base, are presented in Exhibit SRC-1

6 for Ameritech and the remaining 11 companies which constitute the

7 comparable group utilized in the Staff's analysis. The current yields are

8 derived from Value Line and Compustat data. The EPS and DPS growth

9 rates identified as "VLEG" and "VLDG" are the calculated compound

10 annual growth rates from the 1994 estimate to the estimate for the 1997-

11 99 time frame, evaluated at the midpoint of 1998. The growth rates

12 identified as "Box" are the rates reported in the Annual Rates box, as

13 "Est'd '90-'92 to '97-'99," and represent a longer perspective. These "Box"

14 growth rates produce cost of equity estimates of 13.23% and 8.79%. The

15 DPS estimate produces a low equity estimate of 8.79%, because, as with

16 current growth estimates, in general, it is biased downward for DCF

17 application. The increasing future earnings of the past few years for

18 these companies has led to a general medium term dividend growth

19 estimate bias downward, given the comparatively greater inertia of

20 dividends to earnings.

21

22 The "VLEG" and "VLDG" growth rates produce cost of equity estimates

23 of 15.04% and 9.82%, which is low and resultant from a downward biased

24 growth estimate. The 1988 to 1993 historic Value Line growth rates

25 result in cost of equity estimates of 5.64% for earnings and 9.70% for

26 dividends. The 5.64% estimate should be dismissed as it is inconsistent

27 with current costs of capital. The 9.70% estimate is low, consistent with

its derivation from a dividend growth estimate. The Value Line prospective "BxR," derived from the projected EPS, DPS, and return on equity in the "'97-'99" column, results in an equity estimate of 12.43%. Analysis of Value Line points to an estimated cost of equity of about 12.35%.

The Institutional Brokers Estimate Survey (IBES) earnings growth estimates result in an cost of equity estimate of 12.04% for the comparable group. Zacks Corporate Earnings Estimator earnings estimates result in a 12.69% equity cost estimate. Using 1989 to 1993 average "BxRs," computed from CompuStat data, results in an unreasonable 7.24% equity cost estimate. Together with Value Line, these estimators imply an estimated cost of equity of about 12.35%.

According to CompuStat data, the comparable group's earnings available for common (before extraordinary items) were 12.49% of average common equity over the years 1989 through 1993. However, during this same period, overall interest rates and costs of capital have fallen considerably. Moody's Aa rated public utility bonds average annual yields were 9.55%, 9.64%, 9.09%, 8.54%, and 7.44% for 1989, 1990, 1991, 1992, and 1993 respectively. Thus, over the interval that the comparable group was earning 12.5% on equity, Aa bond rates were approximately 8.85%. As of middle May of 1994, their yield was approximately 8.33%, over fifty basis points lower. In middle August of 1993, after years of a steady downward trend, Aa bond rates took a dive from about 7.25% to about 6.80%, and then reversed direction to begin what has been a steady upward trend. The earned returns have fallen dramatically from 14.2%

1   for 1992, with a 13.8% average for 1988 through 1992, to 7.9% for 1993.

2   Both bond yields and earned returns seem to have become less stable.

3

4   Another consideration is the relatively short time range of EPS

5   projections (generally no more than five years), as compared with the

6   "expected growth rate" of the DCF model, which assumes an infinite

7   horizon. If earnings growth is expected to significantly accelerate after

8   the projection period, the use of the EPS projections will understate the

9   true expected growth rate and produce a cost of equity estimate with a

10   downward bias. It has been argued that the growth of earnings from

11   cellular technology represents an instance of this type of bias. The Staff

12   recognizes the validity of this consideration, in that significant earnings

13   growth can be expected from cellular technology, but believes that some

14   of this growth is already captured in the earnings estimates of the period.

15   Also, care must be made to distinguish between absolute growth and

16   growth rates. S&P's projections of increasing numbers of cellular

17   subscribers also show a declining growth rate to this increase. S&P also

18   projects a decline in the monthly revenues per subscriber, as the industry

19   extends its penetration of the mass market.

20

21   Lastly, the Staff has also considered the question of the various classes of

22   risk facing the Applicant and companies in the comparable group.

23   Under the conditions present in the telecommunications industry, a fair

24   and reasonable return on capital employed in the public service may be

25   different than the overall cost of capital to a company. It cannot be

26   denied that the risk element has increased for providing local exchange

27   and other services whose rates are subject to regulatory authority.

1	However, telecommunications companies are investing in many
2	services, activities, and technologies for which a very high degree of
3	uncertainty exists regarding future profitability. The Staff believes that
4	the provision of those services whose rates are subject to regulatory
5	authority is a less risky undertaking than other activities, and that the
6	capital so employed is subject to less risk than the average level of risk
7	facing the company. Because of the Staff's cost of capital approach, Staff
8	recommendations have reflected, to a limited extent, some costs of
9	capital associated with non-regulated or non-utility operations. This is
10	unavoidable, and is not allowed to reflect on a significant portion of the
11	Staff rate of return recommendations. This case is no different.
12	Consideration of the uncertainty associated with this issue, allows for an
13	appropriate equity recommendation for a regulated enterprise. Future,
14	as well as, present involvement in competitive enterprise is taken into
15	account.
16	
17	Based upon the considerations discussed above, the Staff believes that a
18	fair and reasonable return on common equity is between 11.85% and
19	12.85%. To provide for this return allowance must be made for issuance
20	and other costs, as shown on Table 2, resulting in an adjustment factor of
21	1.02029. Applying this factor to the baseline cost of common equity range
22	results in a recommendation of 12.09% to 13.11%.

1   11.   Q.   Has the Staff changed the cost of common equity used in the Staff
2   Report?

4   A.   Yes, the Staff's recommended common equity cost now reflects twelve
5   month average stock prices for July 1993 through June 1994, rather than
6   January 1993 through December 1993 as used in the Staff Report. The
7   declared dividend over the last four quarters is updated to reflect the
8   second quarter of 1994. Zacks and IBES were updated to June estimates.
9   The Value Line issued April 15, 1994 is referenced (see Attachment). The
10   adjustment for equity issuance costs now reflects retained earnings and
11   total common equity balances as of December 31, 1993. The adjustment
12   factor is now 2.02029% rather than the 2.02094% in the Staff Report (see
13   Table 2). The resultant Staff-recommended cost of common equity
14   range, incorporated in Table 1, is 11.99% to 13.01%.

TABLE 2

Ameritech and Subsidiaries
Adjustment for Equity Issuance Costs
December 31, 1993
(Dollars in Thousands)

(1)	Retained Earnings	$ 3,455,300
(2)	Total Common Equity	$ 7,844,635
(3)	Ratio of (1) to (2)	0.44047
(4)	External Equity Ratio, w [1.0-(3)]	0.55953
(5)	Generic Issuance Cost, f	3.50%
(6)	Net Adjustment Factor (w/(1-f)) + (1-w)	1.02029
(7)	Low End Equity Cost [11.85% x (6)]	12.09%
(8)	High End Equity Cost [12.85% x (6)]	13.11%

1   12.   Q.   Why does the Staff recommend a cost of equity rate range?

2

3   A.   The Staff recognizes an unavoidable tradeoff between certainty and

4   usefulness. On one hand, one could estimate the Applicant's cost of

5   equity with a more-than-sufficient degree of certainty to be within a

6   range of, possibly, four-hundred basis points. A four-hundred basis

7   point range is not, however, very useful or informative for equity cost

8   determination.

9

10   13.   Q.   What are common stock issuance costs?

11

12   A.   Issuance costs include expenditures made directly by the company

13   issuing stock, for the purpose of issuing stock. Some of these

14   expenditures would be for filing with the SEC, accounting, legal

15   representation, printing, and exchange listing. Issuance costs also

16   include the underwriting spread, which is not an expenditure for the

17   issuing company. Basically, the underwriting spread is the difference

18   between the proceeds to the company and the price paid by the primary

19   purchasers of an issue. Issuance costs are the difference between the

20   amount paid by the primary purchasers and the net proceeds, which is

21   the amount available for investment by the company.

22

23   14.   Q.   Are you aware of any empirical measurement of the magnitude of

24   issuance costs?

25

26   A.   Yes, published studies have provided some measurement of the

27   magnitude of underwriter spread relative to issue size. A study by

14

1 Borun and Malley (1) finds that underwriter spreads average 2.93% of

2 "initial price" for competitive bids brought by electric utilities. Logue

3 and Jarrow (2) examined spreads for large utilities. They found

4 magnitudes of 3.011% of offering price for competitive registered issues.

5 Finnerty (3) found an average spread of 3.34% of offering price (or

6 "closing price prior to offering") for electric utility issues. Pettway (4)

7 found an average cost of 3.6580% for competitively bid issues by electric

8 utilities, not only for underwriter spread but also for direct issuance

9 expenditures. Borun and Malley (1) found electric utilities paid 0.09% to

10 3.1% of "initial price," with an average of 0.4% for direct issuance costs

11 alone. Based on these studies, a reasonable estimate of underwriter

12 spread would be 3.0% of the offering price, and a reasonable estimate of

13 underwriter spread together with direct issuance costs would be 3.5%. In

14 its generic determination of cost of common equity for public utilities

15 issued January 3, 1990, the Federal Energy Regulatory Commission

16 adopted 3.18% as the percent issuance costs are of total common equity.

17

18 15. Q. Why is an adjustment for issuance cost necessary?

19

20 A. The cost of issuance is properly spread over the life of the stock issue. As

21 long as stock has been issued, an equity adjustment is necessary. It does

22 not matter what future financing plans have been prepared. The

23 investor requires a full return as long as the investor owns the stock.

24 The company issuing new equity, initially receives funds in the amount

25 of the equity issued. The amount of equity issued less the issuance cost is

26 the amount available to the company for investment, yet the investor is,

27 as required, paid a return on the full amount of investment. A greater

1 return, therefore, must be earned on the lesser amount that can be
2 invested. This is made possible by the Staff's adjustment to the baseline
3 cost of equity.

4

5 16. Q. Should an adjustment be made to the cost of equity to reflect dilution or
6 price pressure?

7

8 A. No. The investors pay the public offering price, which reflects any
9 dilution effect. The investors require a return on the amount they have
10 invested, not the amount that their investment would have entailed
11 had they been able to buy shares at market price prior to any public
12 announcement of stock issuance.

13

14 17. Q. Why has the Staff applied its equity issuance adjustment to the common
15 equity balance less retained earnings?

16

17 A. Consider a company at the stage of its initial public offering and later.
18 The funds collected through the initial public offering are used to
19 finance company operations. The earnings from company operations
20 that are not paid in dividends are retained and are available to fund
21 further operations. Retained earnings that are reinvested in company
22 operations earn a return for the initial investor. As long company
23 operations continue to grow, reinvested funds that are not paid as
24 dividends will compound over the life of the company, enhancing the
25 value of investors' holdings. The cost of issuance associated with the
26 initial public offering is money paid by investors on which the company
27 cannot earn a return. But as the company accumulates retained

1 earnings, the proportion of investors capital that is not available for

2 company operations is reduced. In this way, it becomes easier for the

3 company to meet or exceed the returns required by initial investors.

4

5 Subsequent stock offerings are subject to the same sequence. A fraction

6 of invested funds, issuance expense, cannot earn a return. The

7 difference, total investment less issuance, is equity and is available for

8 company operations. As retained earnings accumulate, the proportion

9 of invested capital that can earn a return increases. By applying its equity

10 issuance adjustment to the common equity balance less retained

11 earnings, the Staff allows a premium to be earned to compensate for

12 invested funds the company could not commit to operations, but does

13 not apply that premium to retained earnings, which are available in

14 their entirety for reinvestment. As the proportion of investment which

15 can earn a return increases, the adjustment commensurately decreases.

16 Retained earnings increases the available pool of capital, but issuance

17 expense, which is not available to the company, increases only with new

18 stock issuance. The adjustment increases commensurately with the

19 occurrence of new stock issuance, by virtue of the retained earnings

20 proportion of equity decreasing.

21

22 The Applicant's implied argument that the proportion of funds not

23 available would remain the same, over the years, as the proportion of

24 the issuance cost to the initial funds raised publicly, would be true only

25 in the absence of an adjustment. With an adjustment, the full return is

26 earned in the first and every year. Although a portion of the initial

27 investment is absent and always remains absent, the money the absent

1   portion would have earned goes into the pool of available funds every

2   year by virtue of the adjustment. The money attained by virtue of the

3   adjustment is compounded in subsequent years. Because only the

4   nominal amount of the issuance cost is not available, its deleterious

5   effect on earnings decreases over the years in line with the decrease in

6   the adjustment.

7

8   18. Q. Are the current DCF estimates for Ameritech useful for DCF analysis?

9

10   A. Currently, these estimates may be useful. At the time of the Staff Report,

11   the average DCF estimate for Ameritech was 10.04%. At present the

12   average is 12.21%. The Staff uses comparable group DCF equity estimates

13   in its DCF analysis, and not Ameritech alone, because the results for

14   Ameritech are too volatile over time, and a group is likely to produce

15   significantly less volatile results.

16

17   19. Q. Why does the Staff not apply a quarterly DCF formulation?

18

19   A. Were the Staff to apply a quarterly DCF, it would also account for the

20   effect of monthly receipts, which the Staff believes would counteract the

21   effect of quarterly dividends on the cost of equity.

22

23   20. Q. What is the result of CAPM analysis?

24

25   A. The average 30 year Treasury bond yields over the past three, six, nine,

26   and twelve months are 7.36%, 6.96%, 6.69%, and 6.60%. These average to

27   6.90%. Adding to that the product of the .75 beta for Ameritech and the

1   7.2% premium of total equity returns over 20 year Treasury yields,

2   results in an cost of equity estimate of 12.30%. The average difference

3   over the last year between 30 year and 20 year Treasury yields is .513%.

4   Subtracting half that difference from the 12.30% equity estimate, to

5   account for use of the 20 year premium with the 30 year yield, by

6   interpolation, results in a corrected estimate of 12.04%. Adding .25% for

7   issuance cost brings the estimate to 12.29%, which is within the Staff's

8   recommended range.

9

10   21.   Q.   Why are long term yields correctly used for CAPM analysis?

11

12   A.   Equity investments are, by nature, long term investments, regardless of

13   the investor's horizon. Short term investors accept the possibility of

14   price losses, when the market devalues a stock, in anticipation of

15   conditions or events thought to occur after the short term horizon.

16   Equity investors accept risks associated with changes in inflation and

17   interest rates that may occur in the long term. Short term yields would

18   improperly omit much of the effect of these risks on the CAPM equity

19   estimate.

20

21   22.   Q.   Is the cost of equity altered by alternative regulation provisions?

22

23   A.   Possibly. The regulatory climate throughout the country, over the last

24   few years, has changed. Alternative regulation for telephone companies

25   has been implemented across the country. As such, market prices would

26   reflect alternative regulation. No explicit cost of equity adjustment

27   should be made, therefore, to compensate for an alternative regulation

1   effect, regardless of what the proper magnitude and direction of such an

2   effect would be.

3

4   23. Q. Would you respond to AARP objection number 6.?

5

6   A. Yes. The Staff are using a parent-consolidated capital structure, which

7   incorporates the capital structures of all Ameritech subsidiaries. These

8   subsidiary capital structures would be incorporated whether they are

9   high-equity or low-equity. The argument made in the objection that the

10   capital structure is, "inappropriate to the extent that it supports lower

11   cost capital structures (greater debt) in the Ameritech non-LEC

12   subsidiaries," would apply to a stand alone capital structure. It is not,

13   however, an argument that is pertinent to this case, as Staff uses a

14   parent-consolidated capital structure.

15

16 24. Q. Does this conclude your testimony?

17

18   A. Yes, it does.

REFERENCES

(1) Borun, Victor M., and Malley, Susan L., "Total Flotation Costs for Electric Company Equity Issues," Public Utilities Fortnightly, February 20, 1986, pp. 33-39.

(2) Logue, Dennis E., and Jarrow, Robert A., "Negotiations vs. Competitive Bidding in the Sale of Securities by Public Utilities," Financial Management, Autumn 1978, pp. 31-39.

(3) Finnerty, John D., "How to Lower the Cost of Floating A New Stock Issue," Public Utilities Fortnightly, March 17, 1983, pp. 25-29.

(4) Pettway, Richard H., "A Notice on the Flotation Costs of New Equity Capital Issues of Electric Companies, Public Utilities Fortnightly, March 18, 1982, pp. 68-69.

AMERITECH AND SUBSIDIARIES
Comparable DCF Equity Cost Analysis

Stock Prices ($, Monthly High over Monthly Low) From Dow Jones Retrieval:

Month	AIT	BEL	BLS	NYN	PAC	SBC	USW	AT	CSN	GTE	RTC	SNG	AVE
7/93	40.68750	60.12500	58.50000	46.00000	49.75000	40.75000	47.75000	28.37500	23.50000	37.12500	22.00000	35.87500	
	38.81250	56.62500	54.37500	44.81250	48.00000	38.62500	45.62500	25.50000	19.75000	35.25000	20.50000	34.00000	
8/93	43.56250	64.12500	59.25000	46.37500	55.37500	45.62500	47.37500	29.87500	21.62500	36.87500	22.06250	37.00000	
	40.06250	55.62500	54.12500	43.50000	47.87500	39.62500	44.50000	26.00000	19.12500	34.62500	20.62500	34.50000	
9/93	45.56250	64.87500	62.87500	48.87500	56.50000	47.00000	49.37500	31.25000	21.37500	39.00000	24.37500	37.12500	
	42.00000	60.87500	58.75000	45.62500	52.62500	41.75000	46.00000	28.75000	19.75000	36.25000	22.00000	34.87500	
10/93	43.00000	66.00000	61.00000	46.50000	55.62500	43.75000	50.25000	30.87500	23.62500	39.87500	25.12500	38.12500	
	41.56250	58.87500	56.62500	42.87500	52.12500	39.62500	47.50000	27.50000	21.00000	37.12500	22.50000	35.00000	
11/93	42.68750	64.50000	63.50000	43.75000	59.25000	44.25000	50.75000	29.25000	24.00000	39.62500	24.56250	37.12500	
	38.00000	57.00000	54.12500	40.37500	53.00000	39.87500	45.75000	25.75000	20.12500	35.87500	21.68750	33.87500	
12/93	40.37500	62.00000	59.75000	43.00000	58.62500	45.25000	47.25000	28.62500	21.37500	37.87500	24.06250	37.50000	
	37.75000	59.62500	56.75000	40.12500	54.00000	40.37500	45.87500	25.62500	17.87500	35.00000	22.43750	34.75000	
1/94	42.00000	59.62500	61.50000	41.37500	58.00000	42.00000	46.25000	29.50000	18.87500	35.25000	22.43750	36.25000	
	36.37500	53.25000	53.62500	38.37500	52.50000	38.00000	42.12500	26.62500	17.12500	33.25000	20.25000	33.75000	
2/94	42.00000	56.37500	60.87500	41.00000	57.62500	41.75000	43.75000	28.75000	18.50000	34.75000	22.00000	34.62500	
	39.87500	52.25000	53.00000	36.62500	54.00000	36.75000	39.00000	26.12500	15.50000	31.50000	21.00000	30.75000	
3/94	42.25000	54.87500	58.37500	37.62500	55.75000	41.75000	41.25000	27.62500	17.00000	33.25000	21.61250	32.25000	
	36.75000	51.00000	53.62500	34.25000	51.00000	38.50000	38.50000	25.00000	15.50000	30.00000	20.50000	28.62500	
4/94	43.12500	55.25000	63.50000	37.25000	54.00000	44.37500	43.75000	27.00000	17.50000	33.62500	23.00000	32.62500	
	36.25000	49.00000	55.50000	33.25000	30.62500	38.62500	39.12500	24.00000	15.37500	29.50000	20.81250	28.25000	
5/94	40.50000	54.37500	61.12500	39.25000	32.00000	41.62500	41.25000	27.50000	16.87500	32.75000	25.25000	32.37500	
	37.00000	50.12500	57.25000	35.87500	30.00000	38.50000	38.25000	25.37500	16.00000	30.50000	20.87500	29.12500	
6/94	41.87500	56.75000	62.25000	39.75000	31.50000	43.75000	43.37500	27.00000	17.50000	32.25000	24.62500	33.75000	
	37.87500	52.87500	59.25000	35.37500	29.87500	40.62500	39.75000	25.00000	15.87500	29.62500	22.12500	30.50000	
Average $	40.41406	57.30729	58.31250	40.90885	49.15104	41.36458	44.34896	27.36979	18.94792	34.61458	22.35938	33.85938	

Latest Four Quarterly Dividends, ($) From Value Line and Compustat:

	AIT	BEL	BLS	NYN	PAC	SBC	USW	AT	CSN	GTE	RTC	SNG	AVE
	0.46000	0.67000	0.69000	0.59000	0.54500	0.37750	0.53500	0.20000	0.20000	0.47000	0.19250	0.44000	
	0.48000	0.67000	0.69000	0.59000	0.54500	0.37750	0.53500	0.22000	0.20000	0.47000	0.20250	0.44000	
	0.48000	0.67000	0.69000	0.59000	0.54500	0.37750	0.53500	0.22000	0.20000	0.47000	0.20250	0.44000	
	0.48000	0.69000	0.69000	0.59000	0.54500	0.39500	0.53500	0.22000	0.20000	0.47000	0.20250	0.44000	

Annual Dividend, ($):

	AIT	BEL	BLS	NYN	PAC	SBC	USW	AT	CSN	GTE	RTC	SNG	AVE
	1.90000	2.70000	2.76000	2.36000	2.18000	1.52750	2.14000	0.86000	0.80000	1.88000	0.80000	1.76000	
Yield:	0.04701	0.04711	0.04733	0.05769	0.04435	0.03693	0.04825	0.03142	0.04222	0.05431	0.03578	0.05198	

BXR from Compustat:

	AIT	BEL	BLS	NYN	PAC	SBC	USW	AT	CSN	GTE	RTC	SNG	AVE
BXR 89	0.05842	0.02455	0.04102	(0.00378)	0.06786	0.04735	0.05396	0.08865	0.09290	0.05526	0.04014	0.08669	
BXR 90	0.05353	0.04780	0.02790	0.01112	0.03977	0.04350	0.05122	0.09361	0.06895	0.05890	0.01645	0.03354	
BXR 91	0.03332	0.04413	0.02966	(0.02413)	0.03344	0.04555	(0.02148)	0.07211	(0.02479)	0.00841	0.04998	0.02864	
BXR 92	0.05346	0.04183	0.04281	0.04836	0.04243	0.05740	0.04295	0.07915	(0.03349)	0.01604	0.03049	0.05440	
BXR 93	0.06921	0.04053	(0.02003)	(0.13413)	(0.07046)	0.07470	(0.04758)	0.07598	(0.20717)	(0.07940)	0.04323	(0.13309)	
BXR 5AV	0.05359	0.03977	0.02427	(0.02051)	0.02261	0.05370	0.01581	0.08190	(0.02072)	0.01184	0.03605	0.01404	
COE5BR	0.10312	0.08876	0.07275	0.03599	0.06796	0.09261	0.06483	0.11589	0.02063	0.06680	0.07312	0.06675	0.07243

Exhibit SRC-1
(Continued)

	AIT	BEL	BLS	NYN	PAC	SBC	USW	AT	CSN	GTE	RTC	SNG	AVE
VL DIV '94 ($)	1.94	2.76	2.76	2.36	2.18	1.56	2.14	0.88	0.80	1.90	0.83	1.76	
VL DIV '98 ($)	2.90	3.08	3.50	2.75	2.40	1.90	2.35	1.25	0.96	2.40	1.15	1.85	
VLDG	0.10051 / 0.15224	0.02742 / 0.07583	0.05938 / 0.10952	0.03823 / 0.09813	0.02404 / 0.06946	0.04929 / 0.08804	0.02340 / 0.07279	0.08774 / 0.12192	0.04558 / 0.08973	0.05840 / 0.11589	0.08152 / 0.12022	0.01247 / 0.06510	0.09824
VL EARN '94 ($)	2.55	3.65	4.25	3.20	2.60	2.65	2.90	1.65	0.85	2.35	1.40	2.55	
VL EARN '98 ($)	4.15	4.90	5.80	4.50	3.65	3.70	4.30	2.60	2.00	3.35	2.20	3.15	
VLEG	0.12175 / 0.17449	0.07363 / 0.12421	0.07773 / 0.12875	0.08523 / 0.14784	0.08480 / 0.13292	0.08344 / 0.12345	0.09848 / 0.15148	0.11368 / 0.14868	0.21392 / 0.26517	0.08864 / 0.14776	0.11300 / 0.15282	0.05283 / 0.10755	0.15043
IBES	0.061 / 0.11088	0.072 / 0.12251	0.066 / 0.11646	0.050 / 0.11057	0.048 / 0.09448	0.083 / 0.12299	0.066 / 0.11744	0.099 / 0.13353	0.073 / 0.11830	0.082 / 0.14077	0.108 / 0.14764	0.054 / 0.10879	0.12036
ZACKS	0.059 / 0.10879	0.069 / 0.11937	0.069 / 0.11960	0.051 / 0.11163	0.044 / 0.09030	0.080 / 0.11988	0.064 / 0.11534	0.112 / 0.14694	0.139 / 0.18709	0.078 / 0.13655	0.119 / 0.15904	0.053 / 0.10773	0.12686
VL "B" '98	0.30120	0.37143	0.39655	0.38889	0.34247	0.48649	0.45349	0.51923	0.52000	0.28358	0.47727	0.41270	
VL "R" '98	0.19500	0.19000	0.16000	0.19500	0.14500	0.18500	0.20500	0.20500	0.19000	0.21000	0.16000	0.15500	
VLBXR '98	0.05873 / 0.10851	0.07057 / 0.12101	0.06345 / 0.11378	0.07583 / 0.13790	0.04966 / 0.09621	0.09000 / 0.13025	0.09297 / 0.14570	0.10644 / 0.14121	0.09880 / 0.14519	0.05955 / 0.11710	0.07636 / 0.11488	0.06397 / 0.11927	0.12425
DIV '83 ($)	1.38	2.04	2.36	2.02	1.76	1.24		0.38	0.35	0.99	0.55	1.28	
DIV '88 ($)	1.86	2.68	2.76	2.36	2.18	1.51	1.76	0.52	0.56	1.30	0.68	1.52	
DIV '93 ($)							2.14	0.82	0.80	1.85	0.80	1.76	
EARN '83 ($)	2.21	3.33	3.51	3.32	2.81	1.77		0.59	0.66	1.58	0.85	1.98	
EARN '88 ($)	2.67	3.39	3.58	3.12	2.80	2.39	2.85	1.04	1.31	1.77	1.06	2.50	
EARN '93 ($)							2.72	1.39	0.86	2.20	1.20	2.53	
G5D / G10D	0.05970	0.05457	0.03131	0.03111	0.04280	0.03940	0.03910	0.09110 / 0.07691	0.07133 / 0.08267	0.07056 / 0.06252	0.03250 / 0.03747	0.02932 / 0.03185	
G5E / G10E	0.03782	0.00357	0.00395	(0.01243)	(0.00071)	0.06006	(0.00934)	0.05802 / 0.08569	(0.08417) / 0.02647	0.04350 / 0.03310	0.02481 / 0.03448	0.00239 / 0.02451	
5D / 10D	0.10952 / 0.04701	0.10426 / 0.04711	0.08013 / 0.04733	0.09060 / 0.05769	0.08905 / 0.04435	0.07778 / 0.03693	0.08924 / 0.04825	0.12538 / 0.11075	0.11657 / 0.12838	0.12871 / 0.12023	0.06945 / 0.07459	0.08282 / 0.08548	0.09696
5E / 10E	0.08661 / 0.04701	0.05085 / 0.04711	0.05147 / 0.04733	0.04455 / 0.05769	0.04361 / 0.04435	0.09921 / 0.03693	0.03847 / 0.04825	0.09126 / 0.11981	(0.04550) / 0.06981	0.10017 / 0.08921	0.06148 / 0.07150	0.05449 / 0.07777	0.05639
VL BOX EARN / VL BXE R	0.080 / 0.13077	0.065 / 0.11518	0.095 / 0.14683	0.060 / 0.12115	0.040 / 0.08613	0.095 / 0.13544	0.075 / 0.12687	0.125 / 0.16035	0.115 / 0.16208	0.080 / 0.13666	0.130 / 0.17043	0.040 / 0.09406	0.13233
VL BOX DIV / VL BXD R	0.085 / 0.13601	0.020 / 0.06806	0.040 / 0.08922	0.030 / 0.08942	0.015 / 0.06002	0.045 / 0.08359	0.015 / 0.06398	0.085 / 0.11909	0.025 / 0.06828	0.050 / 0.10703	0.070 / 0.10828	0.010 / 0.06250	0.08796

AMERITECH NYSE-AIT

| RECENT PRICE | 37 | P/E RATIO | 15.3 | (Trailing 13.9 Median 10.0) | RELATIVE P/E RATIO | 0.98 | DIV'D YLD | 5.2% | VALUE LINE | 749 |

																Target Price Range 1997 1998 1999
TIMELINESS 4 Below Average (Relative Price Perform) (since Nov 12 Nos.)	High: Low:	11.1 10.4	13.0 10.4	17.8 12.4	25.4 16.3	25.0 18.5	24.5 20.6	34.1 23.4	34.9 28.3	34.9 27.9	37.0 29.1	45.6 36.1	42.3 36.3		

SAFETY 1 Highest
(Scale: 1 Highest to 5 Lowest)

BETA .75 (1.00 = Market)

1997-99 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	75	(+105%)	23%
Low	60	(+60%)	17%

Insider Decisions

Institutional Decisions
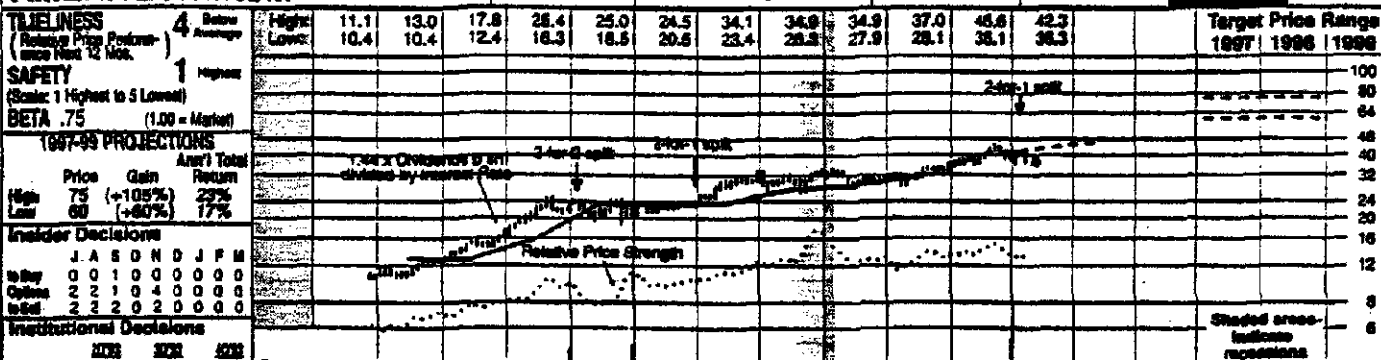
American Information Technologies Corp. (Ameritech), is one of the seven regional holding companies resulting from the breakup of the American Telephone & Telegraph Co. on January 1, 1984. One share of Ameritech stock was exchanged for 10 shares of AT&T (pre-divestiture) common stock. The stock began trading on a when-issued basis on November 21, 1983. "Regular" trading of Ameritech shares began on February 16, 1984.

CAPITAL STRUCTURE as of 12/31/93

Total Debt $6692.0 mill. Due in 5 Yrs $2903.4 mill.
LT Debt $4090.4 mill. LT Interest $283.8 mill.
Incl. $109.6 mill. capitalized leases.
(LT interest earned: 8.8x; total interest coverage: 5.8x)

Leases, Uncapitalized: Annual rentals $90.1 mill.

Pension Liability None

Pfd Stock None

Common Stock 546,843,000 shs.
(adjusted for 2-for-1 stock split, paid 1/24/94.)

CURRENT POSITION 1991 1992 12/31/93

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	© VALUE LINE PUB, INC. 97-99
Revenues per sh	14.18	15.44	16.40	17.36	13.30	13.90	20.17	20.29	20.84	21.42	22.25	23.25	27.15
"Cash Flow" per sh	3.97	4.59	4.91	5.43	5.50	5.82	5.82	5.90	6.25	6.61	6.80	7.70	9.95
Earnings per sh	1.70	1.84	1.97	2.12	2.21	2.30	2.37	2.32	2.51	2.67	2.55	3.30	4.15
Div'ds Decl'd per sh	1.00	1.10	1.20	1.28	1.38	1.49	1.61	1.72	1.78	1.86	1.94	2.25	2.90
Cap'l Spending per sh	2.97	3.41	3.64	3.56	3.47	3.85	4.00	4.04	4.14	3.83	3.45	3.45	3.30
Book Value per sh	12.04	12.75	13.33	13.86	14.57	14.22	14.63	15.18	12.94	14.36	15.29	14.70	21.46
Common Shs Outst'g	588.53	584.11	570.88	549.22	538.40	540.36	528.86	533.27	540.34	546.84	552.65	558.40	574.15
Avg Ann'l P/E Ratio	6.9	8.1	10.7	10.5	10.3	12.5	13.0	13.4	12.9	14.7			16.0
Relative P/E Ratio	.64	.66	.73	.70	.86	.95	.97	.86	.78	.87			1.25
Avg Ann'l Div'd Yield	8.6%	7.4%	5.7%	5.8%	6.0%	5.2%	5.2%	5.5%	5.5%	4.7%			4.4%
Revenues ($mill)	8348.3	9021.1	9362.1	9538.0	8803.3	10211	10663	10818	11153	11710			15590
Net Profit ($mill)	990.6	1077.7	1138.4	1166.1	1203.4	1236.2	1253.8	1232.9	1348.0	1451.1			2375
Income Tax Rate	44.2%	43.2%	44.9%	37.8%	33.8%	30.8%	30.7%	30.3%	31.8%	32.1%			32.0%
Net Profit Margin	11.9%	11.9%	12.2%	12.5%	12.2%	12.1%	11.8%	11.4%	12.1%	12.4%			15.2%
Long-Term Debt Ratio	40.4%	37.8%	37.1%	36.9%	38.4%	39.7%	39.6%	38.0%	39.6%	34.3%			20.0%
Common Equity Ratio	59.6%	62.2%	62.9%	63.1%	61.6%	60.3%	60.4%	62.0%	60.4%	65.7%			80.0%
Total Capital ($mill)	11887	11987	12106	12052	12331	12766	12807	13051	11578	11935			15375
Net Plant ($mill)	15024	15382	15769	15933	16169	16395	16652	16958	17335	17365			17700
% Earned Total Cap'l	10.1%	10.7%	10.9%	11.4%	11.3%	11.1%	11.2%	11.1%	13.1%	13.5%			16.5%
% Earned Net Worth	14.0%	14.5%	15.0%	15.6%	15.3%	16.1%	16.2%	15.2%	19.3%	18.5%			19.5%
% Earned Comm Equity	14.0%	14.5%	15.0%	15.6%	15.3%	16.1%	16.2%	15.2%	19.3%	18.5%			19.5%
% Retained to Comm Eq	5.7%	5.8%	5.9%	6.3%	5.9%	5.9%	5.3%	4.1%	5.8%	5.8%			6.0%
% All Div'ds to Net Prof	59%	60%	61%	60%	61%	63%	67%	73%	70%	69%			70%

BUSINESS: Ameritech is a holding co. for IL, IND, MICH, OH, and WIS Bells & other subs. Provides communications services directly to 75% of population in these states. In 10/83 Ameritech became 1st regional holding co. to offer cellular phone service (21 million POPs). Access lines: 17.5 million; 65% of lines digital. '93 rev. breakdown: local service, 43%; long-distance, 12%; network ac-cess, 29%; other, 22%. Purchased 49.9% stake in Telecom Corp. of New Zealand on 9/90 (now 25% after additional equity offerings). Customer lines/Bell employee: 285. '93 dep. rate: 7.4%. Has 67,192 employees, 1.04 million shareholders. Chairman: William L. Weiss, Inc.: Delaware. Address: 30 South Wacker Drive, Chicago, Illinois 60606. Telephone: 312-750-5000.

Ameritech's first-quarter earnings comparison will not be a good one. The company is in the midst of a labor buyout plan, whereby it is offering incentives to various workers in return for their early retirements. The cost of these incentives will be charged against first-quarter earnings to the tune of about 60¢ per share, creating a poor comparison for that period and causing share net for the year to likely fall below 1993's tally.

Going forward though, we expect positive earnings comparisons for Ameritech. The company refinanced some $1.6 billion in long-term debt last year. The interest expense savings as well as the absence of refinancing costs should add about a dime to '94's bottom line. Also, equity income comparisons from the company's Telecom of New Zealand subsidiary will benefit considerably from the absence of restructuring expenses incurred last year.

Starting in 1995, we think earnings growth ought to outdistance historical trends. Ameritech is actively seeking to lift the restrictions that prohibit it from offering long-distance service, a business whose secular growth rate exceeds that of Ameritech's core local exchange business. Ameritech could easily provide long distance within the framework of its existing network facilities and its advertising would likely be attached to monthly bills, a more cost-effective medium than the TV spots currently being utilized by the dominant long-distance carriers. Meanwhile, the company plans to gradually replace most of the copper in its network with more efficient broadband fiber-optics. This will generate substantial savings in maintenance and switching expenses and also allow the company to provide comprehensive interactive multimedia services to its customers. Still, for now . . .

Ameritech stock isn't timely. However, long-term investors may want to take a closer look. The strategic steps that Ameritech is presently taking are likely to have a detrimental impact on near-term results but should enhance the long-term value of the stock. Thus, total returns for the pull to 1997-99 look worthwhile, especially if this equity's superior quality is also taken into consideration.

Philip S. Mulqueen April 15, 1994

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **Prepared Testimony of Stephen R. Chaney,** submitted on behalf of the Public Utilities Commission of Ohio, was served by regular U.S. mail, postage prepaid, or hand delivered to the parties of record on this 3rd day of August, 1994.

THOMAS W. MCNAMEE
Assistant Attorney General

PARTIES OF RECORD:

Michael Mulcahy
Ameritech Ohio
45 Erieview Plaza, Room 1400
Cleveland, OH 44114

Barry Cohen
Associate Consumers' Counsel
Office of the Consumers' Counsel
77 South High Street, 15th Floor
Columbus, OH 43266-0550

Judith B. Sanders
Bell, Royer & Sanders Co., LPA
33 South Grant Avenue
Columbus, OH 43215-3927

Robin P. Charleston
AT&T Communications of Ohio, Inc.
227 West Monroe Street, 6th Floor
Chicago, IL 60606

Douglas W. Trabaris
MCI
205 N. Michigan Avenue, Suite 3200
Chicago, IL 60601

Mary Hull
Sprint Communications Co., L.P.
8140 Ward Parkway, 5E
Kansas City, MO 64114

William M. Ondrey Gruber
City of Cleveland
601 Lakeside Avenue, Room 106
Cleveland, OH 44114

Gregory Dunn
Crabbe, Brown, Jones, Potts & Schmidt
500 S. Front Street, Suite 1200
Columbus, OH 43215

Maureen Grady
Hahn Loeser & Parks
431 E. Broad Street, Suite 200
Columbus, OH 43215

Janine Migden
Hahn Loeser & Parks
431 E. Broad Street, Suite 1200
Columbus, OH 43215

William S. Newcomb, Jr.
Vorys, Sater, Seymour & Pease
52 East Gay Street
P. O. Box 1008
Columbus, OH 43216-1008

Bruce J. Weston
AARP
169 West Hubbard Avenue
Columbus, OH 43215-1439

Joseph Meissner
Legal Aid Society of Cleveland
1223 West Sixth Street
Cleveland, OH 44113

Karin Rilley
Education Section
Office of the Attorney General
30 East Broad Street, 15th Floor
Columbus, OH 43266-0410

Ellis Jacobs
Dayton Legal Aide
333 West 1st Street, Suite 500
Dayton, OH 45402

Samuel C. Randazzo
Emens, Kegler, Brown, Hill & Ritter
65 East State Street, Suite 1800
Columbus, OH 43215

Sally W. Bloomfield
Bricker & Eckler
100 South Third Street
Columbus, OH 43215

Dennis K. Muncy
Meyer, Copel, Hirschfield, Muncy,
    Jahn & Aldeen
Athenaeum Building
306 W. Church Street, P.O. Box 6750
Champaign, IL 61826-6750

Cecil O. Simpson, Jr.
Office of The Judge Advocate General
Department of the Army
901 North Stuart Street
Arlington, VA 22203-1837

Daniel Malkoff
Dept. of Administrative Services
30 East Broad Street
Columbus, OH 43215

Sheldon Taft
Vorys, Sater, Seymour and Pease
52 East Gay Street
P. O. Box 1008
Columbus, OH 43216-1008

Clyde Kurlander
Teleport
Three First National Plaza
Chicago, IL 60602

Kerry Bruce
City of Toledo
Dept. of Public Utilities
One Government Center, Suite 1520
Toledo, OH 43604

William A. Adams
Arter & Hadden
10 West Broad Street
Columbus, OH 43215