

- 1 **Q. The Constant Growth DCF method results, shown in Figure 1, page 3, are the**  
2 **highest of the methods used for all three proxy groups used by Mr. Coyne. What**  
3 **conclusion, if any, can be drawn from the fact that the Constant Growth DCF**  
4 **method produces the highest return including whether the results demonstrate that**  
5 **the use of analysts' assumptions with no adjustment for bias does always produce**  
6 **higher results than other methods?**  
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- 8 A. The average results shown in Figure 1 of Mr. Coyne's report are tightly clustered for the  
9 three proxy groups across all three models within a range from 9.33 percent to 9.85  
10 percent. The results of the Constant Growth DCF model are very similar to the results of  
11 the CAPM, especially for the U.S. Electric and North American Electric proxy groups,  
12 which are more risk comparable to Newfoundland Power than the Canadian proxy group.  
13 For example, the Constant Growth DCF results for the U.S. Electric proxy group are only  
14 13 basis points higher than the CAPM results, and for the North American proxy group,  
15 the Constant Growth DCF results are 35 basis points higher than the CAPM results. In  
16 Mr. Coyne's view, the ROE estimates produced by the Constant Growth DCF model are  
17 consistent with those produced by the CAPM for both the U.S. Electric and North  
18 American Electric proxy groups. If Mr. Coyne were to exclude the Constant Growth  
19 DCF results entirely, the average of the CAPM and Multi-Stage DCF results for the three  
20 proxy groups would be 9.40 percent, or only 10 basis points lower than Mr. Coyne's  
21 recommendation for Newfoundland Power. Further, if Mr. Coyne had only used a  
22 forward-looking market risk premium for Canada and the U.S. in his CAPM analysis, the  
23 CAPM results would be higher than the Constant Growth DCF results. In summary, Mr.  
24 Coyne does not agree that the fact that the Constant Growth DCF method produces the  
25 highest results demonstrates that the use of analysts' growth rates, with no adjustment for  
26 bias, is cause for the Board to discount or discard the results of the Constant Growth DCF  
27 model. Rather, as stated in the response to Request for Information PUB-NP-055, the use  
28 of the Constant Growth DCF is most appropriate for companies in mature, stable  
29 industries such as regulated utilities, and was developed by Professor Gordon to estimate  
30 the cost of equity for these types of companies.