Q. Reference Evidence of Laurence Booth dated September 25, 2018

Pages 51-52 and pages 63-64: Explain in what manner Dr. Booth believes that the DCF method and DCF estimates should be considered by the Board in establishing the fair return for Newfoundland Power, for example should it be given equal weight with an adjusted CAPM result or simply used as a factor or a check when considering the fair ROE?

A. Most boards are reluctant to move away from the risk premium approach, which Dr. Booth regards as justified given the fact it has by far the greatest academic support as well as being the most highly ranked model by finance professionals. In contrast, the DCF model is distinctly lower ranked by both groups. As a result, in neither theory nor practise do finance academics or professionals accord equal weight to risk premium and DCF estimates of the fair return. Consequently, Dr. Booth would not advise this Board to do so. Moreover, *any* estimate can be caste in the risk premium framework, even if the data comes from a DCF estimate. For example, in prior testimony before this Board Ms. McShane of Foster Associates on behalf of NP would routinely produce DCF based risk premium estimates. Dr. Booth regards using the insights gained from DCF estimates in a risk premium framework as the best approach.

Currently it is Dr. Booth's assessment that simply adding an historic utility risk premium to a forecast LTC yield does not estimate a fair ROE. This is because real yields, the actual yield minus the forecast inflation rate, are abnormally low. In this low real yield environment, the DCF model provides support for the inputs into the risk premium model, particularly in areas where the DCF model does have validity, which is in the overall market return estimate. The DCF model relies heavily on forecast growth estimates: for the overall market these are bounded by long run GDP growth rates, but for individual stocks these growth estimates are often fanciful and fail simple diagnostics tests.

For example, Mr. Coyne relies on a DCF estimate for the overall market based on individual estimates for the companies in the index in Exhibits JMC 5 & 6. Overall, he accepts a growth rate of 8.21% for Canada and 10.80% for the US both for use in the *constant growth* DCF model. In neither case are these growth rates possible: it is simply impossible for dividends to grow at 8.21% for Canada or 10.80% for the US *forever* when US and Canadian GDP is forecast to grow at barely 5.0%. Applying these short-run *earnings growth* rates to a constant *dividend growth* rate *forever* model is simply wrong. Further looking at the actual estimates makes this conclusion obvious. Apart from the fact that many of the firms in JMC-5 do not have any growth estimates, those that do have rates inconsistent with the assumption of the constant growth DCF model: Kinder Morgan Canada, for example, cannot possibly grow at 61.98% forever. This is almost certainly the short-term earnings growth resulting from the Government of Canada buying the TransMountain pipeline at a premium to book value.