Volume 2: Cost of Capital: Expert Opinion of James Coyne- Capital Structure and Risk Profile

Q. In terms of C&T's forward looking DCF estimates for the market derived at JMC-6:

a) Please confirm that the model used is the constant stage DCF growth model, that is, column 5 has the average dividend yield increased by half the growth rate in column 6, while column 7 has the average forecast growth rate. The resulting constant stage DCF growth model estimate for the Canadian market in column 8 is 8.36%.

b) If the Board accepts this market risk premium estimate, should it also accept the underling fair return on the Canadian capital market of 8.36% and then allow Newfoundland Power a fair return below that as a lower risk regulated utility?

c) For the DCF estimates C&T rely on Zacks, SNL, Value Line and First Call growth estimates, now in Column 10 the growth estimate is referred to as BEst long-term growth estimate. Please explain what BEst means. Is it another estimate or some average of other estimates?

d) Please confirm that for most of the firms in the TSX there is no long-term growth estimate or current dividend yield. Is it C&T's judgment that the constant growth model is valid for firms that do not pay a dividend or where there is no growth estimate?

e) If C&T were asked to estimate the fair return for Ballard Power, would they use an estimated growth rate of 47%, or Centerra Gold with a growth estimate of 60% or Cameco with 57%, Pan American Silver 116%, Eldorado Gold 56% or Bombardier 70.4%? Is it not obvious that these firms do not satisfy the assumptions of the constant growth model as their short-term growth rates are simply not sustainable for the long term?

A. a) Confirmed that Concentric used the constant growth DCF model to estimate the total market return in Exhibit JMC-6. This is consistent with the approach taken by the Federal Energy Regulatory Commission to estimate the forward-looking market risk premium for the CAPM. The correct cell references are Columns 1-4, not 5-8, as stated in the question.

b) As discussed on pages 3-4 of Concentric's *Cost of Capital* report, Volume 2, Concentric's recommended ROE for Newfoundland Power of 9.85% is based on the average results of three models: 1) the multi-stage DCF model; 2) the CAPM using a historical market risk premium for Canada and the U.S., and 3) the risk premium model. Concentric is not asking the Board to accept the forward-looking market risk premium shown in Exhibits JMC-6 and 7 in this proceeding.

c) The long-term growth rates shown in Column 10 of Exhibit JMC-6 are based on consensus estimates provided by Bloomberg Professional. Bloomberg uses the acronym "BEst" estimates to denote that they are "Bloomberg estimates".

d) Confirmed. In calculating the total return for the S&P/TSX Index in Exhibit JMC-6, Concentric excluded companies that did not pay dividends or that did not have a long-term growth rate estimate.

e) In addition to the high growth rates referenced in the question, Exhibit JMC-6 also includes several companies with negative projected long-term growth rates, such as West Fraser Timber at -13.30%, The Bank of Nova Scotia at -2.79%, Suncor Energy at -9.57%, and Lundin Mining at -7.57% to name just a few. However, since Concentric did not rely on the forward-looking market risk premium in establishing our ROE recommendation for Newfoundland Power, the debate over growth rates is not relevant to our final analysis or recommendation.