

1 **Q. Coyne Evidence: Mr. Coyne states (page 21) that investors typically rely on**
2 **projected earnings growth rather than dividend growth. Please provide evidentiary**
3 **support for this statement, given that they only receive the dividend not the**
4 **earnings.**

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6 A. Mr. Coyne discusses the reasons for using earnings growth rather than dividend growth
7 on pages 21-22 of Concentric’s report. In further support of his reliance on earnings
8 growth rates in the DCF model, Mr. Coyne observes that estimates of earnings growth
9 are more indicative of long-term investor expectations than are dividend or book value
10 growth estimates because earnings growth is least influenced by capital allocation
11 decisions that companies may make in response to near-term changes in the business
12 environment. Furthermore, earnings are the fundamental driver of a company’s ability
13 to pay dividends. As noted by Brigham and Houston:

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15 “Growth in dividends occurs primarily as a result of growth in earnings
16 per share (EPS). Earnings growth, in turn, results from a number of
17 factors, including (1) inflation, (2) the amount of earnings the company
18 retains and invests, and (3) the rate of return the company earns on its
19 equity (ROE).”¹

20
21 Investment analysts report predominant reliance on EPS growth projections. In a survey
22 completed by 297 members of the Association for Investment Management and
23 Research, the majority of respondents ranked earnings as the most important variable in
24 valuing a security (more important than cash flow, dividends, or book value).²

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26 Academic research also supports the use of EPS growth estimates. For example, a 2002
27 study in the *Journal of Accounting Research*, examined “the valuation performance of a
28 comprehensive list of value drivers” and found that “forward earnings explain stock
29 prices remarkably well” and were generally superior to other value drivers analyzed.³ A
30 2012 study from the journal *Contemporary Accounting Research*, found that the sell-side
31 analysts with the most accurate stock price targets were those whom the researchers
32 found to have more accurate earnings forecasts and to use DCF valuation.⁴

¹ Eugene F. Brigham and Joel F. Houston, *Fundamentals of Financial Management*, at 317 (Concise Fourth Edition, Thomson South-Western).

² Block, Stanley B., “A Study of Financial Analysts: Practice and Theory”, *Financial Analysts Journal* (July/August 1999).

³ Liu, Jing, et al., “Equity Valuation Using Multiples,” *Journal of Accounting Research*, Vol. 40 No. 1, March 2002.

⁴ Gleason, C.A., et al., “Valuation Model Use and the Price Target Performance of Sell-Side Equity Analysts,” *Contemporary Accounting Research*.