Q. Further to PUB-NP-056, the response does not list or explain changes since 2013 and Board Order No. P.U. 13(2013). Is it correct that no changes have occurred to address the concern expressed by the Board in 2013 in relation to the potential for analysts' bias when using the constant growth discounted cash flow model?

A. In Mr. Coyne's view, the response to Request for Information PUB-NP-056 provides support for his view that analyst bias has been reduced or eliminated since the passage of various financial regulations in the U.S. and Canada that were designed to remove any inherent financial incentives or conflicts of interest that may have caused analysts to provide overly optimistic earnings growth rate forecasts. On that basis, Mr. Coyne does not share the Board's concern in relation to the potential for analysts' bias when using the Constant Growth DCF model. In addition, Mr. Coyne has also used other financial models, such as the Capital Asset Pricing Model and the Multi-Stage DCF model, to estimate the cost of equity. Mr. Coyne's ROE recommendation for Newfoundland Power is supported by the results of his various methods, although he has given less weight to the results of the Constant Growth DCF model for the Canadian proxy group.

Mr. Coyne also notes that according to Zacks Investment Research, a reputable source of consensus growth rate forecasts, brokerage analysts are "expected to be objective experts for the industries that they cover."[1] With regard to guidance provided by companies to brokerage analysts, Zacks writes:

> "*It is not in the best interest of corporate executives to share the most optimistic projections with brokerage analysts, however. A large percentage of executive compensation comes from company stock and stock option plans. Executives realize that if their company reports earnings that are below analysts' forecasts, almost without exception, the stock price will tumble. This in turn costs them money. Therefore, it is more advantageous for executives to provide brokerage analysts with conservative earnings estimates.*"[2]

With respect to analyst's incentive to provide overly optimistic earnings forecasts, Zacks observes:

> "*Clients will only act on a brokerage analyst's recommendation if they think the recommendation will help them make money. The more money a firm's clients make from a particular analyst's recommendations, the more valuable the analyst is to the firm. Since the analysts issue far more "buy" recommendations than "sell" recommendations, they want to avoid making earnings forecasts that are overly optimistic. The incentive for issuing conservative earnings estimates is that the company has a better chance of reporting earnings that exceed forecasts. In turn, clients will be*

[1] Source: http://www.zacks.com/help/zrank-guide.php?p=3.
[2] Ibid.

> *happy to see the stock's price rise. Conversely, there is no incentive to issue an earnings forecast that is overly optimistic."*[3]

Finally, in terms of the issue of reported earnings vs. forecasted earnings, Zacks observes:

> "*Over 10 years ago, only about 50% of companies met or exceeded earnings estimates every quarter. Now that number has moved to 80% as corporate executives and brokerage analysts have wised up to the importance of creating conservative earnings estimates."*[4]

[3] Ibid.
[4] Ibid.