Consumers Council of Canada and the Vulnerable Energy Consumers Coalition (CCC) and (VECC) INTERROGATORY #32 List 1

Interrogatory

Ref: B1/T3/S1 p. C-1

Issue 4.0
Issue: Cost of Capital/Capital Structure

Topic: DCF Risk premium estimates

Request:

a) Can Ms. McShane please explain how the monthly DCF estimates are independent given that they rely on growth estimates that analysts do not change on a monthly basis, that is, how does she adjust for overlapping observations?

b) Has Ms. McShane ever admitted that analyst earnings forecasts are biased high and as a result had her DCF estimates rejected by a regulator due to her failure to make any adjustments to them?

c) Can Ms. McShane please explain why she has not made any adjustments to her analyst forecasts given the preponderance of academic judgment that they are biased high and are mainly used as a vehicle to help brokerages sell stock.

Response

a) Every month I/B/E/S publishes a new consensus of long-term forecasts. While some of the individual forecasts may not have changed since the prior month, there is no reason to expect them to change every month, since a change in the long-term forecast would require a material event that would change the firm's long-term outlook. Thus, there is no reason to adjust for "overlapping observations" (which Ms. McShane interprets to mean individual forecasts that have not been revised from one month to the next).

b) Ms. McShane has acknowledged the results of studies that pointed to the optimism of analysts. She also indicated that the forecasts remained a relevant indicator of investors' expectations when investors share that optimism and price shares accordingly. Analysts continue to be employed, and the forecasts continue to be widely disseminated and widely relied upon, which suggests that investors continue to find value in them. Further, see page D-5 of Ms. McShane's testimony and response to J.1.128.

c) Ms. McShane does not agree with the premise of the question. See response to b)