DUFF & PHELPS

Office of Professional Practice

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Technical Update

Duff & Phelps Recommended U.S. Equity Risk Premium Lowered from 5.5% to 5.0%

For further inquiries on Costs of Capital issues, please contact the Office of Professional Practice or Roger Grabowski.

This Technical Update brings you information on current **Cost of Capital** issues.

Executive Summary

The Equity Risk Premium (ERP) changes over time. Fluctuations in global economic and financial conditions warrant periodic reassessments of the selected ERP. Based on current market conditions, **Duff & Phelps is decreasing its U.S. Equity Risk Premium recommendation from 5.5% to 5.0%** when developing discount rates **as of February 28, 2013 and thereafter**, until further guidance is issued. This ERP recommendation is to be used in conjunction with a **normalized risk-free rate of 4.0%.**

We continuously monitor the economy and financial markets for changes in the indicated ERP. We will be sending out updated guidance as frequently as warranted, to assist you in documenting and supporting the Duff & Phelps ERP estimate to clients.

Additional support for the current recommendation will be issued by the Office of Professional Practice (OPP) in a "Client Alert" format, which engagement teams will then be able to share externally with clients and auditors. This Client Alert document will be available within one week after the release of the current OPP Technical Update and will be located here.

The Equity Risk Premium (ERP) is a key input used to calculate the cost of capital within the context of the Capital Asset Pricing Model (CAPM) and other models. Duff & Phelps regularly reviews fluctuations in global economic and financial conditions that warrant periodic reassessments of ERP. Based on current market conditions, we are recommending a decrease in the U.S. ERP from 5.5% to 5.0% when developing discount rates as of February 28, 2013 and thereafter, until further guidance is issued. We will maintain our recommendation to use a 5.0% U.S. ERP when developing discount rates until such time evidence indicates equity risk in financial markets has materially changed.

The current ERP recommendation was developed in conjunction with a "normalized" 20-year yield on U.S. government bonds of 4.0% as a proxy for the risk-free rate (R_f), implying a 9.0% (4.0% + 5.0%) "base" U.S. cost of equity capital estimate at the end of February 2013. Were we to use the spot yield-to-maturity of 2.7% as of February 28, 2013, one would arrive at an overall discount rate that is likely inappropriately low vis-à-vis the risks currently facing investors.

Duff & Phelps last changed its U.S. ERP recommendation on January 15, 2012. On that date, our recommendation was lowered to 5.5% (from 6.0%) in response to evidence that suggested a reduced level of risk in financial markets relative to the heightened uncertainty seen in the second half of 2011. Since January 15, 2012, while the evidence is somewhat mixed, we see further indications that equity risk in financial markets has declined.

Recent economic indicators point to a positive, yet below-pace, recovery of the U.S. economy, with the employment situation reaching a level of stability, consumer and business sentiment stable, if not slightly rising, and with the risks of a double-dip recession seemingly tempered. Markets reacted positively to these trends in 2012, with broad equity indices (e.g., the S&P 500) rising, market volatility declining, and credit spreads of U.S. high-yield over U.S. investment grade corporate bonds narrowing substantially.

Consumer and business sentiment increased slightly in 2012, improving further in early 2013, but overall sentiment remains below average. The employment environment shows some signs of stabilization, but the unemployment rate and long-term unemployment remain stubbornly elevated.

In the absence of Washington addressing long-term budgetary issues in a meaningful way, speculation has increased that U.S. sovereign credit could be downgraded by Fitch and Moody's, two major rating agencies. Note that Congress' stalemate in raising the U.S. debt ceiling had already culminated in Standard &Poor's historic decision in August 2011 to downgrade the U.S. sovereign debt rating from AAA to AA+.

Spillover effects from a possible resurfacing of the Euro sovereign credit crisis and weakening Eurozone economies are also significant risk factors.

Duff & Phelps monitors two additional quantitative models as corroboration of the qualitative factors discussed above: 1) the Damodaran Implied ERP Model and (2) the Default Spread Model. Both of these models indicated a somewhat lower ERP at the end of February 2013 relative to our prior recommendation of January 15, 2012.

Ultimately, however, the quantitative easing measures undertaken by the U.S. central bank to stimulate the economy appear to be the catalyst for the current appetite for risk seen in financial markets. Significant risks remain in the U.S. economy but for the time being investors appear to be more confident in equity markets.

Taken together, we found sufficient support for lowering our ERP recommendation relative to our previous recommendation. Accordingly, Duff & Phelps recommends a U.S. Equity Risk Premium of 5.0% when developing discount rates as of February 28, 2013 and thereafter, to be used in conjunction with a normalized risk-free rate of 4.0%.