AVISTA CORPORATION

PROOF

If book value exceeds market price,
the market-to-book ratio is less than 1.0,
and the earnings-price ratio exceeds the cost of capital.

MP = market price
BV = book value
i = cost of equity capital
r = earned return
E = earnings

1. At MP = BV, i = r = .

2. E = rBV.

3. Then, = .

4. When BV > MP, i.e., >1, then,

   a. > r, since = > r, because > 1;

   b. i > r, since at = 1, i = = , but if > 1, then i > r; and

   c. > i, since at = 1, i = = , but if > 1, then > i, because,

      1) > 1, through MP decreasing, and, if so, increases, therefore, > i, or

      2) > 1, through BV increasing, and, if so, given E = rBV, increases, therefore, >i.

5. Ergo, > i > r, the cost of capital exceeds the earned return.