Weighted average cost of capital essay

[Economics](), [Financial Markets]()

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In this model cost of equity - Ke is dependent on three variables which are the current price of the stock denoted by P0, the expected dividend of the stock at the end of year 1 which is D1 and the growth rate of dividends – g.

The cost of capital can be estimated by dividing the expected dividend at the end of the year by the current price of the stock and adding the growth rate to the result of this division. This model has been applied to estimate the cost of equity for Foundation Coal. Foundation Coal has been paying dividends of $0. 20 for the past three years and the expected dividends for next year would be same (Foundation Coal Holdings Inc., 2009).

This means a zero growth in dividends, g = 0 and the cost of equity would be calculated by simply dividing the expected dividend by the current price of the share.

Cost of Debt

The cost of debt is the after tax effect of the interest rate effective on the debt, sometimes the cost of debt is the yield to maturity of a bond but only where a company has issued bonds to acquire long term debt.

After Tax cost of debt = Kd (1-T)

Where Kd may be the interest rate or the yield to maturity but in the case of Foundation Coal there are no bonds and the interest rate effective on the debt - Kd is 7. 95% and the tax rate - T is 35% (Foundation Coal Holdings Inc., 2009).