

Example of essay on cost of capital

[Business](#), [Company](#)



Introduction

The field of finance is a broad one and it applies with different aspects in particular. It is required to apply numerous concepts that come under the ambit of financial management and accounting based stances. Among these concepts, the name of Cost of Capital is one of them

Organizations use different analytical methods to analyze the cost of capital in particular and among these methods the name of Pure Play Method (PPM) is one of them, which has its own significance and importance lies in a broad nutshell. The main theme of this assignment is to analyze the Cost of Capital (COC) of a company with the name of Hubbard Computers Inc, which is in the business of making and selling of computers in particular. Dell

Computers is the company which has been chosen for the Pure Play Method in particular . Dell is an American privately owned multinational technological based company which has its headquartering located in Texas, the United States. The company is in the business of developing, selling, repairing and supporting computer related products and services. The company earned net revenue amounting to US\$ 56. 94 billion in the financial year 2013, with net income provision of US\$ 2. 37 billion in the same year. There are two different things which have been taken into consideration while analyzing the Cost of Capital of an organization, which are Cost of Equity and after tax cost of Debt. The entire structure of the paper is comprised on introduction, Analysis and at last conclusion. Let's now move towards the next section which is Analytical Framework section.

Analytical Framework

There is a mini case attached with this particular analysis mentioned the case of Hubbard Computers Inc, which currently owns around 74 stores in the Southeast with a sales revenue amounting to US\$ 97 million last year. Simultaneously, it is required to compute the cost of equity and cost of capital in particular.

Estimating Cost of Debt of Dell

With the help of Discounted Cash Flow method, the cost of debt of the chosen organization could be found. In order to analyze the cost of debt of Hubbard Inc, it is important for the organization to compute the Market Value of Debt of Dell.

Total Liabilities of Dell in the year 2013 was amounting to US\$ 14, 201, 846

Hence the Cost of Debt of the chosen company before tax is 8. 4%

We are taking this particular analysis for granted and considering the cost of debt of Dell in analyzing the cost of debt of Hubbard Inc. The marginal tax rate is 35%, let's now examine the after tax cost of debt of the company which then be used for the initial analysis of the Cost of Capital in particular.

Cost of Debt (After Tax) = 8. 4% * (1-35%)

Cost of Debt (After Tax) = 5. 46%

Estimating Cost of Equity of Dell

Capital Asset Pricing Model (CAMP) has been used for further analysis to analyze the cost of equity of the chosen organization and it will be applied over the analytical stance of Hubbard Inc. CAPM model is as follows

$$\text{CAPM} = \text{Risk Free Rate} + \text{Beta} * (\text{Market Return} - \text{Risk Free Rate})$$

$$\text{Market Return} - \text{Risk Free Rate} = \text{Risk Premium} = 5\%$$

$$= 4.13\% + 0.286 * 5$$

$$= 4.13\% + 1.43\%$$

$$\text{Cost of Equity (Dell Inc)} = 5.56\%$$

Estimating Weight age of Debt and Equity

This particular aspect can be analyzed with the help of Debt to Equity Ratio analysis

$$\text{Total Debt} = \text{US\$ } 14,201,846$$

$$\text{Total Equity} = \text{US\$ } 2,680,151$$

$$= 14,201,846 / 2,680,151$$

$$= 5.29$$

$$= 5.29 / 6.29$$

0.84 means 84% Debt

Equity weight = 16%

Put all of these things in the initial formula of WACC

WACC = (Cost of Debt) * (Weight of Debt) + (Cost of Equity) * (Weight of Equity)

$$\text{WACC} = (5.46\%) * (84\%) + (5.56\%) * (16\%)$$

$$= 4.58\% + 0.889$$

$$\text{WACC (Hubbard Inc with Pure Play Method)} = 5.476\%$$

Conclusion

The Primary aim of the paper is to calculate the Cost of Capital of Hubbard Computers Inc. that has been associated in manufacturing and selling of

computers with superior quality. After critically observed the entire analytical framework, it is directed that the Cost of Capital of Hubbard Plc, which has been computed through the Pure Play method of Dell Inc is 5.476%, which the company can use in their Capital Budgeting Projects.

References

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