

# [Nike: cost of capital assignment](https://assignbuster.com/nike-cost-of-capital-assignment/)

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We recommend a buy for Nike’s stock on July 6, 2001. Our analysis consists of a discounted cash flows model. We projected unlevered free cash flows over the next 10 years and discounted them according to our derivation of Nike’s weighted average cost of capital. Our analysis suggests the stock is significantly undervalued, given our expectation it will deliver earnings in the future. Below we have analyzed Joanna Cohen’s WACC calculation and her projection of cash flows. We then calculate our own WACC, discuss the results of our own model for cash flow projections, and conclude with our valuation and notes regarding our recommendation.

Evaluation of Joanna Cohen’s WACC Calculation Cohen’s WACC calculation is decent, but has a few issues, and a number of errors, as described below. ??? Weighting the capital structure. She weights the capital structure using the book value of equity. Nike is a public company, and its market capitalization is a more relevant metric for equity than the book value of equity. ??? Cost of debt. To calculate the cost of debt, Cohen simply divides the interest expense by the average balance of the interest-bearing debt. This is an approximation for the true cost of the debt, but is too inaccurate.

The interest expense line may include expenses not directly related to the debt of the company (unlikely, but perhaps non-cash payment-in-kind expenses for the preferred stock, or simply interest expense recognized under GAAP, but not necessarily indicative of real costs of debt). The cost of debt should include the current market yield on Nike’s publicly traded debt, as this is a more pertinent metric. Furthermore, Cohen uses the 20 year yield on treasury bonds to approximate the risk free rate. We feel that the 3-month yield on treasuries is appropriate.