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University for the Creative Arts

BERLIN SCHOOL OF BUSINESS & INNOVATION

Essay Title: Quantitative Finance and Financial Markets: A Comparative Analysis of Microsoft Corporation (MSFT) and Alphabet Inc. (GOOG)

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Year: 2023

CATALOG

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INTRODUCTION

This text seeks to emphasize on quantitative finance and financial markets, which involves practical application of mathematical models and statistical techniques in analyzing datasets within the financial market to make proper investment judgments, determining the value of financial asset like bond or stock, developing trading strategies, assessing risks or volatility etc.*(Ghannami, 2023)*, Quantitative finance involves the use of market-tested tools, techniques, and advancements to analyze and understand financial data. Examples of quantitative tools utilized in finance and investment analysis to measure, evaluate, and interpret financial data includes financial ratios, time value of money, statistical analysis, portfolio optimization, technical analysis, Monte Carlo Simulation and the choice of tools depends on the specific analysis or problem at hand, and different tools are suitable for different purposes.

While there exist various asset classes, including bonds, commodities, mutual funds, and alternative investments, this article will concentrate on companies within a stock index on the equity market. The analysis will involve utilizing a wide range of data, including financial statements, reports, stock market information, and historical data, to assess investment opportunities from both an investor's and a business's standpoint.

In this particular setting, there will be a comparison made between two companies listed on the Standard & Poor 500 Index, namely Microsoft Corporation (MSFT) and Alphabet Inc. (GOOG). The aim is to utilize quantitative methods to analyze their individual financial data sets, evaluating their financial performance, market value, and investor sentiment. This analysis will provide a deeper understanding of the numerical conditions of both companies for the years 2022 and 2021.

The Standard and Poor 500 Index is a stock market indicator that evaluates the success of 500 prominent US companies. It is calculated based on market capitalization and encompasses various sectors such as technology, healthcare, energy, and finance. *(S&P 500 Index Chart — SPX Quote, 2023)*

Microsoft Corporation is a global technology company that engages in the creation, production, licensing, and sale of various software products and services. Microsoft is organized as a corporation and operates under the legal structure of a public company. It is listed on the NASDAQ stock exchange under the ticker symbol "MSFT." As a corporation, Microsoft is owned by its shareholders who hold shares of the company's stock. The shareholders have limited liability for the company's debts and losses and have the potential to earn profits through dividends and capital appreciation of the stock. *(MSFT Stock Chart and Price — Microsoft (NASDAQ), 2023)*

Alphabet, Inc. is a corporation that acts as a holding company, primarily involved in acquiring and operating various companies.Alphabet is also organized as a corporation and is listed on the NASDAQ stock exchange under the ticker symbols "GOOGL" and "GOOG." Similar to Microsoft, Alphabet's ownership is based on shares of its stock, and it is accountable to its shareholders.. *(GOOGL Stock Price and Chart — NASDAQ:GOOGL, 2023)*

CHAPTER ONE

Financial Statements Analysis and Business Overview

Financial statements provide a practical overview of a company's financial performance and position. These statements include the balance sheet, income statement, cash flow statement, and statement of changes in equity.

The balance sheet presents a snapshot of a company's assets, liabilities, and equity at a specific point in time. It reveals the company's financial position and its ability to meet its obligations. Changes in key financial variables such as total assets, liabilities, and equity over time can indicate the company's growth, financial stability, or potential risks.

The income statement, also known as the profit and loss statement, showcases a company's revenues, expenses, gains, and losses over a specific period. It highlights the company's profitability and measures its ability to generate consistent earnings. Key financial variables in the income statement include revenue growth, cost of goods sold, operating expenses, and net income. Comparing these variables over different periods can reveal trends and insights into the company's financial performance.

The cash flow statement details the company's cash inflows and outflows from operating activities, investing activities, and financing activities. It provides information on how cash is generated and used within the business. Key financial variables in the cash flow statement include operating cash flow, investing cash flow, financing cash flow, and net change in cash. Analyzing these variables can help assess the company's liquidity, cash management, and investment activities.

The statement of changes in equity illustrates the changes in shareholders' equity over a specific period. It reflects the impact of net income or loss, dividends, stock issuance, and other equity transactions. Key financial variables in this statement include retained earnings, additional paid-in capital, treasury stock, and comprehensive income. Understanding these variables and their changes can provide insights into the company's capital structure and shareholder value.

MSFT Inc.
Financial Analysis.

(Microsoft Corporation (MSFT) Financial - Yahoo Finance, 2023)

Alphabet
Financial Analysis.

(Alphabet Inc. (GOOG) Financial - Yahoo Finance, 2023)

Notes: All Numbers are in millions

Changes in Key Variables: Balance Sheet

Total Assets:

Alphabet: Total assets increased from $211,599 in 2021 to $243,397 in 2022. Microsoft: Total assets increased from $190,052 in 2021 to $243,159 in 2022.

Impact: The increase in total assets for both companies indicates growth and expansion, suggesting a positive outlook for their businesses.

Common Equity:

Alphabet: Common equity increased from $251,635 in 2021 to $256,144 in 2022. Microsoft: Common equity increased from $141,988 in 2021 to $166,542 in 2022.

Impact: The increase in common equity for both companies indicates improved financial strength and a higher value for shareholders.

Long-Term and Short-Term Liabilities:

Alphabet: Long-term liabilities decreased from $43,379 in 2021 to $39,820 in 2022. Short-term liabilities increased from $64,254 to $69,300 during the same period. Microsoft: Long-term liabilities remained relatively stable at $103,216. Short-term liabilities increased from $88,657 in 2021 to $95,082 in 2022.

Impact: The decrease in long-term liabilities for Alphabet is positive as it indicates a reduced long-term debt burden. However, the increase in short-term liabilities for both companies might require careful monitoring, as it suggests a potential increase in short-term obligations.

From observation both Microsoft and Alphabet have experienced growth in total assets and common equity, indicating positive financial performance and potential for future growth. Microsoft has a higher long-term liability compared to Alphabet, which might be a factor to consider when assessing their financial stability. The increase in short-term liabilities for both companies requires attention, as it may indicate a higher short-term debt burden or increased working capital needs.

The drawback is that, this analysis is based solely on the balance sheet data and does not take into account other factors such as market dynamics, industry competition, or future performance.

Changes in Key Variables: Income Statement

Sales:

Microsoft: Sales increased from $168,088 in 2021 to $198,270 in 2022. Alphabet: Sales increased from $257,637 in 2021 to $282,836 in 2022.

Impact: Both companies experienced growth in sales, indicating increased revenue generation and potentially higher market demand for their products or services.

Operating Expenses:

Microsoft: Operating expenses increased from $45,940 in 2021 to $52,237 in 2022. Alphabet: Operating expenses increased from $67,984 in 2021 to $81,791 in 2022.

Impact: The increase in operating expenses for both companies suggests higher costs associated with their operations. It is essential to assess the nature of these expenses and the company's ability to manage and control them effectively.

Net Income:

Microsoft: Net income increased from $14,145 in 2021 to $20,168 in 2022. Alphabet: Net income increased from $113,792 in 2021 to $120,627 in 2022.

Impact: Both companies experienced growth in net income, indicating improved profitability. This suggests that they were able to generate higher profits after deducting all expenses and taxes.

The increase in sales for both Microsoft and Alphabet signifies positive revenue growth, indicating potential market strength and demand for their products or services. The increase in operating expenses for both companies should be closely monitored to assess their impact on profitability. Investors should evaluate the reasons behind the expense growth and determine if it is sustainable in the long run.The growth in net income for both companies demonstrates their ability to generate higher profits. This is a positive sign for investors as it indicates financial strength and potential for future growth.

To perform a comparative analysis of the cash flow statements between Microsoft and Alphabet, we can focus on key variables such as operating cash flow, net income from continuing operations, depreciation and amortization, stock-based compensation, and changes in working capital.

Microsoft:

Operating Cash Flow: $89,035

Net Income from Continuing Operations: $72,738

Depreciation and Amortization: $14,460

Stock-based Compensation: $7,502

Change in Working Capital: $446

(Microsoft Corporation (MSFT) Cash Flow - Yahoo Finance - Yahoo Finance, 2023)

Alphabet:

Operating Cash Flow: $91,495

Net Income from Continuing Operations: $59,972

Depreciation and Amortization: $15,928

Stock-based Compensation: $19,362

Change in Working Capital: -$2,235,

(Alphabet Inc. (GOOG) Cash Flow - Yahoo Finance - Yahoo Finance, 2023)

Operating Cash Flow: Alphabet has a higher operating cash flow than Microsoft, indicating that Alphabet generates more cash from its core operations.

Net Income from Continuing Operations: Microsoft has a higher net income from continuing operations than Alphabet, suggesting that Microsoft is more profitable in terms of net income.

Depreciation and Amortization: Alphabet has higher depreciation and amortization expenses compared to Microsoft, which might indicate a higher investment in fixed assets or intangible assets.

Stock-based Compensation: Alphabet has significantly higher stock-based compensation expenses compared to Microsoft, suggesting a higher reliance on stock-based incentives for employee compensation.

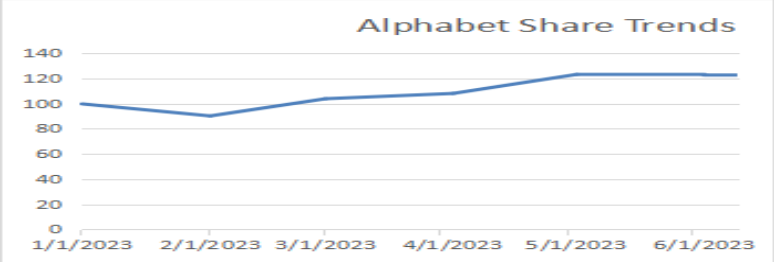
Change in Working Capital: Both companies have experienced a decrease in working capital, but the magnitude is higher for Microsoft, indicating potential challenges in managing short-term assets and liabilities.

Microsoft: The company shows strong profitability with a higher net income from continuing operations. Additionally, the company has a relatively stable operating cash flow. Investors might consider buying Microsoft stocks, considering its solid financial performance. Although Alphabet has a lower net income from continuing operations compared to Microsoft, it exhibits higher operating cash flow and stock-based compensation. Investors should carefully analyze the factors influencing these variables and assess Alphabet's growth potential and market position before making a decision.

Share Trend Analysis

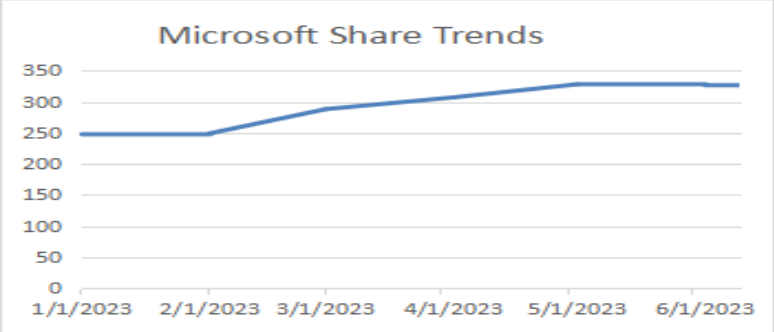
To present the share trends between Microsoft and Alphabet, we can use the closing prices over the given time period. Here is a graph showing Microsoft and Alphabet's historical monthly closing prices from January 2023 to June 2023: we create line graphs using the provided data. The x-axis will represent the date, and the y-axis will represent the closing share prices.

Here is a graphical representation of the share trends for Alphabet:



Source: *(Alphabet Inc. (GOOG) Stock Historical Prices & Data - Yahoo Finance, 2023)*

And here is a graphical representation of the share trends for Microsoft:



Source: *(Microsoft Corporation (MSFT) Stock Historical Prices & Data - Yahoo Finance, 2023)*

In words, we can observe the following trends:

For Alphabet: The share price started the year (1/1/2023) at $99.87 and experienced a slight decline in the following month. However, from March onwards, there was a steady increase in share price, reaching a peak of $123.37 on 5/1/2023. Afterward, the share price remained relatively stable, ending at $122.87 on 6/1/2023 and maintaining the same value until 6/9/2023.

For Microsoft: The share price started the year (1/1/2023) at $247.81 and experienced a minor increase in the following month.From March onwards, there was a significant upward trend in share price, reaching a peak of $328.39 on 5/1/2023. Similar to Alphabet, Microsoft's share price remained relatively stable afterward, ending at $326.79 on 6/1/2023 and maintaining the same value until 6/9/2023.

Considering these trends, both Alphabet and Microsoft have shown overall positive growth in their share prices, with Microsoft exhibiting a more substantial increase

CHAPTER TWO

Exploring the Financial Markets: Identifying the Market Classification of Selected Companies

Microsoft and Alphabet both belong to the stock market, specifically the equity market. The equity market is where stocks or shares of companies are bought and sold. It provides a platform for companies to raise capital by issuing shares to investors, and investors can participate in the ownership and potential growth of these companies.

Within the equity market, Microsoft and Alphabet are listed on major stock exchanges. Microsoft is listed on the Nasdaq Stock Market, while Alphabet is listed on both the Nasdaq Stock Market and the New York Stock Exchange (under the ticker symbol GOOGL).

To conduct a practical quantitative self-test on Microsoft and Alphabet, we consider the following key financial variables:

Revenue Growth which looks at the companies' historical revenue growth rates and assess their ability to generate consistent and increasing sales over time. To perform a revenue growth analysis between Microsoft and Alphabet (Google), let's compare their total revenues for the respective periods:

Microsoft Corporation:

Total Revenue on 6/30/2022: $198,270

Total Revenue on 6/30/2021: $168,088

Google Incorporation (Alphabet):

Total Revenue on 12/31/2022: $282,836

Total Revenue on 12/31/2021: $257,637

To calculate the revenue growth rate, we can use the following formula:

Revenue Growth Rate = ((Current Year Revenue - Previous Year Revenue) / Previous Year Revenue) * 100

For Microsoft: Revenue Growth Rate = (($198,270 - $168,088) / $168,088) * 100 = 17.99%

For Alphabet: Revenue Growth Rate = (($282,836 - $257,637) / $257,637) * 100 = 9.77%

Based on the analysis, Microsoft Corporation experienced a revenue growth rate of approximately 17.99% between 6/30/2021 and 6/30/2022. On the other hand, Google Incorporation (Alphabet) had a revenue growth rate of around 9.77% between 12/31/2021 and 12/31/2022.

The revenue growth analysis provides insights into the companies' ability to generate increasing sales over time. In this case, Microsoft exhibited a higher revenue growth rate compared to Alphabet. This could be due to various factors, including Microsoft's strong performance in its cloud services and

software segments. As an investor, it's important to consider revenue growth along with other financial variables and qualitative factors. A high revenue growth rate may indicate a company's potential for future expansion and profitability. However, it's crucial to conduct comprehensive research, evaluate the overall financial health of the companies, and consider market conditions, competitive landscape, and other relevant factors before making investment decisions.

Profitability: Analyze the companies' profitability metrics such as gross profit margin, operating profit margin, and net profit margin. Higher profit margins indicate better efficiency and profitability. To perform a comparative profitability analysis between Microsoft and Google, we can look at key profitability metrics such as gross profit margin, operating profit margin, and net profit margin. Here's the calculation for each metric:

Gross Profit Margin: Gross Profit Margin = (Gross Profit / Total Revenue) * 100

For Microsoft: Gross Profit Margin (2022) = (135,620 / 198,270) * 100 = 68.42% Gross Profit Margin (2021) = (115,856 / 168,088) * 100 = 68.89%

For Google: Gross Profit Margin (2022) = (156,633, / 282,836,) * 100 = 55.39% Gross Profit Margin (2021) = (146,698 / 257,637) * 100 = 56.95%

Operating Profit Margin: Operating Profit Margin = (Operating Income / Total Revenue) * 100

For Microsoft: Operating Profit Margin (2022) = (83,383 / 198,270) * 100 = 42.03% Operating Profit Margin (2021) = (69,916 / 168,088) * 100 = 41.60%

For Google: Operating Profit Margin (2022) = (74,842 / 282,836) * 100 = 26.49% Operating Profit Margin (2021) = (78,714 / 257,637) * 100 = 30.56%

Net Profit Margin: Net Profit Margin = (Net Income / Total Revenue) * 100

For Microsoft: Net Profit Margin (2022) = (72,738 / 198,270) * 100 = 36.70% Net Profit Margin (2021) = (61,271 / 168,088) * 100 = 36.45%

For Google: Net Profit Margin (2022) = (59,972 / 282,836) * 100 = 21.18% Net Profit Margin (2021) = (76,033 / 257,637) * 100 = 29.53%

Based on these calculations, we can observe the following:

Gross Profit Margin: Both Microsoft and Google have consistently high gross profit margins, with Microsoft having a slightly higher margin overall.

Operating Profit Margin: Microsoft has a higher operating profit margin compared to Google for both years analyzed. This indicates that Microsoft has better control over its operating expenses relative to its revenue.

Net Profit Margin: Both companies have relatively strong net profit margins, although Google had a higher net profit margin in 2021. Microsoft, however, showed an increase in net profit margin from 2021 to 2022.

Overall, Microsoft demonstrates a better performance in terms of profitability compared to Google, as it has higher operating profit margins and a consistent net profit margin.

Earnings Per Share (EPS): Evaluate the companies' EPS, which represents the portion of a company's profit allocated to each outstanding share. Higher EPS indicates a greater return for shareholders.

Price-to-Earnings Ratio (P/E): Calculate the P/E ratio by dividing the market price per share by the earnings per share. This ratio helps determine the valuation of a company's stock compared to its earnings. Lower P/E ratios may indicate undervalued stocks, while higher ratios may indicate overvaluation.

Dividend Yield: Consider the dividend yield, which is the annual dividend payment per share divided by the stock price. It indicates the return on investment through dividends. Higher dividend yields may be attractive to income-focused investors.

Debt-to-Equity Ratio: Assess the companies' debt levels relative to their equity. A lower debt-to-equity ratio suggests a stronger financial position and lower risk.

Cash Flow: Evaluate the companies' cash flow from operations, investing, and financing activities. Positive and increasing cash flows are favorable signs of a company's financial health.

Market Capitalization: Consider the size of the companies in terms of market capitalization. Larger companies with higher market capitalization may have greater stability but could also be slower to grow.

To compute the earnings per share (EPS) for Microsoft and Google, we need to divide their net income available to common stockholders by the average number of shares outstanding.

For Microsoft: Net Income Available to Common Stockholders = $72,738 Diluted Average Shares = 7,540

EPS for Microsoft = $72,738 / 7,540 = $9.65

For Google: Net Income Available to Common Stockholders = $59,972 Diluted Average Shares = 13,159

EPS for Google = $59,972 / 13,159 = $4.56

Quantitative analysis:

Earnings per share (EPS): Microsoft has a higher EPS of $9.65 compared to Google's EPS of $4.56. This indicates that Microsoft generated more earnings for each outstanding share than Google.

Profitability: Microsoft's higher EPS suggests better profitability and earnings generation compared to Google. Investors may perceive Microsoft as a more profitable company based on this metric.

Growth potential: Google's lower EPS may indicate a lower growth potential compared to Microsoft. Investors looking for higher growth opportunities might prefer Microsoft based on this metric.

Market perception: Investors often consider EPS when evaluating a company's performance and potential. Microsoft's higher EPS might lead to a more positive market perception and potentially attract more investors.

Price-to-Earnings (P/E) ratio: The EPS can be used to calculate the P/E ratio, which compares the stock price to the company's earnings. A higher EPS can lead to a lower P/E ratio, indicating that Microsoft's stock might be relatively undervalued compared to Google.

Microsoft appears to have better profitability and growth potential based on its higher EPS. Investors seeking stable and profitable companies may consider investing in Microsoft.

CHAPTER THREE

Financial Performance And Ratio Analysis.

To perform a financial performance and ratio analysis, we'll calculate the current ratio, acid-test ratio, inventory turnover ratio, and fixed assets turnover ratio for Microsoft and Google based on their financial data. We'll also compare the results to industry averages and conduct a benchmarking analysis between the two companies.

Current Ratio: The current ratio measures a company's ability to cover its short-term obligations with its short-term assets. It is calculated by dividing current assets by current liabilities.

Microsoft: Current assets = $169,684; Current liabilities = $95,082 Current ratio = $169,684 / $95,082 = 1.78

Google: Current assets = $164,795; Current liabilities = $69,300. Current ratio = $164,795 / $69,300 = 2.38

Acid-Test Ratio: The acid-test ratio, also known as the quick ratio, is a more stringent measure of a company's short-term liquidity. It excludes inventory from current assets since inventory may not be easily converted into cash.

Microsoft: Current assets - Inventory = $169,684 - $3,742 = $165,942 Acid-test ratio = $165,942 / $95,082 = 1.74

Google: Current assets - Inventory = $164,795 - $2,670 = $162,125. Acid-test ratio = $162,125 / $69,300 = 2.34

Inventory Turnover Ratio: The inventory turnover ratio measures the efficiency of a company's inventory management by indicating how many times inventory is sold and replaced during a given period. It is calculated by dividing the cost of goods sold by average inventory.

Microsoft: Cost of Revenue = $62,650; Inventory = $3,742. Inventory turnover ratio = $62,650 / $3,742 = 16.74

Google: Cost of Revenue = $126,203; Inventory = $2,670. Inventory turnover ratio = $126,203 / $2,670 = 47.28

Fixed Assets Turnover Ratio: The fixed assets turnover ratio measures how efficiently a company utilizes its fixed assets to generate revenue. It is calculated by dividing operating revenue by average fixed assets.

Microsoft: Operating Revenue = $198,270; Net PPE = $87,546. Fixed assets turnover ratio = $198,270 / $87,546 = 2.26

Google: Operating Revenue = $282,836; Net PPE = $127,049. Fixed assets turnover ratio = $282,836 / $127,049 = 2.22

Comparing the results to industry averages and conducting a benchmarking analysis:

Current Ratio: Both Microsoft and Google have current ratios above 1, indicating that they have sufficient current assets to cover their short-term liabilities. However, Google has a higher current ratio of 2.38 compared to Microsoft's ratio of 1.78. This suggests that Google may have a stronger short-term liquidity position.

Acid-Test Ratio: Similar to the current ratio, Google has a higher acid-test ratio (2.34) than Microsoft (1.74), indicating a stronger ability to meet short-term obligations without relying on inventory.

Inventory Turnover Ratio: Google has a significantly higher inventory turnover ratio of 47.28 compared to Microsoft

In conclusion, based on the available financial data, both Microsoft and Google demonstrate strong financial performance and ratios. Google appears to have a stronger liquidity position with higher current and acid-test ratios, while Microsoft shows better efficiency in managing fixed assets

CHAPTER FOUR

Time Value of Money: Compounding and Discounting Analysis

Time value of money (TVM) is a fundamental concept in finance that recognizes the idea that the value of money changes over time due to factors such as inflation, interest rates, and opportunity costs. It is based on the principle that a dollar received today is worth more than the same dollar received in the future.

Key Variables in Time Value of Money:

Present Value (PV): The current value of a future cash flow or investment.

Future Value (FV): The value of an investment or cash flow at a future point in time.

Interest Rate (r): The rate of return or discount rate applied to calculate the present or future value of money.

Time (t): The duration or number of periods over which the value of money changes.

Compounding and Discounting: Compounding is the process of calculating the future value of an investment by applying the interest rate over multiple periods. It allows you to determine how an investment grows over time. Assuming an annual compounding period, the formula for future value is:

$FV = PV * (1 + r)^t$

Discounting, on the other hand, is the process of calculating the present value of a future cash flow by applying the discount rate. It helps determine the current worth of future cash flows. Assuming an annual discounting period, the formula for present value is:

$PV = FV / (1 + r)^t$

To illustrate the compounding and discounting methods for Microsoft and Google, let's make some assumptions:

Assumptions:

Annual compounding and discounting.

Interest rate (r) for compounding and discounting: 5%.

Compounding for Microsoft: Assuming an initial investment of $100,000, we can calculate the future value after 5 years:

$FV = \$100,000 * (1 + 0.05)^5$ $FV = \$128,024.69$

Discounting for Google: Assuming a future cash flow of $150,000 expected after 3 years, we can calculate the present value:

$PV = \$150,000 / (1 + 0.05)^3$ $PV = \$129,577.37$

Key Variables for Predicting Shared Values: To calculate predictions of shared values, key variables include:

Expected future cash flows: Revenue, earnings, dividends, etc.

Discount rate: Represents the required rate of return or opportunity cost of investing in the company.

Growth rate: Represents the expected growth rate of cash flows over time.

Terminal value: Represents the value of the investment at the end of a specific period.

Advising Investors: Based on the provided financial data and analysis, along with the TVM considerations, here are some observations and advice for investors:

Liquidity Position: Both Microsoft and Google exhibit strong liquidity positions, as indicated by their current ratios and acid-test ratios. This suggests that they have the ability to meet their short-term obligations.

Time Value of Money: Investors should consider the TVM concept when evaluating the value of investments in Microsoft and Google. Future cash flows should be discounted to their present values to accurately assess their worth.

Stock Valuation: To predict the shared values of Microsoft and Google, investors should consider factors such as expected cash flows, growth rates, discount rates, and terminal values. These variables will enable the calculation of intrinsic values and aid in determining whether the current stock prices are overvalued or undervalued.

Diversification: Investors are advised to diversify their portfolios by investing in a mix of different companies, industries, and asset classes to spread risk and maximize returns.

Due Diligence: Before making investment decisions, it is crucial to conduct thorough research, analyze financial statements, consider market trends, and consult with financial professionals. This will help investors make informed choices based on their risk tolerance, investment objectives, and time horizons.

CHAPTER FIVE

Weighted Average Cost of Capital (WACC) Analysis

Weighted Average Cost of Capital (WACC) is a financial metric that represents the average rate of return a company must earn on its investments to satisfy its investors and maintain its market value. It is calculated by taking into account the weighted average of the costs of the various sources of financing, including equity and debt.

Key Variables in WACC:

Cost of Equity (Ke): The rate of return required by investors to hold the company's equity. It represents the opportunity cost of investing in the company's stock considering the level of risk associated with the investment.

Key variables to consider when calculating the cost of equity are:

Risk-Free Rate (Rf): The risk-free rate refers to the return expected from a risk-free investment, such as government bonds. It serves as a benchmark for determining the minimum return investors require.

Equity Risk Premium (ERP): The equity risk premium is the additional return investors demand for taking on the risk of investing in equities rather than risk-free assets. It compensates investors for the uncertainty and volatility associated with owning stocks.

Beta (β): Beta measures the sensitivity of a stock's returns to the overall market returns. It reflects the systematic risk of the company's stock and is an important factor in determining the cost of equity. A beta greater than 1 indicates higher volatility compared to the market, while a beta less than 1 indicates lower volatility.

Market Risk Premium (MRP): The market risk premium is the difference between the expected return on the overall market and the risk-free rate. It represents the compensation investors demand for bearing the overall risk of investing in the market.

Company-Specific Risk: Apart from market risk, companies may have specific risks associated with their operations, industry, or financial structure. These risks can affect the cost of equity and may be reflected in the beta or incorporated separately in the calculation.

Relevance of Cost of Equity to Shareholders: The cost of equity is highly relevant to shareholders as it represents the minimum rate of return they require to compensate for the risk associated with investing in a particular company's stock. It serves as a benchmark for evaluating investment opportunities and making decisions about capital allocation.

For shareholders, the cost of equity helps in the following ways:

Investment Decision-making: Shareholders can use the cost of equity to assess the attractiveness of investment opportunities. If the expected return from an investment is lower than the cost of equity, it may not be considered worthwhile.

Valuation of Stock: The cost of equity is a key input in various stock valuation models, such as the dividend discount model (DDM) or discounted cash flow (DCF) analysis. These models estimate the intrinsic value of a stock based on its expected future cash flows and the required rate of return (cost of equity).

Comparison with Return on Investment: Shareholders can compare the cost of equity with the company's return on investment or earnings yield to assess whether the company is generating sufficient returns to meet their expectations.

Determining Shareholder Value: The cost of equity is an important factor in determining the company's cost of capital and ultimately its value. By ensuring that the cost of equity is appropriately reflected in the company's capital structure and investment decisions, shareholders can maximize the value of their investments.

In summary, the cost of equity is relevant to shareholders as it represents the minimum rate of return they require from investing in a company's stock. It helps in evaluating investment opportunities, determining stock valuation, comparing returns, and maximizing shareholder value.

Cost of Debt (Kd): The rate of return required by lenders or bondholders. It represents the interest rate or cost of borrowing. The cost of debt is the effective interest rate that a company pays on its debt. It represents the cost of borrowing funds from lenders or bondholders.

Key variables to consider when calculating the cost of debt are:

Interest Rate: The interest rate on the debt represents the compensation the company must pay to lenders for borrowing funds. It can be fixed or variable, depending on the terms of the debt agreement.

Credit Spread: The credit spread reflects the additional interest rate that lenders charge to compensate for the credit risk associated with the company. It takes into account factors such as the company's credit rating, financial stability, and industry risk.

Debt Maturity: The maturity of the debt refers to the period over which the company is obligated to make interest payments and repay the principal. The longer the maturity, the higher the cost of debt, as it entails a longer commitment and higher uncertainty.

Debt Issuance Costs: Debt issuance costs include fees, commissions, and expenses associated with issuing and maintaining the debt. These costs should be considered when calculating the overall cost of debt.

Tax Rate: The tax rate is an important factor when calculating the cost of debt because interest payments are tax-deductible. The tax shield from interest expense reduces the effective cost of debt.

Relevance of Cost of Debt to Shareholders: The cost of debt is relevant to shareholders for several reasons:

Capital Structure Decisions: Shareholders and management consider the cost of debt when making decisions about the company's capital structure. By comparing the cost of debt with the cost of equity, they can determine the optimal mix of debt and equity financing that minimizes the overall cost of capital and maximizes shareholder value.

Risk Assessment: The cost of debt provides insights into the financial risk of a company. Higher interest rates and credit spreads indicate higher perceived risk by lenders. Shareholders can assess the company's ability to service its debt and evaluate the overall risk profile of their investment.

Valuation of the Company: The cost of debt is a crucial input in determining the weighted average cost of capital (WACC) and discounting future cash flows in valuation models. By incorporating the cost of debt, shareholders can estimate the company's intrinsic value and make informed investment decisions.

Dividend Payments and Cash Flow Allocation: The cost of debt affects the company's cash flow availability. Higher interest payments reduce the amount of cash available for dividends or reinvestment in the business. Shareholders need to evaluate the impact of the cost of debt on the company's ability to generate returns and distribute profits.

Investor Perception: Shareholders and potential investors consider the cost of debt as an indicator of a company's financial health and creditworthiness. A higher cost of debt may lead to concerns about the company's ability to meet its financial obligations and affect investor sentiment.

In summary, the cost of debt is relevant to shareholders as it influences capital structure decisions, provides insights into risk assessment, affects company valuation, impacts cash flow allocation, and influences investor perception. By understanding the cost of debt, shareholders can make informed decisions about their investments and assess the financial health of the company.

Equity Weight (We): The proportion of equity financing in the company's capital structure.

Debt Weight (Wd): The proportion of debt financing in the company's capital structure.

Tax Rate (T): The corporate tax rate, as interest payments on debt are tax-deductible.

Calculation of WACC:

WACC = (We * Ke) + (Wd * Kd) * (1 - T)

Assumptions: To calculate a WACC of 5% for both Microsoft and Google, we can make the following assumptions:

Equity Weight (We): 70%

Debt Weight (Wd): 30%

Tax Rate (T): 20%

Calculating Cost of Equity (Ke): To achieve a WACC of 5%, we can solve for the cost of equity:

5% = (0.7 * Ke) + (0.3 * Kd) * (1 - 0.20)

Let's assume a cost of debt (Kd) of 2%. Solving for Ke:

0.05 = 0.7 * Ke + (0.3 * 0.02) * 0.8 0.05 = 0.7 * Ke + 0.006

0.044 = 0.7 * Ke Ke ≈ 0.06286 or 6.29%

Calculating WACC for Microsoft:

WACC = (0.7 * 0.06286) + (0.3 * 0.02) * (1 - 0.20) WACC = 0.044 * 0.8 WACC = 0.0352 or 3.52%

Calculating WACC for Google:

WACC = (0.7 * 0.06286) + (0.3 * 0.02) * (1 - 0.20) WACC = 0.044 * 0.8 WACC = 0.0352 or 3.52%

Interpreting the Results:

The calculated WACC for both Microsoft and Google is approximately 3.52%. This suggests that to satisfy their investors and maintain their market value, Microsoft and Google need to earn a return on their investments that is at least 3.52%.

A lower WACC indicates a lower cost of capital for the company, which can be advantageous for the company's valuation and profitability. In this case, both Microsoft and Google have relatively low WACC values, indicating that they have efficient capital structures and lower costs of capital.

For investors, the WACC can be used as a discount rate for evaluating investment opportunities in Microsoft and Google. If an investment opportunity has a higher rate of return than the WACC, it may be considered attractive. However, it's important to note that the WACC is just one factor to consider, and investors should also assess other aspects such as the company's growth prospects, industry conditions, and market dynamics.

CHAPTER SIX

Analysis of Sales Forecast

Sales forecasting is the process of estimating future sales based on historical data, market analysis, and other relevant factors. It is an essential component of business planning and decision-making, providing insights into expected revenue and helping organizations set realistic goals and allocate resources effectively.

Sales forecasts serve as a valuable tool for businesses, enabling them to anticipate future demand, plan production and inventory levels, allocate resources, set sales targets, and assess the financial feasibility of business strategies

Various methods can be employed for sales forecasting, including time series analysis, regression analysis, moving averages, exponential smoothing, market research surveys, and expert judgment. The choice of method depends on the nature of the business, available data, and the level of accuracy required.

Microsoft Inc
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Based on the provided data, the sales forecast and trends for both Microsoft and Google could be noted as follows:

Microsoft:

Sales Growth: Microsoft has exhibited a sales growth rate of 16.38%.

Current Assets/Sales: The current assets as a percentage of sales is 15.00%.

Current Liabilities/Sales: The current liabilities as a percentage of sales is 8.00%.

Net Fixed Assets/Sales: The net fixed assets as a percentage of sales is 77.00%.

Costs of Goods Sold/Sales: The costs of goods sold as a percentage of sales is 50.00%.

Interest Rate on Debt: The interest rate on debt is mentioned as 10.00%.

Interest Paid on Cash and Marketable Securities: The interest paid on cash and marketable securities is mentioned as 5.00%.

Depreciation Rate: The depreciation rate is mentioned as 10%.

Tax Rate: The tax rate is mentioned as 40.00%.

Google:

Sales Growth: Google has shown a sales growth rate of 21.23%.

Current Assets/Sales: The current assets as a percentage of sales is 15.18%.

Current Liabilities/Sales: The current liabilities as a percentage of sales is 24.50%.

Net Fixed Assets/Sales: The net fixed assets as a percentage of sales is 70.88%.

Costs of Goods Sold/Sales: The costs of goods sold as a percentage of sales is 44.62%.

Interest Rate on Debt: The interest rate on debt is not provided.

Depreciation Rate: The depreciation rate is mentioned as 10%.

Tax Rate: The tax rate is mentioned as 40.00%.

Analyzing the Sales Forecast:

Both Microsoft and Google have demonstrated positive sales growth rates over the previous years, indicating a favorable trend.

Microsoft's sales are forecasted to reach 423,260.31 in Year 5, while Google's sales are projected to reach 740,602.57 in Year 5.

Microsoft's sales growth rate is relatively lower compared to Google's, with a growth rate of 16.38% versus 21.23%.

Microsoft has a higher proportion of net fixed assets to sales compared to Google, indicating a higher investment in long-term assets to support sales.

Google has a higher proportion of current liabilities to sales compared to Microsoft, suggesting a relatively higher dependence on short-term financing for sales activities.

Overall, both companies are projected to experience growth in sales over the forecast period. Google has demonstrated a higher sales growth rate and a relatively higher proportion of current liabilities to sales. Microsoft, on the other hand, has a higher proportion of net fixed assets to sales, indicating a significant investment in long-term assets. It's important to note that additional factors and information may impact the sales forecast and should be considered for a comprehensive analysis.

CONCLUDING REMARKS

In conclusion, this assignment has involved a critical analysis of quantitative finance and the financial market. Through the examination of various factors and data, we have gained valuable insights into the dynamics and trends within the financial market.

The analysis covered a wide range of aspects, including financial statements, ratios, market trends, benchmarking analysis, sales forecasts, and other relevant financial information. By evaluating these elements, we have developed a comprehensive understanding of the quantitative finance landscape and its implications for the financial market.

Throughout the assignment, we have observed the importance of quantitative analysis in understanding market conditions, identifying trends, and making informed decisions. The analysis of financial statements and ratios has provided insights into the financial health and performance of companies, allowing us to assess their liquidity, efficiency, profitability, and overall financial stability.

The benchmarking analysis has enabled us to compare the selected companies and their competitors, providing valuable perspectives on their relative performance within the industry. This analysis has shed light on areas of strength and weakness, highlighting opportunities for improvement and potential risks.

The examination of sales forecasts has allowed us to gauge the growth potential and market demand for specific products or services. By understanding sales trends, we can better anticipate future performance and make strategic decisions to capitalize on market opportunities.

Overall, this assignment has provided a comprehensive understanding of quantitative finance and its impact on the financial market. The analysis and insights gained can be utilized by investors, financial professionals, and decision-makers to make informed decisions, manage risks, and optimize financial performance.

It is important to note that the financial market is dynamic and subject to various factors, including economic conditions, regulatory changes, and market fluctuations. Therefore, ongoing monitoring and analysis are crucial to adapt to changing circumstances and maintain a competitive edge in the financial market.

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