

# GCC Risk Premium – H1 2021

A Toolkit for Corporate  
Financiers



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# Why purchase the report?

- **COVID-19 Impact:** Our latest Equity Risk Premium values incorporate the impact of COVID-19.
- **3 Approaches:** Robust analysis of Equity Risk Premium of GCC countries using three different approaches. Sovereign ratings approach, Equity market Implied and CDS spread based methods.
- **6 GCC Nations:** Equity Risk Premium calculated for all the six member countries of the GCC region
- **Risk Evolution:** Trend on risk premium provided for all the six countries to better understand the risk evolution in these markets.

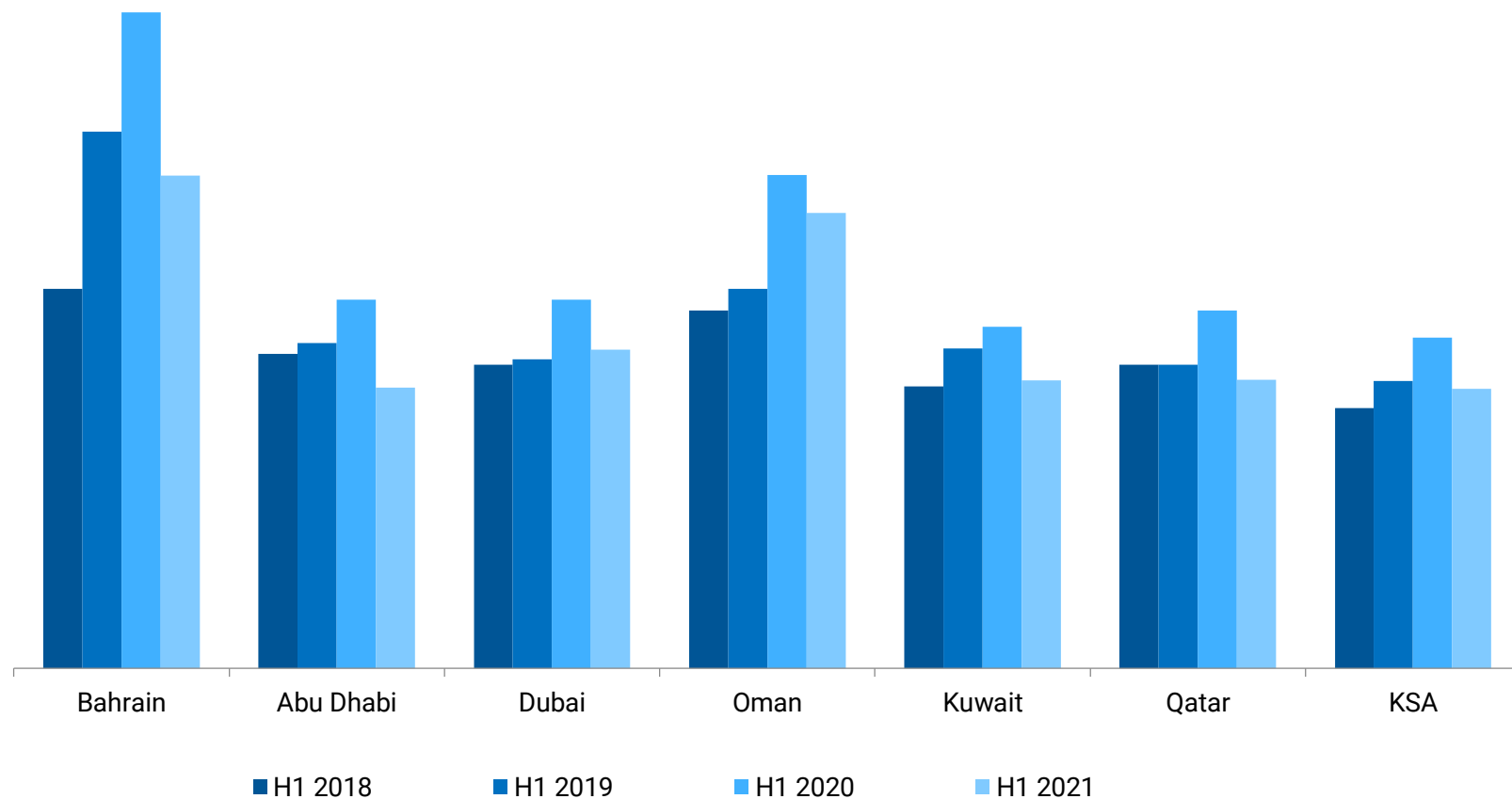
# Importance of Cost of Capital in the current environment

1. Cost of capital represents the opportunity cost of financial capital, primarily debt and equity, invested in an enterprise. Opportunity cost is what is given up as a consequence of an investment decision
2. Opportunity cost' is also referred to as 'hurdle cost' or 'discount rate', and is of primary importance in valuation and helps investors in identifying the right company or project to invest.
3. In reality, not much effort is invested in calculating cost of capital; while a significant amount of time is focused on forecasting uncertain future cash flows.
4. Improper capital cost assumptions could lead to type-I error (accepting projects that do not add shareholder value) or type-II error (rejecting projects that add shareholder value).

# Calculating the Equity Risk Premium

1. **Sovereign rating method:** The equity risk premium ERP of GCC countries are arrived at by taking the U.S market's ERP and adding the default spread based on their credit rating.
2. **CDS Spreads method:** In this method, the CDS spread of a country's bond (adjusted for spread of risk free country) is considered as default spread and added to the U.S market's ERP.
3. **Implied ERP method:** Implied equity risk premium is an alternative approach to estimate risk premiums. Assuming that stocks are correctly priced, if we can estimate the expected cash flows from buying stocks, then we can estimate the expected rate of return on stocks by computing an internal rate of return (IRR). Subtracting out the risk free rate from IRR should yield an implied equity risk premium.

# Evolution of Cost of Capital in the GCC





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