Using the CAPM to Calculate the Cost of Equity

Formula

Ratio of which a stock moves relative to the market; also takes into account capital structure

Cost of Equity

Levered / Equity Beta

$$R = R_f + \beta_c \left(R_m - R_f\right)$$

Risk-Free Rate

Market Risk Premium

Rate of return for a theoretically risk-free investment (i.e. Government bonds)

Return of the 'market' minus the risk-free rate

Assumptions

	Description & Source	Model Input
Risk-Free Rate	▪ 10-Year Government Bond rate of home country of stock ▪ https://www.bloomberg.com/markets/rates-bonds/government-bonds/australia ▪ *However, given record low interest rates, many analysts and investors are using longer-dated averages (~3.0%)*	**3.0%**
Levered / Equity Beta	▪ Typical to use 3-year beta for a stock (how closely it moves with market) ▪ https://www.infrontanalytics.com/fe-en/AU000000BLD2/Boral-Limited/beta	**1.67**
Market Risk Premium	▪ 'Market return' minus the risk-free rate – i.e. extra return for investing in risky assets ▪ Select Australia as home country of stock and main operating geography ▪ http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html	**4.72%**

Source: Bloomberg, Infront, NYU Stern School of Business