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# **Equity valuation**

Non-cash flow methodologies are used to evaluate equity value.

a/

Price earnings ratio (P/E) displays how much a shareholder is prepared to pay for a share, assumed its current earnings per share (EPS). Therefore, P/E can show the investors’ confidence in the expected future performance of a firm.



**Figure 1: Price earnings ratio (P/E) of Edinburgh Plc**

The figure 1 shows the P/E is 20.8 is above P/E of FTSE All-share index +10% (17.2), shares appear overvalued.

b/

Dividend yield (DY) provides a measure of potential return investors expect to receive in exchange for acquiring a specified share.



**Picture 2: Dividend yield of Edinburgh Plc**

The figure 2 indicates dividend yield is 3.8% is below DY of FTSE All-share index -10% (4.7%), shares appear overvalued.

**Conclusion**

• When prospective P/E of FTSE All‐Share index is 15.6, the company P/E (20.8) is above Index PER +10% (17.2), then shares appear overvalued. However, future earnings per share (EPS) growth expectations are nearly 2% for both 2025 and 2026. Therefore, shares are not justified by weak future profit growth expectations.

• When prospective dividend yield of FTSE All‐Share index is 4.3%, the company dividend yield (3.8%) is below Index DY -10% (3.9%), then shares appear overvalued. However, future dividend growth expectations are 4% and 3% for 2025 and 2026, respectively. Therefore, shares are not justified by slow future dividend growth expectations.

• Overall, the company’s shares are not fairly valued by the equity market. They are overvalued.

# **International expansion project in Belgium**

**a/ Cost of Equity (Ke)**



**Figure 3: Cost of equity (Ke) of Edinburgh Plc**

Figure 3 indicates Ke is 7.31%.

**b/ Cost of debt (Kd)**



**Figure 4: Cost of debt (Kd) of Edinburgh Plc**

Figure 4 below shows KD is 3.51%.

**c/ The weighted average cost of capital (WACC)**



**Figure 5: The WACC of Edinburgh Plc**

The WACC renovates market prices of a business’ securities to a money discount rate for investment appraisal purposes. Figure 5 indicates WACC is 6.9%.

**d/ Investment appraisal methodologies:**

WACC is used as the discount rate to determine whether the international facility should be expanded because:

- Investment amount £3.5m (EUR 3m/0.8530) is 0.6% of MV of (£616m) (less than 10%), therefore the project size is marginal.

- There is no business risk because it is only expansion of one of the company's existing facilities in Belgium.

- There is no financial risk because the project can be funded from the company’s existing resources.

(1) Net Present Value (NPV) method uses discounted cash flows (DCF) to evaluate capital investment projects. Figure 6 shows that NPV of expansion project in Belgium is +£1,460,406 which is positive, company should set up the facility.



**Figure 6: Net Present Value (NPV) of expansion project in Belgium**

(2) Internal Rate of Return (IRR) method is the cost of capital. Figure 7 indicates that IRR of expansion project in Belgium is 14.5% is higher than the cost of capital (7.31%), company should set up facility.



**Figure 7: Internal Rate of Return (IRR) of expansion project in Belgium**

(3) Discounted Payback Period (DPP) is the period for a project’s initial cash outflows to be recovered. Figure 8 shows that DPP of expansion project in Belgium is 6.75 years.



**Figure 8: Discounted Payback Period (DPP)** **of expansion project in Belgium**

**e/ Advice:**

The project's IRR (14.5%) is higher than the cost of capital (7.31%) and it has a positive NPV (+£1,460,406), therefore the company should accept the expansion project in Belgium and it is forecast to increase shareholder wealth.

# **Capital structure**

Financial gearing calculation:



**Figure 9: Capital structure of Edinburgh Plc**

**Conclusion:**

- Figure 9 indicates that current financial gearing is 10.7%, well below the optimal level of financial gearing (30%). According to M&M's with-tax theory, the firm is giving up potential tax shields by using insufficient debt. Using M&M theory, we can estimate that increasing debt to align with industry averages (25%-50%) would raise the firm’s market value by (Corporate Tax \* Additional debt needed to reach target gearing).

- Furthermore, the trade-off theory supports this strategy at current levels, as the risk of financial distress is likely minimal at 10.7% gearing. Hence, we conclude the firm’s capital structure is sub-optimal, and a gradual increase in debt toward 30% gearing is recommended to reduce the WACC and enhance shareholder value.

- There are some methods to raise gearing, including

+ Issue more debts by taking out bank loans, issuing bonds that directly increases debts (liabilities) and raise gearing.

+ Repurchase shares (Buybacks) that reduces equity, thus increase gearing.

+ Pay dividends that reduces retained earnings (equity), thus increase gearing

# **Dividend policy**



**Figure 10: Dividend ratio of Edinburgh Plc**

The company’s regular dividend policy can be best described as progressive dividend policy as there was steady dividend growth (around 3.5% per year), even while earnings per share (EPS) growth has remained modest (1.4%–1.6%) and the gradual decline in dividend cover from 1.4 to 1.3.

While M& irrelevance theory suggests that dividend policy does not impact shareholder wealth in a perfect capital market, real-world conditions (e.g., taxes, investor preferences, signalling) mean dividend policy does matter.

Applying dividend relevance theories:

* The bird-in-the-hand theory implies investors may prefer Edinburgh’s steady dividend increases over uncertain future capital gains.
* Signalling theory supports that the progressive increases signal financial health and management confidence.

Thus, while there is no single “optimal” policy, the current approach appears appropriate and sustainable, especially if it aligns with shareholder expectations and market norms.

**Recommendation**: Continue the progressive dividend policy to maintain investor confidence, and clearly communicate any deviations (e.g., special dividends in strong years or temporary reductions in poor years) to avoid adverse market reaction by:

• In “standard” years, remaining unchanging this policy and when dividend increases, paying special dividends;

• Rising growth buy-back and/or rate shares in “good” years;

• Risk the dividend shelter to weaken the growth rate in “bad” years;

• In “bad” years, cutting the dividend.