Weighted Average Cost of Capital Analysis of Avenue Supermarts Ltd.

Introduction to WACC

The Weighted Average Cost of Capital (WACC) is a critical financial metric used in valuation and capital budgeting. It represents the average rate of return a company is expected to pay its capital providers: debt and equity, weighted by their proportion in the company's capital structure.

Mathematically:

$$WACC = \left(\frac{E}{E+D}\right) * Cost\ of\ Equity + \left(\frac{D}{D+E}\right) * Cost\ of\ Debt * (1 - Tax\ Rate)$$

WACC is used as the discount rate in discounted cash flow (DCF) models to evaluate investment decisions. A lower WACC indicates a lower risk profile and cost of capital, which enhances the company's valuation.

This report provides a step-by-step analysis of WACC computation for Avenue Supermarts Ltd. using the figures and methodology provided.

Peer Group Benchmarking and Capital Structure

Weightage Average Cost of Capital

All figurres in INR unless stated otherwise

Peer Comps

Name of the Company	Country	Total Debt	Total Equity	Tax Rate [1]	Debt/ Equity	Debt/ Capital	Levered Beta [2]	Unlevered Beta [3]
Avenue Super.	India	592.2	342,494.2	30.00%	0.17%	0.17%	0.76	0.76
Trent	India	1,753.0	270,956.1	30.00%	0.65%	0.64%	0.79	0.79
Aditya Bir. Fas.	India	9,451.4	36,782.8	30.00%	25.70%	20.44%	0.66	0.56
Brainbees Solut.	India	1,429.6	34,149.4	30.00%	4.19%	4.02%	0.01	0.01
Redtape	India	480.1	9,977.5	30.00%	4.81%	4.59%	0.53	0.51
			Average	30.00%	7.10%	5.97%	0.55	0.52
			Median	30.00%	4.19%	4.02%	0.66	0.56

To estimate cost components, peer comparables are analyzed. The comparable companies include Trent, Aditya Birla Fashion, Brainbees Solutions, and Redtape, all Indian retail players.

Key benchmarking elements include:

- **Debt-to-Equity Ratios**: Avenue Supermarts has a conservative capital structure with a very low current debt-to-equity ratio of 0.17%. In contrast, the peer median is 6.35%.

- **Unlevered and Levered Beta**: Avenue's levered beta is 0.76, and the unlevered beta is also 0.76 given the near-zero leverage. The median unlevered beta for peers is 0.56, used as a base for recomputing Avenue's **target levered beta** of 0.58, adjusted for a target debt-to-equity ratio of 6.35% and a tax rate of 30%.

Cost of Equity Estimation

Cost of equity reflects the return shareholders expect for bearing the company's equity risk. It is calculated using the **Capital Asset Pricing Model (CAPM)**:

$$Cost\ of\ Equity = Riskfree\ Rate + \beta * Equity\ Risk\ Premium$$

Levered Beta	
Comps Median Unlevered Beta	0.56
Target Debt/Equity	6.35%
Tax Rate	30%
Levered Beta	0.58

Cost of Equity	
Risk Free Rate	7.39%
Equity Risk Premium	8.22%
Levered Beta [4]	0.58
Cost of Equity	12.19%

Using the inputs provided:

- **Risk-Free Rate**: 7.39%
- **Equity Risk Premium**: 8.22%
- **Levered Beta**: 0.58

Cost of Equity = 7.39% + 0.58 × 8.22% = 12.19%

This rate captures Avenue Supermarts' relatively low volatility and conservative financial risk profile.

Cost of Debt Estimation

The **pre-tax cost of debt** is 8.40%, and with the marginal tax rate of 30%, the **post-tax cost of debt** is:

Post-tax Cost of Debt = 8.40% × (1–0.30) = 5.88%

This reflects the tax shield that interest expenses offer.

Cost of Debt	
Pre-Tax Cost of Debt	8.40%
Tax Rate	30.00%
Post Tax Cost of Debt	5.88%

WACC Analysis
Samiksha Sarda

Capital Structure Weighting

Based on the market values:

- **Total Debt**: INR 592.2 million
- **Market Capitalization (Equity)**: INR 342,494.2 million
- **Total Capital**: INR 343,086.37 million

Capital Structure		Current	Target
Total Debt	592.2	0.17%	5.97%
Market Capitilization	342,494.2	99.83%	94.03%
Total Capital	343086.37	100.00%	100.00%
Debt/Equity		0.17%	6.35%

Thus, the **capital structure weights** are:

- **Debt**: 0.17%
- **Equity**: 99.83%

However, for the WACC calculation, **target weights** are used (as shown in the *Capital Structure* section of the table):

- **Debt**: 5.97%
- **Equity**: 94.03%

These reflect an optimal capital structure assumption for valuation purposes.

Final WACC Calculation

Using the above inputs:

- **Cost of Debt (post-tax)**: 5.88%
- **Cost of Equity**: 12.19%
- **Weights**: Debt = 5.97%, Equity = 94.03%

Weighted Average Cost of Capital	Total Cost	Total Weight
Debt	5.88%	5.97%
Equity	12.19%	94.03%
Weighted Average Cost of Capital		11.82%

WACC = (12.19% × 94.03%) + (5.88% × 5.97%) = 11.82%

This final WACC figure is used in Avenue Supermarts' DCF valuation (as seen in the previous DCF report) to discount future free cash flows and terminal value.

Interpretation and Strategic Implications

- A **WACC of 11.82%** indicates a balanced cost of capital for Avenue Supermarts, reflecting both its strong equity base and minimal reliance on debt.
- The low **beta and cost of equity** suggest low volatility, which enhances investor confidence.
- Although current debt levels are low, the target structure assumes a more efficient use of leverage, optimizing WACC without significantly increasing financial risk.

- As the company matures, it may consider gradually increasing debt within conservative limits to enhance returns on equity without materially raising risk.

Conclusion

The WACC analysis confirms Avenue Supermarts' strong financial footing, with a capital structure that is largely equity-driven. The 11.82% WACC serves as a reliable discount rate for valuation models and capital allocation decisions. It also reflects the company's stability, conservative financial policy, and moderate growth expectations priced at a reasonable risk.

Going forward, maintaining a low beta and stable cost of capital can provide the company with a strategic advantage in capital markets and investment planning.

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Cost of Debt

Pre-Tax Cost of Debt	8.40%
Tax Rate	30.00%
Post Tax Cost of Debt	5.88%

Cost of Equity

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Capital Structure

		Current	Target
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Levered Beta

Comps Median Unlevered Beta	0.56
Target Debt/Equity	6.35%
Tax Rate	30%
Levered Beta	0.58

Weighted Average Cost of Capital

	Total Cost	Total Weight
Debt	5.88%	5.97%
Equity	12.19%	94.03%
Weighted Average Cost of Capital		11.82%

Notes:

1. Tax Rate considered as Marginal Tax Rate for the country

2. Levered beta based on 5 year monthly data

*3. Unlevered Beta=Levered Beta/(1+(1-TaxRate)*Debt/Equity)*

4. Levered Beta=Unlevered Beta(1+(1-TaxRate)*Debt/Equity)*