

Example WACC Calculation



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- ❖ The WACC can be complicated to calculate so lets work through an example...
- ❖ From the CAPM lecture we calculated the Cost of Equity

Understanding the Capital Asset Pricing Model

- ❖ The Expected Rate of Return for the stock was 12.25%

Risk Free Rate = 1.75%

Market Risk Premium = 7%

Beta = 1.5

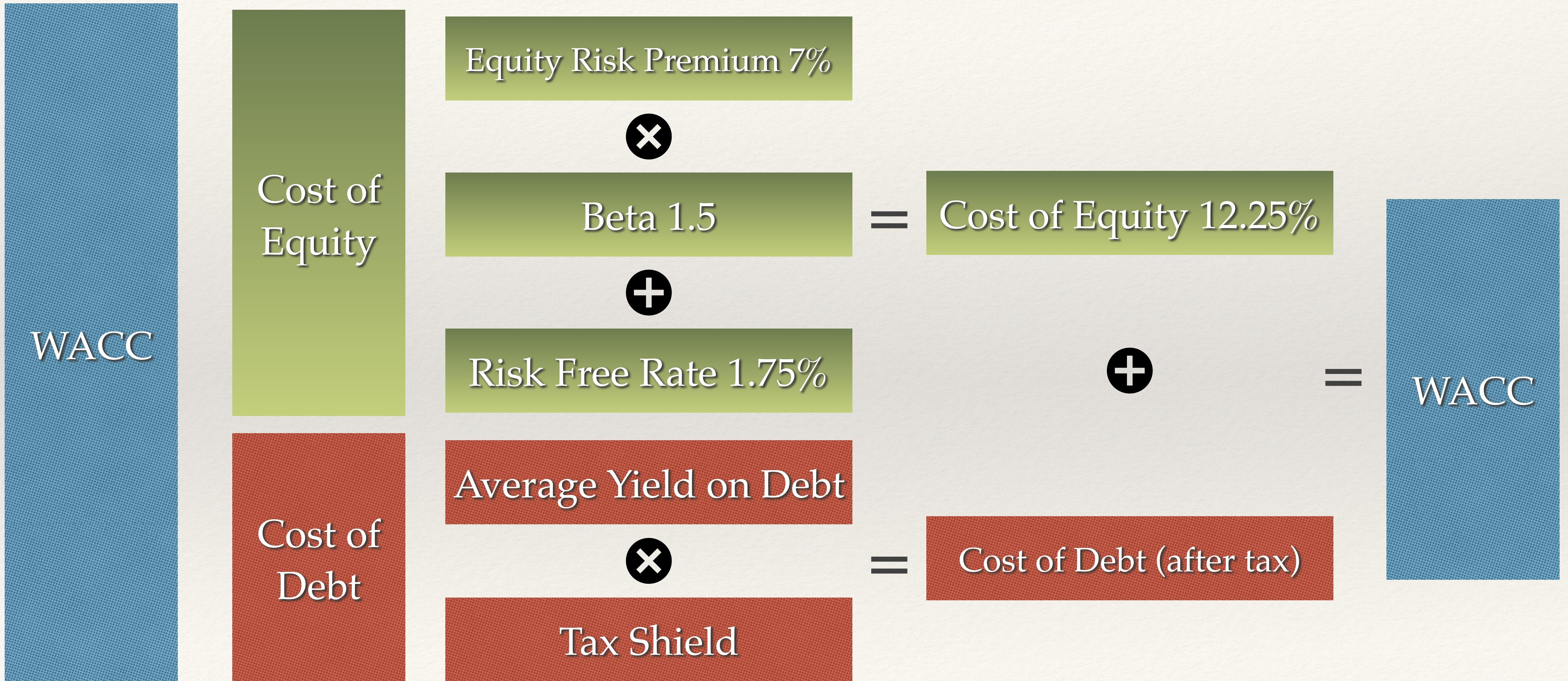
Expected Return =

$$1.75\% + (1.5 \times 7\%) = 12.25\%$$

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- ❖ We can put these figures into the Diagram we have used in the WACC lecture...

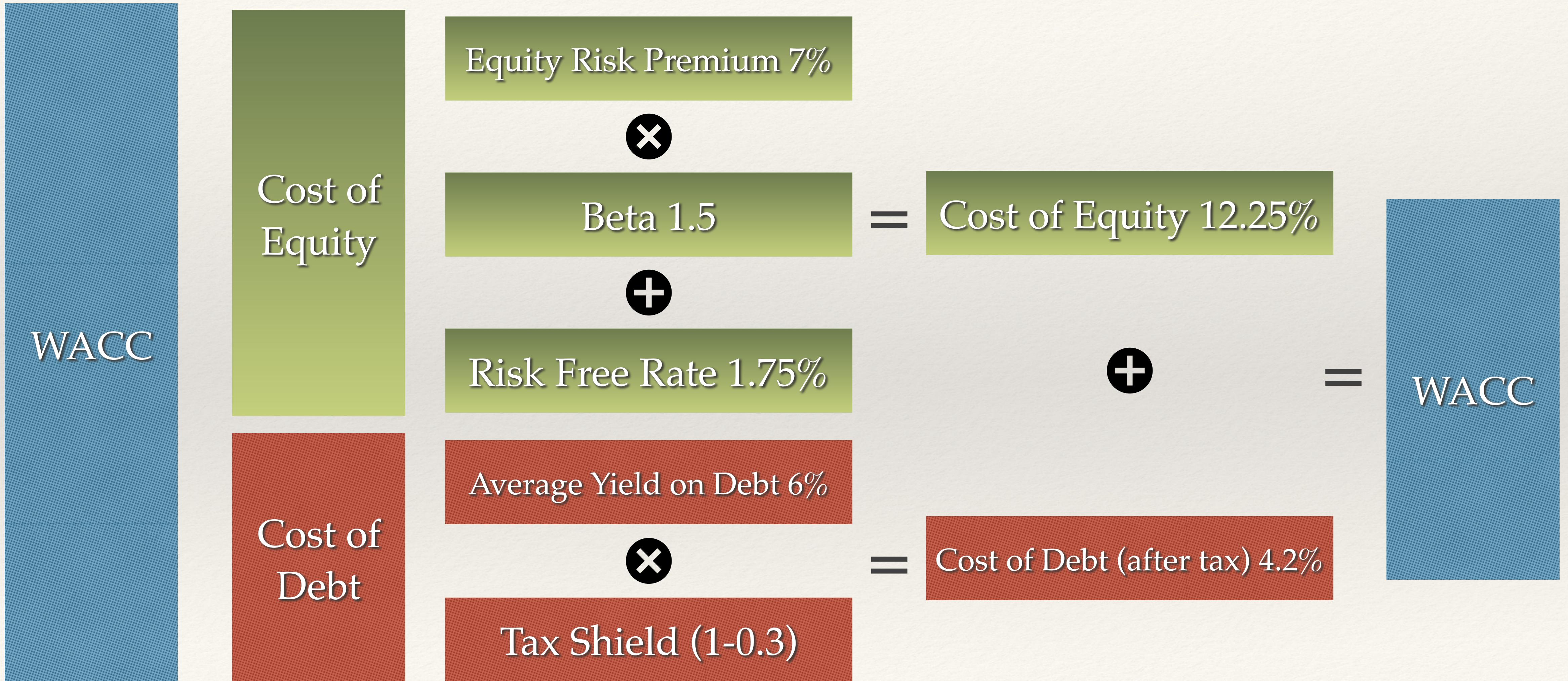
The Weighted Average Cost of Capital Formula



Example WACC Calculation

- ❖ Lets assume that the cost of debt is 6%
- ❖ The Tax Rate is 30%
- ❖ This means that the after tax rate of the debt is $6\% \times (1-0.3)$
 $= 4.2\%$
- ❖ We can put this into our diagram...

The Weighted Average Cost of Capital Formula



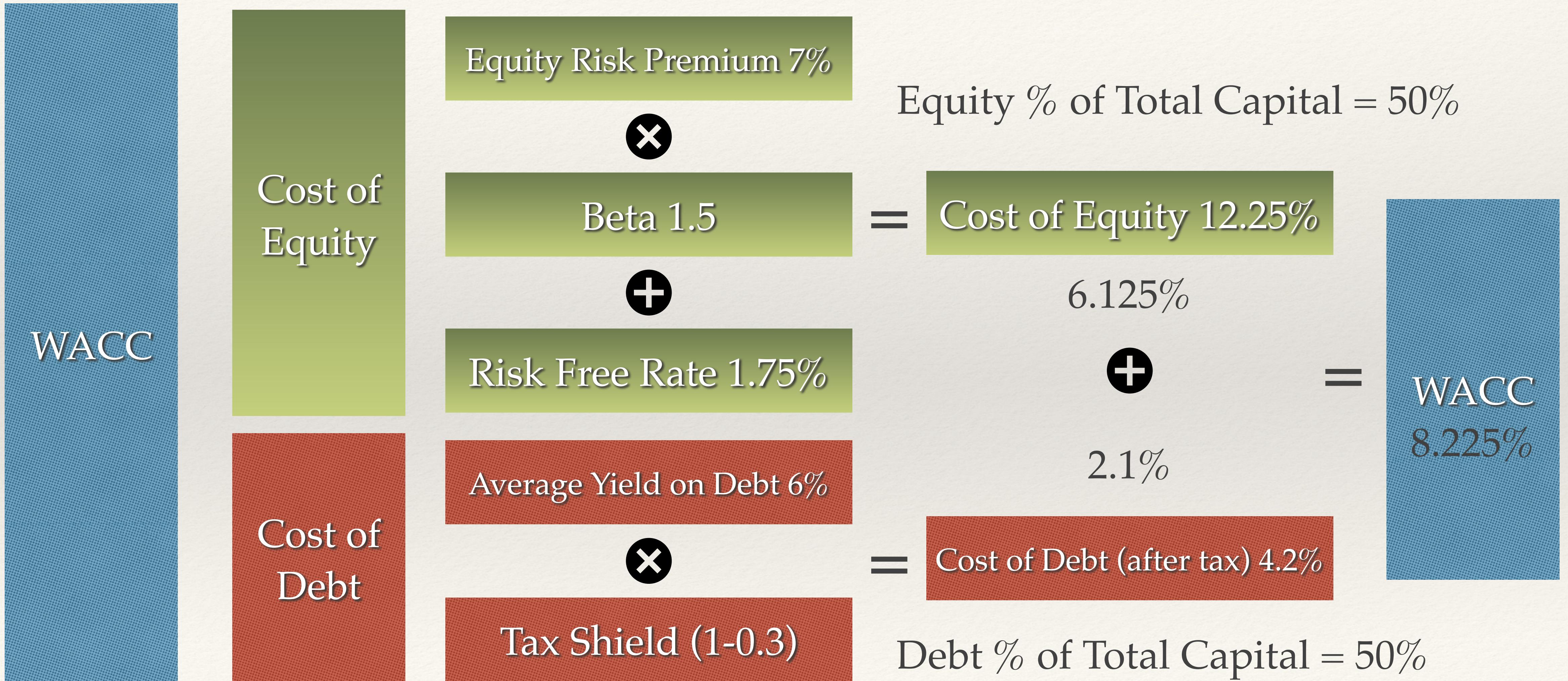
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- ❖ To keep the math simple lets assume that the debt/equity ratio is 50%
- ❖ Half of the capital is debt and half is equity

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- ❖ This means that the weighted cost of equity is 6.125%
- ❖ The weighted cost of debt is 2.1%
- ❖ The WACC = 8.225%

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