

Financial Strategy (F3) . CIMA Strategic level . For revision use only

## Cost of Capital

Cost of equity (CAPM) =  $R_f + \text{Beta} \times (R_m - R_f)$

Cost of equity (dividend growth) =  $[D_0 \times (1+g) / P_0] + g$

Cost of debt (irredeemable, post-tax) =  $\text{Interest} \times (1 - \text{Tax rate}) / \text{Market value}$

WACC =  $(E/(E+D) \times K_e) + (D/(E+D) \times K_d \times (1-T))$

## Dividend Growth & Valuation

Sustainable growth rate (g) =  $\text{Retention ratio} \times \text{ROE}$

Share price (Gordon growth) =  $D_0 \times (1+g) / (K_e - g)$

## Business Valuation

P/E method:  $\text{Value} = \text{Earnings} \times \text{P/E ratio}$

Dividend yield method:  $\text{Value} = \text{Total dividend} / \text{Dividend yield}$

EV/EBITDA method:  $\text{Enterprise value} = \text{EBITDA} \times \text{EV/EBITDA multiple}$

## Rights Issues

Theoretical ex-rights price (TERP) =  $(\text{Value of shares before} + \text{Cash raised}) / \text{Total shares after}$

## Modigliani & Miller (with tax)

Value of geared firm =  $\text{Value of ungeared firm} + (\text{Tax rate} \times \text{Value of debt})$

*MM's tax shield: financial risk increases but the tax benefit of debt raises value*

## Capital Structure

Interest cover =  $\text{PBIT} / \text{Interest expense}$

Gearing (debt to equity, market values) =  $\text{Market value of debt} / \text{Market value of equity} \times 100$

## Foreign Exchange

Forward rate (IRP) =  $\text{Spot rate} \times (1 + \text{interest rate quote currency}) / (1 + \text{interest rate base currency})$

*PPP: higher-inflation currency expected to weaken / trade at a forward discount*