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TOPIC 4 – DETERMINATION OF WEIGHTED AVERAGE COST OF CAPITAL, WACC

1. INTRODUCTION AND OBJECTIVE

This article attempts to discuss on some basic principles that should be considered when determining the WACC, which is the discount rate used when using the FCFF method (discussed in Topic 2).

Method	Explanation
Free Cash Flow to Firm (FCFF)	FCFF derives the enterprise value attributable to the stakeholders which comprise of both the equity and debt providers of a proposed power plant under evaluation. The Internal Rate of Return (IRR), as determined using the net cash flow from FCFF is known as the project IRR.

Cost of Capital, WACC	=	Cost of Capital (K_e) (Discussed in Topic 3)	x	E/(E+D)	+	Cost of borrowing	x	D/(E+D)	x	(1- Marginal tax rate)
				Weights should be based on market values		Weighted cost of borrowing, charged by the debt lenders		Weights should be based on market values		

THANKS FOR READING.

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