

## THE COST OF CAPITAL FOR GOFF COMPUTER, INC.

You have recently been hired by Goff Computer, Inc. (GCI), in the finance area. GCI was founded eight years ago by Chris Goff and currently operates 74 stores in the Southeast. GCI is privately owned by Chris and his family and had sales of \$97 million last year.

GCI sells primarily to in-store customers. Customers come to the store and talk with a sales representative. The sales representative assists the customer in determining the type of computer and peripherals that are necessary for the individual customer's computing needs. After the order is taken, the customer pays for the order immediately, and the computer is assembled to fill the order. Delivery of the computer averages 15 days but is guaranteed in 30 days.

GCI's growth to date has been financed from its profits. Whenever the company had sufficient capital, it would open a new store. Relatively little formal analysis has been used in the capital budgeting process. Chris has just read about capital budgeting techniques and has come to you for help. The company has never attempted to determine its cost of capital, and Chris would like you to perform the analysis. Because the company is privately owned, it is difficult to determine the cost of equity for the company. You have determined that to estimate the cost of capital for GCI, you will use Dell as a representative company. The following steps will allow you to calculate this estimate:

1. Most publicly traded corporations are required to submit 10Q (quarterly) and 10K (annual) reports to the SEC detailing their financial operations over the previous quarter or year, respectively. These corporate filings are available on the SEC Web site at [www.sec.gov](http://www.sec.gov). Go to the SEC Web site, follow the "Search for Company Filings" link and the "Companies & Other Filers" link, enter "Dell Computer," and search for SEC filings made by Dell. Find the most recent 10Q and 10K and download the forms. Look on the balance sheet to find the book value of debt and the book value of equity. If you look further down the report, you should find a section titled either "Long-Term Debt" or "Long-Term Debt and Interest Rate Risk Management" that will list a breakdown of Dell's long-term debt.
2. To estimate the cost of equity for Dell, go to [finance.yahoo.com](http://finance.yahoo.com) and enter the ticker symbol "DELL." Follow the various links to find answers to the following questions: What is the most recent stock price listed for Dell? What is the market value of equity, or market capitalization? How many shares of stock does Dell have outstanding? What is the beta for Dell? Now go back to [finance.yahoo.com](http://finance.yahoo.com) and follow the "Bonds" link. What is the yield on 3-month Treasury bills? Using a 7 percent market risk premium, what is the cost of equity for Dell using the CAPM?
3. Go to [www.reuters.com](http://www.reuters.com) and find the list of competitors in the industry. Find the beta for each of these competitors, and then calculate the industry average beta. Using the industry average beta, what is the cost of equity? Does it matter if you use the beta for Dell or the beta for the industry in this case?
4. You now need to calculate the cost of debt for Dell. Go to [cxa.marketwatch.com/finra/BondCenter/Default.aspx](http://cxa.marketwatch.com/finra/BondCenter/Default.aspx), enter Dell as the company, and find the yield to maturity for each of Dell's bonds. What is the weighted average cost of debt for Dell using the book value weights and the market value weights? Does it make a difference in this case if you use book value weights or market value weights?
5. You now have all the necessary information to calculate the weighted average cost of capital for Dell. Calculate the weighted average cost of capital for Dell using book value weights and market value weights assuming Dell has a 35 percent marginal tax rate. Which cost of capital number is more relevant?
6. You used Dell as a representative company to estimate the cost of capital for GCI. What are some of the potential problems with this approach in this situation? What improvements might you suggest?