

Corporate Finance 15.402
Case 7: Cost of Capital at Ameritrade

Prepare a memo addressing the following questions:

1. What factors should Ameritrade management consider when evaluating the proposal? Why?
2. How can the Capital Asset Pricing Model (CAPM) be used to estimate the cost of capital for a real investment (as opposed to a financial investment)?
3. Using the CAPM:
 - a. What is your estimate of the risk-free rate to use for the cost of capital for Ameritrade? Why?
 - b. What is your estimate for the market risk premium? Why?
 - c. In principal, how would you compute the asset beta of a project?
4. Ameritrade has a short history of trading, so the beta cannot be computed from historical data. Exhibit 4 provides some choices for comparable firms. Which of these firms do you think are appropriate to use as comparables to determine the beta of Ameritrade's planned advertising and technology investments? Why?
5. Using the stock price and returns presented in Exhibit 5 and Exhibit 6, and the capital structure from Exhibit 4, calculate the asset betas for the comparable firms. What beta should Ameritrade use? Why?