KEEPING THE FEEDBACK LOOP OPEN: AN ANTHROPIC FOLLOW UP!

Pushback and Response!

Aswath Damodaran

MY ANTHROPIC VALUATION - REACTIONS

- I knew that my post on Anthropic **would draw strong reactions**, when I made it public last week.
- I have **no interest in selling my estimate of value to the rest of the world**, both because I don't have a dog in this race and also because I don't own the high ground here.
- That is why I **made my model open to changes** that you can make to my story and inputs, and while you have to trust my mechanics, I tried to faithfully carry your inputs into value.
- Much of the pushback I have received **has been thoughtful and productive**, some of it has been emotional and some of it, in my view, reflects a **fundamental disconnect with market history, current market pricing and just basic business sense.**

PLAYING DEVIL'S ADVOCATE: A SELF CRITIQUE

- I plan to **play devil's advocate with my own valuation**, looking at my story inputs, and ranking them in order of fragility, partly to stress-test my value estimate and partly to reinforce some corporate finance first principles.
- This does require that I
  - **Understand how my story tracks through the valuation and affects the final value** – which is why I keep my valuations parsimonious.
  - **Be open about which of my story lines (and assumptions) are most fragile and potentially weakest**

Claude's Bar Mitzvah Moment

Anthropic will continue to deliver scorching growth in the near term delivering revenues of close to $100 billion next year on its way to generating revenues of $1 trillion of an AI market powered to replace labor and revenues from niche businesses like pharmaceuticals, with its own division. The company has high gross margins,with compute costs becoming fixed costs, and as revenues rise, operating margins should move higher, with revenues tilted towards premium pricing, but adjusted for higher costs as regulatory risks rise. The main reinvestment will be in compute power, and that cost, while high now, will ease over time. The high compute commitments will create the risk of failure, if revenues do not rise near term, but costs of capital will decrease to that of a risky US company (third quartile).

The Assumptions

	Base year	*Next year*	*Years 2-5*	*Years 6-10*	*After year 10*	*Link to story*
Revenues (a)	$19,708.00	400.0%	43.00%	Changes to	4.90%	High growth leading into IPO will push revenues up significantly next year, and as AI products and services displace labor in selected industries, the market expands to allow for more growth. In some niche businesses, like drugs, Anthropic has potential to generate its own revenues.
Operating margin (b)	-238.39%	5.0%	Moves to	27.50%	27.50%	Margins improve, with pricing power on premium products, and compute costs are largely grow at rates lower than revenues.
Tax rate	0.00%		0.00%	Changes to	25.00%	Global/US marginal tax rate over time
Sales to Capital (c)		3.00	3.00	3.00	32.67%	Compute costs scarcity and costs will ease over time, allowing for lower reinvestment to sustain growth.
Return on capital	-8.80%	Marginal ROIC =	79.69%		15.00%	Closed frontier models with client data create stickiness that will create long term competitive advantages for Anthropic.
Cost of capital (d)			9.74%		9.13%	Cost of capital starts at about the 90th percentile and moves close to the 75th percentile company over time

The Cash Flows

	Revenues	*Operating Margin*	*EBIT*	*EBIT (1-t)*	*Reinvestment*	*FCFF*
1	$98,540.00	5.00%	$4,927.00	$4,927.00	$14,124.07	-$9,197.07
2	$140,912.20	14.00%	$19,727.71	$19,727.71	$20,197.42	-$469.71
3	$201,504.45	18.50%	$37,278.32	$37,278.32	$28,882.30	$8,396.02
4	$288,151.36	23.00%	$66,274.81	$66,274.81	$41,301.69	$24,973.12
5	$412,056.44	27.50%	$113,315.52	$113,315.52	$48,595.19	$64,720.33
6	$557,842.01	27.50%	$153,406.55	$145,736.23	$51,618.98	$94,117.24
7	$712,698.95	27.50%	$195,992.21	$176,392.99	$47,845.86	$128,547.13
8	$856,236.52	27.50%	$235,465.04	$200,145.29	$35,733.60	$164,411.68
9	$963,437.33	27.50%	$264,945.27	$211,956.21	$15,736.14	$196,220.07
10	$1,010,645.76	27.50%	$277,927.59	$208,445.69	$16,507.21	$191,938.47
Terminal year	$1,060,167.41	27.50%	$291,546.04	$218,659.53	$71,428.78	$147,230.75

The Value

Terminal value	$3,480,632.35	
PV(Terminal value)	$1,397,222.59	
PV (CF over next 10 years)	$418,401.53	
Value of operating assets =	$1,815,624.12	
Adjustment for distress	$90,781.21	Probability of failure = 10.00%
- Debt & Minority Interests	$472,335.56	*Includes lease, purchase and compute commitments,discounted back to today.*
+ Cash & Other Non-operating assets	$216,318.00	*Includes estimated $100 billion from offering with share count adjusted to instrinsic value*
Value of equity	$1,468,825.35	
- Value of equity options	$472.30	*Value of existing employee options*
Number of shares	3,299.29	*Share count is still tentative, but includes restricted shares to employees*
Value per share	$445.05	Stock was trading at = $525.00

SOME ADDED DETAILS

- Value per share: Though I have a share count, created by adding the shares reported as outstanding in the balance sheet to the restricted shares granted to employees, that share count will change before the public offering, as bankers adjust it to deliver on a per share value that they believe will make the company more "sellable".
- Cost of capital choices: I used a 9.74% cost of capital which incorporates risky technology cost of equity and a cost of debt based on a BB+ rating for the company, putting the company at close to the 90th percentile of US companies in 2026.
- Compute commitments: I In my valuation, my estimate of contractual commitments results in an aggregated value of just over $450 billion and a present value of about $373 billion. It is possible that these numbers will need revisiting as details emerge of these commitments, but this will remain a long-term issue for anyone valuing or pricing the company.
- Dilution Risk: Anthropic, like many young companies, has used its equity as currency, paying employees with restricted stock and options and as an add-on to borrow money in the form of convertible bonds. In addition, if the company needs to raise capital in future years, it will issue additional shares for that purpose, and the larger its ambitions, the greater these issuance will be.

VALUE DRIVERS

- The **equity value that I obtain for Anthropic is close to the lower end of the offering price estimates,** and some, but as I noted at the time that I posted it, and will reinforce again now, it is a **function of not just an upbeat story about the company, but also one about how the AI products and services market will evolve over time.**
- To the question that some posed about whether I was concerned that I could be wrong, of course I am, but **what difference does being concerned make?**
- **I would, of course, rather be right than wrong**, but I am trying to forecast the future, and it is a guarantee that I will be wrong. That said, though, **I am more uncertain and exposed on some parts of my story line than others, and here is how I would rank them for Anthropic.**

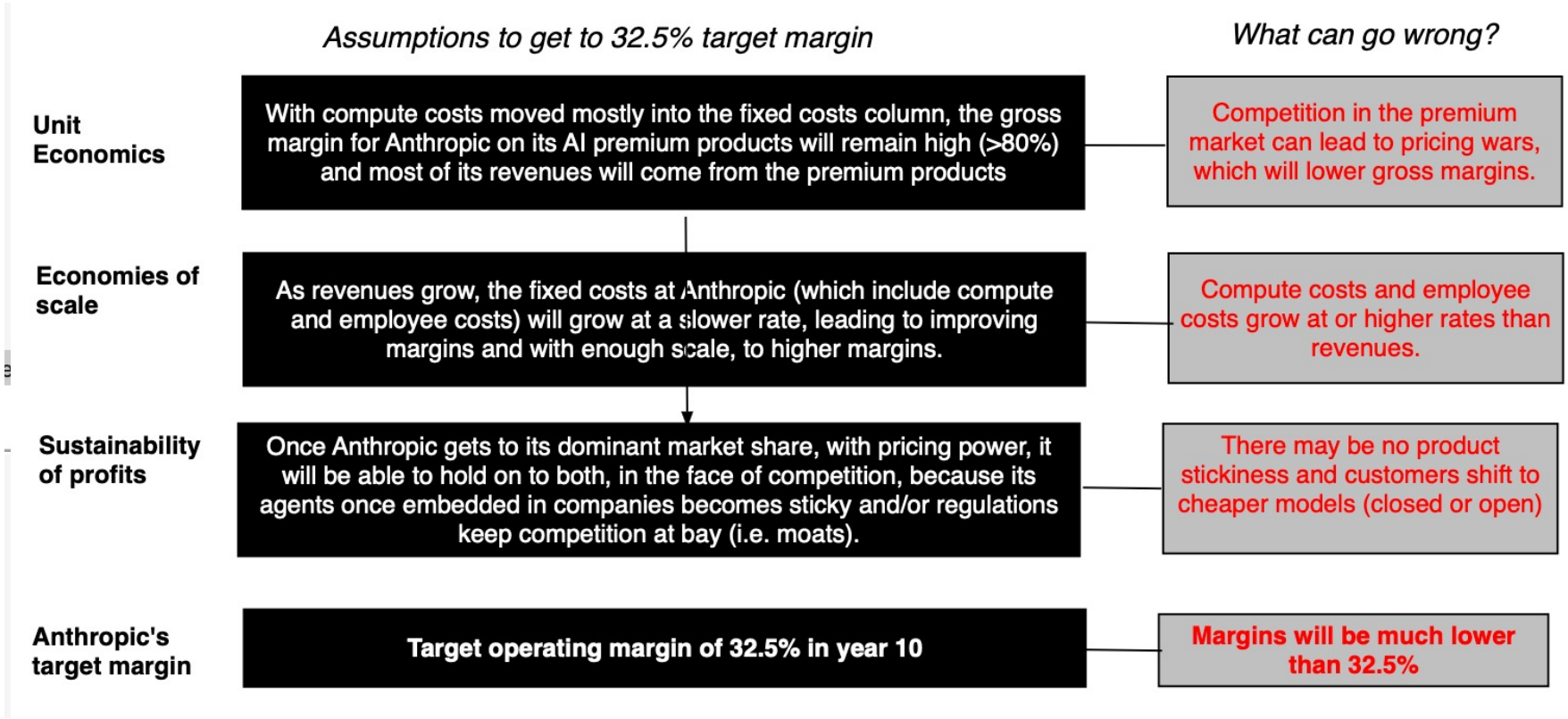
1. TARGET REVENUES

	Assumptions to get to $1 trillion target revenue	*What can go wrong?*
Total market for AI products & services	The AI product and service market will find widespread use across business, increasing productive in some and replacing workers in others, with customers willing to pay high prices to have access to them	The AI products and services may find use only in a subset of businesses, and mostly as a tool.
Market for premium products & services	A significant segment of the AI products market will be premium, i.e., for high powered and expesnive models that use customer data and on-the-job learning to become sticky.	The premium part of the AI market may be a small percent of the total market.
Anthropic's positioning in premium market	Anthropic is a winner (with a dominant market share)in the premium AI product market, partly because of its fast start in that segment, and partly because it is expending resources (compute power) to build a product moat.	The premium market even if large is splintered and competitive, making it difficult to get and hold large market share.
Anthropic's add-on markets	Anthropic will use its success at building premium AI models and agents to become players in businesses, such as pharamaceuticals and some tech, competing and claiming revenues from existing players.	Anthropic may be ill-equipped to operate in tangential businesses, for regulatory, operating and legal reasons.
Anthropic's end revenues	**Target revenues of $1 trillion in year 10**	**Revenues well below $ 1 trillion**

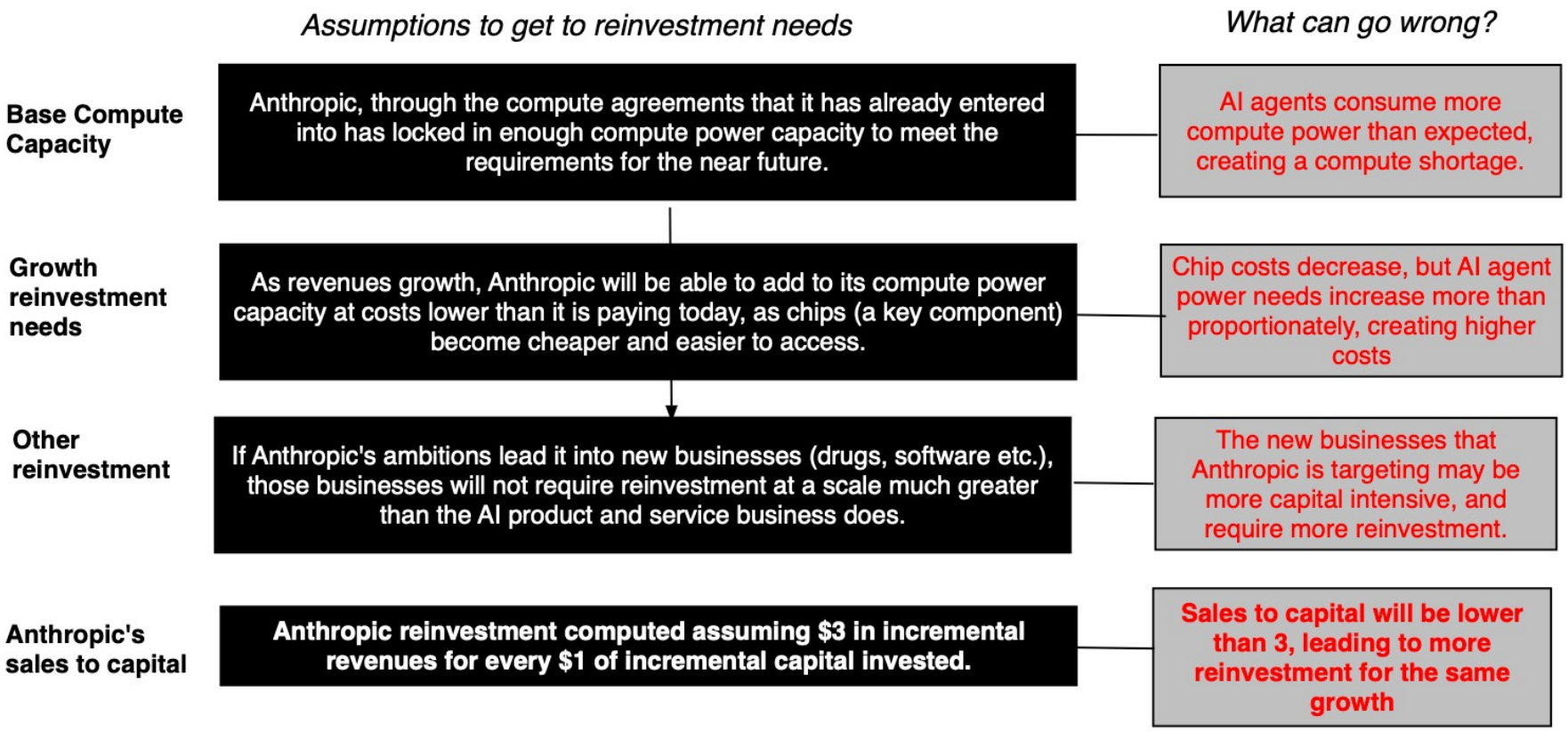
2. GOVERNANCE

- I described the governance structure at Anthropic in my last post, describing the **combination of a public benefit corporation and a voting structure that leaves founders in control, no matter how much capital the company raises in equity markets, as a red flag.**
- I did get some pushback from some, primarily in technology, arguing that this is a good feature, not a bad one, since these are smart people who understand AI better than anyone else in the world.
  - Even if you accept these views as facts, I would still argue, perhaps even more forcefully, that **concentrating power in the hands of founders is a bad idea.**
  - Anthropic has a **plausible or even probable pathways to business riches, but those pathways come with setbacks** (technological, regulatory, competitive), and you need **management that can respond quickly and change**.
  - For the latter to happen, **you need outsiders**, **often not as immersed or even as informed on the technology front, but with different backgrounds** and experiences, to call attention to management missteps and push for change.
- I don't know any of the founders of Anthropic, and this may be unfair, but they **seem to share a worldview (not surprising) and operate in an echo chamber**.

3. PROFITABILITY



4. THE COMPUTE POWER QUESTION



5. REGULATORY RISKS

- I know that **for some of you, the cost of capital of 9.74% is the main stumbling block**, as you put it "the fatal flaw" in the valuation, but I do not think so, and I will address why later in the post.
- I also know that for others, the notion of a money-losing company borrowing hundreds of billions, either directly as debt or through contractual commitments, **creates a failure risk probability that is so high that the rest of the valuation is moot**. I agree with you on the general argument that some players in the AI ecosystem, but Anthropic is no Coreweave, especially if you consider that most of its debt is in contractual commitments spread out over time and that it will have a cash balance large enough to cover its first few years of those commitments.
- It is on the **regulatory risk front that I worry the most about being wrong**, because regulatory risk is as much driven by politics as it is driven by economics. You could be one major election away from onerous regulations, where unlike my base case, where those regulations cost you only a small slice of your operating profits, they take a major bite out of revenues and profits.

INVESTMENT FOLLOW THROUGH!

- At this point, **you are probably why, if I am this uncertain about a company's future, I would even consider investing in it and it is a question that I have pondered for as long as I have been an investor.** Uncertainty is a feature of investing, no matter what you invest in, with the differences across investments lying in how much uncertainty you face, rather than whether you face.
- There are four responses that an investor can take to uncertainty:
  - Avoid investments with high uncertainty entirely
  - Use a "margin of safety"
  - Let the law of large numbers work in your favor

THE MARGIN OF SAFETY: THE TRADE OFF

		The Truth	
		Stock is under priced	*Stock is over priced*
Your Analysis	*Stock is under priced*	A Good Buy	Type 1 investment error: Buy the wrong stock or fail to sell the right stock.
	Stock is over priced	Type 2 investment error: Fail to buy the right stock or sell the wrong one.	A Good Sell

Reduce the likelihood of Type 1 errors

Increase the likelihood of Type 2 errors

Price

Increase the MOS

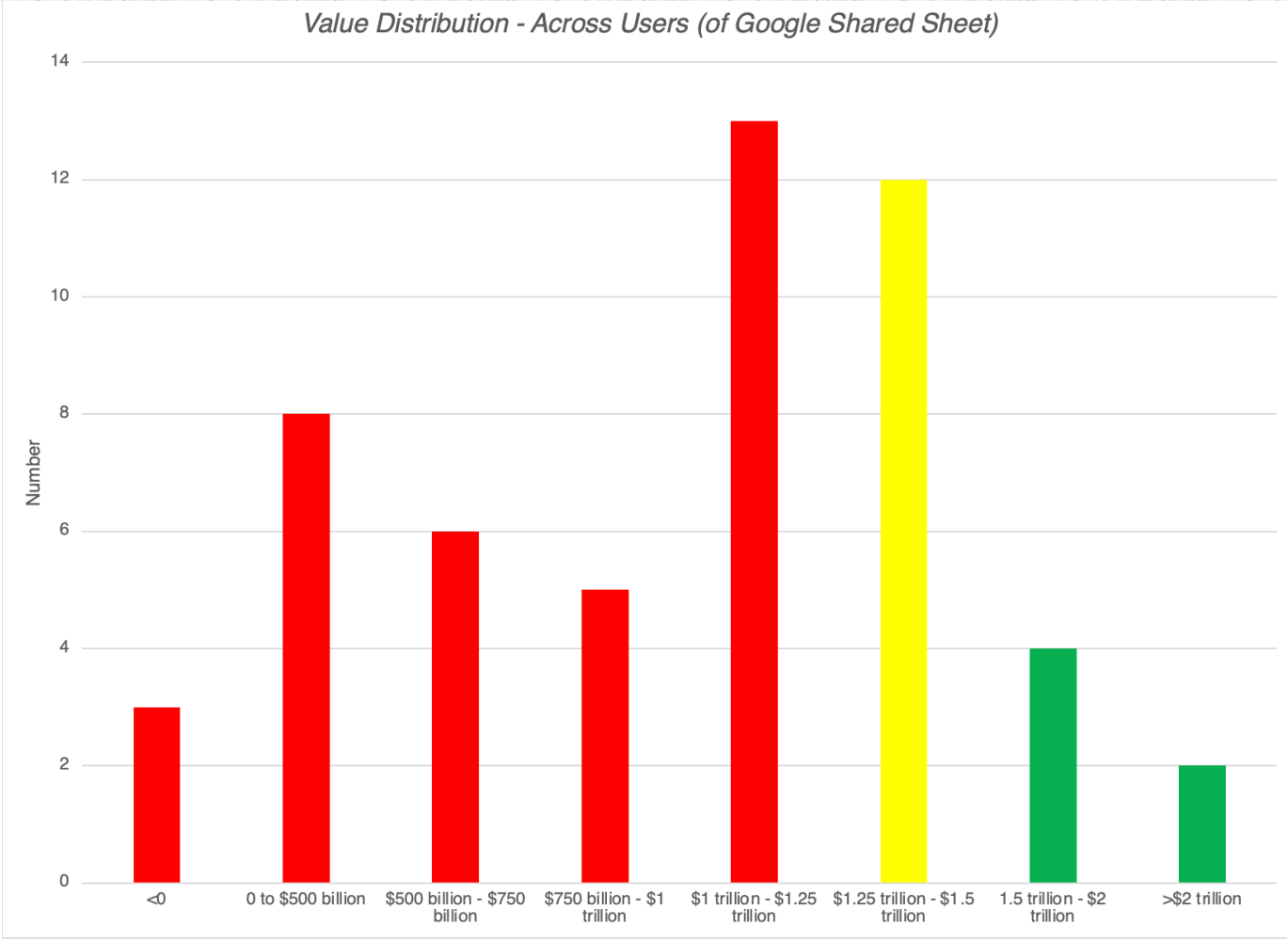
Value

Does the trade off work in your favor?
1. Are you more invested in cash than you would like to be?
2. Do you earn a return on your portfolio (cash included) that is more than you would have made investing passively?

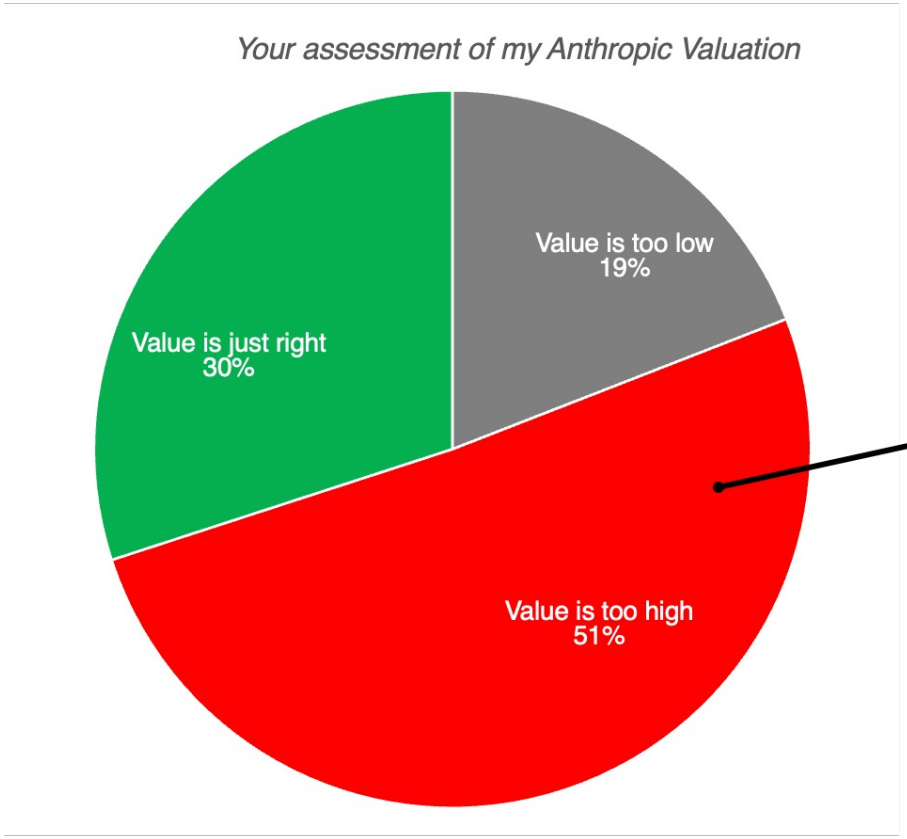
THE LAW OF LARGE NUMBERS

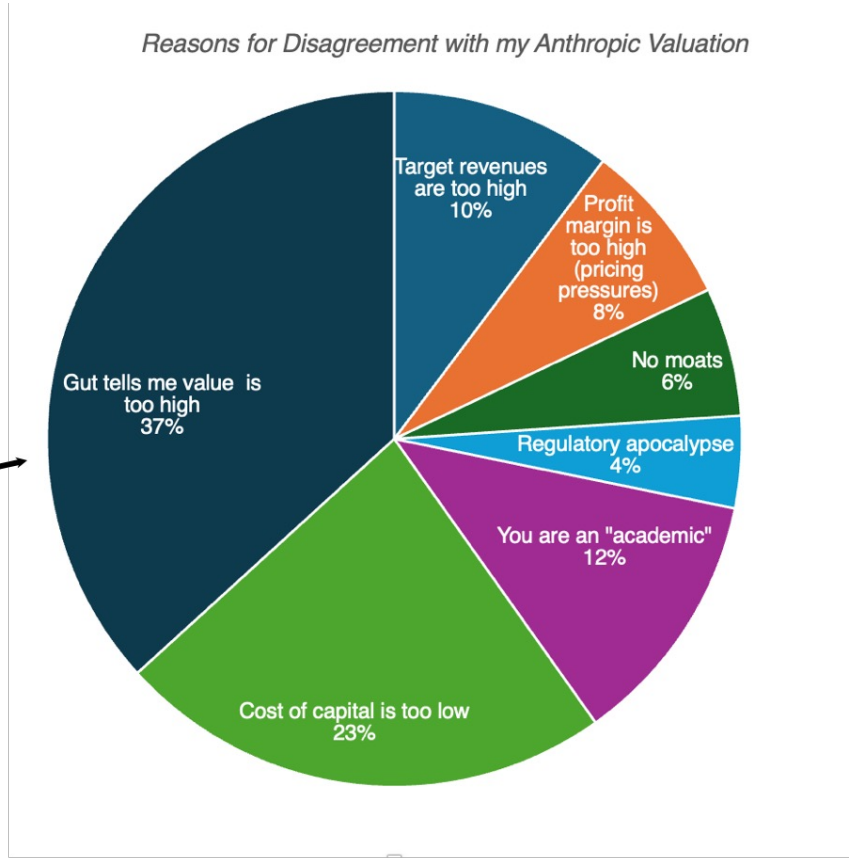
- If I **had a million dollars in investable funds, would I invest that money in Anthropic**, even if it trades at less than your assessed value?
  - The **answer would be no, given the uncertainties associated with the future of the company**, but that **answer would change if my portfolio became less concentrated**, since its performance would be less a function of any individual company's performance (good or bad).
  - In effect, I am **giving the law of large numbers as an ally to not only reduce my risk exposure** to individual companies, but also as a basis for making investments in far riskier stocks than I would normally invest in.

THE FEEDBACK LOOP: YOUR VALUATIONS!



AND YOUR PUSHBACK!

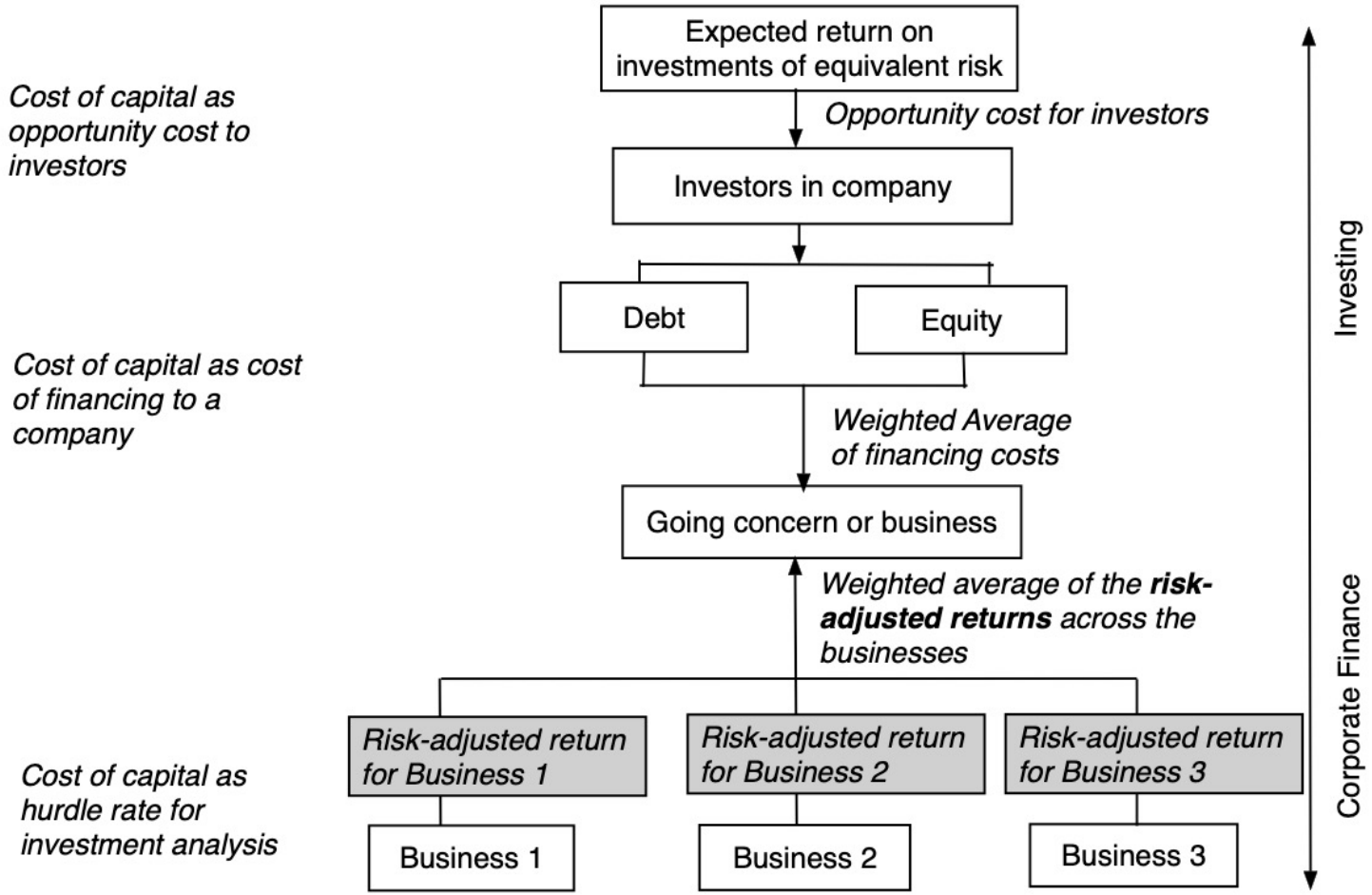




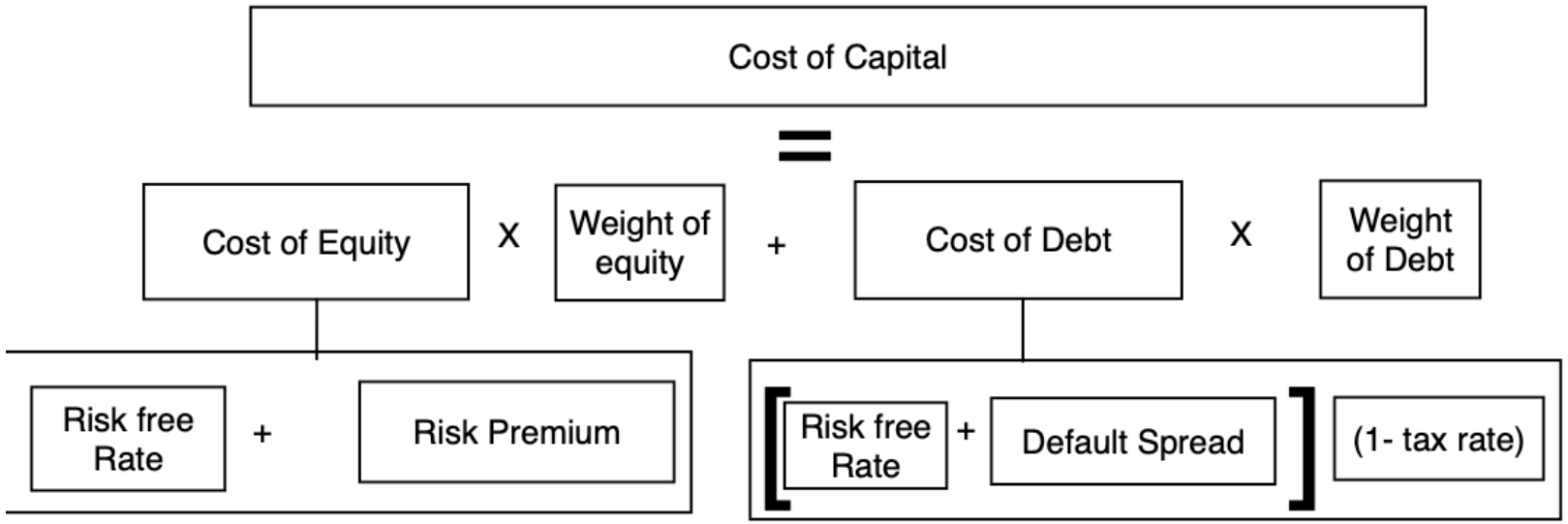
THE COST OF CAPITAL BOGEYMAN

- Among those who disagreed with me, the reasoning varied, but **I was disappointed, albeit not surprised, that the biggest single reason outside of "my gut tells me that Anthropic is worth nothing" was a judgment that my cost of capital estimate for the company (9.74%) was much too low.**
- I was disappointed because I **don't think that the cost of capital is at the center of the DCF universe** (and I used words to that effect in my original valuation) but the lack of surprise at its prominence comes from **observing appraisers and analysts obsess over this number,** often without understanding what it is designed to measure and without a frame of reference (as to what a reasonable value for it is), and **using it as a receptacle for their hopes, fears and fantasies.**

THE COST OF CAPITAL – THE SWISS ARMY KNIFE OF FINANCE!



THE COST OF CAPITAL - COMPONENTS

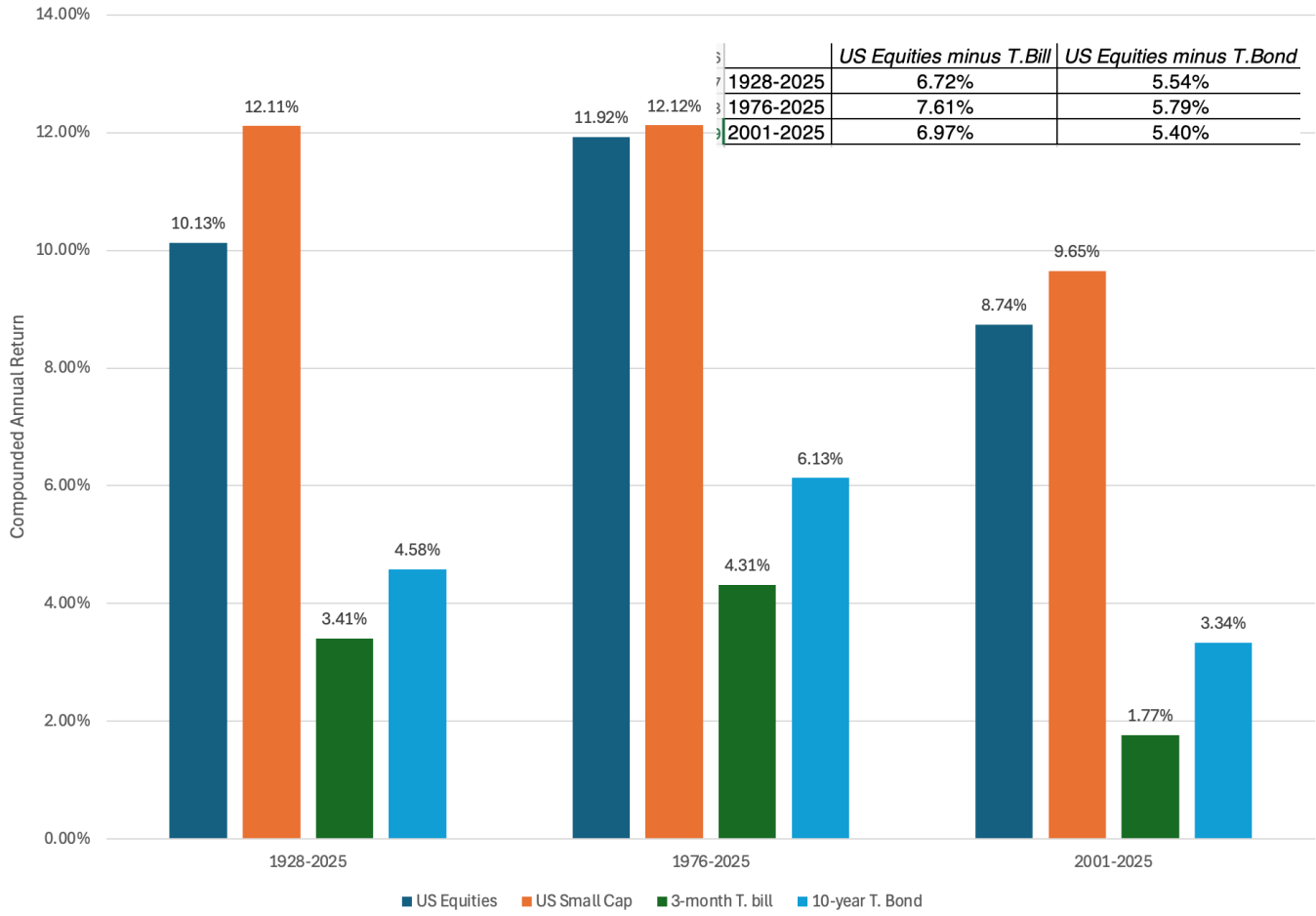


COST OF EQUITY - DEVELOPING A FRAME OF REFERENCE!

- While there is much to be learned from modern portfolio theory, one of its more deleterious consequences has been a dumbing down of the cost of equity, **where intuition and common sense are supplanted by heated arguments about the capital asset pricing model and betas.**
- To bring the discussion back to good sense, it is better to start with a recognition that **the cost of equity for an investor should reflect what investors can earn elsewhere in the market on an investment of equivalent risk** and understand that is what all these models try to measure, often imperfectly.
- That **number is subjective can vary across investors, based on risk aversion**, but the requirement that you can earn that number elsewhere **creates a reality check**.

1. HISTORY

Historical Returns on Equities- US from 1928 to 2025



	US Equities minus T.Bill	*US Equities minus T.Bond*
1928-2025	6.72%	5.54%
1976-2025	7.61%	5.79%
2001-2025	6.97%	5.40%

2. THE MARKET – AN IMPLIED EXPECTED RETURN ON STOCKS

In the trailing 12 months, across all companies in the index.

Base year cash flow (last 12 mths)
Dividends (TTM): 81.61
+ Buybacks (TTM): 116.56
= Cash to investors (TTM): **198.17**

Expected earnings/cashflow growth in next 5 years
Earnings growth rate of 14.59% , based upon analyst estimates, for the next five years and growth dropping to 5.29% over the following years.

Modified Payout
This computation assumes no change in payout. If the payout ratio changes over time to reflect a sustainable payout ratio = g/ ROE, in the stable growth. The resulting ERP is 4.40%

Actual numbers | Forecasted numbers

	2025	2026	2027	2028	2029	2030	*2031*
Earnings	271.29	310.87	356.23	408.21	467.77	536.03	564.38
Cash Payout (%)	63.52%	63.52%	63.52%	63.52%	63.52%	63.52%	63.52%
Dividends + Buybacks	172.32	$197.47	$226.28	$259.30	$297.13	$340.48	358.50

Earnings and Cash flows grow @5.29% (set equal to US T.Bond rate) a year forever.

S&P 500 on 9/30/26= 7651.54

$$7651.54 = \frac{197.47}{(1+r)} + \frac{226.28}{(1+r)^2} + \frac{259.30}{(1+r)^3} + \frac{297.15}{(1+r)^4} + \frac{340.48}{(1+r)^5} + \frac{340.48\,(1.0529)}{(r-.0529)(1+r)^5}$$

The last term in this equation is the expected index level at the end of year 5 (capturing price appreciation)

Solve for r

r = Implied Expected Return on Stocks = 8.99%

Minus

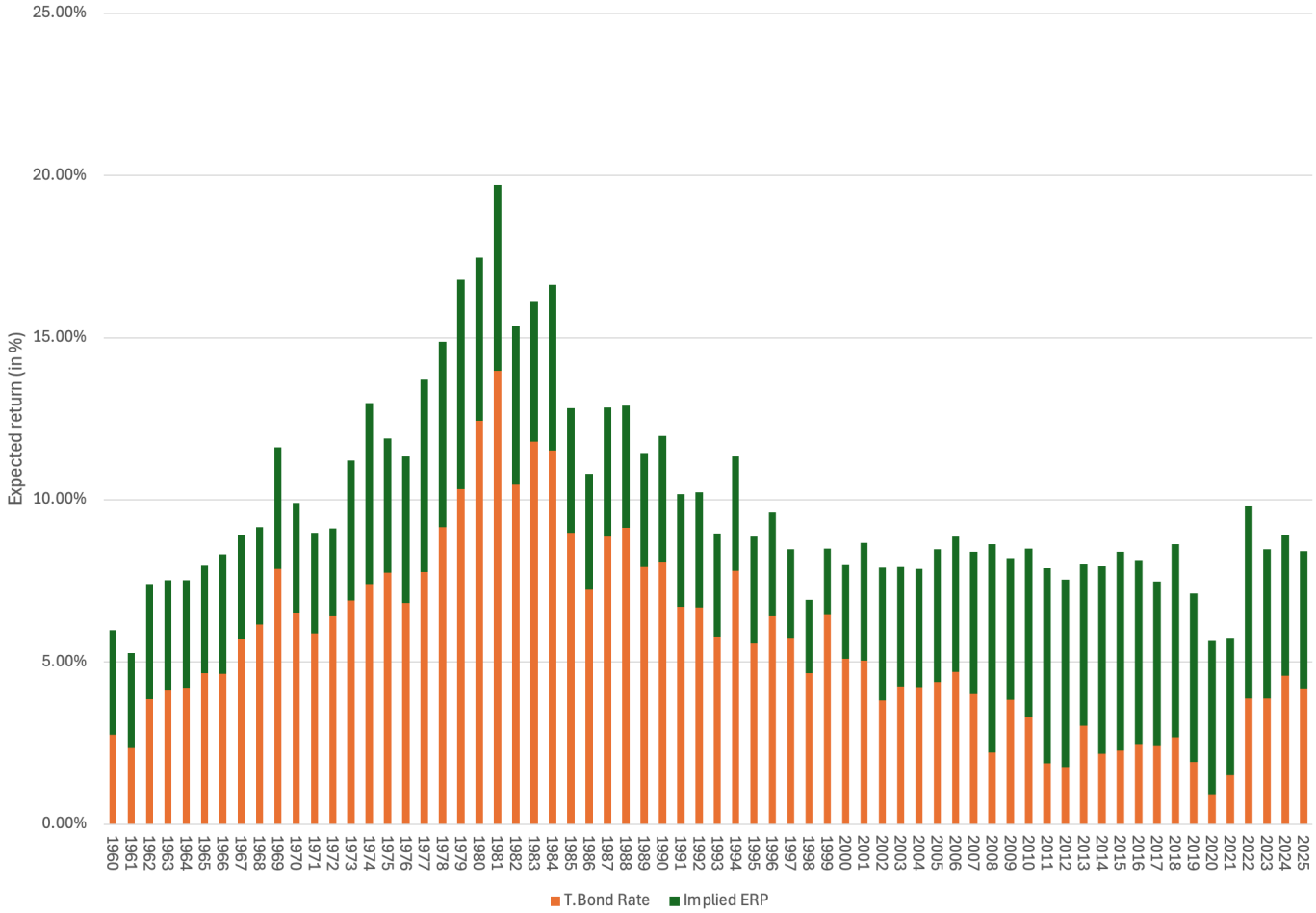
US $ Risk free rate =10-yr T.Bond rate on 9/30/26 minus Default Spread for Aa1 rating= 5.29% - 0.22% = 5.07%

Equals

Implied ERP with US trreasury rate as riskfree = 8.99% - 5.29% = 3.70%
Implied Equity Risk Premium with adj riskfree rate(9/30/26) = 8.99% - 5.07% = 3.92%

AND A HISTORY OF MARKET-IMPLIED EXPECTED RETURNS!

Implied Expected Return on US Equities: 1960 to 2025



3. AND A LINK TO PRICING

$$\text{Value of stock} = \frac{\text{Expected dividends next year}}{(\text{Cost of equity} - \text{Growth rate})} = \frac{\text{Expected earnings (Payout ratio)}}{(\text{Cost of equity} - \text{Growth rate})}$$

$$= \frac{\text{Expected earnings } (1 - \frac{\text{Growth rate}}{\text{Return on Equity}})}{(\text{Cost of equity} - \text{Growth rate})}$$

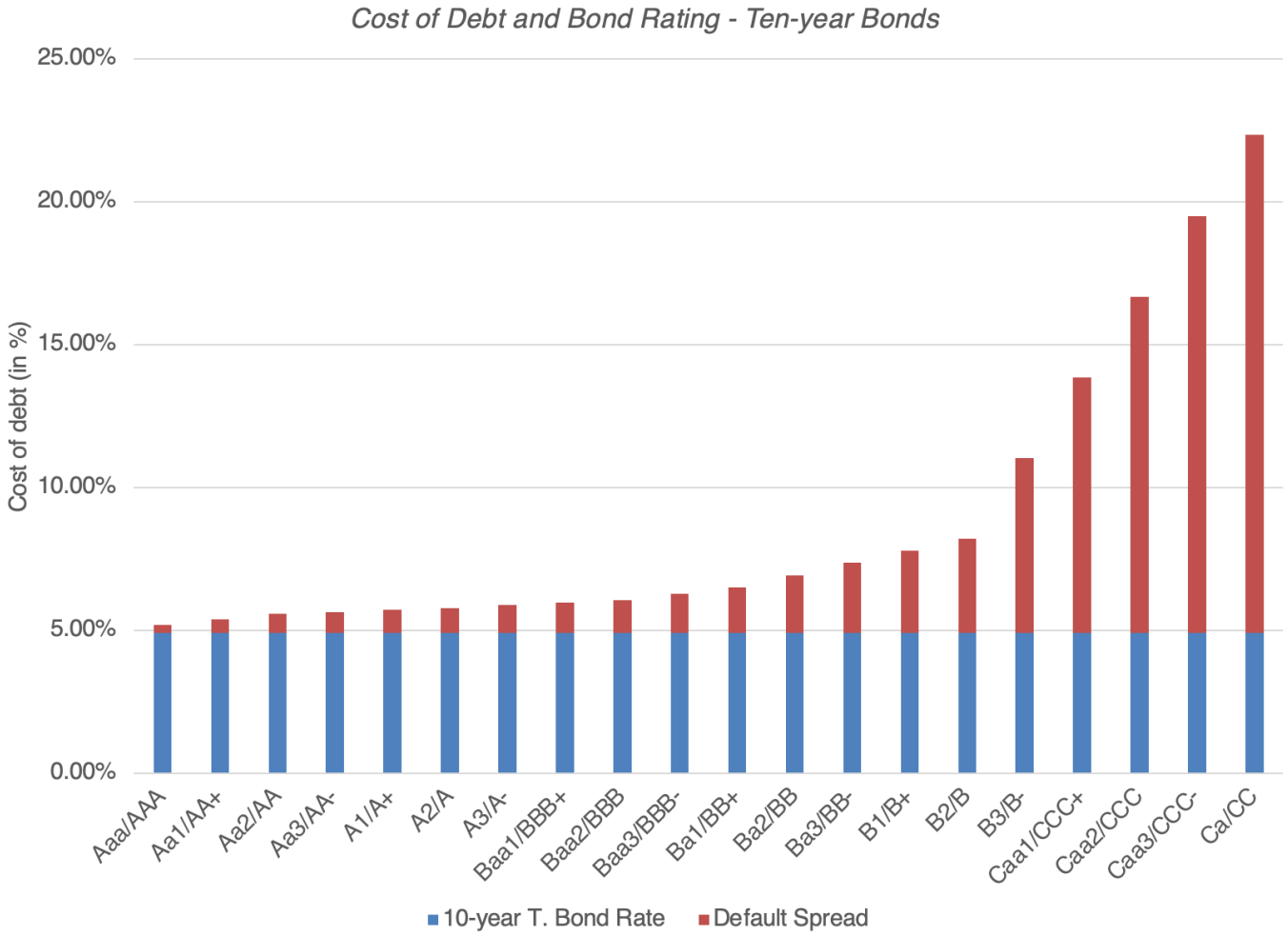
$$\frac{\text{Value of stock}}{\text{Expected earnings}} = \text{Forward PE} = \frac{(1 - \frac{\text{Growth rate}}{\text{Return on Equity}})}{(\text{Cost of equity} - \text{Growth rate})}$$

- If you believe that the cost of equity should be 15% for the average US firm, given that nominal growth in the US economy is about 5% and that the average return on equity across US firms is about 20% (and that is a generous estimate), **the PE ratio for US firms today should be roughly 7.27.**
- **Given that the actual forward PE ratio is closer to 20, you have two choices.** One is to sell all your equities, though I am not sure where you would put that money, and the other is to revisit your cost of equity assessment.

THE COST OF DEBT: INTUITION

- One reason that the Anthropic **cost of capital discussion may have been hijacked is the almost mindless use of debt in funding data centers**, a practice that I have strongly attacked as senseless for both the borrowers and for the lenders.
  - With Coreweave as poster child, this has **led to an explosion of concerns about default risk** and in market-implied default rates and spreads for some companies.
  - By extension, Anthropic has become part of this discussion because of the compute commitments that it has locked in, for good and bad reasons.
- In fact, the argument for a higher cost of capital goes as follows**. If it costs Anthropic 10% or more to borrow money today, it should have a much higher cost of equity to reflect the residual risk**.
- That intuition breaks down for a simple reason. The **cost of debt for companies in this space is high, because of worries about default, and the cost of debt in the cost of capital calculation is designed for going concerns.**

COST OF DEBT AND BOND RATINGS



MY ANTHROPIC COST OF DEBT ESTIMATES

- My estimate for the cost of debt for Anthropic reflects their bond rating of BB+, and it is not a value destroyer for two reasons.
  - First, Anthropic may owe a lot in commitments, but they are spread out over time, with about $60 billion coming due next year and $76 billion the year after. Those are large commitments, but **Anthropic has a cash balance of $114 billion, which will increase to over $200 billion after the IPO**.
  - Second, I am **not ignoring the risk of default, because I am incorporating a failure risk of 10%**, where Anthropic does run into headwinds, is unable to meet its contractual obligations and has to make fire sale. If your concerns about default are higher, that is the number you should be moving, not the cost of capital.
- In fact, **if you ignore failure risk, as many analysts do, and try to jam default risk it into cost of capital, you would need a cost of capital of about 11%** to arrive at an estimate of value close to mine.

COST OF CAPITAL: THE CROSS SECTION!

		Cost of equity (in US $)					Cost of capital (in US $)				
Primary Sector	Number	1st Decile	Ist Quartile	Median	3rd Quartile	9th Decile	1st Decile	Ist Quartile	Median	3rd Quartile	9th Decile
Communication Services	2,193	**6.87%**	8.26%	**9.20%**	10.68%	**17.28%**	**6.16%**	7.21%	**8.26%**	8.99%	**9.31%**
Consumer Discretionary	6,358	**7.10%**	7.75%	**8.61%**	10.96%	**17.34%**	**6.62%**	6.85%	**7.47%**	7.93%	**9.10%**
Consumer Staples	3,202	**6.37%**	6.65%	**7.39%**	8.20%	**10.96%**	**6.03%**	6.33%	**6.76%**	7.39%	**7.72%**
Energy	1,402	**7.16%**	7.16%	**7.60%**	8.71%	**10.96%**	**6.59%**	6.98%	**7.16%**	7.27%	**7.51%**
Financials	5,278	**5.30%**	5.47%	**6.11%**	6.49%	**7.77%**	**5.02%**	5.14%	**5.27%**	6.26%	**6.44%**
Health Care	4,452	**8.39%**	8.94%	**9.29%**	9.98%	**12.45%**	**7.40%**	8.39%	**8.95%**	9.19%	**9.35%**
Industrials	9,007	**7.35%**	7.99%	**9.20%**	10.34%	**12.94%**	**6.76%**	7.32%	**7.93%**	9.53%	**9.89%**
Information Technology	6,234	**9.88%**	9.92%	**10.75%**	12.30%	**14.49%**	**9.02%**	9.71%	**9.88%**	10.86%	**12.27%**
Materials	6,457	**8.41%**	8.94%	**9.43%**	10.32%	**11.80%**	**7.48%**	8.09%	**8.60%**	8.94%	**10.08%**
Real Estate	2,671	**5.95%**	6.22%	**6.67%**	7.85%	**11.83%**	**5.16%**	5.36%	**5.49%**	6.00%	**6.23%**
Utilities	902	**6.12%**	6.46%	**6.83%**	7.48%	**10.10%**	**5.24%**	5.62%	**5.74%**	5.96%	**6.45%**
All firms	6,006	**5.97%**	7.02%	**8.77%**	10.10%	**12.94%**	**5.26%**	6.41%	**7.79%**	9.16%	**9.88%**

A HIGHER COST OF CAPITAL FOR ANTHROPIC?

- It is true, based on this table, that **you could push the cost of capital for Anthropic higher, perhaps towards the 90th percentile of technology firms, and give it a cost of capital of 12%**, but there are two caveats.
  - The first is that **you would then have to set the failure rate to 0%,** since the costs of capital in this table do not adjust for failure (and especially so at the higher risk percentiles).
  - The second is **that your cost of capital, in your valuation, has to change over time to be consistent with your story line for Anthropic as a company.**
- Thus, **if you see Anthropic scaling up revenues over time and profits turning positive**, its cost of capital will move towards a more typical cost of capital for tech companies over time. If **you don't see that happening, you don't need a high cost of capital to conclude that Anthropic is worth little or even nothing.**

COST OF CAPITAL DELUSIONS: INVESTORS AND BUSINESSES

- I know that **there are analysts and investors out there who have picked a required rate of return as their hurdle rate** for investing and never revisit that number, and almost as many CFOs who do the same for the hurdle rates at companies.
- With **individual investors and privately owned businesses**, the consequences of setting an artificially high cost of capital are personal, and if, after being made aware of them, you stick with a 25% cost of capital, you should.
- With **institutional investors and publicly traded companies, you are investing other people's money**, and you have to consider the costs they will bear because of your overreach.

PROFESSIONAL INVESTORS (MANAGING OTHER PEOPLE'S MONEY)

- With subgroups of professional investors, especially venture capitalists and private equity, the numbers that they offer as **target or expected returns are so staggeringly out of sync with reality** that the cynic in you should wonder whether these numbers are marketing props and financial metrics.

	6 months	*1 year*	*3 years*	*5 years*	*10 years*	*15 years*	*20 years*	*30 years*
Private Equity	4.50%	8.70%	8.70%	11.70%	15.20%	15.00%	13.20%	12.40%
S&P 500	11.00%	17.90%	23.00%	14.90%	15.10%	14.30%	11.30%	10.00%
VC	14.10%	21.10%	8.70%	10.20%	14.90%	15.50%	12.90%	8.10%
Nasdaq	14.40%	21.30%	31.10%	14.00%	17.80%	16.70%	13.70%	11.70%

- I believe that **active investors who promise their clients too much (as a expected return) will overreach in terms of the risks they take**, and if the target returns they promise are set too high (relative to what they should be), these equity investors will spend their time looking for ten or hundred baggers, rather than solid long term investments.

PUBLICLY TRADED COMPANIES

- While it is true that company hurdle rates are for internal use and not often visible from the outside, surveys of CFOs, asking them about what the costs of capital are for their company, often come back with the conclusion that **these hurdle are set about 2-3% higher than justified by market numbers.**
- Again, you may be tempted to let this practice go, as just being conservative, and protecting companies from taking bad investments. Here again, though, there is a trade off. For companies that estimate returns on projects rigorously, **having a higher hurdle rate than appropriate will mean the good investments will be left untaken**.
- Early in a company's life, when project choices are plentiful, this may not be a deal breaker, but as companies mature, it will cost investors in the company, as the company holds on to cash and does not invest.
- There is another, and potentially an **even more dangerous consequence that undermines the entire process of investment analysis**. When hurdle rates are set unrealistically high, relative to what you can earn in the market, managers, recognizing that they will never find investments that earn more than those hurdle rates will start to skew cashflows and growth upwards to compensate for discount rates being too high.

WITH SOME PROOF...

Sub Region	# firms	ROE	Cost of equity	% of companies with ROE>COE	% of companies with ROE - C0E>5%	ROIC	Cost of capital	% of companies with ROIC>WACC	% of companies with ROIC - WACC>5%
Africa and Middle Eas	1,958	9.71%	10.82%	41.01%	29.83%	7.84%	9.23%	41.22%	28.14%
Australia & NZ	1,559	-14.19%	8.71%	17.25%	11.87%	-11.33%	8.67%	19.37%	12.51%
Canada	2,392	-17.86%	8.83%	12.12%	8.32%	-12.29%	8.68%	13.21%	7.94%
China	7,451	3.26%	10.08%	20.91%	10.56%	2.69%	8.96%	23.51%	13.64%
EU & Environs	4,951	4.43%	9.66%	29.69%	20.54%	4.94%	8.57%	33.04%	23.09%
Eastern Europe & Rus	372	4.84%	10.08%	24.46%	17.74%	3.68%	9.30%	19.35%	12.37%
India	4,520	8.73%	11.02%	36.42%	24.85%	7.07%	9.52%	35.22%	22.85%
Japan	3,760	8.13%	9.80%	39.57%	21.49%	7.74%	8.35%	45.19%	29.15%
Latin America & Carib	807	7.68%	11.62%	32.09%	21.07%	7.75%	9.05%	39.53%	24.41%
Small Asia	9,503	4.78%	10.82%	25.34%	15.44%	3.86%	9.15%	26.09%	15.67%
UK	835	3.72%	9.74%	28.62%	19.16%	5.50%	8.42%	34.85%	24.67%
United States	4,770	-0.20%	9.24%	22.12%	16.06%	3.41%	8.38%	26.62%	18.66%
Global	**42,878**	**4.70%**	**9.93%**	**27.00%**	**17.10%**	**4.28%**	**8.78%**	**29.23%**	**18.78%**

INDIVIDUAL INVESTOR HURDLE RATES SET TOO HIGH? CONSEQUENCES

- If you stick with **unrealistically high hurdle rates. you will find it difficult, if not impossible, to find equities** that can deliver those rates.
  - I can assure you **that with a 20% cost of equity, for instance, there is not one firm in the S&P 500 that will be undervalued** for you to invest in, and if you do find firms that look undervalued in the broader market, it is because they are basket-case firms on the verge of tipping over.
  - Thus, a **reasonable and logical follow-up would be to reduce or even eliminate your equity exposure in your portfolio**, though if your unreasonableness on hurdle rates carries over into other asset classes, you will find no risky asset class that meets your rate of return criteria.
- More dangerously, it will leave you open to scams, where your search for high return investments will lead you invest with a "friend of a friend" or a "YouTube investment celebrity", who will claim to have found a way to deliver more than your hurdle rate with investing alchemy.

AND FOR PRIVATELY OWNED BUSINESSES...

- For businesses with private owners, **setting the hurdle rate too high will lead them to be more conservative in taking investments**, opening the door to more aggressive competition, often from publicly traded companies or private business competitors with more reasonable hurdle rates.
- **The bigger danger here again is when you get ready to sell, you will sell your business for too low a price.** You will facilitated in this process by **private company appraisers who come up with costs of capital that are outlandishly high**, usually getting there with what they call the "build up" approach, a nonsensical piling on of premiums that are either thinly sourced (a small cap premium that ceases to exist in 1981), double counted (an illiquidity premium, with an additional illiquidity discount of value) or just made up to (a non a company-specific risk premium, where a number is added on to get to whatever discount rate you want).

IN CLOSING...

- In my view, **the key assumption that drives almost of the others is my trillion-dollar revenue projection** in a decade for that company, insofar that if that does not come to fruition, it will ripple through my other assumptions, with lower profit margins and higher failure risk following.
- That **should make it the central question that we should be debating**, and my extended discourse on why making cost of capital your last stand is as much designed to bring attention back to things that matter as to restoring some balance to discussions of what a reasonable or high cost of capital for a company can be.
- You are, of course, **welcome to quote any number you want as the cost of equity**, but while you are entitled to your opinions, you are not entitled to make up facts.
- When you claim that the cost of equity is 12%, 15% or 20% for a typical firm, **you are valuing a company in Turkish lira or Zambian kwacha (where inflation is 15%+) or in Afghanistan or South Sudan (where country risk is daunting) or just making up stuff!**