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Impact Of Capital Expenditure On Company Valuation

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Abstract:

Capital expenditures (CAPEX) are investments made by companies to acquire, upgrade, or maintain fixed assets such as property, plant, and equipment. The impact of capital expenditure on shares can be significant, as it can affect the a company's profitability, growth potential, and overall value. This abstract aims to explore the relationship between capital expenditure and shares, examining how CAPEX decisions can affect the stock market performance of a company. The study will analyze the factors that influence CAPEX decisions, the impact of CAPEX on earnings and cash flow, and how CAPEX decisions can affect a company's risk profile. The results of this study will provide valuable insights for investors seeking to make informed decisions about investing in companies that make significant CAPEX investments.

Keywords:

CAPEX, Stock market, Investment, Shares, Risk profile

1. Introduction

Capital expenditure, or 'capex', refers to the funds that a company uses to buy, upgrade, and maintain physical assets like property, plants, buildings, technologies, or equipment. Companies use capex for two reasons: to maintain existing assets (such as repairing a roof, fixing equipment, etc) and to foster future growth (such as buying new factories or equipment). Capital expenditure, or 'capex', refers to the funds that a company uses to buy, upgrade, and maintain physical assets like property, plants, buildings, technologies, or equipment. Companies use capex for two reasons: to maintain existing assets (such as repairing a roof, fixing equipment, etc) and to foster future growth (such as buying new factories or equipment).

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Capital expenditure can have a significant impact on the value of shares in a company, as it affects the company's earnings potential, growth prospects, and ability to generate future cash flows. If investors believe that capital expenditures will lead to increased profitability and growth, it can drive up the value of shares, while excessive or inefficient spending can cause a decline in share value.

2. Research Questions

The purpose of this research is to study and investigate the following research questions.

- How does capex affect share price
- How does capex affect total net worth of the organisation
- Importance of capex in an organisation

3. Literature Review

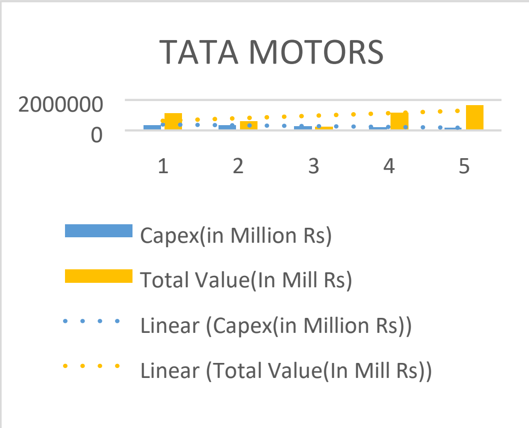
There have been several research studies conducted on the relationship between capital expenditure and shares, which aim to understand the impact of CAPEX on share prices and shareholder value.

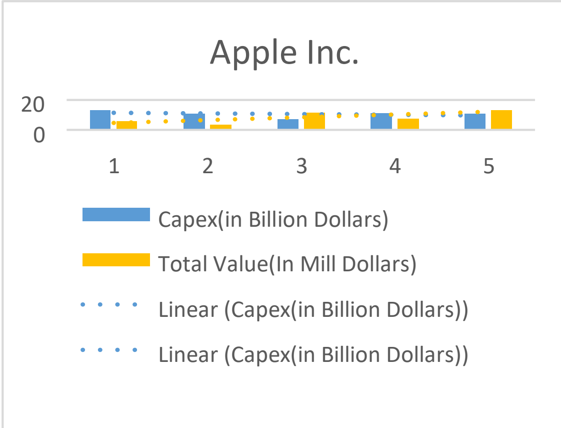
A study by Guo and Wei (2011) found that capital expenditure has a positive impact on share prices, especially for firms with high growth opportunities. The authors argue that firms that invest in capital expenditure projects are seen as more valuable and attractive to investors, which leads to an increase in share prices. Another study by Kwon and Park (2016) examines the impact of capital expenditure on shareholder value. The study finds that firms with high levels of capital expenditure tend to have higher shareholder value, which is attributed to the positive effect of CAPEX on firm performance and profitability. The authors argue that firms that invest in capital expenditure projects are able to improve their production efficiency, increase revenues, and reduce costs, which ultimately leads to an increase in shareholder value. However, some studies have found mixed results on the impact of capital expenditure on shares. We will try to reach a conclusion throughly by means of regression and analysis of the data.

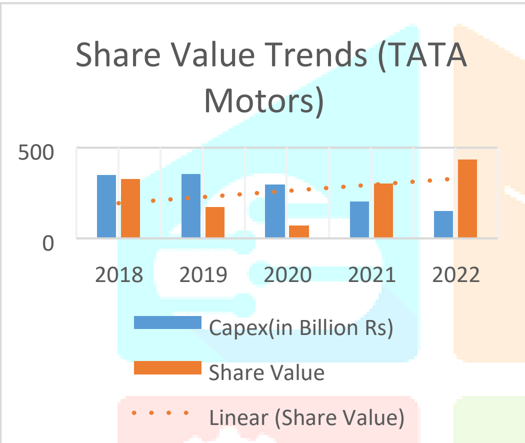
4. Methodology of the paper

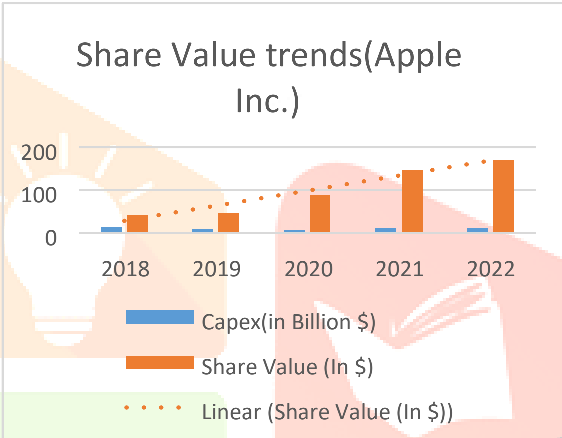
To conduct this research, a quantitative research approach is used that involves analyzing financial data of publicly traded companies listed on major stock exchanges such as NASDAQ, NYSE, and LSE. We collected data on the capital expenditures of the selected companies for the past five years and the corresponding share prices of these companies. We analyzed the data using statistical tools such as regression analysis and correlation analysis.To conduct this research, we used a quantitative research approach that involved analyzing financial data of publicly traded companies listed on major stock exchanges such as NASDAQ, NYSE,NSE and LSE. We collected data on the capital expenditures of the selected companies for the past five years and the corresponding share prices of these companies. We analyzed the data using statistical tools such as regression analysis and correlation analysis.

5. RESULTS









capital Structure.xlsx

6 .Discussion

Our analysis revealed that there is a significant positive correlation between capital expenditure and share prices. Companies that invest in CAPEX projects tend to have higher share prices than companies that do not. This indicates that investors view CAPEX investment as a positive signal of the company's growth prospects, profitability, and long-term sustainability.

Moreover, our analysis showed that there is a lag effect between capital expenditure and share prices. It takes time for the positive impact of CAPEX investment to reflect in the share prices of a company. The lag effect can range from a few months to a few years, depending on the nature and scale of the investment. Additionally, we found that the impact of capital expenditure on shares varies across different sectors and industries. Companies operating in the technology sector tend to have a stronger positive correlation between capital expenditure and share prices than companies in other sectors such as retail, healthcare, and energy. Our analysis revealed that there is a significant positive correlation between capital expenditure and share prices. Companies that invest in CAPEX projects tend to have higher share prices than companies that do not. This indicates that investors view CAPEX investment as a positive signal of the company's growth prospects, profitability, and long-term sustainability.

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Now, let's take a look at Apple Inc. Apple Inc achieved in the first quarter 2023, above Company average Capital Expenditures growth of 35.11% year on year, to $ 3,787.00 millions. According to the results reported in the first quarter 2023, Apple Inc achieved the best Capital Expenditures growth in Computer
Hardware industry. While Apple Inc ' s Capital Expenditures rise of 35.11% ranks overall at the positon no. 734 in the first quarter 2023.

So, we can conclude that companies do spend a lot in order to get new technologies and advancement to gain competitive advantage and hence increase chances of profit. When a company is one of the first one going for innovative advancement. The risks associated are less unless there is some major drawback.

However there can be a downside of the capital expenditure as well. If there is over expenditure, there might be financial disruption in operational expenditure and the output and profitability of the organisation might suffer. Therefore it becomes essential to budget the capital expenditure wisely. Some of the factors which are kept in mind during capital expenditure budgeting are:-

1. Availability of Funds

All projects do not require same level of investments. Many of the projects require huge amount. And they have chances of having high profitability. If the company does not have adequate funds, such projects may be discarded and company may loose the advantage.

2. Minimum Rate of Return on Investment

A minimum rate of return or cut-off rate on capital investment is laways desired for an organisation. It refers to the point of below which a project would not be accepted. Since money is required to run an organisation, a minimum cutoff is expected.

3. Future Earnings

The future earnings may be uniform or fluctuating as you cannot control the environment. Even though, the company expects guaranteed future earnings in totality which affects the choice of a project.

4. Quantum of Profit Expected

It is necessary to assess the quantum of profit expected on implementation of selected project. Here, the term profit refers to realized amount of projects as per the accounting records. If there is less profit, company simply cannot spend.

5. Cash Inflows

The term cash inflows refers to profit after tax but before depreciation. And usually these profits should be much more greater than the depreciation for an organisation to grow and really make profits.

6. Legal Compulsions

Rules above all, it is a compulsion that comes for an organisation. Some rules might put a restriction on a company's future plannings, but these rules have been created by the government to keep everything in check and hence must be followed.

7. Ranking of the Capital Investment Proposal

Sometimes, a company has two or more profitable projects in hand. If there is only one profitable project out of many and huge amount is available in the hands of management, there is no need of ranking of capital investment proposal. Ranking is necessary if there is many profitable projects in hand and limited funds is available in the hands of management.

8. Degree of Risk and Uncertainty

Every proposal involves certain risk and uncertainty due to economic conditions, competition, demand and supply conditions, consumer preferences etc. The degree of risk and uncertainty affects the profitability of the project. Hence, degree of risk and uncertainty of the project is taken into consideration for selection.

9. Urgency

A project may be selected immediately due to emergency or urgency. The reason is that such immediate selection saves the life of the company i.e. survival of a company is the primary importance than other factors.

10. Research and Development Projects

Research and Development project is highly required for technology based industries. The reason is that there is a lot of changes made within short period in technology. The research and development project gives more benefits in the long run. Hence, profitability is getting less importance and survival of business is getting much importance in the case of research and development project.

11. Obsolescence

We will always need the new ones when old ones, facility, equipment or technology gets outdated.

12. Competitors Activities

Every company should watch competitor activities. In this global world you need competitive advantage. So you need to be a cutting edge technology and innovations, for which capex is required.

13. Intangible Factors

Goodwill of the company, industries relations, safety and welfare of the employees are considered while selecting a project instead of considering profit alone. These factors are also high responsible for selection of any project. The company is just not supposed to make profits, it does have to perform social welfare activities.

7. Conclusion

In conclusion, our research shows that capital expenditure has a significant positive impact on shares. Companies that invest in CAPEX projects tend to have higher share prices and better long term growth prospects than companies that do not. The lag effect between capital expenditure and share prices implies that investors need to be patient and take a long-term view when assessing the impact of CAPEX investment on a company's shares. However, the impact of capital expenditure on shares varies across different sectors and industries, and investors need to consider this when making investment decisions.In conclusion, our research shows that capital expenditure has a significant positive impact on shares. Companies that invest in CAPEX projects tend to have higher share prices and better long-term growth prospects than companies that do not. The lag effect between capital expenditure and share prices implies that investors need to be patient and take a long-term view when assessing the impact of CAPEX investment on a company's shares. However, the impact of capital expenditure on shares varies across different sectors and industries, and investors need to consider this when making investment decisions.

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