

Bianco Research L.L.C.

An Arbor Research & Trading Company

Independent · Objective · Original

Volume 13, No. 52

1731 North Marcey, Chicago IL 60614

www.biancoresearch.com

Market Facts Financials' Cost Of Capital

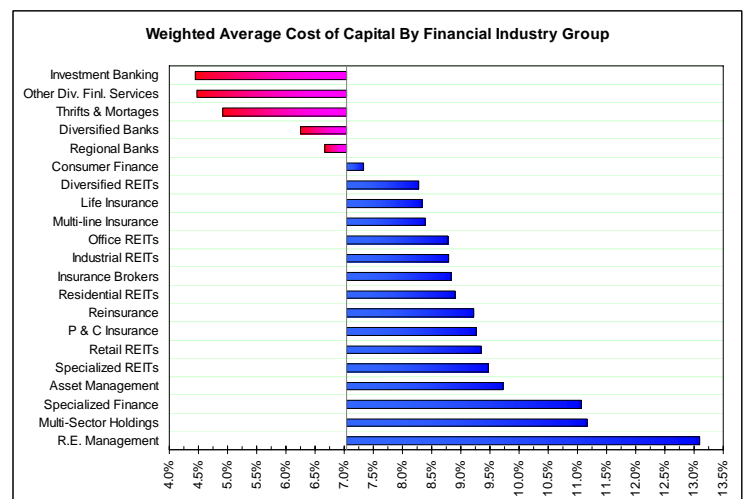
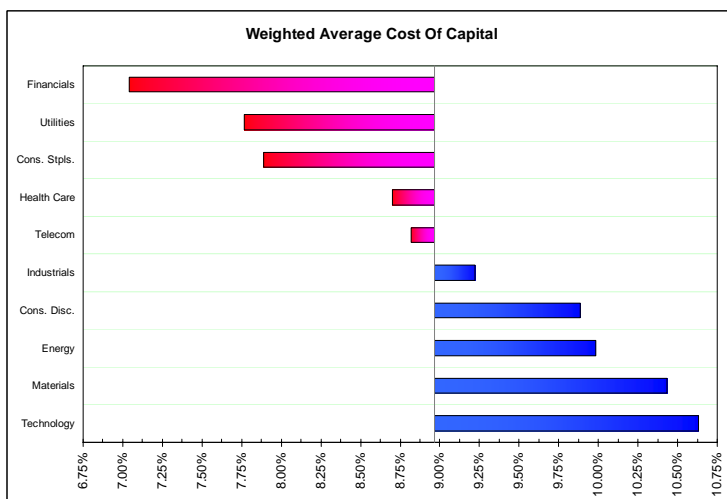
By Howard L. Simons (847) 304-1511

April 25, 2008

What is the financial sector's cost of capital after its various issuances of convertibles, preferred and common stock and private placements? The weighted average cost of capital across the ten economic sectors in the S&P 1500 (left-hand chart) shows the financial sector now has the lowest weighted cost of capital, 7.036%; the weighted average across the S&P 1500 is 8.965%.

If we disaggregate the financial sector into its constituent industry groups (right-hand chart), we see that investment banking, other diversified financial services, thrifts & mortgages and both diversified and regional banks have weighted average costs of capital below the sector's weighted average.

REITs, the subject of a recent [Market Facts](#), and insurance groups have weighted average costs of capital above the sector's weighted average.



Conclusion

The results appear perverse on the face: The financial sector has been the cause of much stress, and within the financial sector it has been the investment and major commercial banks standing at the epicenter of the credit crunch. And yet the market has awarded this sector and these groups with the lowest costs of capital.

Fear not for the market's rationality: While the financials may have been able to issue new paper at a low upfront cost, many of these instruments are back-loaded for the investor. Those preferred shares and convertible issues generally are senior

to existing common stock, and that is before we account for board seats and other forms of, um, non-passive participation in future management.

Finally, a sector with a low cost of capital is not necessarily a great investment. Those low costs often reflect low returns; the energy, basic materials and technology sectors have been able to reward their investors quite well with their relatively high costs of capital; unlike their financial brethren, they provide a return upfront and are not surrendering current or future control over their corporations in exchange.

Bianco Research L.L.C.

1731 North Marcey, Suite 510
Chicago IL 60614

Phone: (847) 304-1511

Fax (847) 304-1749

e-mail: research@biancoresearch.com

<http://www.biancoresearch.com>

For more information about the contents/ opinions contained in these reports:

President (847) 756-3599

James A. Bianco jbianco@biancoresearch.com

Strategist/Analysts (847) 304-1511

Howard L. Simons hsimons@biancoresearch.com

Greg Blaha gblaha@biancoresearch.com

Ryan Malo rmalo@biancoresearch.com

For subscription/service Information:

Arbor Research & Trading, Inc.

Director of Sales & Marketing (800) 625-1860

Fritz Handler fritz.handler@arborresearch.com

Arbor Research & Trading, Inc.

1000 Hart Road, Suite 260

Barrington IL 60010

Phone (847) 304-1560 Fax (847) 304-1595

e-mail inforequest@arborresearch.com

<http://www.arborresearch.com>

Domestic - For more information about Arbor Research & Trading and its services:

New York Sales Office

The Chrysler Building, 405 Lexington Ave
New York, NY 10174

Edward T. McElwreath ed.mcelwreath@arborresearch.com

Phone (212) 867-5326 Fax (212) 370-1218

International - For more information about Arbor Research & Trading and its services:

London Sales Office

4 Broadgate, 2nd Floor, Room 57

London England EC2M 2QY

Phone 44-207-965-4784 Fax 44-207-965-4787

Neil Tritton neil.tritton@arborresearch.com

Ben Gibson ben.gibson@arborresearch.com

European Sales

James L. Perry james.perry@arborresearch.com

Phone (847) 756-3510 Fax (847) 304-1595

Rich Kleinbauer rich.kleinbauer@arborresearch.com

Phone (41) 22 363-9229

Far East Sales

Robert Reynolds robert.reynolds@arborresearch.com

Phone (847) 756-3680 Fax (435) 647-3073