Annex A

Target rate of return for Post Office Trading Fund

		As from 1995-96	**As from 2006-07**	**As from 2012-13**
Cost of Debt				
Risk Free Rate	(a)	6.5%	5.2%	3.42%
Profits Tax Rate	(b)	16.5%	16.5%	16.5%
Cost of Debt	**(c) = (a) x (1 - (b))**	**5.43%**	**4.34%**	**2.86%**
Cost of Equity				
Risk Free Rate	(a)	6.5%	5.2%	3.42%
Equity Risk Premium	(d)	11.71%	5.0%	5.25%
Equity Beta Coefficient	(e)	0.55	0.63	0.47
Cost of Equity	**(f) = (a) + [(d) x (e)]**	**12.94%**	**8.4%**	**5.9%**
Weighting of Debt / Equity				
- Debt	(g)	30%	0	0
- Equity	(h)	70%	100%	100%
Target Rate of Return (Note)	**(i) = (c) x (g) + (f) x (h)**	**10.5%***	**8.4%**	**5.9%**

* Rounded to nearest 0.5%.

Note:

The target rate of return is calculated as follows –

Weighted Average Cost of Capital

= Gearing ratio x Cost of Debt + (1 – Gearing ratio) x Cost of Equity

whereas

Gearing ratio = Debt / (Debt + Equity)

Cost of Debt = Risk Free Rate x (1 - Profits Tax Rate); and

Cost of Equity = Risk Free Rate + (Equity Risk Premium x Equity Beta Coefficient)