Student: KEITH SIMPSON **Date:** 10/12/12 **Time:** 7:00 AM	**Instructor:** UOP Admin **Course:** FIN/370--10-09-12--section 1111MCGENS **Book:** Titman/Martin/Keown: Financial Management: Principles and Applications	**Assignment:** Week Two Practice

1. **(Defining capital structure weights)** Templeton Extended Care Facilities, Inc. is considering the acquisition of a chain of cemeteries for $410 million. Since the primary asset of this business is real estate, Templeton's management has determined that they will be able to borrow the majority of the money needed to buy the business. The current owners have no debt financing but Templeton plans to borrow $290 million and invest only $120 million in equity in the acquisition. What weights should Templeton use in computing the WACC for this acquisition?

The appropriate w_d weight is ☐%. (Round to one decimal place.)

The appropriate w_{cs} weight is ☐%. (Round to one decimal place.)

2. **(Individual or component costs of capital)** Compute the cost of capital for the firm for the following:
a. A bond that has a $1,000 par value (face value) and a contract or coupon interest rate of 11.5%. The bonds have a current market value of $1,124 and will mature in 10 years. The firm's marginal tax rate is 34%.
b. A new common stock issue that paid a $1.81 dividend last year. The firm's dividends are expected to continue to grow at 6.8% per year forever. The price of the firm's common stock is now $27.21.
c. A preferred stock paying a 9.1% dividend on a $123 par value.
d. A bond selling to yield 11.9% where the firm's tax rate is 34%.

a. A bond that has a $1,000 par value (face value) and a contract or coupon interest rate of 11.5%. The bonds have a current market value of $1,124 and will mature in 10 years. The firm's marginal tax rate is 34%.

The cost of capital from this bond debt is ☐%. (Round to two decimal places.)

b. A new common stock issue that paid a $1.81 dividend last year. The firm's dividends are expected to continue to grow at 6.8% per year forever. The price of the firm's common stock is now $27.21.

The cost of capital from the common equity is ☐%. (Round to two decimal places.)

c. A preferred stock paying a 9.1% dividend on a $123 par value.

The cost of the preferred stock is ☐%. (Round to two decimal places.)

d. A bond selling to yield 11.9% where the firm's tax rate is 34%.

The cost of capital from this bond debt is ☐%. (Round to two decimal places.)

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3. **(Individual or component costs of capital)** Your firm is considering a new investment proposal and would like to calculate its weighted average cost of capital. To help in this, compute the cost of capital for the firm for the following:
a. A bond that has a $1,000 par value (face value) and a contract or coupon interest rate of 11.4%. The bond is currently selling for a price of $1,121 and will mature in 10 years. The firm's tax rate is 34%.
b. If the firm's bonds are not frequently traded, how would you go about determining a cost of debt for this company?
c. A new common stock issue that paid a $1.76 dividend last year. The par value of the stock is $14, and the firm's dividends per share have grown at a rate of 7.8% per year. This growth rate is expected to continue into the foreseeable future. The price of this stock is now $28.18.
d. A preferred stock paying a 9.5% dividend on a $121 par value. The preferred shares are currently selling for $153.47.
e. A bond selling to yield 13.5% for the purchaser of the bond. The borrowing firm faces a tax rate of 34%.

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a. A bond that has a $1,000 par value (face value) and a contract or coupon interest rate of 11.4%. The bonds have a current market value of $1,121 and will mature in 10 years. The firm's marginal tax rate is 34%.

The cost of capital from this bond debt is ☐%. (Round to two decimal places.)

b. If the firm's bonds are not frequently traded, how would you go about determining a cost of debt for this company? (Select the best choice below.)

- A. It is standard practice to estimate the cost of debt using the yield to maturity on a treasuty bond of the same maturity.
- B. It is standard practice to estimate the cost of debt using the average coupon rate on a portfolio of bonds with a similar credit rating and maturity as the firm's outstanding debt.
- C. It is standard practice to estimate the cost of debt using the yield to maturity on a portfolio of bonds with a similar credit rating and maturity as the firm's outstanding debt.
- D. It is standard practice to estimate the cost of debt using the bond's coupon rate and adjust it for inflation.

c. A new common stock issue that paid a $1.76 dividend last year. The par value of the stock is $14, and the firm's dividends per share have grown at a rate of 7.8% per year. This growth rate is expected to continue into the foreseeable future. The price of this stock is now $28.18.

The cost of capital from the common equity is ☐%. (Round to two decimal places.)

d. A preferred stock paying a 9.5% dividend on a $121 par value. The preferred shares are currently selling for $153.47.

The cost of the preferred stock is ☐%. (Round to two decimal places.)

e. A bond selling to yield 13.5% for the purchaser of the bond. The borrowing firm faces a tax rate of 34%.

3.
(cont.)

The cost of capital from this bond debt is ☐%. (Round to two decimal places.)