

## Week 2: Week 2 - W2 Assignment 2

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### DROPBOX DELIVERY REQUIRED

Please use the appropriate basket in the Dropbox area to deliver materials required for this assignment.

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## Assignment 2: The Cost of Capital

Canyon Drilling, Inc. has just come under new management. One of the first things the new management wants to accomplish is to identify its capital structure and the cost of additional funding, if needed.

According to the accounting department, the current balance sheet is accurate and reflects the financial structure of the company. They have also calculated the marginal tax rate to be 40%. The company's beta is currently 1.15.

Your Chief Financial Officer, Marge, has also provided you the following information about the market and the company's financials:

Company Specifics
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<b>Debt:</b>
3,600 par value (\$1,000) bonds outstanding. All have a 7% coupon, and will mature in 20 years. Market value is currently \$1,050 and interest is paid once a year.
<b>Equity:</b>
<b>Common Stock</b>
The company has 40,000 shares of common stock outstanding, and has a market price of \$50 per share. The stock last paid a dividend of \$1.40 and had a constant growth of 5% per year.
<b>Preferred Stock</b>
The company has 7,500 shares of 5% preferred stock outstanding. All have \$100 par value and are selling for \$80 per share.
Floatation costs: Debt = 4%, Equity = 5%
Market Specifics
Market risk premium = 7%
Risk free rate = 4%
Return on the average stock = 11%

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**Required:**

- Assuming the same capital structure is to be maintained, what is the optimal capital structure for Canyon Drilling?
- What is the component cost of capital for the firm?
- Calculate Canyon Drilling's after tax weighted average cost of capital, using the information above.

**Deliverables:**

- In an executive summary of 3 to 5 pages, submit your findings from the above-noted requirements in a Microsoft Word or Excel document to the **W2: Assignment 2 Dropbox**, by **Tuesday, May 24, 2016**. Use an MS Excel document to illustrate your calculations.

Name your document(s) SU\_FIN3030\_W2\_A2\_LastName\_FirstInitial.

<b>Assignment 2 Grading Criteria</b>	<b>Maximum Points</b>
Successfully calculated the capital structure.	15
Successfully calculated the component costs of capital	15
Specified appropriate capital restructuring recommendations.	10
Successfully calculated the firm's new cost of capital.	10
<b>Total:</b>	<b>50</b>