Bus401 mini case chapter 9

Business, Company

Percentage of future financing Type of financing Bonds (8%, $1, 000 par, 16-year maturity38% Preferred stock (5, 000 shares outstanding $50 par, $1. 50 dividend15% Common equity47% Total100% A. Market prices are $1, 035 for bonds, $19 for preferred stock, and $35 for common stock. There will be sufficient internal common equity funding (i. e. , retained earnings) available such that the firm does not plan to issue new common stock. Calculate the firm's weighted average cost of capital. BondsPreferred stockCommon Stock 1035-15% (155. 25) = 879. 75 1. 50/(19-2. 01) 16. 99 = 8. 83% 2. 65/35 + . 06 = 13. 57% 9. 9% 9. 49% (1-. 34) = 6. 26% WeightsAfter tax captialProduct Bond 0. 38X6. 26%= 2. 3788 Preferred Stock0. 15X8. 83%= 1. 3245 Common Stock0. 47X13. 57%= 6. 3779 10. 08% B. In part a we assumed that Nealon would have sufficient retained earnings such that it would not need to sell additional common stock tofinanceits new investments. Consider the situation now when Nealon's retained earnings anticipated for the coming year are expected to fall short of the equity requirement of 47% of new capital raised. Consequently, the firm foresees the possibility that new common shares will have to be issued.

To facilitate the sale of shares, Nealon's investment banker has advised management that they should expect a price discount of approximately 7%, or $2. 45 per share. Under these terms, the new shares should provide net proceeds of about $32. 55. What is Nealon's cost of equity capital when new shares are sold, and what is the weighted average cost of the added funds involved in the issuance of new shares? Common Stock 2. 65/32. 55 + . 06 = 14. 14% WeightsAfter tax captialProduct Bond 0. 38X6. 26%= 2. 3788

Preferred Stock0. 15X8. 83%= 1. 3245 Common Stock0. 47X14. 14%= 6. 6458 10. 35%