This assignment will allow you to demonstrate the following objectives:

* Compute the net present value, profitability index, and internal rate of return for a given company.
* Predict the best choice for a company based on analysis of financial data.
* Compute a company’s WACC using given percentages.
* Calculate the cost of capital of a stock.
* Computer the after-tax cost of capital for bonds.

**Instructions:**  Answer the questions directly on this document. When you are finished, select “Save As,” and save the document using this format: Student ID\_UnitVIII. Upload this document to BlackBoard as a .doc, docx, or .rtf file. Show all of your work.

1. The capital structure for Mills Corporation is shown below. Currently, flotation costs are 13% of market value for a new bond issue and $3 per share for preferred stock. The dividends for common stock were $2.50 last year and have an estimated annual growth rate of 6%. Market prices are $1,050 for bonds, $20 for preferred stock, and $40 for common stock. Assume a 34% tax rate.

|  |  |
| --- | --- |
| **Financing Type** | **% of Future** **Financing** |
| Bonds (8%, $1k par, 16 year maturity) | 36% |
| Common equity | 45% |
| Preferred stock (5k shares outstanding, $50 par, $1.50 dividend) | 19% |
| Total % | 100% |

Compute the company’s WACC.

2. The Milton Company plans to issue preferred stock. Currently, the company’s stock sells for $120. Once new stock is issued, the Milton Company would receive only $99 (due to flotation costs). The dividend rate is 12%, and the par value of the stock is $100. Compute the cost of capital of the stock to your firm. Show all work.

3. The Dayton Corporation is considering a new investment, which would be financed from debt. Dayton could sell new $1k par value bonds at a new price of $950. The bonds would mature in 15 years, and the coupon interest rate is 10%. Compute the after-tax cost of capital to Dayton for bonds, assuming a 34% tax rate. Show work.

4. Farrah Corporation is considering two projects (see below). For your analysis, assume these projects are mutually exclusive with a required rate of return of 12%.

|  |  |  |
| --- | --- | --- |
|  | **Project 1** | **Project 2** |
| Initial investment | $185,000 | $1,100,000 |
| Cash inflow Year 1 | $230,000 | $1,450,000 |

Compute the following for each project:

* NPV (net present value)
* PI (profitability index)
* IRR (internal rate of return)

Which project should be selected? Why?