# 1 Cost of Capital - LOS

- Calculate and interpret the weighted average cost of capital (WACC) of a company.
- Describe how taxes affect the cost of capital from different capital sources.
- Describe alternative methods of calculating the weights used in the WACC, including the use of the company's target capital structure.
- Explain how the marginal cost of capital and the investment opportunity schedule are used to determine the optimal capital budget.
- Explain the marginal cost of capital's role in determining the net resent value of a project.
- Calculate and interpret the cost of fixed rate debt capital using the yield-to-maturity approach and the debt-rating approach.
- Calculate and interpret the cost of non-callable, nonconvertible preferred stock.
- Calculate and interpret the cost of equity capital using the capital asset pricing model approach, the dividend discount model approach, and the bond-yield-plus risk-premium approach.
- Calculate and interpret the beta and cost of capital for a project.
- Explain the country equity risk premium in the estimation of the cost of equity for a company located in a developing market.
- Describe the marginal cost of capital schedule, explain why it may be upward-sloping with respect to additional capital, and calculate and interpret its break-points.
- Explain and demonstrate the correct treatment of flotation costs.

# 2 Cost of Capital - Questions

1. What is the formula for the weighted average cost of capital?
2. Given the D/E ratio calculate the weight for debt and equity?
3. What are three approaches that an analyst might use to estimate the target capital structure of a company?
4. Describe the investment opportunity schedule. Draw a diagram of it.
5. Calculate the cost of debt using the yield to maturity approach. NOTE: Their are calculator tricks to know.

6. What is the debt-rating approach to estimating the cost of debt?
7. What are four issues in estimating the cost of debt?
8. What is the formula to calculate the value of preferred stock? How can this be rearranged to calculate the cost of preferred stock?
9. What is the formula for the CAPM? What does it give you?
10. What are the three formulas for the Dividend Discount Model Approach?
11. What is the formula for the sustainable growth rate?
12. What is the formula for the Bond Yield plus Risk Premium Approach?
13. How can you estimate a companies stock beta by using a market regression model?
14. Beta estimates are sensitive to the method of estimation and data used. Give five examples of issues surrounding this.
15. What is the formula to calculate the asset beta?
16. What is the formula to calculate the equity beta?
17. What are the four steps in estimating a beta using the pure-play method?
18. What is the formula to calculate the beta of a comparable company?
19. Assuming that we have the beta of a comparable company, how do we calculate the beta for our project?
20. Calculate the before-tax marginal cost of debt. What is the formula?
21.