

Chapter - THE COST OF CAPITAL

1. XYZ Ltd. issued 10 year, 12% debenture 3 years ago. The face value was Rs. 100 and is currently selling for Rs. 106.
 - 1) What is the pre-tax cost of debt?
 - 2) What is the pos-tax cost of debt if the tax is 30%?
2. MNP Ltd. issued 8 year, 10% debenture 2 years ago. The face value was Rs. 100 and is currently selling for Rs. 91.
 - 1) What is the pre-tax cost of debt?
 - 2) What is the pos-tax cost of debt if the tax is 40%?
3. Max Ltd. issued 10 year, 14% Preference share 4 years ago. The face value was Rs. 100 and is currently selling for Rs. 91. What is the cost of preference share?
4. Tom Ltd. issued 15 year, 12% Preference share 5 years ago. The face value was Rs. 100 and is currently selling for Rs. 120. What is the cost of preference share?
5. Jinay Company's tax rate is 35 percent. Jinay Company's pre-tax cost of debt is 12 percent and its debt-equity ratio is 1:1. The risk-free rate is 8 percent and the market risk premium is 7 percent. The Beta of Firm is 0.85. What is WACC?
6. Sigma Company's equity beta is 1.2. The risk-free rate is 8 percent and the market risk premium is 9 percent. Sigma's debt-equity ratio is 2:3. Its pre-tax cost of debt is 14 percent. If the tax rate is 30 percent, what is its WACC?
7. Pioneer corporation has cost of equity of 12% and pre-tax cost of debt of 9%. Tax rate is 30%. What will be the cost of capital if –
 - a) the debt equity weightage is 1:2
 - b) the debt equity weightage is 2:3

8. Jerry corporation has cost of equity of 17% and pre-tax cost of debt of 10%. Tax rate is 30%. What will be the cost of capital if –
- a) the debt equity weightage is 1:3
 - b) the debt equity weightage is 1:2

9. Susheel Corporation has the following book value capital structure:

Equity capital (15 million shares, Rs. 10 par)	Rs. 150 million
Preference capital, 11 percent (50,000 shares, Rs. 100 par)	Rs. 5 million
Retained earnings	Rs. 70 million
Debentures 14 percent (500,000 debentures, Rs. 100 par)	Rs. 40 million
Term loans, 16 percent	Rs. 70 million
Total	<u>Rs. 335 million</u>

The next expected dividend per share is Rs. 2. The dividend per share is expected to grow at the rate of 8 percent. The market price per share is Rs. 20.00. Preference stock, redeemable after 10 years, is currently selling for Rs. 85.00 per share. Debentures, redeemable after 6 years, are selling for Rs. 90.00 per debenture. The tax rate for the company is 50 percent.

Calculate the average cost of capital using

- (i) book value proportions, and
- (ii) market value proportions