You are the chief financial officer of a multinational company in the Do-It-Yourself (DIY) retail business based in the United States. Your company is considering a major expansion into the rapidly developing China market where one of your competitors has already established a presence with three stores, one in Beijing and two in Shanghai. After conducting local market research and a personal review, you are convinced that, although your competitor has successfully opened a new market in those cities, the demand is considerably greater than its ability to supply. Your overseas operations group report that they can open the appropriate supply chains and that, unlike the competition, you will be able to get a greater variety of goods onto the shelves and maintain supply at competitive prices.

Your assessment is that the company will need to raise the equivalent of $380 million of new finance over 10 years for this venture, of which $80 million could come from the company's existing liquid reserves. You have completed your review of the financial merits of the case and the project offers a rate of return in excess of 80 per cent. The company's current credit rating is assessed at AA–. Its total market capitalisation is $3.5bn, which includes a ten year syndicated loan of $0.5 billion due for retirement in three years. The balance of the firm's capital is in the form of common stock (ordinary shares) trading on the New York and Hong Kong markets.

You wish to undertake a preliminary review of the options for financing this project. Your assessment is that borrowing the money is a possibility but that the increase in gearing would drop the credit rating on the existing loan to A+. You are unsure what credit rating would be attached to a new debt issue but estimate a 60 per cent chance of A+, with a further 40 per cent chance that the rating could fall to A. The company's existing weighted average cost of capital (tax adjusted at the company's average corporation tax rate of 30 per cent) is 6.8 per cent.

Analysis of the yield curve reveals that the 3 year risk free interest rate is 3.8% and the 10 year rate 4.3%

Yield spreads for retail sector (in basis points)

Rating	1yr	2yr	3yr	5yr	7yr	10yr	30yr
Aaa/AAA	4	8	12	18	20	30	50
Aa1/AA+	8	12	20	30	32	35	60
Aa2/AA	15	24	30	34	40	50	65
Aa3/AA –	24	35	40	45	54	56	78
A1/A+	28	37	44	55	60	70	82
A2/A	55	65	75	85	95	107	120

Required:

Estimate the expected cost of capital for this project on the assumption that the additional finance is raised through a bond issue in the US market.