

Chapter 14 Practice Problems

From the book: Self Test Problem 14.1-14.2. Question and Problems: 1-4, 6-7, 9a, 10-14

1. Dunder Mifflin Paper Company has 10,000,000 shares outstanding, an EPS of 2 and a P/E Ratio of 17. The company currently has a beta of 2.2. The company just paid a dividend of \$1.50 and has a constant growth rate of 4.5%. There are currently 50,000, 8% semi annual coupon bonds outstanding with a face value of \$1,000. They are priced at 108.5 with have 14 years left to maturity. The expected market return is 11.5%, t-bills are yielding 7.5 percent, and the marginal tax rate is 21%.
 - (a) What is the cost of equity. (Use both CAPM and DGM)
 - (b) What is the after-tax cost of debt?
 - (c) What are the capital weights?
 - (d) What is the WACC (use the CAPM cost of equity)
 - (e) Given the company WACC would you accept a project with an initial investment of \$500,000 with cash flows of \$75,000 for the next 30 years?

Answers to Textbook

11th Edition

- 1) 11.20% 2) 12.13% 3) 10.25%; 9.57%
- 4) 9.88%; 9.87% 6) 3.40% 7) a) 7.61%
- b) 4.95% c) The aftertax rate is more relevant because that is the actual cost to the company.
- 9) a) 9.09% 10) 9.90% 11) .5513 12) a) .2932 ; .7068
- b) .8106; .1894 c) Market value 13) 10.31%
- 14) a) 7.81% b) 12.54%

12th Edition

- 1) 9.54% 2) 10.46% 3) 10.75%; 9.79%
- 4) 11.89%; 11.88% 6) 4.55% 7) a) 6.56%
- b) 5.11% c) The aftertax rate is more relevant because that is the actual cost to the company.
- 9) a) 8.41% 10) 8.78% 11) .8732 12) a) .3373; .6627
- b) .8108; .1892 c) Market value 13) 8.98%
- 14) a) 4.33% b) 11.31%

Answer to above problems

- 1) 16.3% and 9.11%
- 2) 5.56% 3) 0.86 and 0.14
- 4) 14.82% 5) No