Chapter 10 Review

Discount rate to figure out the value of projects is called WACC (weighted average cost of capital)

WACC = weight of debt \* cost of debt \*(1-tax rate) + weight of equity \*( cost of equity)

Cost of debt = rate(nper, coupon, price – flotation costs, 1000)

IBM financed 10m via debt coupon 5%, 10 year, price is $950 and flotation is 7% of the price, tax 40%.

IBM financed 20m via equity. D1=$5. r is 10%, g is 5%. So WACC?

Wd=1/3. We=2/3.

Kd = rate(10, 5%\*1000, 950-950\*7%, 1000)\*(1-40%)

Ke =5/(10%-5%)

WACC = Wd\*Kd +We\*Ke =

Cost of equity = D1/ (r-g)