**Corporate Finance – I**

**1. Cummins Engines Ltd currently has 1.2 million common shares of stock outstanding and the stock has a beta of 2.2. It also has $ 10 million face value of bonds that have five years remaining to maturity and 8% coupon with semi-annual payments and are priced to yield 13.65%. If the company issues up to $ 2.5 million of new bonds, the bonds will be priced at par and have a yield of 13.65%; if it issues bonds beyond $ 2.5 million, the expected yield on the entire issue will be 16%. The company management has learnt that it can issue new common stock at $ 10 a share. The current risk-free rate of interest is 3% and the expected market return is 10%. The company’s marginal tax rate is 30%. If the company raises $ 7.5 million of new capital while maintaining the same debt-to-equity ratio, what would be its weighted average cost of capital? (10 Marks) –**

**Ans:**

The weighted average cost of capital, frequently called WACC, is a measure of the average value, after taxes, of acquiring capital for an employer from all available resources. Those sources include common stock, desired stock, bonds, and other types of debt. The weighted average cost of capital (WACC) is the rate that an organization tasks it will pay to finance its assets on average.

Because it expresses in a single variety the return that each bondholder and shareholders need to supply the capital to the organization, the weighted ordinary cost of capital (WACC) is a typical

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**2. Assume that your father is now 50 years old and plans to retire after 10 years from now. He is expected to live for another 25 years after retirement. He wants a fixed retirement income of Rs. 5,00,000 per annum. His retirement income will begin the day he retires, 10 years from today, and then he will get 24 additional payments annually. Your father has current savings of Rs. 10,00,000 and he expects to earn a return on his savings @ 10% p.a., annually compounding. How much (to the nearest of rupee) must your father save during each of next 10 years to meet his retirement goal? (10 Marks)**

**Ans:**

Thinking about how life will be in one's 1960s and beyond is one of the more challenging aspects of preparing for retirement. Many people locate that the possibility of saving cash for an unsure future reason them to experience so overwhelmed that they end up not saving something in any respect. You might not put in excessive effort to plan for your retirement, which is good news, but you'll want an avenue map — preferably one that may be changed over time — to keep you on target.

The amount of cash a couple needs to put away for a comfortable retirement is going to depend,

**3. Westcoast Paper Ltd is expected to generate $ 1,500,000 in revenues and $ 500,000 in operating earnings next year. Currently, the company does not use debt financing and has assets of $ 2,000,000. Suppose the company were to change its capital structure, buying back $ 1,000,000 of stock and issuing $ 1,000,000 in debt. If we assume that interest on debt is 5% and income is taxed at 30%, what is the effect of debt financing on the company’s net income and return on equity if operating earnings may vary as much as 40% from expected earning operating earnings in following circumstances?**

**a. When the company has no debt, and**

**b. When the company has debt to total assets = 50%.**

**Ans:**

**If earning remains at same level**

|  |  |  |
| --- | --- | --- |
| Particulars | No debt | With Debt |
| EBIT | 500000 | 500000 |