BPF2213 (Final Examination, June 2017) QUESTION 1

Globe Berhad has to choose the best project(s) to be enrolled. The options are as follows:

PROJECT	INITIAL INVESTMENT	IRR
Anthurium Resident	RM1,000,000	16%
Amaryllis Shop House	RM900,000	18%
Calatheas Shop Office	RM800,000	14%

Table 1: Initial Investment Cost and the Expected Return of Project

The company's existing capital structure consists of 40% debt, 10% preferred share and 50% common equity. The company has RM 400,000 of retained earnings available for reinvestment purpose.

To finance the new project, the company has decided to issue new bond, preferred stock and common equity. The cost of debt before taxes is 6% for the first RM200,000 and further issuance would incur 9% (before taxes). The company paid RM3 per share as dividend last year and it's current stock price is RM15. The expected growth rate in earnings and dividends is 5%. If new common stocks are issued, there will be floatation cost of 10% of the market price. Preferred shares' after tax cost is 8% for the first RM150,000 and it will be at 12% thereafter. The corporate tax rate applied is 35%.

a) Calculate after-tax cost of bond and common equity.

(10 Marks)

b) Compute the breaking point for each of the financial instrument.

(3 Marks)

c) Prepare the weighted average cost of capital (WACC) schedule.

(7 Marks)

d) Draw graph and recommend which project(s) should be undertaken by the company.

(5 Marks)