



Stone Wood Products has a capital structure of 35 percent debt and 65 percent common equity. The managers consider this mix to be optimal and want to maintain it in the future. Net income for the coming year is expected to be \$1.2 million dollars. Ben Merle, the loan officer at the local bank, has set up the following schedule for Stone Wood Products' borrowings.

Loan Amount	Interest Rate
\$0 to \$250,000	10%
> \$250,000	12%

There are 40,000 shares of common stock outstanding. The firm's tax rate is 40 percent. The market price per share of Stone Wood Products' common stock is \$50 per share. They have declared a \$5 per share dividend to be paid in one year. The company's expected growth rate is 9 percent. The flotation costs for new common stock issued are set at 8 percent of the market price. The managers are considering several investment opportunities for the upcoming year. They have asked the senior financial analyst, Gabrielle Maple, to recommend which of the following projects the firm should undertake. Because you are the newest member of her team and need the experience, she has passed this management request on to you.

Investment Opportunities		
Project	Initial Investment (in millions)	Rate of Return
A	\$500,000	16%
B	\$1,600,000	12%
C	\$600,000	15%
D	\$1,500,000	18%

1. Component costs of capital

a. Cost of cheaper debt

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b. Cost of more expensive debt

\_\_\_\_\_

c. Cost of internally generated (existing) equity

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d. Cost of externally generated (new) equity

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2. Marginal Cost of Capital break points

Break Point 1:

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Break Point 2:

\_\_\_\_\_

Break Point 3:

\_\_\_\_\_

3. Calculate all the marginal cost of capital figures:

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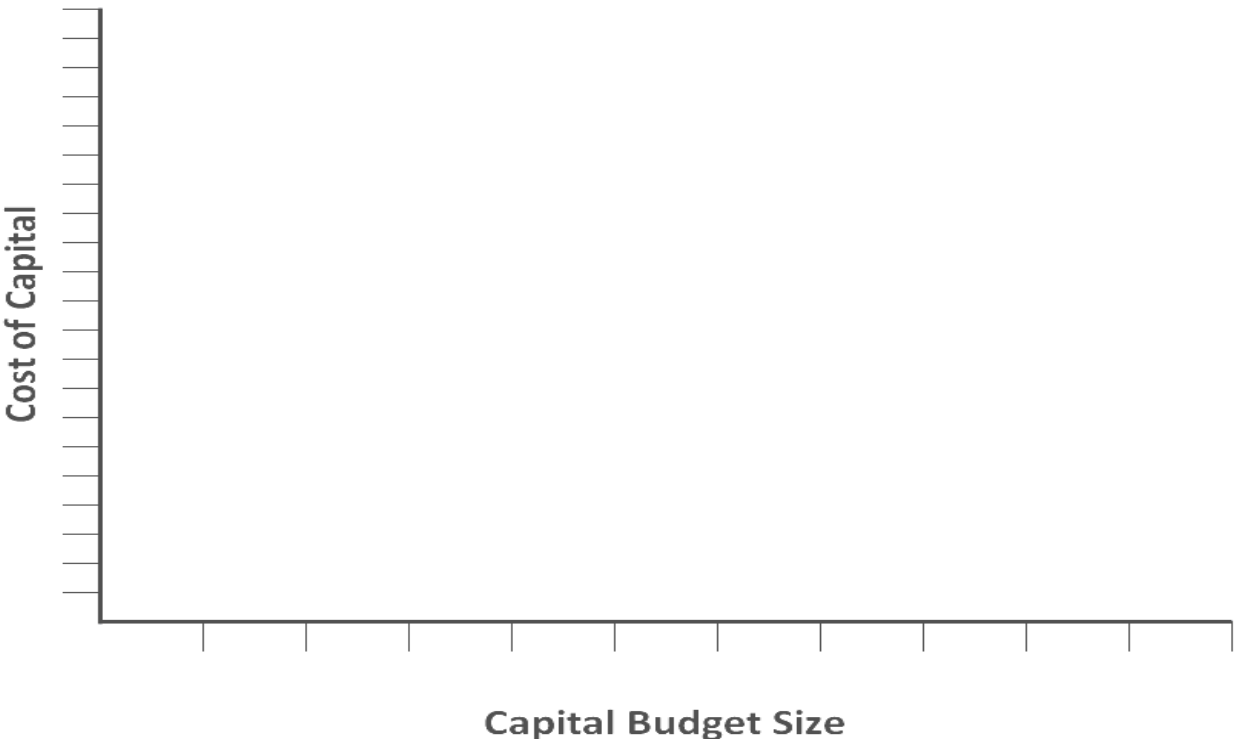
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4. Make a highest-to-lowest Investment Opportunity Schedule

Investment Opportunities		
Project	Initial Investment (in millions)	Rate of Return

5. Plot the MCC and IOS on the same graph.



6. Which projects should be accepted?

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