Understanding Business and Financial Risk

The two firms have the same level of total assets and expected net operating profit after tax (NOPAT)

But they differ on two critical characteristics: Total Debt and standard deviation of expected NOPAT. The information below outlines some of the Company A and Company B characteristics.

Company A: Company B

Total Assets $5,200.00 $5,200.00

Total Debt $1,196,000 $2,340.00

Expected NOPAT $1,248.00 $1,248.00

Standard Deviation of expected NOPAT $348, 00 $223,600

Which Company has more Business Risk?

Which Firm has more financial Risk?

2. Project will require 400,000 in assets

. The Project is expected to produce an EBIT of 50,000.

. The project will be financed with 100% equity

. There will be 25,000 shares of common equity outstanding

. The company faces a tax rate of 30%

3.What will the ROE for this project? A. 8.31% B. 7.44%, C. 8.75% D. 7.00%

4.What will the EPS will be if finances the project with 100% equity? $1.12,1.47,1.33,1.19,1.40

5.Same Project is being financed with 50% debt and 50% equity. The interest rate on the debt will be 13%. Only 50% of project is financed with equity, it will only have 12,500 shares outstanding. What will be the ROE on this project if the company decides to finance with 50% debt and 50% equity?

1. 8.40%
2. 8.82%
3. 9.66%
4. 10.08%

6. What is the EPS? $1.61, 1.47, 1.07,1.27,1.347. Using this financial leverage will \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_projects ROE

a. Increase

b. decrease