1. MSM company is considering an investment in and the introduction of a new product line. The financial performance of the line will depend upon the state of the economy. The following forecasts have been made for this project.

If the economy is strong (20% probiblity) the return is expected to be 20%

If the economy is moderate (50% probability) the return is expected to be 8%

If the economy is weak (30% probability) the return is expected to be a negative 4%

Please compute the following:

1. The expected return from this investment
2. The standard deviation of returns from this investment
3. Instead of this investment, another opportunity is available that offers an expected return of 10% and a standard deviation of 4%. Please briefly describe (in a paragraph) the relative risk comparisons between the two projects.
4. XYZ company is considering an expansion of manufacturing capacity. This expansion is the first for the company and will slightly more than double plant capacity. The reason for the expansion is that XYZ believes that it can sell its product line on a national basis instead of the smaller regional basis that is has been selling for 5 years. The firms sales last year were $4,000,000 with an EBIT ration of 10% and a NI ration of 5%. The tax rate is 30%. The new financing will total $3,000,000. Discuss primary factor that the firm should consider when choosing a capital structure mix that includes debt and equity (common stock). Be sure to identify pros and cons of each of your suggested choices.
5. Moody Blues Company uses the following capital structure to finance its $1,000,000 total asset investment.
6. Debt $ 400,000 – average before tax cost of debt is 8% and the firm is in the 35% combined federal and state income tax bracket.
7. Preferred stock $100,000 – stock was issued to the public at $40 per share. The issue calls for a $4 annual dividend. Floatation costs were $2 per share.
8. Common stock $300,000 – stock was issued to the public at $40 per share. The dividend paid this past year was $1 per share. The firm’s EPS has been growing at an annual rate of 9%. Floatation costs were $4 per share.
9. Retained earnings $200,000.
10. Calculate MBC’s WACC (carry all decimal calculations to 4 places)
11. Suppose the moving forward MBC generates an after tax return on assets of 9%. Briefly discuss the likely impact on the market value of the firm’s common stock.
12. MSM company is planning an upgrade to its warehouse. The upgrade involves computerizing many of the material handling activities. The cost of the upgrade is expected to be $2,800,000. The equipment falls into the 7 year IRS depreciation range but is expected to provide annual cash cost savings and other annual cash benefits totaling $600,000 over each of the next 6 years. MSM is in the 35% tax bracket and has decided to use a 10% hurdle rate, as a first pass, to examine the financial viability of the proposed project. At the end of year 6 the used equipment is expected to be sold for $ 250,000.
13. Prepare a well organized schedule that concludes with the calculation of the expected NPV from this project.
14. LMN Inc. is considering the acquisition of FGH Inc. FGH has outstanding bond priced at $950 per bond and common stock currently priced at $40 per share. You lead the research effort to determine whether or not the current market prices for the bonds and the common stock are overvalued, unvervalued, or fairly valued (fairly valued is determined as plus or mimus 3% of the current market price. FGH is considered a constant growth company and you use a semi annual basis to value the bonds.

* Remaining bond term is 10 years. Par value of each bond is $1000. The stated rate in the bond contract is 7%. You determine that the risk characteristics of the market and of FGH support a YTM of 8%.
* The constant growth EPS rate is forecasted to be 7%. The dividend paid last year was $1.50 per share. Based upon market and firm specific characteristics you believe that a required return on the common stock investment 11% is appropriate.
* A. compute what you believe to be the “true” values for each corporate bond and for each share of common stock. B. are the market values for each security fairly, under, or over valued given what you believe the “true” value to be. C. provide a brief conclusion stating whether or not you believe that acquiring the outstanding common stock and debt of FGH is “reasonable.”