

Figure 1

BERKSHIRE INSTRUMENTS			
Statement of Financial Position			
December 31, 2004			
Assets			
Current assets:			
Cash .....		\$	400,000
Marketable securities .....			200,000
Accounts receivable .....	\$ 2,600,000		
Less: Allowance for bad debts .....	<u>300,000</u>		2,300,000
Inventory .....			<u>5,500,000</u>
Total current assets .....		\$	8,400,000
Fixed Assets:			
Plant and equipment, original cost .....	30,700,000		
Less: Accumulated depreciation .....	<u>13,200,000</u>		
Net plant and equipment .....			<u>17,500,000</u>
Total assets .....			<u>\$25,900,000</u>
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable .....		\$	6,200,000
Accrued expenses .....			<u>1,700,000</u>
Total current liabilities .....			7,900,000
Long-term financing:			
Bonds payable .....		\$	6,120,000
Preferred stock .....			1,080,000
Common stock .....			6,300,000
Retained earnings } Common equity .....			<u>4,500,000</u>
Total common equity .....			10,800,000
Total long-term financing .....			<u>18,000,000</u>
Total liabilities and stockholders' equity .....			<u>\$25,900,000</u>

Figure 2  
Cost of prior issues  
of debt and preferred  
stock

Security	Year of Issue	Amount	Yield
Bond .....	1992	\$1,120,000	6.1%
Bond .....	1996	3,000,000	13.8
Bond .....	2002	2,000,000	8.3
Preferred stock .....	1997	600,000	12.0
Preferred stock .....	2000	480,000	7.9

formulas: one: one for the cost of retained earnings and one for the cost of new common stock. His investment banker suggested that he follow the normally accepted approach used in determining the marginal cost of capital. First, determine the cost of capital for as large a capital structure as current retained earnings will support; then, determine the cost of capital based on exclusively using new common stock.