

1:25 Quiz: 3/5/12

Name _____

Quiz: Assume that markets are perfect, that the market value of MegaStore equity is \$100 million, that the beta of MegaStore's equity is 0.9, and that MegaStore's equity cost of capital is 8.3%. Assume also that MegaStore is considering issuing \$25 million of debt and using the proceeds to repurchase shares. The beta of the debt will equal 0.1 and the cost of capital on the debt will equal 2.3%.

- a. Without doing any calculations, explain how the change will affect the cost of capital on MegaStore's equity? Why is this the case?
- b. Set up the equations and plug in as many numbers as possible to determine the beta of MegaStore's equity after the change.
- c. Set up the equations and plug in as many numbers as possible to determine the cost of capital on MegaStore's equity after the change.