**Question 1**

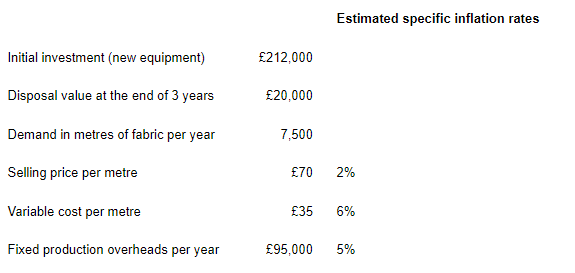
Read through the information below and answer the questions that follow.

* **a.**This part of the question has three different scenarios for the calculation of weighted average cost of capital (WACC) and asks you to explain some issues surrounding it.
  + i.Hasbeen Enterprise has 2 million shares in issue. The current market price is €10 per share. The company’s debt is publicly traded on the Paris Stock Exchange and the most recent quote for its price was at 90% of face value. The debt has a total face value of €10 million and Hasbeen Enterprise’s credit risk premium is currently 2%. The risk-free rate is 3% and the equity market risk premium is 5%. The company’s beta is estimated at 1.4 and its corporate tax rate is 40%. Calculate Hasbeen Enterprise’s WACC.
  + ii.Florence Toothpaste plc has an average market cost of borrowing of 7% per year and an equity beta of 1.2. Florence Toothpaste has a consistent ratio of debt to equity of 2:1 and a tax rate of 30%. The expected return on the market portfolio is 15% and the expected risk-free rate is 4%. Calculate the WACC for Florence Toothpaste plc.
  + iii.Given the following data, calculate Unhealthy Living’s weighted average cost of capital (WACC).  
    Risk-free rate (Rf) = 4% p.a.  
    Unhealthy Living’s beta (*β*) = 0.6  
    Unhealthy Living’s share price = £4.06  
    Number of Unhealthy Living shares in issue = 8.05 million  
    Unhealthy Living’s credit risk premium (Rp) = 1% p.a.  
    Unhealthy Living’s market value of debt (D) = £11.08m  
    Equity risk premium (E(Rm) −Rf) = 6.5% p.a.  
    Unhealthy Living's corporate tax rate (t) = 24%
  + iv.The companies in (i) and (ii) above have a beta greater than one. Explain what this means and the benefits to managers of knowing the cost of equity capital of their companies.
* **b.**What are the strengths and weaknesses of a system of credit ratings from an agency such as S&P Global Ratings or Moody’s?
* **c.**A firm is planning to increase its international business without changing its leverage. On the basis of the CAPM, how would this affect the cost of equity?

**Question 2**

Read through the information below and answer the questions that follow.

Fabric plc is considering a project to produce a new product line of fabric treated with silver ions which has been shown to reduce odour associated with bacteria in the fabric. The manufacturing process is significantly different to Fabric’s more traditional fabrics and so will require investment in new equipment. Because this is new technology, the expected life of the project is only three years. The following information and estimates have been collated.



* The tax rate is 30% paid one year in arrears. Capital allowances on equipment are claimed on a straight line basis over the life of the project.
* Fabric’s CFO uses the real weighted average cost of capital as the discount rate. This is 8.57% and the general rate of inflation is 5%.
* **a.**Provide Fabric plc with a Net Present Value (NPV) analysis of the project and make a recommendation. The analysis should be in good form and show workings. Round to the nearest whole pound and percentage. Use discount factors to four decimal places.
* **b.**Write a report for Fabric plc’s CFO that evaluates the use of the weighted average cost of capital to analyse the project and suggest a better alternative.
* **c.**The CEO of Fabric plc tells you that he finds it easier to understand IRR relative to NPV. Write a report to the CEO critically comparing NPV and IRR, and their relative merits and drawbacks.

**Question 3** (The word limit for this question is 1,200 words. Do not exceed the word limit by more than 10%) (Higher marks will be awarded for quality of report presentation, clarity of expression and correctness of referencing)

Read through the information below and answer the questions that follow.

You have been recently hired as an analyst for an international financial company. You have been tasked to write a report on the following article provided by your senior manager. The article is written by Hyun Song Shin, economic adviser and head of research of the Bank for International Settlements:

Shin, H.S. (2019) ‘Global imbalances and the international footprint of firms: what role for exchange rates?’, *Bank for International Settlements* [Online]. Available at: [https://www.bis.org/ speeches/ sp190410.pdf](https://www.bis.org/speeches/sp190410.pdf)

Your senior manager is currently working on a project to better understand how global imbalances could contribute to financial instability. He indicated that your report will be shared with the whole team and has asked you to cover the following questions in your report:

**a.** What is the main aim of the article?

**b.** What is the basic point of the article?

**c.** Provide the team with a brief critical assessment of the article. Your firm is an India-based large multinational corporation that exports to the USA with significant intra-company trade between different subsidiaries in different parts of the world. The management team is expecting an appreciation of the dollar, seeing that as a competitive opportunity in the US market. What would be your response?