

STUDY GUIDELINES FIN3701 - STUDY UNIT 5

1 GENERAL

This study unit is covered in chapter 11 of the prescribed textbook. The study unit is a continuation of study unit 4. The cost of different sources of capital discussed and calculated in study unit 4 will now be split and added together to get the total average cost. This will be achieved through the use of capital structure weights assigned to them. The weights will be given to students for the purpose of this study unit.

2 FORMAT OF ASSESSMENT

The content of this study unit will be assessed by means of multiple choice questions. No formulae will be provided in the examination for this study unit.

3 IMPORTANT AREAS IN THE STUDY UNIT

Pay attention to the following:

- The most important formulae:
 - The weighted average cost of capital (WACC) formula (textbook page 463, equation 11.9).
 - The break point formula (textbook page 467, equation 11.10).
 - The financial decision based on the IOS and WMCC graph.
- The most important graphs:
 - The weighted marginal cost of capital (WMCC) graph (textbook page 469).
 - The investment opportunity schedule (IOS) and WMCC graphs (textbook page 470).

4 Study Guide Errata

Areas to correct:

Page 52: Example of scenario analysis

Source	Market Value	Weights	Cost	Weighted Average
Debt	R22 000 000.00			
Preferred Stock				
Common Stock				8.21%
Retained earnings				

Overall cost of capital = 12.74%

Page 53: Break point equation

$$BP_j = AF_j/w_j$$

Page 54: Break point equation

$$BP_j = AF_j/w_j$$

Page 55: IOS and WMCC graph

On the Investment Opportunity Schedule (IOS), change project C to project A and vice versa.

Page 57: Feedback on self assessment questions

Question 2

$$\text{Weight of retained earnings} = (R360\,000/R1\,000\,000 = 0.36 = 36\%)$$