

Quiz 3: Corporate Finance

Answer all questions and show necessary work. Please be brief. This is an open books, open notes exam.

1. Severino Enterprises is a chemical company that has 10 million shares outstanding, trading at \$15 a share **and no debt**; its **current cost of capital is 7.4%**. The firm is has announced that it is borrowing \$50 million and will be paying a special dividend with that money. If the risk free rate is 2%, the equity risk premium is 6% and the marginal tax rate is 40%, estimate how high the pre-tax cost of borrowing has to be for the company's cost of capital to remain unchanged. (4 points)

