**Activity 11.1**

***Calculating WACC:***

The CFO of MRZ airlines Daniele D. is trying to determine the company’s Book value WACC. Mr. Kimani, the accounting department chair says that the company should calculate the book value WACC. So the Controller Mr. Joe O pulls up the required balance sheet information and gives it to Kimani as in table 1 below.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **MRZ Airlines** | | | | | | | |
| **Balance Sheet ($ in millions)** | | | | | | | |
| **Asset** | **Dollar Amt** |  | **Liability** | **Dollar Amt** | **weight** | **Rate/ cost** | **Eff. cost** |
| CA | 150 |  | Short term liabilities | 100 |  | 4.00% |  |
| LTA | 850 |  | LT Bonds | 200 |  | 9.58% |  |
|  |  |  | Loans | 150 |  | 7.00% |  |
|  |  |  | Pref Stock | 200 |  | 11.0% |  |
|  |  |  | Owners’ Equity | 200 |  | 15.8% |  |
|  |  |  | Ret Earnings | 150 |  | 15.8% |  |
|  |  |  |  |  |  |  |  |
| TA | ?? |  | TL & OE | ?? | WACC |  |  |

**Table 1**

The column at the right gives the rate to be applied for WACC computation. Borrowing rates (bonds and loans) have not been adjusted for taxes. Tax rate is 21% and is only applicable to the debt part of liabilities.

Kimani needs to calculate tax effective borrowing costs in the column called “eff cost”. However, he requests Ms. Hattie K. and Grace F., co-workers in merchant banking department to find out the WACC for MRZ airlines in Excel file provided by filling up weights, and effective cost.

They need to calculate WACC with and without accounting for tax rate and report it to CEO Mr. Harry O.

Because of tax and debt, WACC \_\_\_\_\_\_\_.