The answer to the question is highlighted in red. Explanations are highlighted in green.

11. Analysts of the ICM Corporation have indicated that the company is expected to grow at a 5 percent rate for as long as it is in business. Currently the ICM’s stock is selling for $70 per share. The most recent dividend paid by the company was $5.60 per share. If ICM issues new common stock it will incur flotation costs equal to 7 percent. If ICM’s marginal tax rate is 35 percent, what is its cost of retained earnings—that is, its internal equity?

\[
\begin{align*}
\text{r}_s &= \frac{\hat{D}_1 + g}{P_0} = \frac{$5.60(1.05)}{$70} + 0.05 = 0.084 + 0.05 = 0.134 = 13.4\% \\
\end{align*}
\]

Taxes are not considered here because dividends are not tax deductible.

RETURN TO THE SAMPLE QUESTIONS