Financial management individual work 2 week 2

Finance

Finance and Accounting Financial Management Individual Work 2 Week 2

Describe briefly the Legal Rights and Privileges of Common Stockholders:-

Commonstockholders have various legal rights and privileges such as common stockholders get the ownership of the company as per their shareholding percentages. Common stockholders have the voting rights in electing the board of directors of the company. They can participate in the annual general meeting of the company.

Write out a Formula that can be Used to Value any Stock, Regardless of its Dividend Pattern:-

The value of any financial asset can be equal to present value of future cash flows of the asset. When an investor invests into a particular share then the investor expects to receive cash either in the form of dividends or sell the stock to receive cash from the sale. The value of a stock depends on the cash dividends provided by the company and the discount rate used to find the present value of those dividends.

The basic dividend valuation equation is

$P_0 = (D_1 / (1 + r_s)) + (D_2 / (1+r_s)^2) + \ldots (D_n / (1+r_s)^n)$

What is a Constant Growth Stock? How are Constant Growth Stocks Valued?

Constant growth stock can be referred to those stocks of a company whose earnings will grow at a rate which is higher than the average rate of market. In the stock valuation model, we need to assume that the dividend and shares will grow at a constant rate for infinity times.

$P_0 = D_1 / (r_s - g)$

In this equation, (g) or the long run growth rate can be derived by multiplying the company's return on assets by the retention ratio. Generally the long run growth rate of a company remains between 5% t0 8% in a year.

What happens if a company has a constant g which exceeds rs? Will many stocks have expected g > rs in the short run (i. e., for the next few years)? In the long run (i. e., forever)?

If a company has a constant g that exceeds rs then many stocks will have higher growth rate for the short run but in long run g will not be at a higher constant rate.

Beta coefficient = 1. 2, the risk free rate = 7%, market risk premium is 5%. Then the required rate of return of the firm's stock will be-

CAPM = RF + b(RF –RM)

= 7% + 1.. 2 (7%- 5%)

= 9. 4%

Answer D.

$D_0 = \$2$

$G = 6\%$

$R_s = 13\%$

$P_0 = (D_1 / (1+ r_s)) = (D_0 * (1 + g)) / (r_s – g) = \$ 30. 29$

Stock Price 1 year from now-

$P_1 =$

D_2

($r_s – g$)

P1 =

2. 2472

0. 07

P1 =

$32. 10

Dividend Yield =

D1

CG Yield =

P1 – P0

P0

P0

Dividend Yield =

$2. 12

CG Yield =

$1. 82

$30. 29

$30. 29

Dividend Yield =

7. 00%

CG Yield =

6. 00%

Total Yield =

Dividend Yield

+

CG

Yield

Total Yield =

13. 00%

Answer E

Now we will assume that the stock is currently selling at $30. 29 thus the

expected rate of return will be

rs =

D1

+

g

P0

rs =

$2. 12

+

0. 06

$30. 29

rs =

13%

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