

# Managerial account and finance essay examples

[Business](#), [Company](#)



## **Answering Questions about Management, Accounting and Finance**

**1A. why is it taking so long to have a Facebook IPO?**

According to one of the Facebook insiders there are several reasons why Facebook is taking so long to do an S1 filing. One is that they have not decided yet as to which banks will do the underwriting the offer. As of December 2010 the social networking giant had raised \$1.5 billion with an estimated valuation of \$50 billion, but co-founder and CEO Mark Zuckerberg has does not agree to the idea to rush the company into IPO because as of this time their main concern is to expand their operations.

**1B. how do you suppose they will set the IPO price?**

One of the most anticipated events in stock market is the Facebook initial public offering. This is when the social networking giant goes public in distributing stocks. But the big question is " how much? Facebook worth roughly around \$50 billion in valuation, because of that, analysts predicts that if Facebook trades with projected sales of 12 times higher, then it should be avoided. The normal stock trades should only worth about two to five times of its sales going forward especially for high-growth internet based company. The best way to justify the valuation price and set the 12 times higher sales, Facebook have to generate income of at least \$2.5 billion next year moving forward.

**1C. Do you suppose it will be a fair price?**

In general it is quite over the roof, but if Facebook is able to justify the valuation and sales are met to at least \$2.5 billion a year in total revenue,

then it is just fair enough for them to set an above the benchmark stock price when they go public.

## **2A. IBM and the Residual Theory of Dividends**

IBM was able to increase their quarterly dividends by buying back shares; this allowed them to shrink the number of shareholders thus limiting their annual dividend payables. In Residual Theory of Dividends, it is said that the company uses equity leftovers to use for paying their stock holders, by the use of current cash flows to fulfill expenditures IBM was able to save money that were invested for acquisitions and research and development. By buying back stocks, they were able to reduce the outstanding shares by a fifth and resulted to increase stock price to a double.

## **2B. General Electric and Financial Signaling**

In general financial signaling indicates the positive future of a company in terms of financial growth. Like for example, if General Electric hires a very competitive manager it is his best opportunity to drive the company for a good investment opportunities and that is an indicator of higher dividend pay-outs for stock holders. As for General Electric the buyback strategy they did actually did not gave out a good response. A worst performance data indicates that the strategies are not signaling a positive outcome.

## **2C. Walt Disney and the “ Staircase” method of paying dividends**

Staircase dividend method is when the value of the investment goes up so as the dividend. This is the same method used by Walt Disney to practice caution during the recession. When you invest to Walt Disney the share

holder will get a return that is equivalent to the equity return. It can be compared to a salary investment that when the income increases the dividends will also follow.

## **2D. Alcoa and Tax Theory of Dividends**

Alcoa haven't been able to buy back stocks since 2008, this means that as of this time they are still paying out dividends to its share holders even when in a situation that the company is not on a very good position in the market. One of the main factors results to their poor performance is that they are using Tax Theory Dividends this is when a stock was held for at least 60 days by the stock holder, the returns paid from the profits are called qualified dividends, and this will incur a maximum tax rate of 15%, whereas if Alcoa ensured that they were able to divide the profits to the shareholders and buy them back using the residual method, they would not be experiencing a huge marginal loss.

## **3A. what type of merger do you suppose this is?**

The type of merger that Caterpillar and Bucyrus have entered into is called the " Horizontal Merger". This is defined as two directly competing company in a common market joined together. Caterpillar acquired Bucyrus in hope of dominating the market which Caterpillar have a stronghold. Instead of competing to get the most slice of the pie, the two companies entered into an agreement to channel their products as a one solid enterprise.

## **3B. what do you suppose the motivation was?**

Evidently the motivation for this merger is Caterpillar's worth of estimate \$400 million of annual synergies that is set to begin in 2015 because of the

combined financial stability and product offerings. Other motivating factors include market leading sales, remanufacturing of products for Bucyrus, lower owning and operating cost for Bucyrus, cost efficiency in purchasing and engineering and best practices in manufacturing through Caterpillar's production system.

3C. given the transaction cost \$8.6 billion and Caterpillar stock has rose about 10% subsequently, what does it say about the Net Present Value?

If the transaction cost Caterpillar \$8.6 billion respectively, and their stock price raised to 10% we can conclude that the net present worth is about \$4,854,475,798. That still depends on the inflows and outflows of cash for the next coming years. The net present value was obtained after comparing the cost of the transaction to the given interest rate.

#### **4A. why would Pepsi consider hedging?**

The main objective of Pepsi Company in considering hedging is to maintain low risk in loses by keeping the market in one place. It may reduce the potential to returns but the fact the risks involve are lower the share holders can expect a more positive investment outcome. Another reason is that the company is avoiding the decline in currency value in other countries,, thus using only dollars in all its transactions.

#### **4B. what would be downside of hedging?**

Although hedging has the potential to reduce loses, it also has a downside to it. Hedging would need a lot of concentration because of the technical methods that comes along with it where trades are based on indicators and technical graphs. In hedging a trader must take the position of a perfect

entry level and has a capability to exit on the same manner. The basis of strategy in hedging is making decision in a short period of time. Analyzing the chart should be done on short time frames just like M1 or M5 time frames.

#### **4C. why would? --- (incomplete question)**

5. In 2008, Warren Buffett purchased about \$1 billion worth of warrants from General Electric when they were seemingly under financial distress. As part of its strategy, General Electric would be borrowing from the Federal Reserve System. Why do you suppose he would buy warrants instead of stock or bonds from General Electric? How would this effect their cost of capital?

#### **Answer:**

There is a lot of reason as to why Warren Buffett chose warrants over stocks or bonds that is because warrants works like an option. It can provide the holder a right to purchase underlying securities at a definite price, quantity and expiration. Unlike option which acts as a tool in stock exchange market, warrants are issued by the company and the securities represented in it came directly from the company rather than from an investor share holder. Aside from the fact that warrants hold more value in terms of underlying security over the other two investment options, all warrants are well specified in details such as the expiry date as well as the last date as to when the warrant can be executed.

A warrant also can represent different form of assets other than shares like currency, index and commodities. To explain the benefits of warrants based on the Warren Buffett purchase, for example if the share can gain \$0.10 for

each \$10 share it will close at \$10.10 the percentage gain is 10%, whereas with warrants if the share price is \$5 plus the share gains of \$0.10 all in all the company gained 20%. Since return of capital should always be greater than the cost of capital, investing on warranties would definitely cover the cost of capital because of the given ratio of returns that warrant can generate, provide that it should be exercised on a timely manner otherwise, a bigger risk of capital losses will come at hand.

### **6A. why do you suppose they would engage in such a move?**

Microsoft decided to open their doors and sell debt authorizations in order for them to maintain their debt credibility by issuing bonds. The company is confident that the opportunity is just right because a lot of investors are hungry for a little taste of Microsoft shares through high quality credits. They are also taking the chance to benefit from the record high yield spreads hitting 656 basis points over the treasury. The move is quite risky for some investors but Microsoft reiterated that they do not need the money but the fact that they need to finance their working capital and to buy back stock, it seems the selling of debt authorization is the best way for the company to maintain its position in the market.

### **6B. do you suppose this increases their risk profile?**

Evidently it will not affect their risk profile, because of the fact that they hold a good credit rating, the company emphasized that they do not need the money and the time is right because of the good market condition.

## **6C. what is their cost of capital?**

In terms of cost of capital Microsoft has a short term investment of \$25.3 billion. Given that they issued \$3.75 billion worth of issued bonds they have a total cash flow of \$29.05 billion less the remaining \$2.25 billion, the company has a total cost of capital of \$26.8 billion.

6D. assuming they are heavily involved in the competitive software industry, does this makes sense to you? Why or why not?

Yes, because besides the fact that they are already the biggest and the most prominent name in software engineering, they still need to maintain that status and push forward for further expansion and they can only do that if they have enough capital to fund it and Microsoft can make use of such strategy in order to keep up with the market's demands.

## **7A. Indenture**

It is defined as the contract between the bond holder and the issuer stating particulars such as the time of repayment, the amount of interest, if the bond can be converted with specific price and ratio, if it's callable and also the amount of money to be repaid.

## **7B. Call Provision**

It is a part or provision in the bond which will allow the issuer to re-buy and close the bond. If there is one in place it usually has a time window as to when the bond can be called as well as the price to be paid to the bondholder including the accrued interests.



### **7C. Sinking Fund**

Meaning to repay the funds that were owed through the bonds the issuer will make scheduled payments to the trustee who retires part of the bond by purchasing it in the open market.

### **7D. Par Value**

Par value is defined as the face value of a bond.

### **7E. Coupon**

It also refers to as the coupon percent rate or coupon rate, it is also known as the interest rate stipulated in the bond when issued and it has to be paid semi-annually.

### **7F. Restrictive Covenant**

Restrictive Covenant is any type of agreement which requires a buyer to abstain or take from a definite action. These are written binding legal obligations in relation to a deed of a property imposed by the seller. This obligation can levy penalties when the buyer fails to comply.