Discussion questions: financial markets and securities assignment

Business

5. If common stockholders are the owners of the company, why do they have the last claim on assets and a residual claim on income? Common stock ownership carries three primary rights of privileges. There is a residual claim to income, they alone have the privilege of voting, and they enjoy a first option to purchase new shares. The common stockholder is the last in line to receive payment but the stockholder's potential participation is unlimited. Instead of getting a $1 dividend, the investor may someday receive many times that much in dividends and also capital appreciation in stock value. . Why might management use a poison pill strategy? A poison pill represents a rights offer made to existing shareholders of a company with the sole purpose of making it more difficult for another firm or outsiders to take over a firm against management's wishes. Most poison pills have a trigger point tied to the percentage ownership in the company that is acquired by the potential suitor. Once the trigger point is reached, the other shareholders (the existing shareholders) have the right to buy many additional shares of company stock at low prices.

This automatically increases the total number of shares outstanding and reduces the voting power of the firm wishing to acquire the company. Chapter 17 Problems 7. Boson Fishery has been experiencing declining earnings, but has just announced a 50 percent salary increase for its top executives. A dissident group of stockholders wants to oust the existing board of directors. There are currently 11 directors and 60, 000 shares of stock outstanding. Mr. Bass, the president of the company, has the full support of the existing board.

The dissident stockholders control proxies for 20, 001 shares. Mr. Bass is worried about losing his job. a. Under cumulative voting procedures, how many directors can the dissident stockholders elect with the proxies they now hold? No. of directors that can be elected = (Shares owned ??? 1) x (Total # of directors to be elected + 1) (Total number of shares outstanding) = (20, 001 ??? 1) x (11 + 1) = 20, 000 x 12 = 240, 000 = 4 directors 60, 00060, 00060, 000 How many directors could they elect under majority rule with these proxies?

Under majority voting, any group of stockholders owning over 50 percent of the common stock may elect all of the directors. The dissident stockholders only control 33. 4% of the common stock so therefore the cannot elect any stock holders cumulatively. b. How many shares (or proxies) are needed to elect six directors under cumulative voting? Shares required = (# of directors desired) x (Total # of shares outstanding) Total # of directors to be elected + 1 = 6 x 60, 000 = 360, 000 = 30, 000 shares 11 + 1 12 12. Boles Bottling Co. has issued rights to its shareholders.

The subscription price is $45 and four rights are needed along with the subscription price to buy one of the new shares. The stock is selling for $55 rights-on. a. What would be the value of one right? R = Mo ??? S N + 1 R = Value of a right Mo = Market value of rights-on $55 S = Subscription price $45 N = Number of rights necessary to purchase a new share 4 R = 55 ??? 45 = 10 = $2. 00 4 + 1 5 b. If the stock goes ex-rights, what would the new stock price be? Me = Mo ??? R $55 – $2 = $53. 00

____ _____ Chapter 18

Discussion Questions 7. If you buy stock on the ex-dividend date, will you receive the upcoming quarterly dividend? No. If you bought the stock on the ex-dividend date or later, your name will eventually be transferred to the corporate books, but you bought the stock without the current quarterly dividend privilege. 10. Does it make sense for a corporation to repurchase its own stock? Explain. It makes sense for a corporation to repurchase its own stock if: ? A firm with excess cash may choose to make a corporate stock repurchase of its own shares in the market, rather than pay a cash dividend. Corporate management may acquire its own shares in the market, because it believes they are selling at a low price. ? The corporation can maintain a constant demand for its own securities and, perhaps, stave off further decline. 11. What advantages to the corporation and the stockholder do dividend reinvestment plans offer? ? They provide the investor with an opportunity to buy additional shares of stock with the cash dividend paid by the company. ? The company is the beneficiary of increased cash flow, since dividends paid are returned to the company for reinvestment in common stock. no investment banking or underwriting fees need be paid.) ? shareholder benefits from much lower transaction costs, the right to own fractional shares, and more flexibility in choosing between cash and common stock. Chapter 18 Problems 1. Moon and Sons, Inc. earned $120 million last year and retained $72 million. What is the payout ratio? 120, 000, 000 – 72, 000, 000 = 48, 000, 000 Payout Ratio = 48, 000, 000= 40 percent 120, 000, 000 9a. Show the effect on the capital account(s) of a two-for-one stock split. Before Common stock (50, 000 shares at $2 par)……………. 100, 000 Capital in excess of par……………………………….. 00, 000 Retained

earnings……………………………………500, 000 800, 000 After Common stock (100, 00 million shares at $1 par)……100, 000 Capital in excess of par………………………………200, 000 Retained earnings……………………………………500, 000 800, 000 9b. Show the effect on the capital accounts of a 10 percent stock dividend. Part b is separate from part a. In part b do not assume the stock split has taken place. Capital accounts before stock dividend Common Stock (50, 000 shares at $2 par) …………….. 100, 000 Capital in excess of par………………………………. 200, 000 Retained earnings…………………………………….. 500, 000 Net worth……………………………………………. 00, 000 Capital accounts after stock dividend Common Stock (55, 000 shares at $2 par)……………….. 110, 000 Capital in excess of par………………………………. 280, 000 Retained earnings…………………………………….. 410, 000 Net worth……………………………………………. 800, 000

Chapter 19 Discussion Questions 11. What is the difference between a call option and a put option? An option is the right, but not the obligation, to buy or sell a security at a set priced for a fixed period of time. A call option is an option to buy while a put option is an option to sell. 2. Suggest two areas where the use of futures contracts is most common. Futures contracts are very common for commodities, currencies, and interest rate securities, especially government bonds. What percentage of the value of the underlying security is typical as a down payment in a futures contract? 5 percent is often the down payment of the value of the underlying value of the securities or commodities.

Chapter 20 Discussion Questions 2. What is the difference between a merger and a consolidation?

A merger is defined as a combination of two or more companies in which the resulting firm maintains the identity of the acquiring company. In a consolidation two or more companies are combined to form a new entity. A consolidation might be utilized when the firms are of equal size and market power. 8. How is goodwill now treated in a merger? No longer must merger-related goodwill be amortized over a maximum period of 40 ears, but rater it is placed on the balance sheet of the acquiring firm at the time of acquisition and not subsequently written down unless it is impaired.

At least once a year goodwill must be tested to see if it has been impaired. Chapter 20 Problems 7. The Jeter Corporation is considering acquiring the A-Rod Corporation. The data for the two companies are as follows: ____ A-Rod Corp. Jeter Corp. Total earnings…………………. $1, 000, 000$4, 000, 000 Number of shares of stock outstanding 400, 000 2, 000, 000 Earnings per share$ 2. 50$ 2. 00 Price-earnings ratio (P/E) 12 15 Market price per share$ 30 30 ____ a. The Jeter Corp. is going to give A-Rod Corp, a 60 percent premium over A-Rod’s current market value. What price will it pay? $30 x 1. 60 = $48 market price per share. 7c. At the price computed in part a, what is the P/E ratio Jeter Corp. is assigning A-Rod Corp.? $48/$2. 50 = 19. 2 Price-earnings ratio

Chapter 21 Discussion Questions 1. What risks does a foreign affiliate of a multinational firm face in today's business world? A multinational firm is exposed to foreign exchange risk in addition to the usual business and financial risks. . Differentiate between the spot exchange rate and the forward exchange rate. The spot rate for a currency is the exchange rate at which the currency is traded for immediate delivery and the forward rate is the exchange rate that is established for future delivery. 10. What is a letter of credit? The importer's bank issues the letter of credit, in which the bank promises to subsequently pay the money for the merchandise. Chapter 21 Problems 1. The Wall Street Journal reported the following spot and forward rates for the Swiss franc ($/SF). ________________________________ Spot……………………$0. 202 30-day forward……….. $0. 8244 90-day forward……….. $0. 8295 180-day forward………$0. 8343 ________________________________ 1a. Was the Swiss franc selling at a discount or premium in the forward market? The forward rates on the Swiss franc are at a premium in relation to the spot rate. 1b. What was the 30-day forward premium (or discount)? Forward premium = Forward rate – Spot Rate x 12 x 100 (or discount) Spot rate Length of Forward contract (in months) = 0. 8244 – 0. 8202 x 12 x 100 0. 202 1 = 0. 005120702 x 12 x 100 = 6. 145% (premium) 1d. Suppose you executed a 90-day forward contract to exchange 100, 000 Swiss francs into U. S. dollars. How many dollars would you get 90 days hence? 1/0. 8295 = 1. 205545509 100, 000SF/1. 205545509 = $82, 950. 00 7. You are the vice president of finance for International Resources, Inc. , head-quartered in Denver, Colorado. In January 2007 your firm's Canadian subsidiary obtained a six-month loan of 100, 000 Canadian dollars

from a bank in Denver to finance the acquisition of a titanium mine in Quebec province.

The loan will also be repaid in Canadian dollars. At the time of the loan, the spot exchange rate was $0. 8852/Canadian dollars. At the time of the loan, the spot exchange rate was $0. 8852/Canadian dollar and the Canadian currency was selling at a discount in the forward market. The June 2007 futures contract (Face value = $100, 000 per contract) was quoted at U. S. $0. 8817. 7a. Explain how the Denver bank could lose on this transaction if it does not hedge. 7b. If the bank does hedge, what is the maximum amount it can lose?