Chapter 19
Dividends and Other Payouts

Multiple Choice Questions

1. Payments made out of a firm's earnings to its owners in the form of cash or stock are called:
A. dividends.
B. distributions.
C. share repurchases.
D. payments-in-kind.
E. stock splits.

2. Payments made by a firm to its owners from sources other than current or accumulated earnings are called:
A. dividends.
B. distributions.
C. share repurchases.
D. payments-in-kind.
E. stock splits.

3. A cash payment made by a firm to its owners in the normal course of business is called a:
A. share repurchase.
B. liquidating dividend.
C. regular cash dividend.
D. special dividend.
E. extra cash dividend.

4. A cash payment made by a firm to its owners when some of the firm's assets are sold off is called a:
A. liquidating dividend.
B. regular cash dividend.
C. special dividend.
D. extra cash dividend.
E. share repurchase.

5. The date on which the board of directors passes a resolution authorizing payment of a dividend to the shareholders is the _____ date.
A. ex-rights
B. ex-dividend
C. record
D. payment
E. declaration

6. The date before which a new purchaser of stock is entitled to receive a declared dividend, but on or after which she does not receive the dividend, is called the _____ date.
A. ex-rights
B. ex-dividend
C. record
D. payment
E. declaration

7. The date by which a stockholder must be registered on the firm's roll as having share ownership in order to receive a declared dividend is called the:
A. ex-rights date.
B. ex-dividend date.
C. date of record.
D. date of payment.
E. declaration date.

8. The date on which the firm mails out its declared dividends is called the:
A. ex-rights date.
B. ex-dividend date.
C. date of record.
D. date of payment.
E. declaration date.

9. The ability of shareholders to undo the dividend policy of the firm and create an alternative dividend payment policy via reinvesting dividends or selling shares of stock is called (a):
A. perfect foresight model.
B. MM Proposition I.
C. capital structure irrelevancy.
D. homemade leverage.
E. homemade dividends.

10. The market's reaction to the announcement of a change in the firm's dividend payout is likely the:
A. information content effect.
B. clientele effect.
C. efficient markets hypothesis.
D. MM Proposition I.
E. MM Proposition II.

11. The observed empirical fact that stocks attract particular investors based on the firm's dividend policy and the resulting tax impact on investors is called the:
A. information content effect.
B. clientele effect.
C. efficient markets hypothesis.
D. MM Proposition I.
E. MM Proposition II.

12. A _____ is an alternative method to cash dividends which is used to pay out a firm's earnings to shareholders.
A. merger
B. acquisition
C. payment-in-kind
D. stock split
E. share repurchase

13. A payment made by a firm to its owners in the form of new shares of stock is called a _____ dividend.
A. stock
B. normal
C. special
D. extra
E. liquidating

14. An increase in a firm's number of shares outstanding without any change in owners' equity is called a:
A. special dividend.
B. stock split.
C. share repurchase.
D. tender offer.
E. liquidating dividend.

15. The difference between the highest and lowest prices at which a stock has traded is called its:
A. average price.
B. bid-ask spread.
C. trading range.
D. opening price.
E. closing price.

16. In a reverse stock split:
A. the number of shares outstanding increases and owners' equity decreases.
B. the firm buys back existing shares of stock on the open market.
C. the firm sells new shares of stock on the open market.
D. the number of shares outstanding decreases but owners' equity is unchanged.
E. shareholders make a cash payment to the firm.

17. The last date on which you can purchase shares of stock and still receive the dividend is the date _____ business day(s) prior to the date of record.
A. zero
B. one
C. three
D. five
E. seven

18. Leslie purchased 100 shares of GT, Inc. stock on Wednesday, June 7^{th}. Marti purchased 100 shares of GT, Inc. stock on Thursday, July 8^{th}. GT declared a dividend on June 20^{th} to shareholders of record on July 12^{th} and payable on August 1^{st}. Which one of the following statements concerning the dividend paid on August 1^{st} is correct given this information?
A. Neither Leslie nor Marti are entitled to the dividend.
B. Leslie is entitled to the dividend but Marti is not.
C. Marti is entitled to the dividend but Leslie is not.
D. Both Marti and Leslie are entitled to the dividend.
E. Both Marti and Leslie are entitled to one-half of the dividend amount.

19. All else equal, the market value of a stock will tend to decrease by roughly the amount of the dividend on the:
A. dividend declaration date.
B. ex-dividend date.
C. date of record.
D. date of payment.
E. day after the date of payment.

20. Which one of the following is an argument in favor of a low dividend policy?
A. the tax on capital gains is deferred until the gain is realized
B. few, if any, positive net present value projects are available to the firm
C. a preponderance of stockholders have minimal taxable income
D. a majority of stockholders have other investment opportunities that offer higher rewards with similar risk characteristics
E. corporate tax rates exceed personal tax rates

21. The fact that flotation costs can be significant is justification for:
A. a firm to issue larger dividends than its closest competitors.
B. a firm to maintain a constant dividend policy even if it frequently has to issue new shares of stock to do so.
C. maintaining a constant dividend policy even when profits decline significantly.
D. maintaining a high dividend policy.
E. maintaining a low dividend policy and rarely issuing extra dividends.

22. Which of the following may tend to keep dividends low?
I. a state law restricting dividends in excess of retained earnings
II. a term contained in bond indenture agreements
III. the desire to maintain constant dividends over time
IV. flotation costs
A. II and III only
B. I and IV only
C. II, III, and IV only
D. I, II, and III only
E. I, II, III, and IV

23. Ignoring capital gains as an alternative, the tax law changes in 2003 tend to favor a:
A. lower dividend policy.
B. constant dividend policy.
C. zero-dividend policy.
D. higher dividend policy.
E. restrictive dividend policy.

24. Which of the following are factors that favor a high dividend policy?
I. stockholders desire for current income
II. tendency for higher stock prices for high dividend paying firms
III. investor dislike of uncertainty
IV. high percentage of tax-exempt institutional stockholders
A. I and III only
B. II and IV only
C. I, III, and IV only
D. II, III, and IV only
E. I, II, III, and IV

25. An investor is more likely to prefer a high dividend payout if a firm:
A. has high flotation costs.
B. has few, if any, positive net present value projects.
C. has lower tax rates than the investor.
D. has a stock price that is increasing rapidly.
E. offers high capital gains which are taxed at a favorable rate.

26. The information content of a dividend increase generally signals that:
A. the firm has a one-time surplus of cash.
B. the firm has few, if any, net present value projects to pursue.
C. management believes that the future earnings of the firm will be strong.
D. the firm has more cash than it needs due to sales declines.
E. future dividends will be lower.

27. Of the following factors, which one is considered to be the primary factor affecting a firm's dividend decision?
A. personal taxes of company stockholders
B. consistent dividend policy
C. attracting retail investors
D. attracting institutional investors
E. sustainable changes in earnings

28. Financial managers:
A. are reluctant to cut dividends.
B. tend to ignore past dividend policies.
C. tend to prefer cutting dividends every time quarterly earnings decline.
D. prefer cutting dividends over incurring flotation costs.
E. place little emphasis on dividend policy consistency.

29. If you ignore taxes and transaction costs, a stock repurchase will:
I. reduce the total assets of a firm.
II. increase the earnings per share.
III. reduce the PE ratio more than an equivalent stock dividend.
IV. reduce the total equity of a firm.
A. I and III only
B. II and IV only
C. I, II, and IV only
D. I, III, and IV only
E. I, II, III, and IV

30. From a tax-paying investor's point of view, a stock repurchase:
A. is equivalent to a cash dividend.
B. is more desirable than a cash dividend.
C. has the same tax effects as a cash dividend.
D. is more highly taxed than a cash dividend.
E. creates a tax liability even if the investor does not sell any of the shares he owns.

31. All else equal, a stock dividend will _____ the number of shares outstanding and _____ the value per share.
A. increase; increase
B. increase; decrease
C. not change; increase
D. decrease; increase
E. decrease; decrease

32. A small stock dividend is defined as a stock dividend of less than _____%.
A. 10 to 15
B. 15 to 20
C. 20 to 25
D. 25 to 30
E. 30 to 35

33. Nu Tech, Inc. is a technology firm with good growth prospects. The firm wishes to do something to acknowledge the loyalty of its shareholders but needs all of its available cash to fund its rapid growth. The market price of its stock is currently trading in the middle of its preferred trading range. The firm could consider:
A. issuing a liquidating dividend.
B. a stock split.
C. a reverse stock split.
D. issuing a stock dividend.
E. a special cash dividend.

34. Which of the following are valid reasons for a firm to reduce or eliminate its cash dividends?
I. The firm is on the verge of violating a bond restriction which requires a current ratio of 1.8 or higher.
II. A firm has just received a patent on a new product for which there is strong market demand and it needs the funds to bring the product to the marketplace.
III. The firm can raise new capital easily at a very low cost.
IV. The tax laws have recently changed such that dividends are taxed at an investor's marginal rate while capital gains are tax exempt.
A. I and III only
B. II and IV only
C. II, III, and IV only
D. I, II, and IV only
E. I, II, III, and IV

35. A stock split:
A. increases the total value of the common stock account.
B. decreases the value of the retained earnings account.
C. does not affect the total value of any of the equity accounts.
D. increases the value of the capital in excess of par account.
E. decreases the total owners' equity on the balance sheet.

36. Stock splits are often used to:
A. adjust the market price of a stock such that it falls within a preferred trading range.
B. decrease the excess cash held by a firm.
C. increase both the number of shares outstanding and the market price per share simultaneously.
D. increase the total equity of a firm.
E. adjust the debt-equity ratio such that it falls within a preferred range.

37. Which of the following tend to increase the appeal of a firm's stock to the average investor?
I. a cessation of dividends by a firm which has a long history of increasing dividends
II. the distribution of a special dividend by a dividend-paying firm
III. a reverse stock split for a low-priced stock
IV. the declaration of a stock dividend by a growth firm
A. I and III only
B. II and IV only
C. I, II, and IV only
D. II, III, and IV only
E. I, II, III, and IV

38. Wydex, Inc. stock is currently trading at $82 a share. The firm feels that its primary clientele can afford to spend between $2,000 and $2,500 to purchase a round lot of 100 shares. The firm should consider a:
A. reverse stock split.
B. liquidating dividend.
C. stock dividend.
D. stock split.
E. special dividend.

39. A one-for-four reverse stock split will:
A. increase the par value by 25%.
B. increase the number of shares outstanding by 400%.
C. increase the market value but not affect the par value per share.
D. increase a $1 par value to $4.
E. increase a $1 par value by $4.

40. A reverse stock split is sometimes used as a means of:
A. decreasing the liquidity of a stock.
B. decreasing the market value per share of stock.
C. increasing the number of stockholders.
D. keeping a firm's stock eligible for trading on a stock exchange.
E. raising cash from current stockholders.

41. Which of the following lists events in chronological order from earliest to latest?
A. date of record, declaration date, ex-dividend date.
B. date of record, ex-dividend date, declaration date.
C. declaration date, date of record, ex-dividend date.
D. declaration date, ex-dividend date, date of record.
E. ex-dividend date, date of record, declaration date.

42. In an efficient market, ignoring taxes and time value, the price of stock should:
A. decrease by the amount of the dividend immediately on the declaration date.
B. decrease by the amount of the dividend immediately on the ex-dividend date.
C. increase by the amount of the dividend immediately on the declaration date.
D. increase by the amount of the dividend immediately on the ex-dividend date.
E. Both B and C.

43. On the date of record the stock price drop is:
A. a full adjustment for the dividend payment.
B. a partial adjustment for the dividend payment because of the tax effect.
C. zero because it happens on the ex-dividend date.
D. zero because it happens on the payment date.
E. None of the above.

44. The use of homemade dividends allows stockholders to change the:
A. return pattern of the firm by leveraging their position like the firm.
B. cash payout received by selling off shares to receive current dividends or purchasing additional shares with the dividends, as desired.
C. value of the company by sending dividend requirement letters to the home office of the corporation.
D. Both A and C.
E. Both B and C.

45. Homemade dividends are described by Modigliani and Miller to be the:
A. dividend one pays oneself to avoid risky stocks.
B. re-arrangement of the firm's dividend stream as management needs.
C. re-arrangement of the firm's dividend stream by investors buying or selling their holdings in the stock.
D. present value of all dividends to be paid.
E. None of the above.

46. The dividend-irrelevance proposition of Miller and Modigliani depends on the following relationship between investment policy and dividend policy:
A. The level of investment does not influence or matter to the dividend decision.
B. Once dividend policy is set the investment decision can be made as desired.
C. The investment policy is set before the dividend decision and not changed by dividend policy.
D. Since dividend policy is irrelevant there is no relationship between investment policy and dividend policy.
E. Miller and Modigliani were only concerned about capital structure.

47. Dividends are relevant and dividend policy irrelevant when:
A. cash dividends are always constant and dividend policy is changed as management needs.
B. cash dividends are increased for one year while others are held constant, thus causing an increase in stock price, and dividend policy establishes the trade-off between dividends at different dates.
C. cash dividends are always constant and dividend policy establishes the trade-off between dividends at different dates.
D. cash dividends are increased for one payment while others are held constant and dividend policy is changed as management needs.
E. None of the above.

48. A reverse split is when:
A. the stock price gets too high for investors to purchase in round lots.
B. the stock becomes too liquid and highly marketable.
C. the stock price moves into the popular trading range.
D. several old shares, such as 4, are replaced by 1 new share.
E. None of the above.

49. A firm announces that it is willing to purchase a number of shares back at various prices and shareholders have the option to indicate how many shares they are willing to sell at various prices. This process is called a:
A. dividend creation model.
B. secondary market transaction.
C. free market sale.
D. Dutch auction.
E. None of the above.

50. Characteristics of a sensible dividend policy include:
A. over time pay out all free cash flows
B. set the current regular dividend consistent with a long-run target payout ratio
C. use repurchases to distribute transitory cash flow increases
D. A and B
E. All of the above

51. You owned 200 shares last year and received a stock dividend of 5% at the end of last year. The number of shares you now have is _____ and your wealth has increased by ______%.
A. 10; 5
B. 210; 5
C. 210; 0
D. 50,000; 5
E. 50,000; 0

52. The Rent It Company declared a dividend of $.60 a share on October 20th to holders of record on Monday, November 1st. The dividend is payable on December 1st. You purchased 100 shares of Rent It Company stock on Wednesday, October 27th. How much dividend income will you receive on December 1st from the Rent It Company?
A. $0
B. $1.50
C. $6.00
D. $15.00
E. $60.00

53. You purchased 200 shares of ABC stock on July 15th. On July 20th, you purchased another 100 shares and then on July 22st you purchased your final 200 shares of ABC stock. The company declared a dividend of $1.10 a share on July 5th to holders of record on Friday, July 23rd. The dividend is payable on July 31st. How much dividend income will you receive on July 31st from ABC?
A. $0
B. $220
C. $330
D. $440
E. $550

54. The KatyDid Co. is paying a $1.25 per share dividend today. There are 120,000 shares outstanding with a par value of $1.00 per share. As a result of this dividend, the:
A. retained earnings will decrease by $150,000.
B. retained earnings will decrease by $120,000.
C. common stock account will decrease by $150,000.
D. common stock account will decrease by $120,000.
E. capital in excess of par value account will decrease by $120,000.

55. On May 18th, you purchased 1,000 shares of BuyLo stock. On June 5th, you sold 200 shares of this stock for $21 a share. You sold an additional 400 shares on July 8th at a price of $22.50 a share. The company declared a $.50 per share dividend on June 25th to holders of record as of Thursday, July 10th. This dividend is payable on July 31st. How much dividend income will you receive on July 31st as a result of your ownership of BuyLo stock?
A. $100
B. $200
C. $300
D. $400
E. $500

56. You own 300 shares of Abco, Inc. stock. The company has stated that it plans on issuing a dividend of $.60 a share one year from today and then issuing a final liquidating dividend of $2.20 a share two years from today. Your required rate of return is 9%. Ignoring taxes, what is the value of one share of this stock today?
A. $2.36
B. $2.40
C. $2.62
D. $2.80
E. $2.85

57. Priscilla owns 500 shares of Delta stock. It is January 1, 2006, and the company recently issued a statement that it will pay a $1.00 per share dividend on December 31, 2006 and a $.50 per share dividend on December 31, 2007. Priscilla does not want any dividend this year but does want as much dividend income as possible next year. Her required return on this stock is 12%. Ignoring taxes, what will Priscilla's homemade dividend per share be in 2007?
A. $0
B. $.50
C. $1.50
D. $1.62
E. $1.68

58. A firm has a market value equal to its book value. Currently, the firm has excess cash of $600 and other assets of $5,400. Equity is worth $6,000. The firm has 500 shares of stock outstanding and net income of $900. What will the new earnings per share be if the firm uses its excess cash to complete a stock repurchase?
A. $1.20
B. $1.50
C. $1.80
D. $2.00
E. $2.40

59. A firm has a market value equal to its book value. Currently, the firm has excess cash of $800 and other assets of $5,200. Equity is worth $6,000. The firm has 600 shares of stock outstanding and net income of $700. The firm has decided to spend all of its excess cash on a share repurchase program. How many shares of stock will be outstanding after the stock repurchase is completed?
A. 480 shares
B. 500 shares
C. 520 shares
D. 540 shares
E. 560 shares

60. A firm has a market value equal to its book value. Currently, the firm has excess cash of $500 and other assets of $9,500. Equity is worth $10,000. The firm has 250 shares of stock outstanding and net income of $1,400. What will the stock price per share be if the firm pays out its excess cash as a cash dividend?
A. $36
B. $38
C. $40
D. $42
E. $44

61. A firm has a market value equal to its book value. Currently, the firm has excess cash of $400 and other assets of $7,600. Equity is worth $8,000. The firm has 200 shares of stock outstanding and net income of $900. The firm has decided to pay out all of its excess cash as a cash dividend. What will the earnings per share be after the dividend is paid?
A. $0.25
B. $0.45
C. $2.50
D. $3.80
E. $4.50

62. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account, and $42,700 in the retained earnings account. The firm just announced a 10% (small) stock dividend. What will the balance in the retained earnings account be after the dividend?
A. $34,700
B. $35,700
C. $42,700
D. $49,700
E. $50,700

63. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account and $42,700 in the retained earnings account. The firm just announced a 10% (small) stock dividend. What will the market price per share be after the dividend?
A. $7.20
B. $7.27
C. $7.33
D. $8.00
E. $8.80

64. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the value of the capital in excess of par account after the dividend?
A. $58,000
B. $61,500
C. $87,000
D. $96,500
E. $100,000

65. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the value of the retained earnings account after the dividend?
A. $29,000
B. $30,500
C. $32,500
D. $34,500
E. $36,000

66. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the value of the common stock account after the dividend?
A. $7,000
B. $8,500
C. $9,000
D. $10,500
E. $14,000

67. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account, and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the market value per share after the dividend?
A. $6.00
B. $8.00
C. $9.00
D. $10.50
E. $12.00

68. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. How many shares of stock will be outstanding after the split?
A. 10,000 shares
B. 12,500 shares
C. 20,000 shares
D. 22,500 shares
E. 27,500 shares

69. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the market price per share be after the split?
A. $18
B. $24
C. $42
D. $48
E. $54

70. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the value of the common stock account be after the split?
A. $10,000
B. $12,500
C. $15,000
D. $18,500
E. $22,500

71. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the capital in excess of par account value be after the split?
A. $126,000
B. $210,000
C. $283,500
D. $315,000
E. $472,500

72. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a capital in excess of par account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the common stock account balance be after the split?
A. $3,000
B. $4,500
C. $6,000
D. $9,000
E. $12,000

73. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a capital in excess of par account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the market price per share be after the split?
A. $35
B. $40
C. $55
D. $70
E. $140

74. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a capital in excess of par account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the retained earnings account balance be after the split?
A. $117,000
B. $234,000
C. $351,000
D. $410,000
E. $468,000

75. The Tinslow Co. has 125,000 shares of stock outstanding at a market price of $93 a share. The company has just announced a 5-for-3 stock split. How many shares of stock will be outstanding after the split?
A. 62,500 shares
B. 75,000 shares
C. 83,333 shares
D. 175,000 shares
E. 208,333 shares

76. The Tinslow Co. has 125,000 shares of stock outstanding at a market price of $93 a share. The company has just announced a 7-for-3 stock split. What will the market price per share be after the split?
A. $38.27
B. $39.86
C. $40.40
D. $46.18
E. $55.80

77. The common stock of Margot, Inc. is selling for $56 a share. The par value per share is $1. Currently, the firm has a total market value of $89,600. How many shares of stock will be outstanding if the firm does a 2-for-1 stock split?
A. 800 shares
B. 1,200 shares
C. 1,600 shares
D. 3,200 shares
E. 4,800 shares

78. Bob's Auto Group has 25,000 shares of stock outstanding at a market price of $4.50 a share. What will the market price per share be if the company does a 1-for-5 reverse stock split?
A. $18.00
B. $20.00
C. $22.50
D. $27.00
E. $29.50

79. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. How many shares of stock will be outstanding after the split?
A. 25,000 shares
B. 250,000 shares
C. 312,500 shares
D. 500,000 shares
E. 625,000 shares

80. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the par value per share be after the split?
A. $0.20
B. $1.00
C. $2.50
D. $5.00
E. $10.00

81. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the market value per share be after the split?
A. $1.00
B. $5.00
C. $10.00
D. $25.00
E. $50.00

82. Michael's Boating Supplies has 150,000 shares of stock outstanding with a par value of $1 per share and a market value of $10 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. How many shares of stock will be outstanding after the split?
A. 30,000 shares
B. 250,000 shares
C. 312,500 shares
D. 500,000 shares
E. 625,000 shares

83. Michael's Boating Supplies has 150,000 shares of stock outstanding with a par value of $1 per share and a market value of $10 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the par value per share be after the split?
A. $0.20
B. $1.00
C. $3.00
D. $5.00
E. $10.00

84. Michael's Boating Supplies has 150,000 shares of stock outstanding with a par value of $1 per share and a market value of $10 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the market value per share be after the split?
A. $1.00
B. $5.00
C. $10.00
D. $25.00
E. $50.00

Essay Questions

85. Schaeffer Shippers announced on May 1, 2009, that it will pay a dividend of $5.00 per share on June 15 to all holders on record as of May 31^{st}. The firm's stock price is currently at $70 per share. Assume that all investors are in the 33% tax bracket. Given that the ex-dividend date is May 29, what should happen to Schaeffer's stock price on May 29?

86. It has been shown that in the absence of taxes and other market imperfections firm value will be unaffected by dividend policy. Explain the logic behind this conclusion. Next, describe three real-world factors that may cause one dividend policy to be preferable to another.

Chapter 19 Dividends and Other Payouts Answer Key

Multiple Choice Questions

1. Payments made out of a firm's earnings to its owners in the form of cash or stock are called:
A. dividends.
B. distributions.
C. share repurchases.
D. payments-in-kind.
E. stock splits.

Difficulty level: Easy
Topic: DIVIDENDS
Type: DEFINITIONS

2. Payments made by a firm to its owners from sources other than current or accumulated earnings are called:
A. dividends.
B. distributions.
C. share repurchases.
D. payments-in-kind.
E. stock splits.

Difficulty level: Easy
Topic: DISTRIBUTIONS
Type: DEFINITIONS

3. A cash payment made by a firm to its owners in the normal course of business is called a:
A. share repurchase.
B. liquidating dividend.
C. regular cash dividend.
D. special dividend.
E. extra cash dividend.

Difficulty level: Easy
Topic: REGULAR CASH DIVIDENDS
Type: DEFINITIONS

4. A cash payment made by a firm to its owners when some of the firm's assets are sold off is called a:
A. liquidating dividend.
B. regular cash dividend.
C. special dividend.
D. extra cash dividend.
E. share repurchase.

Difficulty level: Easy
Topic: LIQUIDATING DIVIDENDS
Type: DEFINITIONS

5. The date on which the board of directors passes a resolution authorizing payment of a dividend to the shareholders is the _____ date.
A. ex-rights
B. ex-dividend
C. record
D. payment
E. declaration

Difficulty level: Easy
Topic: DECLARATION DATE
Type: DEFINITIONS

6. The date before which a new purchaser of stock is entitled to receive a declared dividend, but on or after which she does not receive the dividend, is called the _____ date.
A. ex-rights
B. ex-dividend
C. record
D. payment
E. declaration

Difficulty level: Easy
Topic: EX-DIVIDEND DATE
Type: DEFINITIONS

7. The date by which a stockholder must be registered on the firm's roll as having share ownership in order to receive a declared dividend is called the:
A. ex-rights date.
B. ex-dividend date.
C. date of record.
D. date of payment.
E. declaration date.

Difficulty level: Easy
Topic: DATE OF RECORD
Type: DEFINITIONS

8. The date on which the firm mails out its declared dividends is called the:
A. ex-rights date.
B. ex-dividend date.
C. date of record.
D. date of payment.
E. declaration date.

Difficulty level: Easy
Topic: DATE OF PAYMENT
Type: DEFINITIONS

9. The ability of shareholders to undo the dividend policy of the firm and create an alternative dividend payment policy via reinvesting dividends or selling shares of stock is called (a):
A. perfect foresight model.
B. MM Proposition I.
C. capital structure irrelevancy.
D. homemade leverage.
E. homemade dividends.

Difficulty level: Medium
Topic: HOMEMADE DIVIDENDS
Type: DEFINITIONS

10. The market's reaction to the announcement of a change in the firm's dividend payout is likely the:
A. information content effect.
B. clientele effect.
C. efficient markets hypothesis.
D. MM Proposition I.
E. MM Proposition II.

Difficulty level: Medium
Topic: INFORMATION CONTENT EFFECT
Type: DEFINITIONS

11. The observed empirical fact that stocks attract particular investors based on the firm's dividend policy and the resulting tax impact on investors is called the:
A. information content effect.
B. clientele effect.
C. efficient markets hypothesis.
D. MM Proposition I.
E. MM Proposition II.

Difficulty level: Easy
Topic: CLIENTELE EFFECT
Type: DEFINITIONS

12. A _____ is an alternative method to cash dividends which is used to pay out a firm's earnings to shareholders.
A. merger
B. acquisition
C. payment-in-kind
D. stock split
E. share repurchase

Difficulty level: Easy
Topic: SHARE REPURCHASE
Type: DEFINITIONS

13. A payment made by a firm to its owners in the form of new shares of stock is called a _____ dividend.
A. stock
B. normal
C. special
D. extra
E. liquidating

Difficulty level: Easy
Topic: STOCK DIVIDENDS
Type: DEFINITIONS

14. An increase in a firm's number of shares outstanding without any change in owners' equity is called a:
A. special dividend.
B. stock split.
C. share repurchase.
D. tender offer.
E. liquidating dividend.

Difficulty level: Easy
Topic: STOCK SPLITS
Type: DEFINITIONS

15. The difference between the highest and lowest prices at which a stock has traded is called its:
A. average price.
B. bid-ask spread.
C. trading range.
D. opening price.
E. closing price.

Difficulty level: Easy
Topic: TRADING RANGE
Type: DEFINITIONS

16. In a reverse stock split:
A. the number of shares outstanding increases and owners' equity decreases.
B. the firm buys back existing shares of stock on the open market.
C. the firm sells new shares of stock on the open market.
D. the number of shares outstanding decreases but owners' equity is unchanged.
E. shareholders make a cash payment to the firm.

Difficulty level: Easy
Topic: REVERSE SPLITS
Type: DEFINITIONS

17. The last date on which you can purchase shares of stock and still receive the dividend is the date _____ business day(s) prior to the date of record.
A. zero
B. one
C. three
D. five
E. seven

Difficulty level: Easy
Topic: DIVIDEND PAYMENTS
Type: CONCEPTS

18. Leslie purchased 100 shares of GT, Inc. stock on Wednesday, June 7th. Marti purchased 100 shares of GT, Inc. stock on Thursday, July 8th. GT declared a dividend on June 20th to shareholders of record on July 12th and payable on August 1st. Which one of the following statements concerning the dividend paid on August 1st is correct given this information?
A. Neither Leslie nor Marti are entitled to the dividend.
B. Leslie is entitled to the dividend but Marti is not.
C. Marti is entitled to the dividend but Leslie is not.
D. Both Marti and Leslie are entitled to the dividend.
E. Both Marti and Leslie are entitled to one-half of the dividend amount.

Difficulty level: Medium
Topic: DIVIDEND PAYMENTS
Type: CONCEPTS

19. All else equal, the market value of a stock will tend to decrease by roughly the amount of the dividend on the:
A. dividend declaration date.
B. ex-dividend date.
C. date of record.
D. date of payment.
E. day after the date of payment.

Difficulty level: Medium
Topic: DIVIDEND PAYMENTS
Type: CONCEPTS

20. Which one of the following is an argument in favor of a low dividend policy?
A. the tax on capital gains is deferred until the gain is realized
B. few, if any, positive net present value projects are available to the firm
C. a preponderance of stockholders have minimal taxable income
D. a majority of stockholders have other investment opportunities that offer higher rewards with similar risk characteristics
E. corporate tax rates exceed personal tax rates

Difficulty level: Medium
Topic: FACTORS FOR LOW DIVIDENDS
Type: CONCEPTS

21. The fact that flotation costs can be significant is justification for:
A. a firm to issue larger dividends than its closest competitors.
B. a firm to maintain a constant dividend policy even if it frequently has to issue new shares of stock to do so.
C. maintaining a constant dividend policy even when profits decline significantly.
D. maintaining a high dividend policy.
E. maintaining a low dividend policy and rarely issuing extra dividends.

Difficulty level: Medium
Topic: FACTORS FOR LOW DIVIDENDS
Type: CONCEPTS

22. Which of the following may tend to keep dividends low?
I. a state law restricting dividends in excess of retained earnings
II. a term contained in bond indenture agreements
III. the desire to maintain constant dividends over time
IV. flotation costs
A. II and III only
B. I and IV only
C. II, III, and IV only
D. I, II, and III only
E. I, II, III, and IV

Difficulty level: Medium
Topic: FACTORS FOR LOW DIVIDENDS
Type: CONCEPTS

23. Ignoring capital gains as an alternative, the tax law changes in 2003 tend to favor a:
A. lower dividend policy.
B. constant dividend policy.
C. zero-dividend policy.
D. higher dividend policy.
E. restrictive dividend policy.

Difficulty level: Easy
Topic: FACTORS FOR HIGH DIVIDENDS
Type: CONCEPTS

24. Which of the following are factors that favor a high dividend policy?
I. stockholders desire for current income
II. tendency for higher stock prices for high dividend paying firms
III. investor dislike of uncertainty
IV. high percentage of tax-exempt institutional stockholders
A. I and III only
B. II and IV only
C. I, III, and IV only
D. II, III, and IV only
E. I, II, III, and IV

Difficulty level: Medium
Topic: FACTORS FOR HIGH DIVIDENDS
Type: CONCEPTS

25. An investor is more likely to prefer a high dividend payout if a firm:
A. has high flotation costs.
B. has few, if any, positive net present value projects.
C. has lower tax rates than the investor.
D. has a stock price that is increasing rapidly.
E. offers high capital gains which are taxed at a favorable rate.

Difficulty level: Easy
Topic: FACTORS FOR HIGH DIVIDENDS
Type: CONCEPTS

26. The information content of a dividend increase generally signals that:
A. the firm has a one-time surplus of cash.
B. the firm has few, if any, net present value projects to pursue.
C. management believes that the future earnings of the firm will be strong.
D. the firm has more cash than it needs due to sales declines.
E. future dividends will be lower.

Difficulty level: Medium
Topic: INFORMATION CONTENT
Type: CONCEPTS

27. Of the following factors, which one is considered to be the primary factor affecting a firm's dividend decision?
A. personal taxes of company stockholders
B. consistent dividend policy
C. attracting retail investors
D. attracting institutional investors
E. sustainable changes in earnings

Difficulty level: Medium
Topic: DIVIDEND SURVEY RESULTS
Type: CONCEPTS

28. Financial managers:
A. are reluctant to cut dividends.
B. tend to ignore past dividend policies.
C. tend to prefer cutting dividends every time quarterly earnings decline.
D. prefer cutting dividends over incurring flotation costs.
E. place little emphasis on dividend policy consistency.

Difficulty level: Easy
Topic: DIVIDEND SURVEY RESULTS
Type: CONCEPTS

29. If you ignore taxes and transaction costs, a stock repurchase will:
I. reduce the total assets of a firm.
II. increase the earnings per share.
III. reduce the PE ratio more than an equivalent stock dividend.
IV. reduce the total equity of a firm.
A. I and III only
B. II and IV only
C. I, II, and IV only
D. I, III, and IV only
E. I, II, III, and IV

Difficulty level: Medium
Topic: STOCK REPURCHASE
Type: CONCEPTS

30. From a tax-paying investor's point of view, a stock repurchase:
A. is equivalent to a cash dividend.
B. is more desirable than a cash dividend.
C. has the same tax effects as a cash dividend.
D. is more highly taxed than a cash dividend.
E. creates a tax liability even if the investor does not sell any of the shares he owns.

Difficulty level: Medium
Topic: STOCK REPURCHASE
Type: CONCEPTS

31. All else equal, a stock dividend will _____ the number of shares outstanding and _____ the value per share.
A. increase; increase
B. increase; decrease
C. not change; increase
D. decrease; increase
E. decrease; decrease

Difficulty level: Easy
Topic: STOCK DIVIDENDS
Type: CONCEPTS

32. A small stock dividend is defined as a stock dividend of less than _____%.
A. 10 to 15
B. 15 to 20
C. 20 to 25
D. 25 to 30
E. 30 to 35

Difficulty level: Easy
Topic: STOCK DIVIDENDS
Type: CONCEPTS

33. Nu Tech, Inc. is a technology firm with good growth prospects. The firm wishes to do something to acknowledge the loyalty of its shareholders but needs all of its available cash to fund its rapid growth. The market price of its stock is currently trading in the middle of its preferred trading range. The firm could consider:
A. issuing a liquidating dividend.
B. a stock split.
C. a reverse stock split.
D. issuing a stock dividend.
E. a special cash dividend.

Difficulty level: Medium
Topic: STOCK DIVIDEND
Type: CONCEPTS

34. Which of the following are valid reasons for a firm to reduce or eliminate its cash dividends?
I. The firm is on the verge of violating a bond restriction which requires a current ratio of 1.8 or higher.
II. A firm has just received a patent on a new product for which there is strong market demand and it needs the funds to bring the product to the marketplace.
III. The firm can raise new capital easily at a very low cost.
IV. The tax laws have recently changed such that dividends are taxed at an investor's marginal rate while capital gains are tax exempt.
A. I and III only
B. II and IV only
C. II, III, and IV only
D. I, II, and IV only
E. I, II, III, and IV

Difficulty level: Medium
Topic: STOCK DIVIDENDS
Type: CONCEPTS

35. A stock split:
A. increases the total value of the common stock account.
B. decreases the value of the retained earnings account.
C. does not affect the total value of any of the equity accounts.
D. increases the value of the capital in excess of par account.
E. decreases the total owners' equity on the balance sheet.

Difficulty level: Medium
Topic: STOCK SPLITS
Type: CONCEPTS

36. Stock splits are often used to:
A. adjust the market price of a stock such that it falls within a preferred trading range.
B. decrease the excess cash held by a firm.
C. increase both the number of shares outstanding and the market price per share simultaneously.
D. increase the total equity of a firm.
E. adjust the debt-equity ratio such that it falls within a preferred range.

Difficulty level: Easy
Topic: STOCK SPLITS
Type: CONCEPTS

37. Which of the following tend to increase the appeal of a firm's stock to the average investor?
I. a cessation of dividends by a firm which has a long history of increasing dividends
II. the distribution of a special dividend by a dividend-paying firm
III. a reverse stock split for a low-priced stock
IV. the declaration of a stock dividend by a growth firm
A. I and III only
B. II and IV only
C. I, II, and IV only
D. II, III, and IV only
E. I, II, III, and IV

Difficulty level: Medium
Topic: STOCK SPLITS
Type: CONCEPTS

38. Wydex, Inc. stock is currently trading at $82 a share. The firm feels that its primary clientele can afford to spend between $2,000 and $2,500 to purchase a round lot of 100 shares. The firm should consider a:
A. reverse stock split.
B. liquidating dividend.
C. stock dividend.
D. stock split.
E. special dividend.

Difficulty level: Medium
Topic: STOCK SPLIT
Type: CONCEPTS

39. A one-for-four reverse stock split will:
A. increase the par value by 25%.
B. increase the number of shares outstanding by 400%.
C. increase the market value but not affect the par value per share.
D. increase a $1 par value to $4.
E. increase a $1 par value by $4.

Difficulty level: Medium
Topic: REVERSE STOCK SPLITS
Type: CONCEPTS

40. A reverse stock split is sometimes used as a means of:
A. decreasing the liquidity of a stock.
B. decreasing the market value per share of stock.
C. increasing the number of stockholders.
D. keeping a firm's stock eligible for trading on a stock exchange.
E. raising cash from current stockholders.

Difficulty level: Easy
Topic: REVERSE STOCK SPLITS
Type: CONCEPTS

41. Which of the following lists events in chronological order from earliest to latest?
A. date of record, declaration date, ex-dividend date.
B. date of record, ex-dividend date, declaration date.
C. declaration date, date of record, ex-dividend date.
D. declaration date, ex-dividend date, date of record.
E. ex-dividend date, date of record, declaration date.

Difficulty level: Medium
Topic: DIVIDEND DATES
Type: CONCEPTS

42. In an efficient market, ignoring taxes and time value, the price of stock should:
A. decrease by the amount of the dividend immediately on the declaration date.
B. decrease by the amount of the dividend immediately on the ex-dividend date.
C. increase by the amount of the dividend immediately on the declaration date.
D. increase by the amount of the dividend immediately on the ex-dividend date.
E. Both B and C.

Difficulty level: Medium
Topic: EX-DIVIDEND DATES
Type: CONCEPTS

43. On the date of record the stock price drop is:
A. a full adjustment for the dividend payment.
B. a partial adjustment for the dividend payment because of the tax effect.
C. zero because it happens on the ex-dividend date.
D. zero because it happens on the payment date.
E. None of the above.

Difficulty level: Medium
Topic: DATE OF RECORD
Type: CONCEPTS

44. The use of homemade dividends allows stockholders to change the:
A. return pattern of the firm by leveraging their position like the firm.
B. cash payout received by selling off shares to receive current dividends or purchasing additional shares with the dividends, as desired.
C. value of the company by sending dividend requirement letters to the home office of the corporation.
D. Both A and C.
E. Both B and C.

Difficulty level: Medium
Topic: HOMEMADE DIVIDENDS
Type: CONCEPTS

45. Homemade dividends are described by Modigliani and Miller to be the:
A. dividend one pays oneself to avoid risky stocks.
B. re-arrangement of the firm's dividend stream as management needs.
C. re-arrangement of the firm's dividend stream by investors buying or selling their holdings in the stock.
D. present value of all dividends to be paid.
E. None of the above.

Difficulty level: Medium
Topic: HOMEMADE DIVIDENDS
Type: CONCEPTS

46. The dividend-irrelevance proposition of Miller and Modigliani depends on the following relationship between investment policy and dividend policy:
A. The level of investment does not influence or matter to the dividend decision.
B. Once dividend policy is set the investment decision can be made as desired.
C. The investment policy is set before the dividend decision and not changed by dividend policy.
D. Since dividend policy is irrelevant there is no relationship between investment policy and dividend policy.
E. Miller and Modigliani were only concerned about capital structure.

Difficulty level: Medium
Topic: DIVIDEND IRRELEVANCE
Type: CONCEPTS

47. Dividends are relevant and dividend policy irrelevant when:
A. cash dividends are always constant and dividend policy is changed as management needs.
B. cash dividends are increased for one year while others are held constant, thus causing an increase in stock price, and dividend policy establishes the trade-off between dividends at different dates.
C. cash dividends are always constant and dividend policy establishes the trade-off between dividends at different dates.
D. cash dividends are increased for one payment while others are held constant and dividend policy is changed as management needs.
E. None of the above.

Difficulty level: Medium
Topic: DIVIDEND RELEVANCE
Type: CONCEPTS

48. A reverse split is when:
A. the stock price gets too high for investors to purchase in round lots.
B. the stock becomes too liquid and highly marketable.
C. the stock price moves into the popular trading range.
D. several old shares, such as 4, are replaced by 1 new share.
E. None of the above.

Difficulty level: Easy
Topic: REVERSE SPLIT
Type: CONCEPTS

49. A firm announces that it is willing to purchase a number of shares back at various prices and shareholders have the option to indicate how many shares they are willing to sell at various prices. This process is called a:
A. dividend creation model.
B. secondary market transaction.
C. free market sale.
D. Dutch auction.
E. None of the above.

Difficulty level: Easy
Topic: DUTCH AUCTION
Type: CONCEPTS

50. Characteristics of a sensible dividend policy include:
A. over time pay out all free cash flows
B. set the current regular dividend consistent with a long-run target payout ratio
C. use repurchases to distribute transitory cash flow increases
D. A and B
E. All of the above

Difficulty level: Easy
Topic: CHARACTERISTICS OF SENSIBLE DIVIDEND POLICY
Type: CONCEPTS

51. You owned 200 shares last year and received a stock dividend of 5% at the end of last year. The number of shares you now have is _____ and your wealth has increased by ______%.
A. 10; 5
B. 210; 5
C. 210; 0
D. 50,000; 5
E. 50,000; 0

shares = 200(1.05) = 210
The only change is in value per share.

Difficulty level: Easy
Topic: STOCK DIVIDENDS
Type: PROBLEMS

52. The Rent It Company declared a dividend of $.60 a share on October 20th to holders of record on Monday, November 1st. The dividend is payable on December 1st. You purchased 100 shares of Rent It Company stock on Wednesday, October 27th. How much dividend income will you receive on December 1st from the Rent It Company?
A. $0
B. $1.50
C. $6.00
D. $15.00
E. $60.00

Dividend received = $.60 × 100 = $60.00

Difficulty level: Medium
Topic: STOCK DIVIDEND
Type: PROBLEMS

53. You purchased 200 shares of ABC stock on July 15th. On July 20th, you purchased another 100 shares and then on July 22st you purchased your final 200 shares of ABC stock. The company declared a dividend of $1.10 a share on July 5th to holders of record on Friday, July 23rd. The dividend is payable on July 31st. How much dividend income will you receive on July 31st from ABC?
A. $0
B. $220
C. $330
D. $440
E. $550

Dividend received = $1.10 × (200 + 100) = $330

Difficulty level: Medium
Topic: STOCK DIVIDEND
Type: PROBLEMS

54. The KatyDid Co. is paying a $1.25 per share dividend today. There are 120,000 shares outstanding with a par value of $1.00 per share. As a result of this dividend, the:
A. retained earnings will decrease by $150,000.
B. retained earnings will decrease by $120,000.
C. common stock account will decrease by $150,000.
D. common stock account will decrease by $120,000.
E. capital in excess of par value account will decrease by $120,000.

Decrease in retained earnings = $1.25 × 120,000 = $150,000

Difficulty level: Medium
Topic: STOCK DIVIDEND
Type: PROBLEMS

55. On May 18th, you purchased 1,000 shares of BuyLo stock. On June 5th, you sold 200 shares of this stock for $21 a share. You sold an additional 400 shares on July 8th at a price of $22.50 a share. The company declared a $.50 per share dividend on June 25th to holders of record as of Thursday, July 10th. This dividend is payable on July 31st. How much dividend income will you receive on July 31st as a result of your ownership of BuyLo stock?
A. $100
B. $200
C. $300
D. $400
E. $500

Dividend received = $.50 × (1,000 - 200) = $400

Difficulty level: Medium
Topic: STOCK DIVIDEND
Type: PROBLEMS

56. You own 300 shares of Abco, Inc. stock. The company has stated that it plans on issuing a dividend of $.60 a share one year from today and then issuing a final liquidating dividend of $2.20 a share two years from today. Your required rate of return is 9%. Ignoring taxes, what is the value of one share of this stock today?
A. $2.36
B. $2.40
C. $2.62
D. $2.80
E. $2.85

Value per share = ($.60 ÷ 1.09^1) + ($2.20 ÷ 1.09^2) = $2.40

Difficulty level: Medium
Topic: HOMEMADE DIVIDENDS
Type: PROBLEMS

57. Priscilla owns 500 shares of Delta stock. It is January 1, 2006, and the company recently issued a statement that it will pay a $1.00 per share dividend on December 31, 2006 and a $.50 per share dividend on December 31, 2007. Priscilla does not want any dividend this year but does want as much dividend income as possible next year. Her required return on this stock is 12%. Ignoring taxes, what will Priscilla's homemade dividend per share be in 2007?
A. $0
B. $.50
C. $1.50
D. $1.62
E. $1.68

Homemade dividend = ($1.00 × 1.12) + $.50 = $1.62

Difficulty level: Medium
Topic: HOMEMADE DIVIDENDS
Type: PROBLEMS

58. A firm has a market value equal to its book value. Currently, the firm has excess cash of \$600 and other assets of \$5,400. Equity is worth \$6,000. The firm has 500 shares of stock outstanding and net income of \$900. What will the new earnings per share be if the firm uses its excess cash to complete a stock repurchase?
A. \$1.20
B. \$1.50
C. \$1.80
D. \$2.00
E. \$2.40

Price per share = \$6,000 ÷ 500 = \$12; Number of shares repurchased = \$600 ÷ \$12 = 50 shares; New EPS = \$900 ÷ (500 - 50) = \$2.00

Difficulty level: Medium
Topic: STOCK REPURCHASE
Type: PROBLEMS

59. A firm has a market value equal to its book value. Currently, the firm has excess cash of \$800 and other assets of \$5,200. Equity is worth \$6,000. The firm has 600 shares of stock outstanding and net income of \$700. The firm has decided to spend all of its excess cash on a share repurchase program. How many shares of stock will be outstanding after the stock repurchase is completed?
A. 480 shares
B. 500 shares
C. 520 shares
D. 540 shares
E. 560 shares

Price per share = \$6,000 ÷ 600 = \$10; Number of shares repurchased = \$800 ÷ \$10 = 80; New number of shares outstanding = 600 - 80 = 520

Difficulty level: Medium
Topic: STOCK REPURCHASE
Type: PROBLEMS

60. A firm has a market value equal to its book value. Currently, the firm has excess cash of $500 and other assets of $9,500. Equity is worth $10,000. The firm has 250 shares of stock outstanding and net income of $1,400. What will the stock price per share be if the firm pays out its excess cash as a cash dividend?
A. $36
B. $38
C. $40
D. $42
E. $44

Price per share = ($10,000 - $500) ÷ 250 = $38

Difficulty level: Medium
Topic: CASH DIVIDEND
Type: PROBLEMS

61. A firm has a market value equal to its book value. Currently, the firm has excess cash of $400 and other assets of $7,600. Equity is worth $8,000. The firm has 200 shares of stock outstanding and net income of $900. The firm has decided to pay out all of its excess cash as a cash dividend. What will the earnings per share be after the dividend is paid?
A. $0.25
B. $0.45
C. $2.50
D. $3.80
E. $4.50

Earnings per share = $900 ÷ 200 = $4.50

Difficulty level: Medium
Topic: CASH DIVIDEND
Type: PROBLEMS

62. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account, and $42,700 in the retained earnings account. The firm just announced a 10% (small) stock dividend. What will the balance in the retained earnings account be after the dividend?

A. $34,700
B. $35,700
C. $42,700
D. $49,700
E. $50,700

Retained earnings = [(10,000 shares × .10) × $8 × -1] + $42,700 = $34,700

Difficulty level: Medium
Topic: SMALL STOCK DIVIDEND
Type: PROBLEMS

63. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account and $42,700 in the retained earnings account. The firm just announced a 10% (small) stock dividend. What will the market price per share be after the dividend?

A. $7.20
B. $7.27
C. $7.33
D. $8.00
E. $8.80

Market price per share = (10,000 shares × $8) ÷ (10,000 shares × 1.10) = $7.27; Note that the total market value of the firm does not change.

Difficulty level: Medium
Topic: SMALL STOCK DIVIDEND
Type: PROBLEMS

64. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the value of the capital in excess of par account after the dividend?

A. $58,000
B. $61,500
C. $87,000
D. $96,500
E. $100,000

The capital in excess of par account does not change with a large stock dividend.

Difficulty level: Medium
Topic: LARGE STOCK DIVIDEND
Type: PROBLEMS

65. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the value of the retained earnings account after the dividend?

A. $29,000
B. $30,500
C. $32,500
D. $34,500
E. $36,000

Retained earnings = [(7,000 shares × .50) × $1 × -1] + $32,500 = $29,000

Difficulty level: Medium
Topic: LARGE STOCK DIVIDEND
Type: PROBLEMS

66. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the value of the common stock account after the dividend?
A. $7,000
B. $8,500
C. $9,000
D. $10,500
E. $14,000

Common stock = [(7,000 shares × .50) × $1] + $7,000 = $10,500

Difficulty level: Medium
Topic: LARGE STOCK DIVIDEND
Type: PROBLEMS

67. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account, and $32,500 in the retained earnings account. The firm just announced a 50% (large) stock dividend. What is the market value per share after the dividend?
A. $6.00
B. $8.00
C. $9.00
D. $10.50
E. $12.00

Market value per share = (7,000 shares × $12) ÷ (7,000 × 1.5) = $8.00; Note that the total market value of the firm does not change.

Difficulty level: Medium
Topic: LARGE STOCK DIVIDEND
Type: PROBLEMS

68. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. How many shares of stock will be outstanding after the split?
A. 10,000 shares
B. 12,500 shares
C. 20,000 shares
D. 22,500 shares
E. 27,500 shares

Number of shares = 15,000 × 3 ÷ 2 = 22,500 shares

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

69. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the market price per share be after the split?
A. $18
B. $24
C. $42
D. $48
E. $54

Market price per share = $36 × 2 ÷ 3 = $24

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

70. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the value of the common stock account be after the split?
A. $10,000
B. $12,500
C. $15,000
D. $18,500
E. $22,500

A stock split does not change the total value of the common stock account.

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

71. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the capital in excess of par account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the capital in excess of par account value be after the split?
A. $126,000
B. $210,000
C. $283,500
D. $315,000
E. $472,500

A stock split does not change the total value of the capital in excess of par account.

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

72. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a capital in excess of par account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the common stock account balance be after the split?
A. $3,000
B. $4,500
C. $6,000
D. $9,000
E. $12,000

Common stock account value = 6,000 × $1 = $6,000; A stock split does not change the total value of the common stock account.

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

73. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a capital in excess of par account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the market price per share be after the split?
A. $35
B. $40
C. $55
D. $70
E. $140

Market price per share = ($420,000 ÷ 6,000 shares) × 1 ÷ 2 = $35

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

74. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a capital in excess of par account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the retained earnings account balance be after the split?
A. $117,000
B. $234,000
C. $351,000
D. $410,000
E. $468,000

A stock split does not change the total value of the retained earnings account.

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

75. The Tinslow Co. has 125,000 shares of stock outstanding at a market price of $93 a share. The company has just announced a 5-for-3 stock split. How many shares of stock will be outstanding after the split?
A. 62,500 shares
B. 75,000 shares
C. 83,333 shares
D. 175,000 shares
E. 208,333 shares

Number of shares = 125,000 × 5 ÷ 3 = 208,333 shares

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

76. The Tinslow Co. has 125,000 shares of stock outstanding at a market price of $93 a share. The company has just announced a 7-for-3 stock split. What will the market price per share be after the split?
A. $38.27
B. $39.86
C. $40.40
D. $46.18
E. $55.80

Market price per share = $93 × 3 ÷ 7 = $39.86

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

77. The common stock of Margot, Inc. is selling for $56 a share. The par value per share is $1. Currently, the firm has a total market value of $89,600. How many shares of stock will be outstanding if the firm does a 2-for-1 stock split?
A. 800 shares
B. 1,200 shares
C. 1,600 shares
D. 3,200 shares
E. 4,800 shares

Number of shares = ($89,600 ÷ $56) × 2 ÷ 1 = 3,200 shares

Difficulty level: Medium
Topic: STOCK SPLIT
Type: PROBLEMS

78. Bob's Auto Group has 25,000 shares of stock outstanding at a market price of $4.50 a share. What will the market price per share be if the company does a 1-for-5 reverse stock split?
A. $18.00
B. $20.00
C. $22.50
D. $27.00
E. $29.50

Market price = $4.50 × 5 ÷ 1 = $22.50

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

79. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. How many shares of stock will be outstanding after the split?
A. 25,000 shares
B. 250,000 shares
C. 312,500 shares
D. 500,000 shares
E. 625,000 shares

Number of shares = 125,000 ÷ 5 × 1 = 25,000 shares

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

80. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the par value per share be after the split?
A. $0.20
B. $1.00
C. $2.50
D. $5.00
E. $10.00

Par value per share = $1 × 5 ÷ 1 = $5

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

81. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the market value per share be after the split?
A. $1.00
B. $5.00
C. $10.00
D. $25.00
E. $50.00

Market value per share = $5 × 5 ÷ 1 = $25

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

82. Michael's Boating Supplies has 150,000 shares of stock outstanding with a par value of $1 per share and a market value of $10 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. How many shares of stock will be outstanding after the split?

A. 30,000 shares
B. 250,000 shares
C. 312,500 shares
D. 500,000 shares
E. 625,000 shares

Number of shares = 150,000 ÷ 5 × 1 = 30,000 shares

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

83. Michael's Boating Supplies has 150,000 shares of stock outstanding with a par value of $1 per share and a market value of $10 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the par value per share be after the split?

A. $0.20
B. $1.00
C. $3.00
D. $5.00
E. $10.00

Par value per share = $1 × 5 ÷ 1 = $5

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

84. Michael's Boating Supplies has 150,000 shares of stock outstanding with a par value of $1 per share and a market value of $10 a share. The company has retained earnings of $76,500 and capital in excess of par of $340,000. The company just announced a 1-for-5 reverse stock split. What will the market value per share be after the split?
A. $1.00
B. $5.00
C. $10.00
D. $25.00
E. $50.00

Market value per share = $10 × 5 ÷ 1 = $50

Difficulty level: Medium
Topic: REVERSE STOCK SPLIT
Type: PROBLEMS

Essay Questions

85. Schaeffer Shippers announced on May 1, 2009, that it will pay a dividend of $5.00 per share on June 15 to all holders on record as of May 31st. The firm's stock price is currently at $70 per share. Assume that all investors are in the 33% tax bracket. Given that the ex-dividend date is May 29, what should happen to Schaeffer's stock price on May 29?

The stock price should fall by $5.00(1 - .33) = $3.35
New price = $70 - $3.35 = $66.65

Topic: DIVIDEND POLICY
Type: ESSAYS

86. It has been shown that in the absence of taxes and other market imperfections firm value will be unaffected by dividend policy. Explain the logic behind this conclusion. Next, describe three real-world factors that may cause one dividend policy to be preferable to another.

The first part of the question asks the student to explain the "homemade dividends" proposition. The second part requires the student to identify and describe the effects on dividend policy of such things as taxes, transactions costs, the desire for current income, and information effects.

Topic: DIVIDEND POLICY
Type: ESSAYS