FIN 521: Case 4: Blaine Kitchenware

Due on Tuesday, April 3, 2018

Wanbae Park

Question 1

Question 2

The current capital structure and payout policies of the firm are not appropriate since there are lots of benefits from using debt. Of course, increasing leverage makes firm's revenue risky, but on the current status, compensation from increasing leverage is much larger since the current amount of debt is zero. Most of firms which uses debt has larger market-to-book ratio, and larger ROE than Blaine Kitchenware. Assuming that industrial background among the firms are negligible, it justifies the argument that Blaine should raise debt. It is reasonable to increase D/V ratio to 17.09%, which is the average D/V ratio of other firms.

Question 3

a) 1) From exhibit 3 of the case, we can find cash, enterprise value, debt, and equity of the firm at 2006. Table 1 shows the balance sheet before announcement.

Asset		Liabilities	
Cash	230,866	Debt	0
Enterprise Value	728,730	Equity	959,596

Table 1: Balance sheet before announcement

2) After the announcement but before any debt issuance or repurchase is made, under perfect market, the balance sheet does not change because the announcement itself does not affect capital structure and systematic risk of the firm. Therefore, the balance sheet after announcement is same as Table 1.

3) After the firm issue 100,000(thousand dollars) amount of debt, debt increases and cash also increases on balance sheet. Therefore, the balance sheet of the firm changes to Table 2. Equity value and enterprise value does not change.

Asset		Liabilities	
Cash	330,866	Debt	100,000
Enterprise Value	728,730	Equity	959,596

Table 2: Balance sheet after issuing debt(Perfect market)

4) After repurchase, 300,000 amount of cash decreases, and the same value of equity also decreases. Although market value of equity decreased, because the same amount of cash also decreased, therefore,

Question 3 continued on next page. . .

enterprise value does not change. Furthermore, since number of shares also decreased, stock price also does not change.

Asset		Liabilities	
Cash	30,866	Debt	100,000
Enterprise Value	728,730	Equity	659,596

Table 3: Balance sheet after repurchase(Perfect market)

b) 1)

2)

3)

4)

Question 4

a)

b)

c)

d)

e)

f)

g)

Question 5

a)

b)

Question 6