ABSOLUTE RANKINGS will give their dividend yields. You can also get this information from the VALUATION COMPARISON in this same section. Has MSFT behaved differently from its peers, or have there been industry-wide shifts?

3. Refer back to the FULL COMPANY REPORT used in Question 1. Manually plot earnings and dividends over time. In the text, we point out that dividends are often much more stable than earnings. Do you see a similar pattern for MSFT?
4. In the Interim Financial Data section of the FULL COMPANY REPORT, identify the dividend declared date, the ex dividend date, and the pay date. Explain the significance of these dates. Go back to Overview and access the Interactive Price Chart. Can you observe price shifts around these dates? Explain what price shifts you might expect to see.
5. Investors are more concerned with future dividends than historical dividends, so go to ESTIMATES and scroll down to the Consensus Estimates section. Click on the Available Measures menu to toggle between earnings per share and dividends per share. What do analysts expect MSFT's payout policy to be in the future?
6. Refer back to the FULL COMPANY REPORT, and scroll down to the 5 Yr Annual Balance Sheet section. Does it appear that MSFT has been repurchasing any stock, or has it been issuing new stock?

Mini Case

Southeastern Steel Company (SSC) was formed 5 years ago to exploit a new continuous casting process. SSC's founders, Donald Brown and Margo Valencia, had been employed in the research department of a major integrated-steel company, but when that company decided against using the new process (which Brown and Valencia had developed), they decided to strike out on their own. One advantage of the new process was that it required relatively little capital in comparison with the typical steel company, so Brown and Valencia have been able to avoid issuing new stock and thus own all of the shares. However, SSC has now reached the stage at which outside equity capital is necessary if the firm is to achieve its growth targets. Therefore, Brown and Valencia have decided to take the company public. Until now, Brown and Valencia have paid themselves reasonable salaries but routinely reinvested all after-tax earnings in the firm, so dividend policy has not been an issue. However, before talking with potential outside investors, they must decide on a dividend policy.

Assume you were recently hired by Pierce Westerfield Carney (PWC), a national consulting firm that has been asked to help SSC prepare for its public offering. Martha Millon, the senior PWC consultant in your group, has asked you to make a presentation to Brown and Valencia in which you review the theory of dividend policy and discuss the following issues.

a. (1) What is meant by the term "distribution policy"? How has the mix of dividend payouts and stock repurchases changed over time?
   (2) The terms "irrelevance," "dividend preference, or bird-in-the-hand," and "tax effect" have been used to describe three major theories regarding the way dividend payouts affect a firm's value. Explain what these terms mean, and briefly describe each theory.
   (3) What do the three theories indicate regarding the actions management should take with respect to dividend payouts?
   (4) What results have empirical studies of the dividend theories produced? How does all this affect what we can tell managers about dividend payouts?

b. Discuss (1) the information content, or signaling, hypothesis, (2) the clientele effect, and (3) their effects on distribution policy.

c. (1) Assume that SSC has completed its IPO and has a $112.5 million capital budget planned for the coming year. You have determined that its present capital structure (80% equity and 20% debt) is optimal, and its net income is forecasted at $140 million. Use the residual distribution approach to determine SSC's total dollar distribution.

Assume for now that the distribution is in the form of a dividend. Suppose SSC has 100 million shares of stock outstanding. What is the forecasted dividend payout ratio? What is the forecasted dividend per share? What would happen to the payout ratio and DPS if net income were forecasted to decrease to $90 million? To increase to $160 million?

(2) In general terms, how would a change in investment opportunities affect the payout ratio under the residual distribution policy?

(3) What are the advantages and disadvantages of the residual policy? (*Hint:* Don't neglect signaling and clientele effects.)

d. (1) Describe the procedures a company follows when it make a distribution through dividend payments.

(2) What is a stock repurchase? Describe the procedures a company follows when it make a distribution through a stock repurchase.

e. Discuss the advantages and disadvantages of a firm repurchasing its own shares.

f. Suppose SSC has decided to distribute $50 million, which it presently is holding in very liquid short-term investments. SSC's value of operations is estimated to be about $1,937.5 million, and it has $387.5 million in debt (it has no preferred stock). As mentioned previously, SSC has 100 million shares of stock outstanding.

(1) Assume that SSC has not yet made the distribution. What is SSC's intrinsic value of equity? What is its intrinsic stock price per share?

(2) Now suppose that SSC has just made the $50 million distribution in the form of dividends. What is SSC's intrinsic value of equity? What is its intrinsic stock price per share?

(3) Suppose instead that SSC has just made the $50 million distribution in the form of a stock repurchase. Now what is SSC's intrinsic value of equity? How many shares did SSC repurchase? How many shares remained outstanding after the repurchase? What is its intrinsic stock price per share after the repurchase?

g. Describe the series of steps that most firms take when setting dividend policy.

h. What are stock splits and stock dividends? What are the advantages and disadvantages of each?

i. What is a dividend reinvestment plan (DRIP), and how does it work?

Selected Additional Cases

The following cases from Textchoice, *Cengage Learning's online library, cover many of the concepts discussed in this chapter and are available at* **http://www.textchoice2.com**.

Klein-Brigham Series:
Case 19, "Georgia Atlantic Company," Case 20, "Bessemer Steel Products, Inc.," Case 47, "Floral Fragrance, Inc.," and Case 80, "The Western Company," all illustrate the dividend policy decision.

Brigham-Buzzard Series:
Case 9, "Powerline Network Corporation (Dividend Policy)."