

LEARNING GOALS

When you finish this chapter, you should be able to



LEARNING GOALS

1. Describe nature of corporate form of organization.
2. List major sources of paid-in-capital, including classes of stock.
3. Describe financial statement effect of issuing stock.

Continued



LEARNING GOALS

4. Describe financial statement effects of treasury stock transactions.
5. Describe effect of stock splits on financial statements.
6. Analyze impact of issuing common stock vs. bonds.

Continued



LEARNING GOALS

7. Describe financial statement effects of cash & stock dividends.
8. Describe financial statement presentations of stockholders' equity.
9. Compute, interpret dividend yield, dividend payout ratio on common stock.



MATTEL, INC.

Mattel, Inc.

- Shares of stock represent ownership of company
- Stock may pay a dividend
- Stock that does not pay dividends offers growth potential



LEARNING GOALS

1

Describe nature of corporate form of organization.



EXHIBIT 1

- Advantages of the corporate form of organization include
 - Separate legal existence
 - Continuous life
 - Ability to raise large amounts of capital
 - Ownership rights easily transferred
 - Limited liability

Continued



EXHIBIT 1

- Disadvantages of the corporate form of organization include
 - Owner separate from management
 - Double taxation of dividends
 - Regulatory costs



LEARNING GOALS

2

List major sources of paid-in-capital, including classes of stock.



OWNERSHIP RIGHTS:

Common Stock

- Right to vote in matters concerning corporation
- Right to share in distributions of earnings
- Right to share in assets upon liquidation



Number of shares authorized, issued, and outstanding



COMMON STOCK

- Stock assigned monetary value
 - Par value
 - Related to state laws for legal capital
- When no monetary value assigned
 - No-par stock
 - Sometimes Boards assign a stated value to no-par stock



OWNERSHIP RIGHTS:

Preferred Stock

- Preferred right to stated dividend
 - Dividend stated in monetary terms or as % of par
- Cumulative preferred stock has right to dividends passed (in arrears)



LEARNING GOALS

3

Describe financial statement effect of issuing stock.



How do you record the sale of
5,000 shares of \$100 par
preferred stock and 50,000 shares
of \$20 common stock for
\$1,500,000?



ENTRY: Sale of Preferred & Common Stock

SCF	BS	IS
↑	↑ ↑	—

Cash	1,500,000
Preferred Stock	500,000
Common Stock	1,000,000

Issued stock at par value

Increases financing cash flow

Increases assets, equity on balance sheet

No effect on income statement



How do you record the sale of 2,000 shares of \$1 par common stock for \$55 (sold at a \$54 premium)?



ENTRY: Sale of Common Stock at Premium

SCF	BS	IS		
↑	↑ ↑	—	Cash	110,000
			Common Stock	2,000
			Paid In Capital in Excess of Par – Common Stock	108,000

Issued stock with \$54 premium per share

Increases financing cash flow

Increases assets, equity on balance sheet

No effect on income statement



ENTRY: Sale of NO-PAR Common Stock

SCF	BS	IS
↑	↑ ↑	—

Cash	400,000
Common Stock	400,000

Issued no-par common stock

Increases financing cash flow

Increases assets, equity on balance sheet

No effect on income statement



LEARNING GOALS

4

Describe financial statement effects of treasury stock transactions.



What is treasury stock
and how does a
corporation have it?

Treasury stock (T-stock) is
a contra-equity that arises
when a corporation buys
its own stock back.



ENTRY: Purchase of Treasury Stock

SCF	BS	IS
↓	↓ ↓	—

Treasury Stock	45,000
Cash	45,000

Purchased 1,000 shares of treasury stock at \$45

Decreases financing cash flow

Decreases assets, equity on balance sheet

No effect on income statement



How do you record the sale of
200 shares of the formerly
purchased treasury stock for **\$60**
per share?



ENTRY: Sale of Treasury Stock Above Cost

SCF	BS	IS
↑	↑ ↑	—

Cash	12,000
Treasury Stock	9,000
Paid in Capital in Excess of par – Treasury Stock	3,000

Sold 200 shares of treasury stock at \$60

Increases financing cash flow

Increases assets, equity on balance sheet

No effect on income statement



How do you record the sale of
200 shares of the formerly
purchased treasury stock for **\$40**
per share?



ENTRY: Sale of Treasury Stock Below Cost

SCF	BS	IS		
↑	↑ ↑	—	Cash	8,000
			Paid in Capital in Excess of par – Treasury Stock	1,000
			Treasury Stock	9,000

Sold 200 shares of treasury stock at \$40

Increases financing cash flow

Increases assets, equity on balance sheet

No effect on income statement



EXHIBIT 4

Stockholders' Equity		
Paid-in capital:		
Common stock, \$25 par (20,000 shares authorized and issued)	\$500,000	
Paid-in capital in excess of par—common	150,000	
Paid-in capital—treasury stock	<u>2,000</u>	
Total paid-in capital		\$652,000
Retained earnings		<u>130,000</u>
Total		\$782,000
Deduct treasury stock (600 shares at cost)		<u>27,000</u>
Total stockholders' equity		<u>\$755,000</u>



LEARNING GOALS

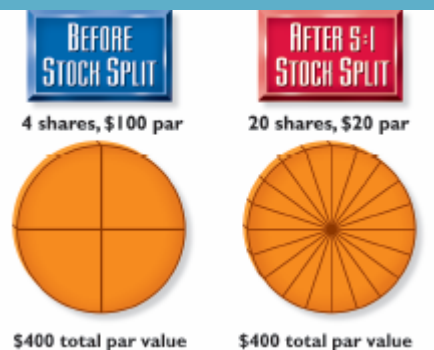
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Describe effect of stock splits on financial statements.



STOCK SPLITS

- Stock splits
 - Reduce the par value of stock
 - Increase number of shares of stock proportionately



LEARNING GOALS

6

Analyze impact of
issuing common stock
vs. bonds.



How do you compare the effects of different financing methods?

Look at the impact on earnings-per-share.



EXHIBIT 5

	\$15 per Share Common Stock Financing	10% Bond Financing	No Financing
Earnings before interest and taxes—base case (EBIT)	\$1,220,000	\$1,220,000	\$1,220,000
Return on Investment (12% × \$1,500,000)	180,000	180,000	—
Interest on bonds (10% × \$1,500,000)	—	(150,000)	—
Earnings before taxes	\$1,400,000	\$1,250,000	\$1,220,000
Income tax (@40%)	560,000	500,000	488,000
Net Income	<u>\$ 840,000</u>	<u>\$ 750,000</u>	<u>\$ 732,000</u>
Base number of shares outstanding	500,000	500,000	500,000
Plus additional shares issued	100,000	—	—
Total shares outstanding	<u>600,000</u>	<u>500,000</u>	<u>500,000</u>
Earnings per share (EPS)	<u>\$ 1.40</u>	<u>\$ 1.50</u>	<u>\$ 1.46</u>



LEARNING GOALS

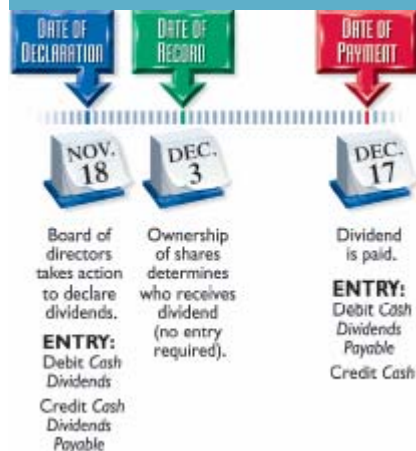
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Describe financial statement effects of cash & stock dividends.



CASH DIVIDEND

- Requirements for cash dividend are
 - Sufficient retained earnings
 - Sufficient cash
 - Formal action by board of directors



12/1 ENTRY: Declaring Cash Dividend

SCF	BS	IS
—	↑ ↓	—

12/1 Retained Earnings	42,500
Dividends Payable	42,500

Declared cash dividend

No effect cash flow

Increases liabilities, decreases equity on balance sheet

No effect on income statement



1/2 ENTRY: Paying Cash Dividend

SCF	BS	IS
↓	↓ ↓	—

1/2 Dividends Payable	42,500
Cash	42,500

Paid cash dividend

Decreases financing cash flow

Decreases assets, liabilities on balance sheet

No effect on income statement



EXERCISE 11-2a

Fiji, Inc. has 25,000 shares of 1%, cumulative preferred stock, \$100 par, and 250,000 shares of \$50 par common stock outstanding. No dividends were declared year 1; \$40,000 were declared year 2; \$80,000 declared year 3.

1. The amount of dividends paid for preferred stock year 2 was
2. The amount of dividends paid for common stock year 2 was

\$40,000

\$0

Press “Enter” or click left mouse button for answer.



*Click
button to
skip this
exercise*

Continued



EXERCISE 11-2b

Fiji, Inc. has 25,000 shares of 1%, cumulative preferred stock, \$100 par, and 250,000 shares of \$50 par common stock outstanding. No dividends were declared year 1; \$40,000 were declared year 2; \$80,000 declared year 3.

1. The amount of dividends paid for preferred stock year 3 was **\$35,000**
2. The amount of dividends paid for common stock year 3 was **\$45,000**

Press “Enter” or click left mouse button for answer.

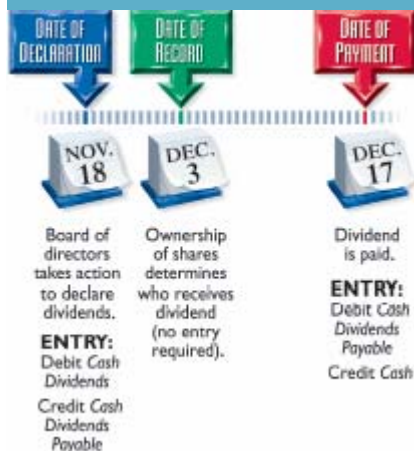


*Click
button to
skip this
exercise*



STOCK DIVIDEND

- Requirements for stock dividend are
 - Sufficient retained earnings
 - Formal action by board of directors
- Small stock dividend recorded at market price



Small stock dividend is less than
20% of outstanding shares.

$$5\% * 2,000,000 * \$31 =$$
$$3,100,000$$



ENTRY: Declaring Stock Dividend

SCF	BS	IS
—	↑ ↓	—

Retained Earnings	3,100,000
Stock Dividends Distributable	2,000,000
Paid in Capital in Excess of Par – Common Stock	1,100,000

Declared stock dividend

No effect cash flow

No net effect equity on balance sheet

No effect on income statement



ENTRY: Distributing Stock Dividend

SCF	BS	IS		
—	↑ ↓	—	1/10 Stock Dividends Distributable	2,000,000
			Common Stock	2,000,000

Distribute stock dividend

No effect cash flow

No net effect equity on balance sheet

No effect on income statement



LEARNING GOALS

8

Describe financial statement presentations of stockholders' equity.



OTHER COMPREHENSIVE INCOME

- Other comprehensive income (loss) includes
 - Foreign currency items
 - Pension liability adjustments
 - Unrealized gains, losses on investments



EXHIBIT 7

Mattel, Inc.
Stockholders' Equity
December 31, 2004 (in millions)

Common stock, \$1.00 par value, 1.0 billion shares authorized; 441.2 million shares issued	\$ 441.2
Additional paid-in capital	1,594.8
Treasury stock at cost; 26 million shares	(473.0)
Retained earnings	1,093.0
Accumulated other comprehensive loss	<u>(270.0)</u>
Total stockholders' equity	<u>\$ 2,386.0</u>



LEARNING GOALS

9

Compute, interpret
dividend yield,
dividend payout ratio
on common stock.



DIVIDEND YIELD

Measures the rate of return on value of investment

$$\text{Dividend Yield} = \frac{\text{Annual Dividend per share}}{\text{Market Price per Share}}$$



DIVIDEND YIELD: Mattel

Mattel's common stock price was \$18.89 at year end. The dividend paid was \$0.45.

$$\begin{aligned}\text{Dividend yield} &= \\ & .45/18.89 \\ & 2.38\%\end{aligned}$$



ANALYZING DIVIDEND YIELD

Company	Dividend Yield (%)
AT&T Corporation	5.06
Duke Energy Corporation	4.46
General Motors	8.10
Hewlett-Packard Company	1.05
Home Depot Inc.	0.82
Oracle Corporation	None
The Coca-Cola Company	1.00

How does Mattel's dividend yield compare to other companies listed above?



DIVIDEND PAYOUT RATIO

Measures the safety of paying out dividend

$$\text{Dividend Payout Ratio} = \frac{\text{Annual Cash Dividend}}{\text{Annual Net Income}}$$



DIVIDEND PAYOUT RATIO: Mattel

If Mattel's reported earnings were \$537.6 and its paid cash dividends were \$171.3, calculate Mattel's dividend payout ratio.

$$\begin{aligned}\text{Dividend payout ratio} &= \\ \$171.3 / \$537.6 &= \\ 31.9\% &\end{aligned}$$



ANALYZING DIVIDEND PAYOUT

Industry (large companies only)	Dividend Payout Ratio (%)
Airlines	0*
Automotive	19
Consumer electronics	5
Consumer products	34
Electric and gas utilities	21
Electronic manufacturing	9
Financial services	11
Food and beverage	8
Petrochemical	4
Retail	9
Software	2
Telecommunications	186

* Due to losses, the industry pays no dividends

How does Mattel's dividend payout ratio compare to other companies listed above?



CHAPTER 11

THE END

