CHAPTER 30

Review Questions

30.10 Arvind Ltd belongs to a risk-class for which the appropriate capitalisation rate is 10 per cent. It currently has outstanding 25,000 shares selling at Rs 100 each. The firm is contemplating the declaration of dividend of Rs 5 per share at the end of the current financial year. The company expects to have a net income of Rs 2.5 lakh and has a proposal for making new investments of Rs 5 lakh.

Show that under the MM assumption, the payment of dividend does not affect the value of the firm. Is the MM model realistic with respect to valuation? What factors might mar its validity ?

30.11 Sahu & Company earns Rs 6 per share having capitalisation rate of 10 per cent and has a return on investment at the rate of 20 per cent. According to Walter's model. What should be the price per share at 30 per cent dividend payout ratio? Is this the optimum payout ratio as per Walter?

Answers

30.10 Value of the firm Rs 25 lakh, P_1 Rs 105 (when dividends are paid) and Rs 110 (when dividends are not paid).

30.11 P = Rs 102; the zero per cent D/P ratio would be optimum (as P is maximum at Rs 120).