**Module 4 – Case Assignment**

**LEVERAGE, CAPITAL STRUCTURE, AND DIVIDEND POLICY**

**Assignment Overview**

Before starting on this assignment, make sure to carefully review the background readings. Part A requires you to make some computations, and Part B requires you to analyze some scenarios using your knowledge of the concepts. So make sure to go through the computational examples in the required readings and also thoroughly review the key concepts before starting on this assignment.

**Case Assignment**

Part A: Quantitative Problems

1. Suppose QuickCharge Corporation manufactures phone chargers. They sell their chargers for $20. Their fixed operating costs are $100,000 and their variable operating costs are $10 per charger. Currently they are selling 30,000 chargers per year.
   1. What is QuickCharge’s EBIT (earnings before interest and taxes) at current sales of 30,000?
   2. What is QuickCharge’s breakeven point?
   3. Calculate the EBIT if QuickCharge’s sales increase 50% to 45,000 chargers. What is the percent of change in EBIT under this increase in sales? Also, calculate the EBIT if the company's sales decrease 50% to 15,000 chargers. What is the percent of change in EBIT under this decrease in sales?
   4. What is QuickCharge’s degree of operating leverage? Based on your computation, what does its operating leverage say about QuickCharge’s business risk?
2. The StayDry Umbrella Corporation will have an EBIT of $100,000 if there is a normal amount of rain this year. But if there is a drought, they will have an EBIT of only $50,000. The interest rate on debt is 10%, and the tax rate is 35%. The company does not pay any preferred dividends.
   1. If StayDry has zero debt and 50,000 outstanding shares, what will its EPS (earnings per share) be if there is normal rain? What will its EPS be if there is a drought? What is its DFL (degree of financial leverage)?
   2. Now suppose StayDry has decided to take on $300,000 in debt and has used these funds to buy back half of the outstanding shares so now there are only 25,000 outstanding shares. What is the new EPS and DFL for both normal rain and drought?
   3. Based on your answers to a) and b) above, what are the trade-offs management has to make between zero debt or $300,000 in debt? What are the benefits and disadvantages of taking on this debt?

Part B: Conceptual Questions

1. For each of the following scenarios, explain whether the situation describes *financial risk* or *business risk*. Explain your answers to each scenario using at least one of the references from the background readings:
   1. A pharmaceutical company has developed a new cancer treatment drug that has a much higher success rate than other drugs currently in the market. It has the  potential to triple the company’s profits. However, the FDA has expressed concern about some side effects, and it is not clear if the FDA will approve the drug.
   2. An airline has an EBIT of $100 million per year. However, it also has a huge amount of debt and pays $97 million per year in interest. Its EBIT is relatively stable but tends to go up or down by $5 million or so each year depending on the economy.
   3. A basketball franchise earns an EBIT of $50 million a year when its team has a winning year. However, it earns only $10 million when its team has a losing year.
2. Explain what capital structure theory (or theories) best describes the following situations. Make sure to cite at least one of the required textbook chapters for each answer, and to cite at least two references for this section:
   1. A CEO decides to borrow $50,000 in new debt, and the share prices rise dramatically. He then decides to sell half of his own personal shares, and when this is reported in the Wall Street Journal, the share prices drop dramatically in value.
   2. The corporate tax rate rises from 35% to 45%, and the XYZ Corporation decides to issue more debt. A year later, bankruptcy laws are changed to become much stricter and costlier. XYZ then decides to pay back half of its debt.
   3. A CEO named Joe Bigwig is known for living large with very expensive cars and a huge mansion. Joe is seeking a large loan from a bank to finance some new projects for his corporation. However, the bank becomes concerned when they find out that he recently used company funds to buy a brand-new company jet and also schedules numerous business trips to Hawaii and stays in five-star hotels. The bank tells Joe he will receive the loan only if he agrees to scale back on his personal expenses and not give himself or any other executives a raise until the loan is paid back.

**Assignment Expectations**

* Answer the assignment questions directly.
* Stay focused on the precise assignment questions. Do not go off on tangents or devote a lot of space to summarizing general background materials.
* For computational problems, make sure to show your work and explain your steps.
* For short answer/short essay questions, make sure to reference your sources of information with both a bibliography and in-text citations. See the *Student Guide to Writing a High-Quality Academic Paper***,(See Attached)** including pages 11-14 on in-text citations.
* APA FORMAT
* NO Plagiarism ( will check on Turnitin)

Reference credible sources only

The following resources are **not** **acceptable** for this course, keep in mind, there are many others:

* Wikipedia.com
* Ehow.com
* About.com
* [Smallbusiness.chron.com](http://smallbusiness.chron.com/)
* Diffen.com
* [Yourbusiness.azcentral.com](http://yourbusiness.azcentral.com/)
* Investopedia.com
* Boundless.com and Lumen
* Course hero
* Studypool
* Chegg