**Assignment #1**

**Dividend Policy**

**Instructions:**

***Hard copy*** of the HW is collected on due date. *No email HW will be accepted*.

**Format:**

Part I) Font: Times News Roman; Font size: 11; Double space; Minimum 3 pages-Maximum 5 pages.

Part II) Font: Times News Roman; Font size: 11; Double space; Minimum 1 page-Maximum 2 pages.

**Part I)**

Read Chapter 17 (Section 1, 2, 3, 4,and 5), answer the following questions:

1. What are the different types of cash dividends?
2. What are the mechanics of cash dividend payment?
3. How should the price of a stock change when it goes ex dividend?
4. How can an investor create a homemade dividend?
5. Are dividends irrelevant?
6. What are the tax benefits of low dividends?
7. Why might some individual investors favor a high dividend payout?
8. Why might some non-individual investors prefer a high dividend payout?
9. How does the market react to unexpected dividend changes? What does this tell us about dividends? About dividend policy?
10. What is a dividend clientele effect? Please briefly explain.

**Part II)**

Read the WSJ article carefully, and answer the following questions based on what you have learned about dividend policy. (link: http://www.wsj.com/articles/rolls-royce-may-cut-dividend-as-earnings-outlook-weakens-1447312986)

1. Outlook of RR:
   1. What is going on its Operating Cost?
   2. What is going on its CAPEX?
   3. What is going on its Fixed Cost?
   4. RR’s market: How is it different from its competitors?
2. What happened to its stock price before the dividend-cut announcement? How do you explain stock market reaction based on what you have learned from Chapter 17?

**Rolls-Royce’s Share Price Dives on Dividend Warning, Weaker Outlook**

Engine maker suffers biggest share-price drop in 15 years

LONDON— [Rolls-Royce Holdings](http://quotes.wsj.com/RYCEY) [RYCEY **1.97%**](http://quotes.wsj.com/RYCEY?mod=chiclets)PLC warned it may cut its dividend to cope with spiraling costs and profit shortfalls—sending the jet engine maker’s shares into their sharpest tailspin in 15 years.

One of the most recognized names on London’s blue-chip FTSE 100 stock market index and a mainstay of British pension-fund portfolios, the company has failed to deliver cost cuts across the business. Orders for some of its older engine lines also have weakened, while big capital outlays aimed at delivering newer engines won’t generate returns for years to come.

Rolls-Royce long ago split from the luxury car maker of the same name, and makes the majority of its profit selling aircraft engines for large, commercial jets, like [Boeing](http://quotes.wsj.com/BA) Co.’s[BA **-0.05%**](http://quotes.wsj.com/BA?mod=chiclets)787 Dreamliner and Airbus Group SE’s A380. Those plane makers in recent years have been delivering record numbers of planes and profits, but years of failing to rein in spending damped the benefits for Rolls-Royce.

Rolls-Royce’s biggest competitor in commercial-aviation engines, [General Electric](http://quotes.wsj.com/GE) Co. , has benefited from a boom in orders for smaller, narrow body jets. But Rolls-Royce exited the market to power single-aisle jets several years ago to focus on other markets.

The company also disclosed for the first time on Thursday that activist investor ValueAct Capital Management LP, [which revealed over the summer that it had built a more than 5% stake in the company](http://www.wsj.com/articles/valueact-takes-more-than-5-stake-in-rolls-royce-1438358227), is seeking a board seat.

Rolls-Royce said full-year underlying pretax profit, a measure that excludes some costs, is expected to be at the low end of its previously issued £1.33 billion and £1.48 billion ($2.02 billion to $2.25 billion) range. It also said its 2016 earnings outlook had weakened. Further rattling investors, it suspended its medium-term earnings guidance, which it started providing not much more than a year ago.

The company said it would decide by February, when it reports full-year earnings, whether to cut its dividend. Shares fell 19.6% to £5.37 in London. Shares in Rolls-Royce have retreated more than 50% since February 2014, when it issued the first in a string of profit warnings.

“As a business, we carry too much fixed cost and are inflexible in managing this in response to changes in market conditions,” Chief Executive Warren East said in a statement. The company’s balance sheet and liquidity were strong, Mr. East said, but he called the cost issues “unacceptable.”

The company elevated Mr. East, a former CEO at microchip design giant [ARM Holdings PLC](http://quotes.wsj.com/ARMH) , [to the top job in July](http://www.wsj.com/articles/rolls-royces-new-boss-signals-scale-of-his-task-1436193786), with a mandate to turn the business around. Two days after joining, he issued [his first profit warning](http://www.wsj.com/articles/rolls-royce-suspends-share-buyback-after-weak-first-half-trading-1436164641) and initiated a broad operational review. The same month ValueAct disclosed its holdings in Rolls-Royce, ratcheting up the pressure

Mr. East has engaged with ValueAct over his tenure, but it is unclear if the investor has made any other requests aside from the board seat. “They have some very good questions,” Mr. East said on Thursday, without detailing them. ValueAct couldn’t immediately be reached for comment.

Rolls-Royce faces upheavals across its product lines. Its commercial aircraft engine business—the biggest profit contributor—is moving from delivering well-established, profit-generating engines, such as those powering Airbus A330 widebodies, to newer engines, like the TrentXWB, which powers Airbus’s latest long-haul plane.

Rolls-Royce has invested billions of dollars to develop the engine and build production plants, but won’t generate profit from these new products for several years. The company’s servicing business also weakened as some of the older planes using its engines are flying less. It is also losing market share in powering business jets, after failing to invest in new products. Meanwhile, demand for Rolls-Royce turbines, used to power ships and in electricity generation, also has suffered.

Rolls-Royce announced on Thursday initial findings of Mr. East’s operational review. The review was aimed at finding ways to boost Rolls-Royce’s returns, though shies away from major shifts in strategy.

The company said savings measures identified, including streamlining senior management, should yield incremental gross cost savings of between £150 million and £200 million a year from 2017. Rolls-Royce plans to spell out full details on these measures in a Nov. 24 investor day.

Rolls-Royce said a previous cost-savings program was on track to deliver a promised £115 million in year-over-year savings in the aerospace and marine businesses next year. The company has announced big job cuts in both areas.

“The next few years are going to be important in laying the foundations for our long-term profitable growth,” Mr. East said.

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