1.The financial strength of Deanna Perez Fashions in comparison to the industry can be found by a relative comparison of its Current and TIE ratios to the industry averages. Both of these averages show the lack of their ability, relative to the industry to cover expenses. DPF's current ratio, an indicator of the extent to which claims of short-term creditors are covered by current assets, is much lower than the industry average, suggesting that it's liquidity position is relatively weak. The DPF's TIE ratio of 1.5 is also very low in comparison to the industry average of 3.5. This shows that for DPF, relative to the industry they have less leeway in the amount operating income can decline before the firm is unable to meet the annual interest costs. DPF has been getting weaker in recent years. Their Current and TIE ratios were, in 1985, at par with the industry. DPF's financial weakness is likely to have a binding effect on the dividend policy. The corporation will be forced to hold onto retained earnings, instead of paying them out, in order to protect themselves from bankruptcy costs and legal action.

2. Do investors prefer dividends or do they prefer companies to retain earnings? This is a question that is very much unresolved. It is very hard to understand dividends. Three explanations keep coming up. The first one is that dividends are irrelevant. In other words investors only care about total returns. They don't care whether their total return comes from all dividends or all capital gains or a little of both (this comes from MM). The second argument is that dividends are taxed at higher rates then capital gains and therefore cannot be viewed in favor over capital gains. This could suggest that companies that do pay a dividend have a lower stock price. The third explanation is that dividends may provide investors with an idea about a firm's future earnings strength. Large dividend increases can cause the stock price to go up, while dividend cuts can send a stock price down. So if investors are using the changes in dividend policies as indications about upcoming corporate ability to pay the dividend and its continued prospects, this price fluctuation says nothing about preferences for dividends and capital gains.

3.

4. Earnings over the last 15 years have on a average been growing at a rate of 6.9% - found by 14.00 EPS '95 / 6.86 EPS '80 = 2.04-1=1.04 EPS g total /15 *yrs.= 0.069 or 6.9% average Dividend growth. The P/E ratio for DFP from 1980 to 1995 has been 1%- 5% points higher than that of the industry. The M/B ratio has been any where from 5%-16.5% points higher respectively, than that of the industry. What this means is that even though EPS growth was not spectacular, it was consistently improving at about the same rate as the industry and investors have been trading the stock at what is a good premium to the rest of the industry, it would appear that shareholders are satisfied with the dividend policy in its current state. Their stock has on average been returning 10.7% annually for the past 15 years-found by 287/110 = 2.609-1 = 1.609/15 yrs. = 0.107 or 10.7% annually.*

5. Yes DFP's management should be very concerned about the signaling theory that could occur if the dividend policy is altered. If the company were to decide to reduce the dividend it could very well send a signal to investors that the company will not be earning as much as needed to pay a higher dividend. It could also be seen by investors that the company has some good NPV projects in the pipeline and it would be beneficial to reduce the payout ratio, but it is very difficult to say how the investors will react to this and it is more likely to be negative than positive in accordance with the first view. If the company is to purchase stock back this could be considered a good signal by investors that management thinks the stock is cheap. However, in this case DFP is considered a take over target and if management buys back stock, it would signal to investors that the company is trying to avoid a take over which would maximize shareholders wealth and would be a very negative signal that management is not working in the best interests of the shareholders. Due to asymmetry, the stockholders will not know exactly what management intent is in all aspects of the business.

6. The clientele effect of dividend policy is very important. A firm should try and be aware of what type investors own their stock. If the majority of the stockholders are retired individuals that are in very low tax brackets and need that income for living expenses then they will want the company to use as high of a payout ratio as possible. On the other hand if most of the shareholders are those that are in their peak earnings years then these clientele would rather the company use the earnings for reinvestment These investors would have to pay ordinary tax income on the dividends and then reinvest so they prefer capital gains. What this all *means as that companies must understand their shareholders needs and be sympathetic to them, they are the owners.*

7. Yes DFP should consider agency costs when considering dividend policy. Investors have to worry about managements' use of retained earnings if there is no or very small payout ratio. Because of asymmetry shareholders will not know for sure if management is investing that money into positive NPV projects as they should, or if they are spending retained earnings in as irresponsible manner, such as purchasing too many corporate jets, ect. These types of irresponsible actions are what create "agency costs". If the company has a large payout ratio then investors are less prone to the agency cost due to the fact that they know where the earnings are going.

9. Yes we would recommend a stock split or large stock dividend because they do have some positive effects. One of those effects is the forcing of a stock price into its optimal price range. This optimal price range is believed to be between $20 and $80, making round lot purchases economical by most investors. Round lot purchases are done at reduced commissions. Another benefit is the provided by the signaling theory. It is believed that a stock split or large stock dividend is a show of confidence by the corporation of future success. Due to the fact that stock spits can be in any number of ways, both options have the same effect. DPF can make a decision on the method of accounting used for each decision. No, DPF should not use small annual stock dividends in the future. There is no economic value being created by using small stock dividends, yet shareholders will have to bear the administrative costs of the distribution.

10. It could be beneficial for the company to repurchase stock instead of issuing out its cash dividend. But this again goes back to the clientele effect, do your shareholders prefer a cash dividend or do they prefer capital gains. We must understand our shareholder in order to make that determination. This is due to the fact that dividends are really irrelevant, if no dividends are paid one could always just sell a percentage of stock to obtain the cash needed.

13. It is hard to say for sure if DFP should pay dividends or not. It largely depends on the type of clientele shareholders that own the majority of their stock. If the clientele are in a low tax bracket then dividends should start to be paid out to *the shareholders. This dividend should be large enough to satisfy shareholders needs yet small enough that the firm can always make the payments even if the firm goes through some rough times. In the case of the clienteles' preference for capital gains, then the company might want to think about a stock buy back program to enhance stockholders wealth. If the company does decide to pay the dividends then yes they should make an announcement. This may have a couple of signals, first shareholders might consider this to be a very positive announcement because they the shareholders will know how much of the retained earnings are being spent and thus worry less about the impact of agency costs. However the announcement could also be considered a negative because investors may perceive this to mean that the company does not have any positive NPV projects that could be beneficial to the firms overall growth which would affect shareholders wealth.*

Bibliography

None needed

Word Count: 1450