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The Baksar Company has two divisions, A and B. There are no transactions between the two divisions. The company raises its invested capital, i.e. long term debt plus stockholder's equity so that term debt is 50% of invested capital. Baksar pays 10 % interest on the long term debt borrowed and it does not pay any interest on its current liabilities. Baksar has no permanent or timing differences for its tax bill. The figures from operation for 2001 are as follows for the two divisions:

Operating Results 2001	Division	
	A	B
Net Sales	110	280
COGS (including depreciation)	(50)	(155)
Selling & General Expenses	(20)	(65)
Operating Income before taxes	40	60

Other rates	
Interest rate	10.00%
Tax rate	40.00%

Balance Sheet December 31 2001	A		B	
Current assets	\$40		\$100	
Long term assets	\$80		\$250	
Current liabilities	\$20		\$50	



Questions:

- 1 Prepare the balance sheet and the income statement for Baksar Co. and the two operating divisions for 2001.
- 2 What is the return on investment (ROI) for Division A, Division B and for Baksar in 2001 ? Can you derive the company ROI from the divisional ROI's?
- 3 What is the return on equity (ROE) and after tax cost of debt for Baksar? Can you derive the company ROE from ROI and after tax cost of debt?
- 4 Suppose Baksar uses its company ROI as the capital charge rate for the two divisions. What is the residual income for the two divisions and the total residual income ?
- 5 Suppose the cost of equity capital for Baksar is 18% and Baksar maintains the debt to equity ratio at 100% always. What is the weighted average cost of capital for Baksar ? How does the weighted average cost of capital compare with ROI, the cost of equity capital and ROE ?
- 6 Suppose Baksar uses the weighted average cost of capital as the capital charge rate for the two divisions. What is the residual income for the two divisions and the total residual income ? How does the total residual income compare with the net income ?