

STUDY GUIDELINES

FIN3701 - STUDY UNIT 6

1 GENERAL

This study unit is covered in chapter 12 of the prescribed textbook. This study unit is an introduction of study unit 7. Its focus is on the effect on the company's earnings per share (EPS) when long-term debt (fixed costs) is introduced in the company's operations. Change in total sales, earnings before taxes (EBIT) and earnings per share (EPS) of the company, as a result of using fixed costs in operations is also analysed in this study unit.

2 FORMAT OF ASSESSMENT

The content of this study unit will be assessed by means of multiple choice questions. No formulae will be provided in the examination and students will not be required to draw graphs for this study unit.

3 IMPORTANT AREAS IN THE STUDY UNIT

Pay attention to the following:

- The most important formulae:
 - The degree of operating leverage (DOL) formula (textbook page 494, equation 12.4).
 - The degree of financial leverage (DFL) formula (textbook page 497, equation 12.6).
 - The degree of financial leverage (DTL) formula (textbook page 499, equation 12.8).
 - Operating break-even point formula (textbook page 490, equation 12.3).

4 Study Guide Errata

Areas to correct:

Page 65: Example From page 64

Students must take note of an extra zero on the earnings available to ordinary shareholders amount.

	Ordinary shares	Preferred stock	Debt
Earnings available to ordinary shareholders	R6 500	R2 850	R5 3200

Areas to skip:

Page 62: Cash break-even point equation

Students must skip this equation: $X = (FC - d) / (P - V)$