Corporate Finance, Module 13: “Corporate Financing”

Homework Assignment

(The attached PDF file has better formatting.)

Market and Book Equity

An insurer is incorporated on January 1, 20X7, with 4 million shares authorized, of which 2 million shares are sold with a par value of $1.00 each and a sale price of $12.50 each.

The insurer rents office space and spends $5 million on renovations, all of which is written off on the financial statements. (They are expenses deducted from book equity; they are not capitalized.) An additional $8 million is used to buy land, which does not depreciate.

By December 31, 20X7, the insurer has earned $6 million, separate from the $5 million spent on renovations. The insurer sells another 1 million shares at a par value of $1.00 each and a sale price of $17.50 each. The year-ending stock price is $17.50.

Ignore corporate income taxes for this homework assignment.

A. How many shares are outstanding? (4 million are authorized; 2 million are sold on January 1 and 1 million are sold on December 31.)
B. What is the common capital stock on the insurer’s books? (Number of shares times their par value.)
C. What is the additional paid-in capital on the insurer’s books? (Sale price minus the common capital stock.)
D. What are the retained earnings on the insurer’s books? (Don’t forget to subtract the renovation expenses from the earnings. The land is not depreciated, so the purchase price is exchanged for an asset called *land*, and earnings are not affected.)
E. What is the book equity? (Original cash plus earnings minus renovation expenses.)
F. What is the market equity? (Number of shares times market price.)