

CorpFin Mod 14 rights issue practice exam question

- ! The common stock of a firm is trading at 92 per share.
- ! A rights issue allows investors to buy one new share at 84 for each 9 shares held.

Assume no other items influence the new stock price except the rights issue.

Question 14.1: Value of shares initially held

What is the value of the nine shares initially held?

Answer 14.1: Each share is worth 92, so the nine shares are worth $9 \times 92 = 828$.

Question 14.2: Value of new shares (new stock price)

What is the value of each new share after the after the rights are exercised?

Answer 14.2: The ten new shares are worth the original 828 plus the 84 paid in by the investor, so each share is worth $(9 \times 92 + 84) / 10 = 91.20$.

Question 14.3: Value of a right

What is the value of a right to buy one new share?

Answer 14.3: If the investor could not buy a new share at 84, he would have 9 new shares at 91.60 apiece, for a total investment of $9 \times 91.60 = 824.40$.

With the right to buy a new share at 84, he spends $824.40 + 84 = 908.40$ and he has an investment of $10 \times 91.60 = 916.00$, so the right is worth $916.00 - 908.40 = 7.60$.