

BUSN3049 Corporate Finance

Tutorial 10

1. Koepka Co. and Johnson Co. both have announced IPOs at \$40 per share. One of these is undervalued by \$12.25, and the other is overvalued by \$5.50, but you have no way of knowing which is which. You plan on buying 1,000 shares of each issue. If an issue is underpriced, it will be rationed, and only half of your order will be filled. If you could get 1,000 shares in Koepka and 1,000 shares in Johnson, what would your profit be? What profit do you actually expect? What principle have you illustrated?

Answer

If you receive 1000 shares of each, the profit is $1000(\$12.25) - 1000(\$5.50) = \$6,750$. Since you will only receive one-half of the shares of the oversubscribed issue, your profit will be $500(\$12.25) - 1000(\$5.50) = \$625$.

2. The Sullivan Co. needs to raise \$78 million to finance its expansion into new markets. The company will sell new shares of equity via a general cash offering to raise the needed funds. If the offer price is \$31 per share and the company's underwriters charge a spread of 7 percent, how many shares need to be sold?

Answer

Using X to stand for the required sale proceeds, the equation to calculate the total sale proceeds, including flotation costs is

$$\begin{aligned}X(1 - 0.07) &= \$78,000,000 \\X &= \$83,870,968\end{aligned}$$

required total proceeds from sale. So the number of shares offered is the total amount raised divided by the offer price, which is

$$\frac{\$83,870,968}{\$31} = 2,705,515$$

3. The Elkmont corporation needs to raise \$63.8 million to finance its expansion into new markets. The company will sell new shares of equity via a general cash offering to raise the needed funds. If the offer price is \$22 per share and the company's underwriters charge a spread of 7.5 percent, how many shares need to be sold?

Answer Using X to stand for the required sale proceeds, the equation to calculate the total sale proceeds, including flotation costs is

$$\begin{aligned}X(1 - 0.075) &= \$63,800,000 \\X &= \$68,972,973\end{aligned}$$

So the number of shares offered is the total amount raised divided by the offer price, which is

$$\frac{\$68,972,973}{\$22} = 3,135,135$$