20-2

The Beranek Company, whose stock price is now $25, needs to raise $20 million in common stock. Underwriters have informed the firm’s management that they must price the new issue to the public at $22 per share because of the signaling effects. The underwriters’ compensation will be 5% of the issue price, so Beranek will net $20.90 per share. The firm will also incur expenses in the amount of $150,000.

How many shares must the firm sell to net $20 million after underwriting and flotation expenses?

18-2

Consider data in problem 18-1 (see below). Assume that Reynolds tax rate is 40% and that the equipment’s depreciation would be $100 per year. If the company leased the asset on a 2-year lease, the payment would be $110 at the beginning of each year. If Reynolds borrowed and bought, the bank would charge 10% interest on the loan. In either case, the equipment is worth nothing after 2 years and will be discarded.

Should Reynolds lease or buy the equipment?

Data from 18-1

Current Assets - $300 Debt - $400

Net fixed assets - $500 Equity - $400

Total Assets - $800 Total Claims - $800