

Initial public offering paper



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c. Ownership and control become more disperse. Before the IPO, Del-Ta Engineering is the direct beneficial owner of 46.64% of its outstanding shares and may be deemed the beneficial owner of a total of 67.55% of its outstanding ordinary shares by virtue of its shareholders agreement with David Rivel, its Chief Executive Officer and a principal shareholder. Following the IPO, Del-Ta Engineering will be the direct beneficial owner of 36.50% of its outstanding ordinary shares, or 35.30% if the underwriters exercise their over-allotment option in full, and may be deemed the beneficial owner of 51.81% of its outstanding ordinary shares, or 50.10% if the underwriters exercise their over-allotment option in full, by virtue of its shareholders agreement with David Rivel. In this case, even after the IPO, Del-Ta Engineering is still the controlling shareholder by virtue of its shareholders agreement with David Rivel (Initial Public Offerings (IPO): RRSAT Global Communications Network Ltd. n. d.).

IPOs have positive initial returns on average. This is the phenomenon of underpricing (Ross, Westerfield, and Jaffee, 1996). For example, at start of the first day after the RRSat Global Communications Network Ltd., the shares were 12.16% $[(\$14.02 - \$12.50)/\$12.50]$ above their initial offering price. At the end of the first day, the shares were 20.24% $[(\$15.03 - \$12.50)/\$12.50]$ above their initial offering price (RRSat Global Communications Network Ltd. n. d.).

Ch. 6 Question 10. Stock Values.

1. Expected dividend at the end of year 1 = $\$1 \times 1.04 = \1.04

Expected dividend at the end of year 2 = $\$1.04 \times 1.04 = \1.0816

Expected dividend at the end of year 3 = $\$1.0816 \times 1.04 = \1.124864

3. Expected stock price 3 years from now =

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4. I will receive dividends of \$1.04 at the end of year 1, \$1.0816 at the end of year 2, and \$1.124864 at the end of year 3.

The present value of the first three payments comprises a significant portion (20.73%) of the price of stock. This can be explained by the time value of money. A dollar now is worth more than a dollar in the future.

Ch. 6 question 19. Constant-Growth Model.

1. Dividends payout ratio = Dividends per share/Earnings per share

Dividends payout ratio for Stock A = $\$1/\$2 = 0.5$

Dividends payout ratio for Stock B = $\$1/\$1.50 = 0.667$

2. Expected dividend growth rate = Return on equity X Retention rate (Reilly and Brown, 1997)

Expected dividend growth rate for Stock A = $15\% \times (1 - 0.5) = 0.075$

Expected dividend growth rate for Stock B = $10\% \times (1 - 0.667) = 0.03$

3. Proper stock price for A = $(1 \times 1.075)/(0.15 - 0.075) = \14.33

Proper stock price for B = $(1 \times 1.03)/(0.15 - 0.03) = \8.58

Ch. 16 Q. 20. Dividend Policy

a. Most companies set a target dividend payout ratio. True

b. They set each year's dividend equal to the target payout ratio times that year's earnings. True

c. Managers and investors seem more concerned with dividend changes than dividend levels. True

d. Managers often increase dividends temporarily when earnings are unexpectedly high for a year or two.

False. Dividends are more likely to be raised following a permanent, rather than a temporary, increase in earnings (Ross, Westerfield, and Jaffe, 1996).

Q. 21. Dividend Policy.

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a. High-risk companies. High-risk companies are expected to distribute a relatively low proportion of current earnings and have a relatively low PE ratio. A high-risk company is likely to retain more of its earnings as the probability of bankruptcy is higher. The PE ratio is lower as investors will pay a lower price for every dollar of earning compared to other less risky companies.

b. Companies that have recently experienced a temporary decline in profits. If the company has insufficient cash, it is likely to distribute low proportion of current earnings as due to issuance cost of obtaining financing from market. If it has sufficient cash and all positive NPV projects have been taken up, it is likely to distribute the same proportion of earnings as previous years so as not to provide a negative signal to shareholders (Ross, Westerfield, and Jaffe, 1996). The PE ratio would be expected to be relatively low if the market is smart by pricing the stock of the company correctly. If the market is fooled, the PE ratio would be higher as the denominator decreases.

c. Companies that expect to experience a decline in profits. The company is likely to distribute the same proportion of earnings as previous years so as not to provide a negative signal to shareholders (Ross, Westerfield, and Jaffe, 1996). The PE ratio would be expected to be relatively low if the price reflects the expectation by investors of the decline in profits.

d. " Growth" companies with valuable future investment opportunities. " Growth" companies with valuable future investment opportunities are expected to distribute a relatively low proportion of current earnings as they are expected to retain more of their earnings to reinvest. They are expected to have a relatively high PE ratio.

Q. 22. Dividend Policy.

Dividend payout ratio is the proportion of earnings distributed as dividends. Adjustment rate is the rate at which the dividends are changed from one year to another. This is so because managers avoid making a change in the level of dividend payments if it will have to be reversed later. Hence, target payout ratios are likely to be maintained at a low level. Managers want to avoid increasing the payout ratio only to have to decrease it later on, which is especially likely in the case of a risky company where earnings are more volatile.

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