UNIVERSITY OF THE PEOPLE

BUS 4404-01 PRINCIPLES OF FINANCE 2 - AY2024-T3

WRITTEN ASSIGNMENT UNIT 7

INSTRUCTOR: SHWETA POOJARI

Given:

The company needs $35,943,750 to finance a major project.

Expected total earnings next year = $45,650,000

Current outstanding shares = 5,075,000

Current share price = $17.75

Issuing new shares won't affect the current share price.

A) If raising $35,943,750 by issuing new shares:

Amount needed / Current share price = New shares to be issued

$35,943,750 / $17.75 = 2,025,000 new shares

Total outstanding shares next year = Current shares + New shares = 5,075,000 + 2,025,000 = 7,100,000

EPS next year = Expected earnings / Total outstanding shares = $45,650,000 / 7,100,000

EPS = $6.43

B) If raising by new shares:

PE ratio = Share price / EPS

= $17.75 / $6.43

PE ratio = 2.76

C) If raising $35,943,750 by issuing new debt:

No new shares issued.

Outstanding shares remain at 5.075,000.

EPS next year = Expected earnings / Outstanding shares = $45,650,000 / 5,075,000

EPS = $9.00

D) If raising by new debt:

PE ratio = Share price / EPS

= $17.75 / $9.00

PE ratio = 1.97

In summary:

If equity, EPS next year = $6.43, PE = 2.76

If debt, EPS next year = $9.00, PE = 1.97

The key difference is that issuing new shares increases the share count and dilutes EPS, while debt avoids dilution. But debt also doesn't increase the company's earnings.