**Seminar 2 Examples**

**Issuing shares**

**1.** DRK, Inc., has just sold 100,000 shares in an initial public offering. The underwriter’s explicit fees were $60,000. The offering price for the shares was $40, but immediately upon issue the share price jumped to $44.

1. What is your best guess as to the total cost to DRK of the equity issue?
2. Is the entire cost of the underwriting a source of profit to the underwriters?

**Market and limit orders**

**3.**  Here is some price information on Fincorp stock. Suppose first that Fincorp trades in a dealer market.

|  |  |
| --- | --- |
| Bid | Ask |
| 55.25 | 55.50 |

a) Suppose you have submitted an order to your broker to buy at market. At what price will you trade be executed?

b) Suppose you have submitted an order to sell at market. At what price will your trade be executed?

c) Suppose an investor has submitted a limit order to sell at $55.62. What will happen?

d) Suppose another investor has submitted a limit order to buy at $55.37. What will happen?

**4.** Consider the following limit-order book of a specialist. The last trade in the stock took place at a price of $50.

|  |  |  |  |
| --- | --- | --- | --- |
| Limit-Buy orders |  | Limit-Sell orders |  |
| Price | shares | price | shares |
| 49.75 | 500 | 50.25 | 100 |
| 49.50 | 800 | 51.50 | 100 |
| 49.25 | 500 | 54.75 | 300 |
| 49.00 | 200 | 58.25 | 100 |
| 48.50 | 600 |  |  |

1. If a market-buy order for 100 shares comes in, at what price will it be filled?
2. At what price would the next market-buy order be filled?
3. If you were the specialist, would you desire to increase or decrease your inventory of this stock?

**Stop orders**

**5. (80/1.)** If you place a stop-loss order to sell 100 shares of stock at $55 when the current price is $62, how much will you receive for each share if the price drops to $50?

1. $50.
2. $55.
3. $54.87.
4. Cannot tell from the information given.

**6. (78/10.)** Suppose that you sell short 100 shares of IBM, now selling at $120 per share.

1. What is your maximum possible loss?
2. What happens to the maximum loss if you simultaneously place a stop-buy order at $128?

**Margin account**

**7. (79/16.)** You are bullish on Telecom stock. The current market price is $50per share, and you have $5,000 of your own to invest. You borrowed an additional $5,000 from your broker at an interest rate of 8% per year and invest $10,000 in the stock.

1. What will be your rate of return if the price of Telecom stock goes up by 10% during the next year? (Ignore the expected dividend.)
2. How far does the price of Telecom stock have to fall for you to get a margin call if the maintenance margin is 30%? Assume the price fall happens immediately.

**8. (78/13.)** Dée Trader opens a brokerage account, and purchases 300 shares of Internet Dreams at $40 per share. She borrows $4,000 from her broker to help pay for the purchase. The interest rate on the loan is 8%.

1. What is the margin in Dée’s account when she first purchases the stock?
2. If the price falls to $30 per share by the end of the year, what is the remaining margin in her account?
3. If the maintenance margin requirement is 30%, will she receive a margin call?
4. What is the rate of return on her investment?

**Short Selling**

**9. (80/2.)** You wish to sell short 100 shares of XYZ Corporation stock. If the last two transactions were at 34.12 followed by 34.25, you only can sell short on the next transaction at a price of

1. 34.12 or higher.
2. 34.25 or higher.
3. 34.25 or lower.
4. 34.12 or lower.