1A - Equity and Debt Securities

Introduction to Equity Securities

1. Security: any investment product that can be exchanged for value and involves risk. Additionally, it must be readily transferable between two parties and the owner must be subject to the loss of some, or all, of the invested principal.
2. Equity/Stock
    a. Equity is perpetual, meaning that there is no maturity date.
    b. Issuing equity is the main source through which corporations raise working capital.
    c. Companies must issue common stock before they can issue preferred stock.
3. Corporate Timeline
    a. Authorized Stock: refers to the maximum number of shares that a company may sell to the investing public. This number is arbitrarily determined at the time of incorporation, and can only be increased if shareholders vote it to be.
    b. Issued Stock: refers to stock that has been authorized for sale and actually sold to the investing public. This number is typically lower than the authorized stock, which allows companies to issue stock in order to fulfill business needs. Additional authorized stock can be issued to pay a stock dividend, expand current operations, exchange common shares for convertible / convertible preferred bonds, or satisfy obligations under employee stock options or purchase plans. Once issued, issued stock is always considered issued stock, even if it is repurchased.
    c. Outstanding Stock: Issued stock that is actually owned by the investing public.
    d. Treasury Stock: refers to stock that has been repurchased by the issuing company from the investing public after its issuance. Treasury stock can be reissued or retired, and it does not receive dividends nor have voting rights. A corporation may elect to repurchase shares in order to maintain control of the company, increase earnings per share, fund employee stock purchase plans, or use shares to pay for M&A/
        i. Issued Stock - Outstanding Stock = Treasury Stock
4. Features of Equity
    a. Value: of common stock is determined by supply and demand, and not necessarily equal to its intrinsic value. Determination of price is based on current and future expectations of the company.
    b. Book Value: the theoretical value of a company in the instance of liquidation. This is equal to a company's total asset minus total liabilities. Book value per share is equal to book value divided by the total number of outstanding shares.
    c. Par Value: mainly used for accounting, refers to the price at which shares are issued at, equating it with the amount of capital it raised.
    d. Rights of Common Stockholders:
    e. Preemptive Rights: refer to the right of an investor to maintain their percentage interest in the company. Should a company issue additional shares, they must first be offered to existing shareholders. The board of directors of a company must approve issuance of new shares.
        i. Rights Offering: refers to the issuance of rights to existing shareholders prior to a company issuing additional shares. The subscription price, which is the price at

which shareholders can purchase additional shares, will be at a discount rate relative to market value. Rights are valid for up to 45 days after issuance. The three possible outcomes of rights are exercised, sold, or expired (which will only occur after the market price has fallen below the subscription price and 45 has elapsed)

f. Characteristics of a Rights Offering
    i. Once a rights offering is declared, the common stock will trade cum rights, and the market value will be adjusted for the value of the rights. After 45 days, the common stock will trade ex rights. Each share is offered one right, and the subscription price and share to rights ratio will be detailed. Often, an investment bank will serve as a standby underwriter to the issuing company and will purchase unsold shares.
g. Voting
    i. Common stockholders have voting rights, which are usually used in the determination of board member elections, issuance of bonds or additional shares, stock splits, M&A, and changes in policy.
    ii. Methods of Voting: the two methods through which voting can be accomplished are the statutory and cumulative methods. Each share is given one voting right. Statutory voting allows for rights to be evenly distributed among a voter's choices, whereas cumulative requires all of a shareholder's voting rights to go to one choice
h. Limited Liability: refers to the fact that a shareholder's liability is limited to their amount of invested capital.
i. Freely Transferable: refers to the fact that common stock (as well as most other securities) may be sold between investors without permission of the issuing company. This usually takes place in secondary markets, on exchanges, and with broker dealers. Ownership of stock is evidenced by a stock certificate which lists the name of the issuing company, the number of shares owned, the name of the owner of the record, and CUSIP number. Transfer requires that the owner endorse a new stock certificate or sign a power of substitution known as stock or bond power.
    i. Transfer Agent: the company that actually transfers record of ownership between investors. They can cancel, recover, issue, and authenticate stock certificates. They also maintain records.
    ii. Registrar: the company responsible for auditing transfer agents. Transfer and registrar functions may not be performed by a single department within a company. Usually, a bank of trust company fulfills these functions.
j. CUSIP Numbers: Committee on Uniform Securities Identification Procedures issues CUSIP numbers. They must appear on trade confirmations.
k. Inspection Rights: all shareholders have the right to inspect a company's books and records. This is mainly fulfilled through quarterly and annual reports. Some information may be deemed confidential by the company.
l. Residual Claims to Assets: Common shareholders have the right to receive their proportion of residual assets in the event of liquidation. This occurs after other security holders and debtors of the company are paid.