AcF302: Corporate Finance
Lent term
Week 15 Workshop Questions
Raising Equity Capital

Equity Financing for Private Companies

Exercise 1)

Which of the following statements is NOT true regarding venture capitalists?

A) They can provide substantial capital for young companies.

B) They offer limited partners a number of advantages over investing directly in start-ups themselves as angel investors.

C) They use their control to protect their investments, so they may therefore perform a key nurturing and monitoring role for the firm.

D) They might invest for strategic objectives in addition to the desire for investment returns.

Exercise 2)

A(n) _________ invests in the equity of existing privately held firms.

A) venture capital firm

B) private debt firm

C) vulture fund

D) private equity firm

Exercise 3)

Assume you founded your own firm two years ago. You initially contributed $50,000 of your money and in return received 1,000,000 shares of stock. Since then, you have sold an additional 750,000 shares to angel investors. You are now considering raising even more capital from a venture capitalist. The venture capitalist would invest $2 million and would receive 2,000,000 newly issued shares.

a) What is the post-money valuation?

b) What is the pre-money valuation?

c) Assuming that this is the venture capitalist's first investment in your company, what percentage of the firm will he end up owning?

d) What percentage will you own?

e) What is the value of your shares?

f) What is the return on your investment?

Exercise 4)

In addition to common shares, your firm raised \$10 million in Series A financing with a 2x liquidation preference, no participation rights, and a \$25 million post-money valuation.

a) **What is the minimum sale price such that the Series A investors will convert their shares?**

b) What is the minimum sale price such that all investors will convert their shares?

The Initial Public Offering

Exercise 5)

Which of the following statements is FALSE?

A) After deciding to go public, managers of the company work with an underwriter, an investment banking firm that manages the offering and designs its structure.

B) The shares that are sold in the IPO may either be new shares that raise new capital, known as a secondary offering, or existing shares that are sold by current shareholders (as part of their exit strategy), known as a primary offering.

C) Many IPOs, especially the larger offerings, are managed by a group of underwriters.

D) At an IPO, a firm offers a large block of shares for sale to the public for the first time.

Exercise 6)

R A X House is a private company considering going public. R A X House has assets of $585 million and liabilities of $415 million. The firm's cash flow from operations was $137 million for the previous year. After the I P O, R A X House will have 118 million shares outstanding.
The industry average cash flow per share multiple is 3.0, and the average book value per share is 2.3.
Based on these multiples, estimate the I P O price for R A X House.

<u>The Seasoned Equity Offering</u>

Exercise 7)

Which of the following statements is FALSE?
A) More often than not, firms return to the equity markets and offer new shares for sale, a type of offering called a seasoned equity offering (SEO).
B) Usually, profitable growth opportunities occur throughout the life of the firm, and in some cases, it is not feasible to finance these opportunities out of retained earnings.
C) When a firm issues stock using an SEO, it follows many of the same steps as for an IPO. The main difference is that a market price for the stock already exists, so the price-setting process is not necessary.
D) A firm's need for outside capital usually ends at the IPO.

Exercise 8)

You are the C F O of a company that is currently worth $1 billion. The firm has 100 million shares outstanding, so the shares are trading at $10 per share. You need to raise $200 million and have announced a rights issue. Each existing shareholder is sent one right for every share he or she owns. You have not decided how many rights you will require to purchase a share of new stock. You will require either four rights to purchase one share at a price of $8 per share, or five rights to purchase two new shares at a price of $5 per share. Which approach will raise more money?