SHARE DEALINGS

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Increasingly, the area in which students have more difficulty, concerning the calculations associated with share dealings.

All students are aware that shares are dealt with on a **F.I.F.O.** basis and this presents no problem.

Bonus issues, where "free" shares are given and so increase the quantity but not the cost of the shares held, do not generally give rise to problems either.

Mention a Rights Issue in a question however and all question plans disappear out the window and a student's imagination usually creeps into the solution!

This article will concentrate on share dealings where a Rights Issue is involved.

The calculations in share transactions are straightforward. Usually two to three lines at most. However, it is the approach and lay-out that students have difficulty with. The correct lay-out helps to get the number of shares correct. Once the numbers are correct, the rest of the calculation should fall into place.

The key phrase here is **"get the number of shares correct………"** To achieve this, the lay-out of calculations is crucial. Follow these four lay-out rules:

Rule 1: Show each new issue as a separate block.
Rule 2: Bonus issues ATTACH TO the existing block(s) at no extra cost.
Rule 3: Rights Issues taken up TRAVEL ALONGSIDE each existing block (like a shadow).
Rule 4: The sale of Rights not taken up is a PART DISPOSAL of the existing block cost.

When a company wishes to raise new capital, the cheapest source of "borrowing" is from the existing (and new) shareholder base - through a new share issue. However, existing shareholders have a right to be offered new shares, on a pro-rata basis, before the shares are offered to others. This right is known as a pre-emptive right.

The new shares will be offered:
a) Initially to the existing shareholders;
b) At a discounted price;
c) In proportion to the number of shares already held i.e. the holder of 300 shares will be offered 100 shares in a Rights Issue of 1:3 (1 for 3).

Shares issued under a Rights Issue will be like a shadow block and **travel alongside** the existing share block(s)!

Rule 3

Block 1		.	Block 1 Rights	
#	€		#	€
300	€€€		100	€€€

When you think of Rights attaching alongside a share block like a shadow, it is easy to see that if the main share block is reduced, the shadow block will be proportionately reduced. If 100 shares are sold in total above, (i.e. ¼ of the total shareholding), you will have to reduce the main block by ¼ PLUS the shadow block by ¼. The main block will therefore reduce by 75 shares and the shadow block will reduce by 25 shares.

The following comprehensive example demonstrates all the syllabus permutations in relation to share transactions. It is set out in six incremental stages, highlighting each rule in action. Follow the example slowly to the end.

EXAMPLE:

Stage 1 - Rules 1 & 2:

On 26th March 1984, Gordon bought 1,000 Bank shares for €800
On the 27th February 1985, the Bank made a bonus issue of 2:1
On 1st March 1988, Gordon sold 2,250 shares @ €6 each

Solution 1: March 84
Block 1

	#	€
1984 Purchase	1,000	800
1985 Bonus	2,000	
	3,000	800
1988 Sale	(2,250)	(600)
Remaining	750	200

	€
87/88 Sales proceeds	13,500
83/84 Cost €600 x 1.266	(760)
GAIN	12,740

Stage 2:

In June 2000, Gordon bought a further 1,200 bank shares @ €3 each.
In July 2001, the bank had a second bonus issue of 1:3.
In December 2002, Gordon sold 1,500 shares for €3,600

Solution 2 – Rules 1 & 2:

- The sale will be done on a FIFO basis.
- A separate sale calculation is done for each block.
- Each share is sold for €2.40 i.e. €$\frac{3,600}{1,500}$

	March 84 Block 1		*		June 00 Block 2	
	#	€	*		#	€
Remaining	750	200	*	2000 Purchase	1,200	3,600
2001 Bonus	250		*	2001 Bonus	400	
	1,000	200	*		1,600	3,600
2002 Sale	(1,000)	(200)	*		(500)	(1,125)
	-	-	*	Remaining	1,100	2,475

	€		€
2002 Sale proceeds	2,400	2002 Sale proceeds	1,200
83/84 Cost €200 x 1.911	(382)	00/01 Cost €1,125 x 1.091	(1,227)
GAIN	2,018		No loss/No gain

Stage 3:

In November 2002, Gordon bought 2,000 more bank shares for €4,000
In January 2003, the bank made a Rights Issue of 1:5 (1 for 5) at €1.30 per share.
Gordon took up his Rights.
In May 2004, Gordon sold 1,200 shares for €3,600

Solution 3 – Rules 1 & 3:

- Block 1 has now been exhausted. Only Blocks 2 and 3 remain.
- The sale will be done on a FIFO basis, BUT…
- The linked 'Rights block' shadows and moves with the 'main block'……….
- ……..You must exhaust a block **and its associated Rights**, before moving onto the next block!
- **Only one calculation** is done for each block. **Rights are enhancement** expenditure.
- The 1,320 shares of Block 2 (original block + Rights block) will cover the disposal.
- Block 3 will be unaffected.

	June 00 Block 2		Jan. 2003 Block 2 Rights		*		Nov. 2002 Block 3		Jan. 2003 Block 3 Rights	
	#	€	#	€	*		#	€	#	€
Remaining	1,100	2,475			*	2002 Purchase	2,000	4,000		
2003 Rights	-	-	220	286	*	2003 Rights	-	-	400	520
2004 Sale	(1,000) w	(2,250)	(200)	(260)	*					
Remaining	100	225	20	26	*					

W: $1{,}200 \times \frac{1{,}100}{1{,}320\ (1{,}100 + 220)}$

		€
2004	Sale proceeds	3,600
00/01	€2,250 x 1.144	(2,574)
2003	€200 x 1	(200)
	GAIN	826

The index only applies up to the 31st December 2003.

Stage 4:

In August 2004, Gordon sold a further 1,750 bank shares for €4,025

Solution 4 – Rules 1 & 3:

- Block 2 will now be exhausted
- Block 3 will be reduced, in proportion by 1,630 in total i.e. 1,750 - 120.
- A separate calculation will be done for blocks 2 and 3
- Again, the Rights expenditure is enhancement expenditure.
- Sales price each share = €2.30

	June 00 Block 2		Jan. 2003 Block 2 Rights				Nov. 2002 Block 3		Jan. 2003 Block 3 Rights	
	#	€	#	€	*		#	€	#	€
Remaining	100	225	20	26	*		2,000	4,000	400	520
2004 2nd Sale	(100)	(225)	(20)	(26)	*	2004 Sale	(1,358) **w**	(2,716)	(272)	(353)
	-	-	-	-	*	Remaining	642	1,284	128	167

W: 1,630 x 2,000 / 2,400

	€
2004 Sale proceeds	276
00/01 €225 x 1.144	(257)
2003 €26 x 1	(26)
No loss/No gain	

	€
2004 Sale proceeds	3,749
2002 €2,716 x 1.049	(2,849)
2003 €353 x 1	(353)
GAIN	547

Stage 5:

In March 2005, Gordon sells 770 shares for €3,833

In July 2005 Gordon purchased 6,000 shares for €24,000 in anticipation of a take-over bid.

Solution 5 – Rules 1, & 3:

- The sale will come entirely from Block 3
- Only Block 4 will remain

	Nov. 2002 Block 3		Jan. 2003 Block 3 Rights				July 2005 Block 4	
	#	€	#	€	*		#	€
Remaining	642	1,284	128	167	*	2005 Purchase	6,000	24,000
2005 Sale	(642)	(1,284)	(128)	(167)	*			
	-	-	-	-	*			

	€
2005 Sale proceeds	3,833
2002 €1,284 x 1.049	(1,347)
2003 €167 x 1	(167)
GAIN	2,319

A final point to note is that when a Rights Issue occurs, the Rights offered are not always taken up. The Rights to purchase a pre-defined number of shares at a discounted price is a valuable asset and can be sold to a 3rd party. In such event a straightforward asset sale arises. **The part disposal formula is used** as it is a part disposal of the original holding and therefore a part disposal of the original cost base.

Stage 6:

By December 2005, the take-over bid did not arise. The bank made another Rights Issue of 1 for 6 at €3.70 per share. Gordon did not take up his Rights but sold them to George for €2,600. After the Rights Issue was announced the share value was €4.25 per share

Solution 6 – Rule 4:

- Use the part disposal formula for the sale of the Rights.

July 2005
Block 4

	#	€
2005 Purchase	6,000	24,000
2005 Disposal	______	(2,220)
Remaining	6,000	21,780

		€
2005 Sales proceeds		2,600
2005 Cost €24,000 x $\frac{2,600}{2,600 + 25,500^*}$		(2,220)
GAIN		380

* 6,000 x €4.25

If you have now arrived at this point, well done! You should now have a clearer understanding of the manner of the lay-out of share blocks and also in the use of the 4 rules. You should also be able to score well in any exam question at this level dealing with share transactions.