Ex-Rights and Cum Rights

Although the Pass the 7© material explains the concept of subscriptions rights, you may need to know a little bit more than this to answer a Series 7 question or two.

Cum Rights

When a stock with rights is trading on an exchange, it has what is called “cum-rights” or “with rights.” As you know a rights offering is short-term, so there is a deadline to buy the stock and receive the rights. That deadline begins 2 days before the rights record date—which is the ex-date for the rights offering. From the time of the announcement of the rights offering to the ex-rights date, the rights are attached to the stock (cum rights). During this period, we can calculate a hypothetical value for a “cum right” with the following formula:

Value of 1 Cum Right = (Stock market price – subscription price) DIVIDED BY (# of rights needed to buy 1 new share PLUS 1)

As with most Series 7 formulae, this one is MUCH easier than it looks. Let’s say that XYZ stock trades right now for $50. One right plus $45 will get you 1 new share of XYZ. So, if we plug that into our formula, we get $50 - $45 DIVIDED BY 2. That’s $5 divided by 2, which means the value of 1 “cum right” is $2.50.

Ex-Rights

Okay, as we said, there is a record date, and you have to be an owner of XYZ stock on or before that record date. Since it takes 3 business days for a trade to settle, if you buy XYZ from somebody just two business days before the record date, your trade won’t settle in time. So, on the ex-rights date, XYZ stock trades “ex-rights” or “without rights,” and the market price drops accordingly. The formula now is exactly the same as before, only we drop the little “+1” on the bottom.

Value of 1 “Ex-Right = (Stock market price – subscription price) DIVIDED BY (# of rights needed to buy 1 new share)

Again, XYZ isn’t going to be trading much higher than the exercise price of the right at this point, since buyers of the stock won’t get rights. What are the existing rights worth at this point? If XYZ trades at $46 now, and one right plus $45 will get you one new share of XYZ, the value of this right would be $46 - $45 DIVIDED BY 1 = $1.