Problem 19-15

Alciatore Company earned a net income of $150,000 in 2021. The weighted average number of common shares outstanding for 2021 was 40,000. The average stock price for 2021 was $33. Assume an income tax rate of 25%.

For each of the following independent situations, indicate whether the effect of the security is anti-dilutive for diluted EPS.

Part 1: 10,000 shares of 7.7% of $100 par convertible cumulative preferred stock. Each share may be converted into 2 common shares.

Preferred dividend = $77,000 [(7.7% x $100) x 10,000]

# shares on conversion = 2 x 10,000 = 20,000

Conversion ratio for preferred stock = $77,000 ÷ 20,000 = $3.85

Basic EPS = ($150,000 - $77,000) ÷ 40,000 = $1.825

Anti-dilutive because $3.85 is not less than $1.825.

Part 2: 6.4% convertible 10 year, $500,000 bonds, issued at face value. The bonds are convertible into 5,000 shares of common stock.

Interest, net of tax on conversion = [(6.4% x $500,000) x 75%] = $24,000

# shares issued on conversion = 5,000

Conversion ratio for convertible bonds = $24,000 ÷ 5,000 = $4.80

Basic EPS = $150,000 ÷ 40,000 = $3.75

Anti-dilutive because $4.80 is not less than $3.75.


Exercise price = $30; Market price = $33

Dilutive because the exercise price of $30 per share is less than the market price of $33 per share.

Part 4: Warrants for 1,000 common shares with an exercise price of $35 per share.

Exercise price = $35; Market price = $33

Anti-dilutive because the exercise price of $35 per share is not less than the market price of $33 per share.

Part 5: A contingent agreement to issue 5,000 shares of stock to the company president if net income is at least $125,000 in 2022.

Dilutive because an additional 5,000 shares of stock would be added to the denominator in determining EPS.