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The main objective of this paper is to provide a framework to value the underwriting of a rights issue. We consider explicitly the impacts associated with the company being "short rights", "long underwriting" and "long project-to-be-financed", as well as the impact of incomplete exercise at maturity (i.e. the ratio of converted rights to total rights being below unity). Our main conclusion is that the traditional view that states underwriting agreements are "too expensive" may be erroneous. By introducing a valuation formula where the tacit balance sheet takes into account that the underwriting is a company's asset, and by considering that firms issue capital in order to finance risky projects, we obtain undervaluations of the underwriting that range from 10% to 75%, in comparison with the standard approach. In addition we analyse briefly the potential effects associated with the pricing of the underwriting in the presence of taxes and banking regulation. We also illustrate the application of the main valuation model, using the example of Jeronimo Martins, a Portuguese firm which undertook an underwritten rights issue on June 2004. Although we could not account for every single relevant variable in terms of this pricing problem, we believe that the underwriting fee was too expensive; i.e. for this specific example, the differential between the valuation associated with the traditional approach and the observed market price was not fully compensated by the application of our adjusted model.

Keywords: underwriting valuation, rights valuation, equity financing, incomplete exercise, banking, capital structure, martingale pricing.

JEL Classification: G13 (Contingent Pricing; Futures Pricing); G24 (Investment Banking; Venture Capital; Brokerage); G32 (Financing Policy; Capital and Ownership Structure).

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