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# Warrant Pricing—Is Dilution a Delusion?

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Pages 77-80 | Published online: 02 Jan 2019

🗨️ Cite this article   🔗 <https://doi.org/10.2469/faj.v52.n5.2027>

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## Abstract

The textbook treatment of warrants takes as a state variable the total equity value of the firm. When warrants are exercised, the firm's equity value increases, which increases the price of the stock. The firm's stock price is then higher than it would have been if the firm had not issued warrants. This is the dilution effect. The dilution effect is consistent with the theory of the firm, which states that the firm's value is the present value of its future cash flows. The dilution effect is also consistent with the theory of the stock market, which states that the stock price is the present value of its future cash flows. The dilution effect is also consistent with the theory of the warrant market, which states that the warrant price is the present value of its future cash flows.

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