

Chapter 1 *The Firm and the Financial Manager* 3

Chapter 2 *Accounting and Finance* 29

Value 51

Chapter 3 *The Time Value of Money* 53

Chapter 4 *Valuing Bonds and Stocks* 103

Chapter 5 *Net Present Value and Other Investment Criteria* 147

Chapter 6 *Using Discounted Cash-Flow Analysis to Make Investment Decisions* 183

Chapter 7 *Project Analysis* 207

Risk 235

Chapter 8 *Introduction to Risk, Return, and the Opportunity Cost of Capital* 237

Chapter 9 *Risk, Return, and Capital Budgeting* 267

Chapter 10 *The Cost of Capital* 293

Financing 319

Chapter 11 *Corporate Financing and the Lessons of Market Efficiency* 321

Chapter 12 *An Overview of Corporate Financing* 341

Chapter 13 *How Corporations Issue Securities* 367

Capital Structure and Dividend Policy 393

Chapter 14 *Debt Policy* 395

Chapter 15 *Dividend Policy* 427

Financial Planning 451

Chapter 16 *Financial Statement Analysis 453*

Chapter 17 *Financial Planning 483*

Chapter 18 *Working Capital Management and Short-Term Planning 509*

Short-Term Financial Decisions 541

Chapter 19 *Cash and Inventory Management 543*

Chapter 20 *Credit Management and Bankruptcy 567*

Special Topics 593

Chapter 21 *Mergers, Acquisitions, and Corporate Control 595*

Chapter 22 *International Financial Management 623*

Chapter 23 *Options 651*

Chapter 24 *Risk Management 677*

Conclusion 697

Chapter 25 *What We Do and Do Not Know about Finance 699*

Appendix A: Present Value Tables 713

Appendix B: Answers to Selected End-of-Chapter Problems 723

Glossary 737

Index 742

Chapter 1

The Firm and the Financial Manager 3

- 1.1 Organizing a Business 4
Sole Proprietorships/Partnerships/Corporations
- 1.2 The Role of the Financial Manager 7
The Capital Budgeting Decision/The Financing Decision
- 1.3 Who Is the Financial Manager? 10
- 1.4 Understanding Financial Markets and Institutions
Financial Markets/Financial Institutions/Functions of
Financial Markets and Institutions
- 1.5 Goals of the Corporation 14
Shareholders Want Managers to Maximize Market
Value/Ethics and Management Objectives/Do
Managers Really Maximize Firm Value?
- 1.6 Topics Covered in This Book 21
Snippets of History
- 1.7 Summary 24
- Key Terms 24

 *Value 51*

Chapter 3

The Time Value of Money 53

- 3.1 Future Values and Compound Interest 54
- 3.2 An Application of Compounding: Effective
Annual Interest Rates 59
- 3.3 Present Values 60
Finding the Interest Rate

Problems 24

Solutions to Self-Test Questions 26

Chapter 2

Accounting and Finance 29

2.1 The Balance Sheet 30

Book Values and Market Values

2.2 The Income Statement 35

Profits versus Cash Flow

2.3 The Statement of Cash Flows 38

2.4 Accounting for Differences 40

2.5 Taxes 41

Corporate Tax/Personal Tax

2.6 Summary 44

Key Terms 45

Problems 45

Solutions to Self-Test Questions 49

3.4 Multiple Cash Flows 67

Future Value of Multiple Cash Flows/Present Value of
Multiple Cash Flows

3.5 Level Cash Flows: Perpetuities and
Annuities 71

How to Value Perpetuities/How to Value Annuities/
Annuities Due/Future Value of an Annuity

Financial Planning 451

Chapter 16 *Financial Statement Analysis 453*

Chapter 17 *Financial Planning 483*

Chapter 18 *Working Capital Management and Short-Term Planning 509*

Short-Term Financial Decisions 541

Chapter 19 *Cash and Inventory Management 543*

Chapter 20 *Credit Management and Bankruptcy 567*

Special Topics 593

Chapter 21 *Mergers, Acquisitions, and Corporate Control 595*

Chapter 22 *International Financial Management 623*

Chapter 23 *Options 651*

Chapter 24 *Risk Management 677*

Conclusion 697

Chapter 25 *What We Do and Do Not Know about Finance 699*

Appendix A: Present Value Tables 713

Appendix B: Answers to Selected End-of-Chapter Problems 723

Glossary 737

Index 742

Chapter 1

The Firm and the Financial Manager 3

- 1.1 Organizing a Business 4
Sole Proprietorships/Partnerships/Corporations
 - 1.2 The Role of the Financial Manager 7
The Capital Budgeting Decision/The Financing Decision
 - 1.3 Who Is the Financial Manager? 10
 - 1.4 Understanding Financial Markets and Institutions
Financial Markets/Financial Institutions/Functions of
Financial Markets and Institutions
 - 1.5 Goals of the Corporation 14
Shareholders Want Managers to Maximize Market
Value/Ethics and Management Objectives/Do
Managers Really Maximize Firm Value?
 - 1.6 Topics Covered in This Book 21
Snippets of History
 - 1.7 Summary 24
- Key Terms 24

 *Value 51*

Chapter 3

The Time Value of Money 53

- 3.1 Future Values and Compound Interest 54
- 3.2 An Application of Compounding: Effective
Annual Interest Rates 59
- 3.3 Present Values 60
Finding the Interest Rate

1

Problems 24

Solutions to Self-Test Questions 26

Chapter 2

Accounting and Finance 29

2.1 The Balance Sheet 30

Book Values and Market Values

2.2 The Income Statement 35

Profits versus Cash Flow

2.3 The Statement of Cash Flows 38

2.4 Accounting for Differences 40

2.5 Taxes 41

Corporate Tax/Personal Tax

2.6 Summary 44

Key Terms 45

Problems 45

Solutions to Self-Test Questions 49

3.4 Multiple Cash Flows 67

Future Value of Multiple Cash Flows/Present Value of
Multiple Cash Flows

3.5 Level Cash Flows: Perpetuities and
Annuities 71

How to Value Perpetuities/How to Value Annuities/
Annuities Due/Future Value of an Annuity

3.6 Inflation and the Time Value of Money 84

Real versus Nominal Cash Flows/Inflation and Interest Rates/What Fluctuates: Real or Nominal Rates?/ Valuing Real Cash Payments/Real or Nominal?

3.7 Summary 90

Key Terms 91

Problems 91

Solutions to Self-Test Questions 97

Chapter 4

Valuing Bonds and Stocks 103

4.1 Bond Prices and Yields 105

Bond Pricing/The Yield to Maturity/Rate of Return/ Interest Rate Risk/Reading the Financial Pages/ The Yield Curve/Credit Risk

4.2 Stocks and the Stock Market 117

Reading the Stock Market Listings

4.3 Book Values, Liquidation Values, and Market Values 119

4.4 Valuing Common Stocks 122

Today's Price and Tomorrow's Price/The Dividend Discount Model

4.5 Simplifying the Dividend Discount Model 126

The Dividend Discount Model with No Growth/ The Constant-Growth Dividend Discount Model/ Estimating Expected Rates of Return/ Nonconstant Growth

4.6 Growth Stocks and Income Stocks 132

The Price-Earnings Ratio/What Do Earnings Mean?/ Valuing Entire Businesses

4.7 Summary 135

Key Terms 136

Problems 137

Solutions to Self-Test Questions 141

Chapter 5

Net Present Value and Other Investment Criteria 147

5.1 Net Present Value 149

A Comment on Risk and Present Value/Valuing Long-Lived Projects

5.2 Other Investment Criteria 155

Internal Rate of Return/A Closer Look at the Rate of Return Rule/Calculating the Rate of Return for Long-Lived Projects/A Word of Caution/Payback/Book Rate of Return

5.3 Project Interactions 162

Mutually Exclusive Projects/Investment Timing/Long-versus Short-Lived Equipment/Replacing an Old Machine/Mutually Exclusive Projects and the IRR Rule/Other Pitfalls of the IRR Rule

5.4 Capital Rationing 171

Soft Rationing/Hard Rationing/Pitfalls of the Profitability Index

5.5 Summary 173

Key Terms 173

Problems 174

Solutions to Self-Test Questions 178

Chapter 6

Using Discounted Cash-Flow Analysis to Make Investment Decisions 183

6.1 Discount Cash Flows, Not Profits 184

6.2 Discount Incremental Cash Flows 187

Include All Indirect Effects/Forget Sunk Costs/Include Opportunity Costs/Recognize the Investment in Working Capital/Beware of Allocated Overhead Costs

6.3 Discount Nominal Cash Flows by the Nominal Cost of Capital 190

6.4 Separate Investment and Financial Decisions 192

6.5 Example: Blooper Industries 192

Calculating Blooper's Project Cash Flows/Calculating the NPV of Blooper's Project/Further Notes and Wrinkles Arising from Blooper's Project

6.6 Summary 200

Key Terms 200

Problems 200

Solutions to Self-Test Questions 204

Chapter 7

Project Analysis 207

- 7.1 How Firms Organize the Investment Process 208
Stage 1: The Capital Budget/Stage 2: Project Authorizations/Problems and Some Solutions
- 7.2 Some "What-If" Questions 211
Sensitivity Analysis/Scenario Analysis/Break-Even Analysis/Accounting Break-Even Analysis/NPV Break-Even Analysis/Operating Leverage

Risk 235

Chapter 8

Introduction to Risk, Return, and the Opportunity Cost of Capital 237

- 8.1 Rates of Return: A Review 238
- 8.2 Seventy-One Years of Capital Market History 239
Market Indexes/The Historical Record/Using Historical Evidence to Estimate Today's Cost of Capital
- 8.3 Measuring Risk 245
Variance and Standard Deviation/Measuring the Variation in Stock Returns
- 8.4 Risk and Diversification 250
Diversification/Asset versus Portfolio Risk/Market Risk versus Unique Risk
- 8.5 Thinking about Risk 257
Message 1: Some Risks Look Big and Dangerous but Really Are Diversifiable/Message 2: Market Risks Are Macro Risks/Message 3: Risk Can Be Measured
- 8.6 Summary 260
- Key Terms 260
- Problems 260
- Solutions to Self-Test Questions 264

Chapter 9

Risk, Return, and Capital Budgeting 267

- 9.1 Measuring Market Risk 268
Measuring Beta/Betas for Delta Air Lines and Duke Power/Portfolio Betas

- 7.3 Flexibility in Capital Budgeting 223
Decision Trees/The Option to Expand/Abandonment
Options/Flexible Production Facilities/Investment
Timing Options
- 7.4 Summary 227
- Key Terms 228
- Problems 228
- Solutions to Self-Test Questions 232

- 9.2 Risk and Return 274
Why the CAPM Works/The Security Market
Line/Using the CAPM to Estimate Expected
Returns
- 9.3 Capital Budgeting and Project Risk 283
Company versus Project Risk/Determinants of Project
Risk/Don't Add Fudge Factors to Discount Rates
- 9.4 Summary 285
- Key Terms 285
- Problems 285
- Solutions to Self-Test Questions 291

Chapter 10

The Cost of Capital 293

- 10.1 The Cost of Capital 294
- 10.2 The Company Cost of Capital and the Weighted
Average Cost of Capital 296
Calculating Company Cost of Capital as a Weighted
Average/Three Steps in Calculating Cost of
Capital/Market versus Book Weights/Taxes and the
Weighted-Average Cost of Capital/Wrapping Up
Geothermal/Checking Our Logic
- 10.3 Measuring Capital Structure 304
- 10.4 Calculating Required Rates of Return 306
The Expected Return on Bonds/The Expected Return
on Common Stock/The Expected Return on
Preferred Stock
- 10.5 Calculating the Weighted-Average Cost of
Capital 308
Real Oil Company WACCs

10.6 Interpreting the Weighted-Average Cost of Capital 308

When You Can and Can't Use WACC/Some Mistakes People Make Using the WACC/How Changing Capital Structure Affects Expected Returns/What Happens When the Corporate Tax Rate Is Not Zero

10.7 Flotation Costs and the Cost of Capital 312

Financing 319

Chapter 11

Corporate Financing and the Lessons of Market Efficiency 321

11.1 Differences between Investment and Financing Decisions 322

11.2 What Is an Efficient Market? 324

A Startling Discovery: Price Changes Are Random/Three Forms of the Efficient-Market Theory/No Theory Is Perfect/The Crash of 1987

11.3 Lessons of Market Efficiency 333

Markets Have No Memory/There Are No Financial Illusions/There Are No Free Lunches on Wall Street

11.4 Summary 335

Key Terms 336

Problems 336

Solutions to Self-Test Questions 339

Chapter 12

An Overview of Corporate Financing 341

12.1 Common Stock 342

Book Value versus Market Value/Dividends/Stockholders' Rights/Voting Procedures/Classes of Stock/Corporate Governance in the United States and Elsewhere

12.2 Preferred Stock 347

12.3 Corporate Debt 348

Debt Comes in Many Forms/An Example: The Terms of Mobil's Bond Issue/Innovation in the Debt Market

10.8 Summary	313
Key Terms	313
Problems	313
Solutions to Self-Test Questions	316

12.4 Convertible Securities	357
12.5 Patterns of Corporate Financing	358
Do Firms Rely Too Heavily on Internal Funds?/External Sources of Capital	
12.6 Summary	361
Key Terms	361
Problems	362
Solutions to Self-Test Questions	364

Chapter 13

<i>How Corporations Issue Securities</i>	367
13.1 Venture Capital	368
13.2 The Initial Public Offering	370
Arranging a Public Issue	
13.3 The Underwriter	375
Who Are the Underwriters?	
13.4 General Cash Offers by Public Companies	377
General Cash Offers and Shelf Registration/Costs of the General Cash Offer/Market Reaction to Stock Issues	
13.5 The Private Placement	380
13.6 Summary	381
Key Terms	382
Problems	382
Solutions to Self-Test Questions	385
Appendix: Hotch Pot's New Issue Prospectus	387

Chapter 14

Debt Policy 395

14.1 How Borrowing Affects Company Values in a Tax-Free Economy 396

MM's Argument/How Borrowing Affects Risk and Return/Debt and the Cost of Capital

14.2 How Corporate Taxes Affect Debt Policy 404

Debt and Taxes at River Cruises/How Interest Tax Shields Contribute to the Value of Stockholders' Equity/Corporate Taxes and the Weighted-Average Cost of Capital/The Implications of Corporate Taxes for Capital Structure

14.3 Costs of Financial Distress 409

Bankruptcy Costs/Evidence on Bankruptcy Costs/ Direct versus Indirect Costs of Bankruptcy/ Financial Distress without Bankruptcy/ What the Games Cost/Costs of Distress Vary with Type of Asset

14.4 Explaining Financing Choices 416

The Trade-Off Theory/A Pecking Order Theory

14.5 Summary 417

Key Terms 418

Problems 419

Solutions to Self-Test Questions 423

Financial Pl

Chapter 16

Financial Statement Analysis 453

16.1 Financial Ratios 454

Leverage Ratios/Liquidity Ratios/Efficiency Ratios/Profitability Ratios/Market-Value Ratios

16.2 The Du Pont System 468

16.3 Using Financial Ratios 470

Choosing a Benchmark

16.4 The Earnings Record 473

16.5 Summary 474

Key Terms 475

Chapter 15

Dividend Policy 427

15.1 How Dividends Are Paid 428

Cash Dividends/Some Legal Limitations on Dividends/Stock Dividends and Stock Splits/Share Repurchase

15.2 How Do Companies Decide on Dividend Payments? 432

15.3 Why Dividend Policy Should Not Matter 433

Dividend Policy Is Irrelevant in Competitive Markets/The Assumptions behind Dividend Irrelevance

15.4 Why Dividends May Increase Firm Value 438

Market Imperfections/Dividends as Signals

15.5 Why Dividends May Reduce Firm Value 440

Why Pay Any Dividends at All?/Taxation of Dividends and Capital Gains under Current Tax Law

15.6 Summary 443

Key Terms 444

Problems 444

Solutions to Self-Test Questions 448

Planning 451

Problems 476

Solutions to Self-Test Questions 480

Chapter 17

Financial Planning 483

17.1 What Is Financial Planning? 484

Financial Planning Focuses on the Big Picture/Financial Planning Is Not Just Forecasting/Three Requirements for Effective Planning

17.2 Financial Planning Models 488

Components of a Financial Planning Model/An Example of a Planning Model/An Improved Model

17.3 Planners Beware 495

Pitfalls in Model Design/Shortcomings of Percentage of Sales Models/There Is No Finance in Financial Planning Models

17.4 External Financing and Growth 496

17.5 Summary 500

Key Terms 501

Problems 501

Solutions to Self-Test Questions 506

Chapter 18

Working Capital Management and Short-Term Planning 509

18.1 Working Capital 511

The Components of Working Capital/Working Capital and the Cash Conversion Cycle/Managing Working Capital

18.2 Links between Long-Term and Short-Term Financing 516

Short-Term Fin

Chapter 19

Cash and Inventory Management 543

19.1 Cash Collection, Disbursement, and Float 544
Float/Valuing Float

19.2 Managing Float 547

Speeding Up Collections/Controlling Disbursements

19.3 Inventories and Cash Balances 551

Managing Inventories/Managing Inventories of Cash/
Uncertain Cash Flows/Cash Management in the
Largest Corporations/Investing Idle Cash: The
Money Market

19.4 Summary 560

Key Terms 560

Problems 560

Solutions to Self-Test Questions 564

- 18.3 Tracing Changes in Cash and Working Capital 518
- 18.4 Cash Budgeting 520
Forecast Sources of Cash/Forecast Uses of Cash/
The Cash Balance
- 18.5 A Short-Term Financing Plan 524
Options for Short-Term Financing/Evaluating the Plan/
A Note on Short-Term Financial Planning Models
- 18.6 Sources of Short-Term Financing 526
Bank Loans/Commercial Paper/Secured Loans
- 18.7 The Cost of Bank Loans 528
Simple Interest/Discount Interest/Interest with
Compensating Balances
- 18.8 Summary 531
- Key Terms 532
- Problems 532
- Solutions to Self-Test Questions 536

Financial Decisions 541

Chapter 20

Credit Management and Bankruptcy 567

- 20.1 Terms of Sale 568
- 20.2 Credit Agreements 571
- 20.3 Credit Analysis 572
Financial Ratio Analysis/Numerical Credit
Scoring/When to Stop Looking for Clues
- 20.4 The Credit Decision 576
Credit Decisions with Repeat Orders/Some General
Principles
- 20.5 Collection Policy 580
- 20.6 Bankruptcy 581
Bankruptcy Procedures/The Choice between
Liquidation and Reorganization
- 20.7 Summary 584
- Key Terms 585
- Problems 585
- Solutions to Self-Test Questions 589

Chapter 21

Mergers, Acquisitions, and Corporate Control 595

- 21.1 The Market for Corporate Control 596
 - Proxy Contests/Acquisitions/Leveraged Buy-outs/Divestitures and Spin-offs
- 21.2 Sensible Motives for Mergers 600
 - Economies of Scale/Economies of Vertical Integration/Combining Complementary Resources/Mergers as a Use for Surplus Funds
- 21.3 Dubious Reasons for Mergers 602
 - Diversification/The Bootstrap Game
- 21.4 Evaluating Mergers 604
 - Mergers Financed by Cash/Mergers Financed by Stock/A Warning/Another Warning
- 21.5 Merger Tactics 609
 - The Fight for Cities Service/Takeover Defenses/Who Gets the Gains?
- 21.6 Leveraged Buy-outs 612
 - RJR Nabisco/Barbarians at the Gate?
- 21.7 Mergers and the Economy 615
 - Merger Waves/Do Mergers Generate Net Benefits?
- 21.8 Summary 617
- Key Terms 618
- Problems 618
- Solutions to Self-Test Questions 621

Chapter 22

International Financial Management 623

- 22.1 Foreign Exchange Markets 624
- 22.2 Some Basic Relationships 627
 - Exchange Rates and Inflation/Inflation and Interest Rates/Interest Rates and Exchange Rates/The Forward Rate and the Expected Spot Rate/Some Implications
- 22.3 Hedging Exchange Rate Risk 638
- 22.4 International Capital Budgeting 640
 - Net Present Value Analysis/The Cost of Capital for Foreign Investment/Avoiding Fudge Factors

- 22.5 Summary 643
- Key Terms 643
- Problems 643
- Solutions to Self-Test Questions 646

Chapter 23

Options 651

- 23.1 Calls and Puts 652
 - Selling Calls and Puts/Financial Alchemy with Options
- 23.2 What Determines Option Values 659
 - Upper and Lower Limits on Option Values/The Determinants of Option Value/Option—Valuation Models
- 23.3 Spotting the Option 663
 - Options on Real Assets/Options on Financial Assets
- 23.4 Summary 668
- Key Terms 669
- Problems 669
- Solutions to Self-Test Questions 673

Chapter 24

Risk Management 677

- 24.1 Why Hedge? 678
- 24.2 Reducing Risk with Options 679
- 24.3 Futures Contracts 681
 - The Mechanics of Futures Trading/Commodity and Financial Futures
- 24.4 Forward Contracts 687
- 24.5 Swaps 688
- 24.6 Is “Derivative” a Four-Letter Word? 691
- 24.7 Summary 691
- Key Terms 693
- Problems 693
- Solutions to Self-Test Questions 694

Chapter 25

What We Do and Do Not Know about Finance 699

25.1 What We Do Know: The Six Most Important Ideas in Finance 700

Net Present Value/Risk and Return/Efficient Capital Markets/MM's Irrelevance Propositions/Option Theory/Agency Theory

25.2 What We Do Not Know: Seven Unsolved Problems in Finance 702

How Are Major Financial Decisions Made?/What Determines Project Risk and Present Value?/ Risk and Return—Have We Missed Something?/ Are There Important Exceptions to the Efficient-Market Theory?/How Can We Explain Capital

Structure?/How Can We Resolve the Dividend
Controversy?/How Can We Explain Merger
Waves?

25.3 A Final Word 706

25.4 Quiz 707

Appendix A: Present Value Tables 713

*Appendix B: Solutions to Selected
End-of-Chapter Problems* 723

Glossary 737

Index 742