

PART I Overview

Chapter 1

Introduction to Corporate Finance 1

1.1	What Is Corporate Finance?	1
	The Balance Sheet Model of the Firm	1
	The Financial Manager	3
1.2	The Corporate Firm	4
	The Sole Proprietorship	4
	The Partnership	4
	The Corporation	5
	A Corporation by Another Name ...	7
1.3	The Importance of Cash Flows	7
1.4	The Goal of Financial Management	10
	Possible Goals	11
	The Goal of Financial Management	11
	A More General Goal	12
1.5	The Agency Problem and Control of the Corporation	13
	Agency Relationships	13
	Management Goals	14
	Do Managers Act in the Stockholders' Interests?	14
	Stakeholders	15
1.6	Regulation	16
	The Securities Act of 1933 and the Securities Exchange Act of 1934	16
	Sarbanes-Oxley	17
	Summary and Conclusions	18
	Concept Questions	18
	S&P Problems	19

Chapter 2

Financial Statements and Cash Flow 20

2.1	The Balance Sheet	20
	Liquidity	21
	Debt versus Equity	22
	Value versus Cost	22
2.2	The Income Statement	23
	Generally Accepted Accounting Principles	24
	Noncash Items	25
	Time and Costs	25
2.3	Taxes	26
	Corporate Tax Rates	26
	Average versus Marginal Tax Rates	26

2.4	Net Working Capital	28
2.5	Financial Cash Flow	28
2.6	The Accounting Statement of Cash Flows	32
	Cash Flow from Operating Activities	32
	Cash Flow from Investing Activities	32
	Cash Flow from Financing Activities	33
2.7	Cash Flow Management	34
	Summary and Conclusions	35
	Concept Questions	35
	Questions and Problems	35
	S&P Problems	41
	Mini Case: Cash Flows at Warf Computers, Inc.	41

Chapter 3

Financial Statements Analysis and Financial Models 44

3.1	Financial Statements Analysis	44
	Standardizing Statements	44
	Common-Size Balance Sheets	45
	Common-Size Income Statements	46
3.2	Ratio Analysis	48
	Short-Term Solvency or Liquidity Measures	49
	Long-Term Solvency Measures	51
	Asset Management or Turnover Measures	52
	Profitability Measures	54
	Market Value Measures	55
3.3	The Du Pont Identity	59
	A Closer Look at ROE	59
	Problems with Financial Statement Analysis	61
3.4	Financial Models	62
	A Simple Financial Planning Model	62
	The Percentage of Sales Approach	63
3.5	External Financing and Growth	68
	EFN and Growth	68
	Financial Policy and Growth	71
	A Note about Sustainable Growth	
	Rate Calculations	74
3.6	Some Caveats Regarding Financial Planning Models	75
	Summary and Conclusions	77
	Concept Questions	77
	Questions and Problems	78
	S&P Problems	84
	Mini Case: Ratios and Financial Planning at East Coast Yachts	84

PART II Valuation and Capital Budgeting

Chapter 4

Discounted Cash Flow Valuation

4.1	Valuation: The One-Period Case	87
4.2	The Multiperiod Case	91
	Future Value and Compounding	91
	The Power of Compounding: A Digression	94
	Present Value and Discounting	95
	Finding the Number of Periods	98
	The Algebraic Formula	101
4.3	Compounding Periods	101
	Distinction between Stated Annual Interest Rate and Effective Annual Rate	103
	Compounding over Many Years	104
	Continuous Compounding	104
4.4	Simplifications	106
	Perpetuity	106
	Growing Perpetuity	107
	Annuity	109
	Growing Annuity	115
4.5	Loan Amortization	116
4.6	What Is a Firm Worth?	120
	Summary and Conclusions	122
	Concept Questions	123
	Questions and Problems	123
	S&P Problems	133
Appendix 4A:	Net Present Value: First Principles of Finance	133
Appendix 4B:	Using Financial Calculators	133
	Mini Case: The MBA Decision	134

Chapter 5

Net Present Value and Other Investment Rules

5.1	Why Use Net Present Value?	135
5.2	The Payback Period Method	138
	Defining the Rule	138
	Problems with the Payback Method	139
	Managerial Perspective	140
	Summary of Payback	141
5.3	The Discounted Payback Period Method	141
5.4	The Internal Rate of Return	141
5.5	Problems with the IRR Approach	144

	Definition of Independent and Mutually Exclusive Projects	144
	Two General Problems Affecting Both Independent and Mutually Exclusive Projects	145
	Problems Specific to Mutually Exclusive Projects	149
	Redeeming Qualities of IRR	154
	A Test	154
5.6	The Profitability Index	155
	Calculation of Profitability Index	155
5.7	The Practice of Capital Budgeting	157
	Summary and Conclusions	159
	Concept Questions	160
	Questions and Problems	162
	Mini Case: Bullock Gold Mining	169

Chapter 6

Making Capital Investment Decisions

6.1	Incremental Cash Flows: The Key to Capital Budgeting	171
	Cash Flows—Not Accounting Income	171
	Sunk Costs	172
	Opportunity Costs	172
	Side Effects	173
	Allocated Costs	173
6.2	The Baldwin Company: An Example	174
	An Analysis of the Project	176
	Which Set of Books?	179
	A Note about Net Working Capital	179
	A Note about Depreciation	180
	Interest Expense	181
6.3	Inflation and Capital Budgeting	181
	Interest Rates and Inflation	181
	Cash Flow and Inflation	183
	Discounting: Nominal or Real?	184
6.4	Alternative Definitions of Operating Cash Flow	186
	The Top-Down Approach	187
	The Bottom-Up Approach	187
	The Tax Shield Approach	188
	Conclusion	189
6.5	Investments of Unequal Lives: The Equivalent Annual Cost Method	189
	The General Decision to Replace	191
	Summary and Conclusions	193
	Concept Questions	194
	Questions and Problems	195
	Mini Cases: Bethesda Mining Company	203
	Goodweek Tires, Inc.	204

Chapter 7

Risk Analysis, Real Options, and Capital Budgeting

206

7.1 Sensitivity Analysis, Scenario Analysis, and Break-Even Analysis	206
Sensitivity Analysis and Scenario Analysis	206
Break-Even Analysis	210
7.2 Monte Carlo Simulation	214
Step 1: Specify the Basic Model	214
Step 2: Specify a Distribution for Each Variable in the Model	214
Step 3: The Computer Draws One Outcome	217
Step 4: Repeat the Procedure	217
Step 5: Calculate NPV	218
7.3 Real Options	218
The Option to Expand	219
The Option to Abandon	220
Timing Options	222
7.4 Decision Trees	223
Summary and Conclusions	225
Concept Questions	225
Questions and Problems	226
Mini Case: Bunyan Lumber, LLC	232

Chapter 8

Interest Rates and Bond Valuation

234

8.1 Bonds and Bond Valuation	234
Bond Features and Prices	234
Bond Values and Yields	235
Interest Rate Risk	238
Finding the Yield to Maturity: More Trial and Error	240
Zero Coupon Bonds	242
8.2 Government and Corporate Bonds	244
Government Bonds	244
Corporate Bonds	245
Bond Ratings	247
8.3 Bond Markets	248
How Bonds Are Bought and Sold	248
Bond Price Reporting	249
A Note on Bond Price Quotes	252
8.4 Inflation and Interest Rates	253
Real versus Nominal Rates	253
Inflation Risk and Inflation-Linked Bonds	254
The Fisher Effect	255
8.5 Determinants of Bond Yields	257
The Term Structure of Interest Rates	257
Bond Yields and the Yield Curve: Putting It All Together	260

Conclusion	261
Summary and Conclusions	261
Concept Questions	261
Questions and Problems	263
S&P Problem	266
Mini Case: Financing East Coast Yachts's Expansion Plans with a Bond Issue	266

Chapter 9

Stock Valuation

268

9.1 The Present Value of Common Stocks	268
Dividends versus Capital Gains	268
Valuation of Different Types of Stocks	269
9.2 Estimates of Parameters in the Dividend Discount Model	273
Where Does g Come From?	273
Where Does R Come From?	275
A Healthy Sense of Skepticism	276
A Note on the Link between Dividends and Corporate Cash Flows	277
9.3 Growth Opportunities	278
NPVGOs of Real-World Companies	280
Growth in Earnings and Dividends versus Growth Opportunities	281
Does a Higher Retention Ratio Benefit Shareholders?	282
Dividends or Earnings: Which to Discount?	284
The No-Dividend Firm	284
9.4 Price-Earnings Ratio	285
9.5 The Stock Markets	287
Dealers and Brokers	287
Organization of the NYSE	288
NASDAQ Operations	290
Stock Market Reporting	291
Summary and Conclusions	292
Concept Questions	293
Questions and Problems	293
S&P Problems	297
Mini Case: Stock Valuation at Ragan Engines	298

PART III Risk

Chapter 10

Risk and Return: Lessons from Market History

300

10.1 Returns	300
Dollar Returns	300
Percentage Returns	302

10.2 Holding Period Returns	304
10.3 Return Statistics	307
10.4 Average Stock Returns and Risk-Free Returns	311
10.5 Risk Statistics	312
Variance	313
Normal Distribution and Its Implications for Standard Deviation	314
10.6 More on Average Returns	315
Arithmetic versus Geometric Averages	315
Calculating Geometric Average Returns	316
Arithmetic Average Return or Geometric Average Return?	317
10.7 The U.S. Equity Risk Premium: Historical and International Perspectives	318
10.8 2008: A Year of Financial Crisis	321
Summary and Conclusions	322
Concept Questions	322
Questions and Problems	323
S&P Problems	326
Appendix 10A: The Historical Market Risk Premium: The Very Long Run	326
Mini Case: A Job at East Coast Yachts	327

Chapter 11

Return and Risk: The Capital Asset Pricing Model (CAPM) **329**

11.1 Individual Securities	329
11.2 Expected Return, Variance, and Covariance	330
Expected Return and Variance	330
Covariance and Correlation	332
11.3 The Return and Risk for Portfolios	335
The Expected Return on a Portfolio	335
Variance and Standard Deviation of a Portfolio	336
11.4 The Efficient Set for Two Assets	339
11.5 The Efficient Set for Many Securities	344
Variance and Standard Deviation in a Portfolio of Many Assets	345
11.6 Diversification	347
The Anticipated and Unanticipated Components of News	347
Risk: Systematic and Unsystematic	347
The Essence of Diversification	348
11.7 Riskless Borrowing and Lending	350
The Optimal Portfolio	352
11.8 Market Equilibrium	353
Definition of the Market Equilibrium Portfolio	353
Definition of Risk When Investors Hold the Market Portfolio	354

The Formula for Beta	356
A Test	357
11.9 Relationship between Risk and Expected Return (CAPM)	357
Expected Return on Market	357
Expected Return on Individual Security	358
Summary and Conclusions	361
Concept Questions	362
Questions and Problems	363
S&P Problem	369
Appendix 11A: Is Beta Dead?	369
Mini Case: A Job at East Coast Yachts, Part 2	369

Chapter 12

An Alternative View of Risk and Return: The Arbitrage Pricing Theory **371**

12.1 Introduction	371
12.2 Systematic Risk and Betas	371
12.3 Portfolios and Factor Models	374
Portfolios and Diversification	376
12.4 Betas, Arbitrage, and Expected Returns	379
The Linear Relationship	379
The Market Portfolio and the Single Factor	380
12.5 The Capital Asset Pricing Model and the Arbitrage Pricing Theory	381
Differences in Pedagogy	381
Differences in Application	381
12.6 Empirical Approaches to Asset Pricing	383
Empirical Models	383
Style Portfolios	384
Summary and Conclusions	386
Concept Questions	386
Questions and Problems	387
Mini Case: The Fama–French Multifactor Model and Mutual Fund Returns	391

Chapter 13

Risk, Cost of Capital, and Capital Budgeting **392**

13.1 The Cost of Equity Capital	392
13.2 Estimating the Cost of Equity Capital with the CAPM	393
The Risk-Free Rate	396
Market Risk Premium	396
13.3 Estimation of Beta	398
Real-World Betas	398
Stability of Beta	399
Using an Industry Beta	400

13.4 Beta, Covariance, and Correlation	401	The Semistrong Form	439
Beta and Covariance	402	The Strong Form	443
Beta and Correlation	402	14.5 The Behavioral Challenge to Market Efficiency	443
13.5 Determinants of Beta	404	14.6 Empirical Challenges to Market Efficiency	445
Cyclicalities of Revenues	404	14.7 Reviewing the Differences	451
Operating Leverage	404	Representativeness	451
Financial Leverage and Beta	404	Conservatism	452
13.6 Dividend Discount Model	406	The Academic Viewpoints	452
Comparison of DDM and CAPM	406	14.8 Implications for Corporate Finance	453
Can a Low-Dividend or a No-Dividend Stock Have a High Cost of Capital?	407	1. Accounting Choices, Financial Choices, and Market Efficiency	453
13.7 Cost of Capital for Divisions and Projects	408	2. The Timing Decision	454
13.8 Cost of Fixed Income Securities	410	3. Speculation and Efficient Markets	455
Cost of Debt	410	4. Information in Market Prices	457
Cost of Preferred Stock	412	Summary and Conclusions	460
13.9 The Weighted Average Cost of Capital	412	Concept Questions	460
13.10 Estimating Eastman Chemical's Cost of Capital	415	Questions and Problems	463
13.11 Flotation Costs and the Weighted Average Cost of Capital	417	Mini Case: Your 401(k) Account at East Coast Yachts	465
The Basic Approach	417		
Flotation Costs and NPV	418		
Internal Equity and Flotation Costs	419		
Summary and Conclusions	419		
Concept Questions	420		
Questions and Problems	421		
Appendix 13A: Economic Value Added and the Measurement of Financial Performance	426		
Mini Case: The Cost of Capital for Goff Computer, Inc.	426		

PART IV Capital Structure and Dividend Policy

Chapter 14

Efficient Capital Markets and Behavioral Challenges 428

14.1 Can Financing Decisions Create Value?	428
14.2 A Description of Efficient Capital Markets	430
Foundations of Market Efficiency	432
14.3 The Different Types of Efficiency	433
The Weak Form	433
The Semistrong and Strong Forms	435
Some Common Misconceptions about the Efficient Market Hypothesis	436
14.4 The Evidence	437
The Weak Form	437

Chapter 15

Long-Term Financing: An Introduction 467

15.1 Some Features of Common and Preferred Stocks	467
Common Stock Features	467
Preferred Stock Features	470
15.2 Corporate Long-Term Debt	472
Is It Debt or Equity?	472
Long-Term Debt: The Basics	472
The Indenture	474
15.3 Some Different Types of Bonds	477
Floating-Rate Bonds	477
Other Types of Bonds	478
15.4 Long-Term Syndicated Bank Loans	479
15.5 International Bonds	480
15.6 Patterns of Financing	480
15.7 Recent Trends in Capital Structure	482
Which Are Best: Book or Market Values?	483
Summary and Conclusions	484
Concept Questions	484
Questions and Problems	485

Chapter 16

Capital Structure: Basic Concepts 488

16.1 The Capital Structure Question and the Pie Theory	488
16.2 Maximizing Firm Value versus Maximizing Stockholder Interests	489

16.3 Financial Leverage and Firm Value: An Example	491	17.8 Growth and the Debt–Equity Ratio	540
Leverage and Returns to Shareholders	491	No Growth	540
The Choice between Debt and Equity	493	Growth	541
A Key Assumption	495	17.9 Personal Taxes	542
16.4 Modigliani and Miller: Proposition II (No Taxes)	495	The Basics of Personal Taxes	542
Risk to Equityholders Rises with Leverage	495	The Effect of Personal Taxes on Capital Structure	543
Proposition II: Required Return to Equityholders Rises with Leverage	496	17.10 How Firms Establish Capital Structure	544
MM: An Interpretation	502	Summary and Conclusions	548
16.5 Taxes	504	Concept Questions	548
The Basic Insight	504	Questions and Problems	549
Present Value of the Tax Shield	506	Appendix 17A: Some Useful Formulas of Financial Structure	552
Value of the Levered Firm	506	Appendix 17B: The Miller Model and the Graduated Income Tax	552
Expected Return and Leverage under Corporate Taxes	508	Mini Case: McKenzie Corporation's Capital Budgeting	552
The Weighted Average Cost of Capital, R_{WACC} , and Corporate Taxes	510		
Stock Price and Leverage under Corporate Taxes	511		
Summary and Conclusions	513		
Concept Questions	513		
Questions and Problems	514		
S&P Problems	518		
Mini Case: Stephenson Real Estate Recapitalization	519		

Chapter 17

Capital Structure: Limits to the Use of Debt

520

17.1 Costs of Financial Distress	520
Bankruptcy Risk or Bankruptcy Cost?	520
17.2 Description of Financial Distress Costs	523
Direct Costs of Financial Distress: Legal and Administrative Costs of Liquidation or Reorganization	523
Indirect Costs of Financial Distress	524
Agency Costs	525
17.3 Can Costs of Debt Be Reduced?	528
Protective Covenants	528
Consolidation of Debt	529
17.4 Integration of Tax Effects and Financial Distress Costs	530
Pie Again	531
17.5 Signaling	533
17.6 Shirking, Perquisites, and Bad Investments: A Note on Agency Cost of Equity	534
Effect of Agency Costs of Equity on Debt–Equity Financing	536
Free Cash Flow	536
17.7 The Pecking-Order Theory	537
Rules of the Pecking Order	538
Implications	539

Chapter 18

Valuation and Capital Budgeting for the Levered Firm

553

18.1 Adjusted Present Value Approach	553
18.2 Flow to Equity Approach	555
Step 1: Calculating Levered Cash Flow (LCF)	555
Step 2: Calculating R_s	556
Step 3: Valuation	556
18.3 Weighted Average Cost of Capital Method	556
18.4 A Comparison of the APV, FTE, and WACC Approaches	557
A Suggested Guideline	558
18.5 Capital Budgeting When the Discount Rate Must Be Estimated	560
18.6 APV Example	562
18.7 Beta and Leverage	565
The Project Is Not Scale Enhancing	567
Summary and Conclusions	568
Concept Questions	568
Questions and Problems	569
S&P Problem	572
Appendix 18A: The Adjusted Present Value Approach to Valuing Leveraged Buyouts	573
Mini Case: The Leveraged Buyout of Cheek Products, Inc.	573

Chapter 19

Dividends and Other Payouts

575

19.1 Different Types of Payouts	575
19.2 Standard Method of Cash Dividend Payment	575

19.3 The Benchmark Case: An Illustration of the Irrelevance of Dividend Policy	578
Current Policy: Dividends Set Equal to Cash Flow	578
Alternative Policy: Initial Dividend Is Greater Than Cash Flow	578
The Indifference Proposition	579
Homemade Dividends	580
A Test	581
Dividends and Investment Policy	582
19.4 Repurchase of Stock	582
Dividend versus Repurchase: Conceptual Example	583
Dividends versus Repurchases: Real-World Considerations	584
19.5 Personal Taxes, Dividends, and Stock Repurchases	586
Firms without Sufficient Cash to Pay a Dividend	586
Firms with Sufficient Cash to Pay a Dividend	587
Summary of Personal Taxes	589
19.6 Real-World Factors Favoring a High-Dividend Policy	590
Desire for Current Income	590
Behavioral Finance	590
Agency Costs	591
Information Content of Dividends and Dividend Signaling	592
19.7 The Clientele Effect: A Resolution of Real-World Factors?	595
19.8 What We Know and Do Not Know about Dividend Policy	597
Corporate Dividends Are Substantial	597
Fewer Companies Pay Dividends	598
Corporations Smooth Dividends	599
Some Survey Evidence about Dividends	600
19.9 Putting It All Together	602
19.10 Stock Dividends and Stock Splits	604
Some Details about Stock Splits and Stock Dividends	604
Value of Stock Splits and Stock Dividends	606
Reverse Splits	607
Summary and Conclusions	608
Concept Questions	608
Questions and Problems	610
S&P Problem	614
Mini Case: Electronic Timing, Inc.	614

PART V Long-Term Financing

Chapter 20

Issuing Securities to the Public 616

20.1 The Public Issue	616
The Basic Procedure for a New Issue	616
20.2 Alternative Issue Methods	617
20.3 The Cash Offer	619
Investment Banks	622
The Offering Price	623
Underpricing: A Possible Explanation	624
20.4 What CFOs Say about the IPO Process	627
20.5 The Announcement of New Equity and the Value of the Firm	628
20.6 The Cost of New Issues	629
The Costs of Going Public: The Case of Symbion	632
20.7 Rights	633
The Mechanics of a Rights Offering	633
Subscription Price	634
Number of Rights Needed to Purchase a Share	634
Effect of Rights Offering on Price of Stock	635
Effects on Shareholders	636
The Underwriting Arrangements	637
20.8 The Rights Puzzle	637
20.9 Dilution	639
Dilution of Proportionate Ownership	639
Dilution of Value: Book versus Market Values	640
20.10 Shelf Registration	641
20.11 The Private Equity Market	642
Private Placement	642
The Private Equity Firm	643
Suppliers of Venture Capital	643
Stages of Financing	644
Summary and Conclusions	646
Concept Questions	646
Questions and Problems	648
Mini Case: East Coast Yachts Goes Public	651

Chapter 21

Leasing 652

21.1 Types of Leases	652
The Basics	652
Operating Leases	652
Financial Leases	653

21.2	Accounting and Leasing	654
21.3	Taxes, the IRS, and Leases	656
21.4	The Cash Flows of Leasing	656
21.5	A Detour for Discounting and Debt Capacity with Corporate Taxes	658
	Present Value of Riskless Cash Flows	659
	Optimal Debt Level and Riskless Cash Flows	660
21.6	NPV Analysis of the Lease-versus-Buy Decision	660
	The Discount Rate	661
21.7	Debt Displacement and Lease Valuation	661
	The Basic Concept of Debt Displacement	661
	Optimal Debt Level in the Xomox Example	662
21.8	Does Leasing Ever Pay? The Base Case	665
21.9	Reasons for Leasing	666
	Good Reasons for Leasing	666
	Bad Reasons for Leasing	669
21.10	Some Unanswered Questions	670
	Are the Uses of Leases and Debt Complementary?	670
	Why Are Leases Offered by Both Manufacturers and Third-Party Lessors?	670
	Why Are Some Assets Leased More Than Others?	671
	Summary and Conclusions	671
	Concept Questions	671
	Questions and Problems	672
Appendix 21A:	APV Approach to Leasing	674
	Mini Case: The Decision to Lease or Buy at Warf Computers	675

PART VI Options, Futures, and Corporate Finance

Chapter 22

Options and Corporate Finance 676

22.1	Options	676
22.2	Call Options	677
	The Value of a Call Option at Expiration	677
22.3	Put Options	678
	The Value of a Put Option at Expiration	678
22.4	Selling Options	680
22.5	Option Quotes	681
22.6	Combinations of Options	682
22.7	Valuing Options	685
	Bounding the Value of a Call	685
	The Factors Determining Call Option Values	687

	A Quick Discussion of Factors Determining Put Option Values	690
22.8	An Option Pricing Formula	690
	A Two-State Option Model	691
	The Black–Scholes Model	693
22.9	Stocks and Bonds as Options	698
	The Firm Expressed in Terms of Call Options	699
	The Firm Expressed in Terms of Put Options	700
	A Resolution of the Two Views	701
	A Note about Loan Guarantees	702
22.10	Options and Corporate Decisions: Some Applications	703
	Mergers and Diversification	703
	Options and Capital Budgeting	705
22.11	Investment in Real Projects and Options	707
	Summary and Conclusions	709
	Concept Questions	710
	Questions and Problems	711
	Mini Case: Clissold Industries Options	718

Chapter 23

Options and Corporate Finance: Extensions and Applications 719

23.1	Executive Stock Options	719
	Why Options?	719
	Valuing Executive Compensation	720
23.2	Valuing a Start-Up	723
23.3	More about the Binomial Model	726
	Heating Oil	727
23.4	Shutdown and Reopening Decisions	733
	Valuing a Gold Mine	733
	The Abandonment and Opening Decisions	734
	Valuing the Simple Gold Mine	735
	Summary and Conclusions	740
	Concept Questions	740
	Questions and Problems	741
	Mini Case: Exotic Cuisines Employee Stock Options	742

Chapter 24

Warrants and Convertibles 744

24.1	Warrants	744
24.2	The Difference between Warrants and Call Options	745
	How the Firm Can Hurt Warrant Holders	748
24.3	Warrant Pricing and the Black–Scholes Model	748
24.4	Convertible Bonds	749

24.5	The Value of Convertible Bonds	750
	Straight Bond Value	750
	Conversion Value	750
	Option Value	751
24.6	Reasons for Issuing Warrants and Convertibles	753
	Convertible Debt versus Straight Debt	753
	Convertible Debt versus Common Stock	753
	The "Free Lunch" Story	754
	The "Expensive Lunch" Story	755
	A Reconciliation	755
24.7	Why Are Warrants and Convertibles Issued?	755
	Matching Cash Flows	756
	Risk Synergy	756
	Agency Costs	756
	Backdoor Equity	757
24.8	Conversion Policy	757
	Summary and Conclusions	758
	Concept Questions	759
	Questions and Problems	759
	Mini Case: S&S Air's Convertible Bond	762

Chapter 25

Derivatives and Hedging Risk

25.1	Derivatives, Hedging, and Risk	763
25.2	Forward Contracts	764
25.3	Futures Contracts	765
25.4	Hedging	769
25.5	Interest Rate Futures Contracts	771
	Pricing of Treasury Bonds	771
	Pricing of Forward Contracts	772
	Futures Contracts	773
	Hedging in Interest Rate Futures	774
25.6	Duration Hedging	778
	The Case of Zero Coupon Bonds	778
	The Case of Two Bonds with the Same Maturity but with Different Coupons	779
	Duration	780
	Matching Liabilities with Assets	782
25.7	Swaps Contracts	784
	Interest Rate Swaps	784
	Currency Swaps	786
	Credit Default Swap (CDS)	786
	Exotics	787
25.8	Actual Use of Derivatives	789
	Summary and Conclusions	790
	Concept Questions	790
	Questions and Problems	792
	Mini Case: Williamson Mortgage, Inc.	794

PART VII Short-Term Finance

Chapter 26

Short-Term Finance and Planning 795

26.1	Tracing Cash and Net Working Capital	796
26.2	The Operating Cycle and the Cash Cycle	797
	Defining the Operating and Cash Cycles	798
	The Operating Cycle and the Firm's Organization Chart	800
	Calculating the Operating and Cash Cycles	800
	Interpreting the Cash Cycle	803
	A Look at Operating and Cash Cycles	803
26.3	Some Aspects of Short-Term Financial Policy	804
	The Size of the Firm's Investment in Current Assets	805
	Alternative Financing Policies for Current Assets	808
	Which Is Best?	809
26.4	Cash Budgeting	810
	Cash Outflow	811
	The Cash Balance	812
26.5	The Short-Term Financial Plan	812
	Unsecured Loans	812
	Secured Loans	813
	Other Sources	813
	Summary and Conclusions	813
	Concept Questions	814
	Questions and Problems	814
	S&P Problems	822
	Mini Case: Keafer Manufacturing Working Capital Management	822

Chapter 27

Cash Management 824

27.1	Reasons for Holding Cash	824
	The Speculative and Precautionary Motives	824
	The Transaction Motive	825
	Compensating Balances	825
	Costs of Holding Cash	825
	Cash Management versus Liquidity Management	825
27.2	Understanding Float	826
	Disbursement Float	826
	Collection Float and Net Float	827
	Float Management	828
	Electronic Data Interchange and Check 21: The End of Float?	831

27.3 Cash Collection and Concentration	832	28.6 Collection Policy	859
Components of Collection Time	832	Monitoring Receivables	859
Cash Collection	833	Collection Effort	860
Lockboxes	833	28.7 Inventory Management	861
Cash Concentration	834	The Financial Manager and Inventory Policy	861
Accelerating Collections: An Example	835	Inventory Types	861
27.4 Managing Cash Disbursements	837	Inventory Costs	862
Increasing Disbursement Float	837	28.8 Inventory Management Techniques	862
Controlling Disbursements	838	The ABC Approach	863
27.5 Investing Idle Cash	839	The Economic Order Quantity Model	863
Temporary Cash Surpluses	839	Extensions to the EOQ Model	867
Characteristics of Short-Term Securities	840	Managing Derived-Demand Inventories	869
Some Different Types of Money Market Securities	840	Summary and Conclusions	870
Summary and Conclusions	841	Concept Questions	870
Concept Questions	842	Questions and Problems	871
Questions and Problems	843	Appendix 28A: More about Credit Policy Analysis	874
Appendix 27A: Determining the Target Cash Balance	845	Mini Case: Credit Policy at Braam Industries	874
Appendix 27B: Adjustable Rate Preferred Stock, Auction Rate Preferred Stock, and Floating-Rate Certificates of Deposit	845		
Mini Case: Cash Management at Richmond Corporation	845		

Chapter 28

Credit and Inventory Management 846

28.1 Credit and Receivables	846	29.1 The Basic Forms of Acquisitions	875
Components of Credit Policy	846	Merger or Consolidation	875
The Cash Flows from Granting Credit	847	Acquisition of Stock	876
The Investment in Receivables	847	Acquisition of Assets	876
28.2 Terms of the Sale	848	A Classification Scheme	877
The Basic Form	848	A Note about Takeovers	877
The Credit Period	848	29.2 Synergy	878
Cash Discounts	850	29.3 Sources of Synergy	879
Credit Instruments	851	Revenue Enhancement	879
28.3 Analyzing Credit Policy	852	Cost Reduction	880
Credit Policy Effects	852	Tax Gains	882
Evaluating a Proposed Credit Policy	852	Reduced Capital Requirements	884
28.4 Optimal Credit Policy	854	29.4 Two Financial Side Effects of Acquisitions	885
The Total Credit Cost Curve	855	Earnings Growth	885
Organizing the Credit Function	856	Diversification	886
28.5 Credit Analysis	856	29.5 A Cost to Stockholders from Reduction in Risk	887
When Should Credit Be Granted?	857	The Base Case	887
Credit Information	858	Both Firms Have Debt	887
Credit Evaluation and Scoring	859	How Can Shareholders Reduce Their Losses from the Coinsurance Effect?	889
		29.6 The NPV of a Merger	889
		Cash	889
		Common Stock	891
		Cash versus Common Stock	892

PART VIII Special Topics

Chapter 29

Mergers, Acquisitions, and Divestitures 875

29.7	Friendly versus Hostile Takeovers	893
29.8	Defensive Tactics	895
	Deterring Takeovers before Being in Play	896
	Deterring a Takeover after the Company Is in Play	898
29.9	Do Mergers Add Value?	899
	Returns to Bidders	900
	Target Companies	901
	The Managers versus the Stockholders	903
29.10	The Tax Forms of Acquisitions	904
29.11	Accounting for Acquisitions	905
29.12	Going Private and Leveraged Buyouts	906
29.13	Divestitures	906
	Sale	907
	Spin-Off	907
	Carve-Out	908
	Tracking Stocks	908
	Summary and Conclusions	909
	Concept Questions	910
	Questions and Problems	915
	Mini Case: The Birdie Golf-Hybrid Golf Merger	

Chapter 30

Financial Distress

30.1	What Is Financial Distress?	917
30.2	What Happens in Financial Distress?	918
30.3	Bankruptcy Liquidation and Reorganization	921
	Bankruptcy Liquidation	921
	Bankruptcy Reorganization	924
30.4	Private Workout or Bankruptcy: Which Is Best?	926
	The Marginal Firm	927
	Holdouts	927
	Complexity	927
	Lack of Information	928
30.5	Prepackaged Bankruptcy	928
30.6	Predicting Corporate Bankruptcy: The Z-Score Model	929
	Summary and Conclusions	931
	Concept Questions	931
	Questions and Problems	932

Chapter 31

International Corporate Finance 933

31.1	Terminology	934
31.2	Foreign Exchange Markets and Exchange Rates	934
	Exchange Rates	935
31.3	Purchasing Power Parity	939
	Absolute Purchasing Power Parity	940
	Relative Purchasing Power Parity	943
31.4	Interest Rate Parity, Unbiased Forward Rates, and the International Fisher Effect	945
	Covered Interest Arbitrage	945
	Interest Rate Parity	946
	Forward Rates and Future Spot Rates	947
	Putting It All Together	948
31.5	International Capital Budgeting	949
	Method 1: The Home Currency Approach	950
	Method 2: The Foreign Currency Approach	950
	Unremitted Cash Flows	951
	The Cost of Capital for International Firms	951
31.6	Exchange Rate Risk	952
	Short-Term Exposure	952
	Long-Term Exposure	953
	Translation Exposure	954
	Managing Exchange Rate Risk	955
31.7	Political Risk	955
	Summary and Conclusions	956
	Concept Questions	957
	Questions and Problems	958
	S&P Problem	961
	Mini Case: East Coast Yachts Goes International	961

Appendix A: Mathematical Tables 963

Appendix B: Solutions to Selected End-of-Chapter Problems 972

Name Index 975

Subject Index 978