

Brief Contents

Preface vii

I Part One: Value

- 1 Introduction to Corporate Finance 1
- 2 How to Calculate Present Values 20
- 3 Valuing Bonds 46
- 4 The Value of Common Stocks 77
- 5 Net Present Value and Other Investment Criteria 108
- 6 Making Investment Decisions with the Net Present Value Rule 135

I Part Two: Risk

- 7 Introduction to Risk and Return 167
- 8 Portfolio Theory and the Capital Asset Pricing Model 198
- 9 Risk and the Cost of Capital 228

I Part Three: Best Practices in Capital Budgeting

- 10 Project Analysis 257
- 11 How to Ensure that Projects Truly Have Positive NPVs 284
- 12 Agency Problems and Investment 311

I Part Four: Financing Decisions and Market Efficiency

- 13 Efficient Markets and Behavioral Finance 337
- 14 An Overview of Corporate Financing 365
- 15 How Corporations Issue Securities 391

I Part Five: Payout Policy and Capital Structure

- 16 Payout Policy 425
- 17 Does Debt Policy Matter? 451

- 18 How Much Should a Corporation Borrow? 475
- 19 Financing and Valuation 507

I Part Six: Options

- 20 Understanding Options 542
- 21 Valuing Options 563
- 22 Real Options 590

I Part Seven: Debt Financing

- 23 Credit Risk and the Value of Corporate Debt 614
- 24 The Many Different Kinds of Debt 631
- 25 Leasing 663

I Part Eight: Risk Management

- 26 Managing Risk 683
- 27 Managing International Risks 717

I Part Nine: Financial Planning and Working Capital Management

- 28 Financial Analysis 743
- 29 Financial Planning 770
- 30 Working Capital Management 801

I Part Ten: Mergers, Corporate Control, and Governance

- 31 Mergers 830
- 32 Corporate Restructuring 863
- 33 Governance and Corporate Control around the World 888

I Part Eleven: Conclusion

- 34 Conclusion: What We Do and Do Not Know about Finance 909

Preface vii

I Part One: Value

1 Introduction to Corporate Finance 1

- 1-1 Corporate Investment and Financing Decisions 2**
Investment Decisions/Financing Decisions/What Is a Corporation?/The Role of the Financial Manager
- 1-2 The Financial Goal of the Corporation 7**
Shareholders Want Managers to Maximize Market Value/A Fundamental Result/The Investment Trade-Off/Should Managers Look After the Interests of Their Shareholders?/Agency Problems and Corporate Governance
- 1-3 Preview of Coming Attractions 13**
- Summary 15 • Problem Sets 15 • Appendix: Why Maximizing Shareholder Value Makes Sense 18

2 How to Calculate Present Values 20

- 2-1 Future Values and Present Values 20**
Calculating Future Values/Calculating Present Values/Valuing an Investment Opportunity/Net Present Value/Risk and Present Value/Present Values and Rates of Return/Calculating Present Values When There Are Multiple Cash Flows/The Opportunity Cost of Capital
- 2-2 Looking for Shortcuts—Perpetuities and Annuities 28**
How to Value Perpetuities/How to Value Annuities/Valuing Annuities Due/Calculating Annual Payments/Future Value of an Annuity
- 2-3 More Shortcuts—Growing Perpetuities and Annuities 34**
Growing Perpetuities/Growing Annuities

- 2-4 How Interest Is Paid and Quoted 36**
Continuous Compounding

Summary 39 • Problem Sets 40 • Finance on the Web 45

3 Valuing Bonds 46

- 3-1 Using the Present Value Formula to Value Bonds 47**
A Short Trip to Paris to Value a Government Bond/Back to the United States: Semiannual Coupons and Bond Prices
- 3-2 How Bond Prices Vary with Interest Rates 50**
Duration and Volatility
- 3-3 The Term Structure of Interest Rates 56**
Spot Rates, Bond Prices, and the Law of One Price/Measuring the Term Structure/Why the Discount Factor Declines as Futurity Increases—and a Digression on Money Machines
- 3-4 Explaining the Term Structure 60**
Expectations Theory of the Term Structure/Introducing Risk/Inflation and Term Structure
- 3-5 Real and Nominal Rates of Interest 62**
Indexed Bonds and the Real Rate of Interest/What Determines the Real Rate of Interest?/Inflation and Nominal Interest Rates
- 3-6 The Risk of Default 67**
Corporate Bonds and Default Risk/Sovereign Bonds and Default Risk

Summary 70 • Further Reading 71 • Problem Sets 71
Finance on the Web 76

4 The Value of Common Stocks 77

- 4-1 How Common Stocks Are Traded 78**
Trading Results for Boeing
- 4-2 How Common Stocks Are Valued 80**
Valuation by Comparables/Stock Prices and Dividends

- 4-3** Estimating the Cost of Equity Capital 87
Using the DCF Model to Set Water, Gas, and Electricity Prices/Dangers Lurk in Constant-Growth Formulas
- 4-4** The Link between Stock Price and Earnings per Share 92
Calculating the Present Value of Growth Opportunities for Fledgling Electronics
- 4-5** Valuing a Business by Discounted Cash Flow 95
Valuing the Concatenator Business/Valuation Format/Estimating Horizon Value/Free Cash Flow, Dividends, and Repurchases

Summary 100 • Problem Sets 101 • Finance on the Web 106 • Mini-Case: Reeby Sports 106

Net Present Value and Other Investment Criteria 108

- 5-1** A Review of the Basics 108
Net Present Value's Competitors/Three Points to Remember about NPV
- 5-2** Book Rate of Return and Payback 111
Book Rate of Return/Payback/Discounted Payback
- 5-3** Internal (or Discounted Cash Flow) Rate of Return 114
Calculating the IRR/The IRR Rule/Pitfall 1—Lending or Borrowing?/Pitfall 2—Multiple Rates of Return/Pitfall 3—Mutually Exclusive Projects/Pitfall 4—What Happens When There Is More Than One Opportunity Cost of Capital/The Verdict on IRR
- 5-4** Choosing Capital Investments When Resources Are Limited 122
An Easy Problem in Capital Rationing/Uses of Capital Rationing Models

Summary 126 • Further Reading 127 • Problem Sets 127 • Mini-Case: Vegetron's CFO Calls Again 132

6 Making Investment Decisions with the Net Present Value Rule 135

- 6-1** Applying the Net Present Value Rule 135
Rule 1: Discount Cash Flows, Not Profits/Rule 2: Discount Incremental Cash Flows/Rule 3: Treat

Inflation Consistently/Rule 4: Separate Investment and Financing Decisions/Rule 5: Remember to Deduct Taxes

- 6-2** Corporate Income Taxes 142
U.S. Corporate Income Tax Reform
- 6-3** Example—IM&C's Fertilizer Project 144
The Three Elements of Project Cash Flows/Forecasting the Fertilizer Project's Cash Flows/Accelerated Depreciation and First-Year Expensing/Final Comments on Taxes/Project Analysis/Calculating NPV in Other Countries and Currencies
- 6-4** Using the NPV Rule to Choose among Projects 151
Problem 1: The Investment Timing Decision/Problem 2: The Choice between Long- and Short-Lived Equipment/Problem 3: When to Replace an Old Machine/Problem 4: Cost of Excess Capacity

Summary 156 • Further Reading 157 • Problem Sets 157 • Mini-Case: New Economy Transport (A) 165 • New Economy Transport (B) 166

Part Two: Risk

7 Introduction to Risk and Return 167

- 7-1** Over a Century of Capital Market History in One Easy Lesson 167
Arithmetic Averages and Compound Annual Returns/Using Historical Evidence to Evaluate Today's Cost of Capital
- 7-2** Diversification and Portfolio Risk 174
Variance and Standard Deviation/Measuring Variability/How Diversification Reduces Risk
- 7-3** Calculating Portfolio Risk 181
General Formula for Computing Portfolio Risk/Do I Really Have to Add up 36 Million Boxes?
- 7-4** How Individual Securities Affect Portfolio Risk 185
Market Risk Is Measured by Beta/Why Security Betas Determine Portfolio Risk

7-5 Diversification and Value Additivity 189
 Summary 190 • Further Reading 191 • Problem Sets
 191 • Finance on the Web 197

8 Portfolio Theory and the Capital Asset Pricing Model 198

- 8-1 Harry Markowitz and the Birth of Portfolio Theory 198
Combining Stocks into Portfolios/We Introduce Borrowing and Lending
- 8-2 The Relationship between Risk and Return 205
Some Estimates of Expected Returns/Review of the Capital Asset Pricing Model/What If a Stock Did Not Lie on the Security Market Line?
- 8-3 Validity and Role of the Capital Asset Pricing Model 208
Tests of the Capital Asset Pricing Model/Assumptions behind the Capital Asset Pricing Model
- 8-4 Some Alternative Theories 213
Arbitrage Pricing Theory/A Comparison of the Capital Asset Pricing Model and Arbitrage Pricing Theory/The Three-Factor Model

Summary 217 • Further Reading 218 • Problem Sets
 219 • Finance on the Web 225 • Mini-Case: John and
 Marsha on Portfolio Selection 225

9 Risk and the Cost of Capital 228

- 9-1 Company and Project Costs of Capital 229
Perfect Pitch and the Cost of Capital/Debt and the Company Cost of Capital
- 9-2 Measuring the Cost of Equity 232
Estimating Beta/The Expected Return on CSX's Common Stock/CSX's After-Tax Weighted-Average Cost of Capital/CSX's Asset Beta
- 9-3 Analyzing Project Risk 236
What Determines Asset Betas?/Don't Be Fooled by Diversifiable Risk/Avoid Fudge Factors in Discount Rates/Discount Rates for International Projects

- 9-4 Certainty Equivalents—Another Way to Adjust for Risk 242
Valuation by Certainty Equivalents/When to Use a Single Risk-Adjusted Discount Rate for Long-Lived Assets/A Common Mistake/When You Cannot Use a Single Risk-Adjusted Discount Rate for Long-Lived Assets

Summary 248 • Further Reading 249 • Problem Sets
 249 • Finance on the Web 254 • Mini-Case: The
 Jones Family Incorporated 254

I Part Three: Best Practices in Capital Budgeting

10 Project Analysis 257

- 10-1 Sensitivity and Scenario Analysis 258
Value of Information/Limits to Sensitivity Analysis/Scenario Analysis
- 10-2 Break-Even Analysis and Operating Leverage 262
Break-Even Analysis/Operating Leverage and the Break-Even Point
- 10-3 Monte Carlo Simulation 264
Simulating the Electric Scooter Project
- 10-4 Real Options and Decision Trees 266
The Option to Expand/The Option to Abandon/Production Options/Timing Options/More on Decision Trees/Pro and Con Decision Trees

Summary 274 • Further Reading 275 • Problem Sets
 275 • Mini-Case: Waldo County 282

11 How to Ensure That Projects Truly Have Positive NPVs 284

- 11-1 How Firms Organize the Investment Process 284
The Capital Budget/Project Authorizations—and the Problem of Biased Forecasts/Postaudits
- 11-2 Look First to Market Values 287
The BMW and Your Sporting Idol
- 11-3 Economic Rents and Competitive Advantage 292

- 11-4** Marvin Enterprises Decides to Exploit a New Technology—an Example 295
Forecasting Prices of Gargle Blasters/The Value of Marvin's New Expansion/Alternative Expansion Plans/The Value of Marvin Stock/The Lessons of Marvin Enterprises

Summary 303 • Further Reading 303 • Problem Sets 303 • Mini-Case: Ecsy-Cola 309

12 Agency Problems and Investment 311

- 12-1** What Agency Problems Should You Watch Out For? 311

Agency Problems Don't Stop at the Top/Risk Taking

- 12-2** Monitoring 314

Boards of Directors /Auditors/Lenders/ Shareholders/Takeovers

- 12-3** Management Compensation 316

Compensation Facts and Controversies/The Economics of Incentive Compensation/The Specter of Short-Termism

- 12-4** Measuring and Rewarding Performance:

Residual Income and EVA 323

Residual Income or Economic Value Added (EVA®)/Pros and Cons of EVA

- 12-5** Biases in Accounting Measures of Performance 326

Example: Measuring the Profitability of the Nodhead Supermarket/Measuring Economic Profitability/Do the Biases Wash Out in the Long Run?/What Can We Do about Biases in Accounting Profitability Measures?

Summary 331 • Further Reading 332 • Problem Sets 332

I Part Four: Financing Decisions and Market Efficiency

13 Efficient Markets and Behavioral Finance 337

- 13-1** Differences between Investment and Financing Decisions 338

We Always Come Back to NPV

- 13-2** The Efficient Market Hypothesis 340

A Startling Discovery: Price Changes Are Random/Random Walks: The Evidence/Semistrong Market Efficiency: The Evidence/Strong Market Efficiency: The Evidence

- 13-3** Bubbles and Market Efficiency 348

- 13-4** Behavioral Finance 349

Sentiment/Limits to Arbitrage/Incentive Problems and the Financial Crisis of 2008–2009

- 13-5** The Five Lessons of Market Efficiency 354

Lesson 1: Markets Have No Memory/Lesson 2: Trust Market Prices/Lesson 3: Read the Entrails/Lesson 4: The Do-It-Yourself Alternative/Lesson 5: Seen One Stock, Seen Them All/What If Markets Are Not Efficient? Implications for the Financial Manager

Summary 359 • Further Reading 360 • Problem Sets 361 • Finance on the Web 364

14 An Overview of Corporate Financing 365

- 14-1** Patterns of Corporate Financing 365

Do Firms Rely Too Much on Internal Funds?/How Much Do Firms Borrow?

- 14-2** Common Stock 369

Ownership of the Corporation/Voting Procedures/ Dual-Class Shares and Private Benefits/Equity in Disguise/Preferred Stock

- 14-3** Debt 374

Debt Comes in Many Forms/A Debt by Any Other Name/Variety's the Very Spice of Life

- 14-4** Financial Markets and Intermediaries 377

Financial Markets/Financial Intermediaries/ Investment Funds/Financial Institutions

- 14-5** The Role of Financial Markets and Intermediaries 382

The Payment Mechanism/Borrowing and Lending/ Pooling Risk/Information Provided by Financial Markets/The Financial Crisis of 2007–2009

Summary 386 • Further Reading 387 • Problem Sets 388 • Finance on the Web 390

15 How Corporations Issue Securities 391

- 15-1 Venture Capital 391
The Venture Capital Market
- 15-2 The Initial Public Offering 396
The Public-Private Choice/Arranging an Initial Public Offering/The Sale of Marvin Stock/The Underwriters/Costs of a New Issue/Underpricing of IPOs/Hot New-Issue Periods/The Long-Run Performance of IPO Stocks
- 15-3 Alternative Issue Procedures for IPOs 406
Types of Auction: A Digression
- 15-4 Security Sales by Public Companies 408
General Cash Offers/International Security Issues/The Costs of a General Cash Offer/Market Reaction to Stock Issues/Rights Issues
- 15-5 Private Placements and Public Issues 413
Summary 413 • Further Reading 414
Problem Sets 415 • Finance on the Web 420
Appendix: Marvin's New-Issue Prospectus 421

I Part Five: Payout Policy and Capital Structure

16 Payout Policy 425

- 16-1 Facts about Payout 426
How Firms Pay Dividends/How Firms Repurchase Stock
- 16-2 The Information Content of Dividends and Repurchases 428
The Information Content of Share Repurchases
- 16-3 Dividends or Repurchases? The Payout Controversy 431
Payout Policy Is Irrelevant in Perfect Capital Markets/Dividends or Repurchases? An Example/Stock Repurchases and DCF Models of Share Price/Dividends and Share Issues
- 16-4 The Rightists 436
Payout Policy, Investment Policy, and Management Incentives

- 16-5 Taxes and the Radical Left 437
Empirical Evidence on Dividends and Taxes/Alternative Tax Systems
- 16-6 Payout Policy and the Life Cycle of the Firm 441
Payout and Corporate Governance
- Summary 443 • Further Reading 444 • Problem Sets 445

17 Does Debt Policy Matter? 451

- 17-1 The Effect of Financial Leverage in a Competitive Tax-Free Economy 452
Enter Modigliani and Miller/The Law of Conservation of Value/An Example of Proposition 1
- 17-2 Financial Risk and Expected Returns 457
Proposition 2/Leverage and the Cost of Equity/How Changing Capital Structure Affects Beta/Watch Out for Hidden Leverage
- 17-3 No Magic in Financial Leverage 464
Today's Unsatisfied Clientele Are Probably Interested in Exotic Securities/Imperfections and Opportunities
- 17-4 A Final Word on the After-Tax Weighted-Average Cost of Capital 467
Summary 468 • Further Reading 469 • Problem Sets 470 • Mini-Case: Claxton Drywall Comes to the Rescue 474

18 How Much Should a Corporation Borrow? 475

- 18-1 Corporate Taxes 476
How Do Interest Tax Shields Contribute to the Value of Stockholders' Equity?/Recasting Johnson & Johnson's Capital Structure/MM and Taxes
- 18-2 Corporate and Personal Taxes 480
- 18-3 Costs of Financial Distress 482
Bankruptcy Costs/Evidence on Bankruptcy Costs/Direct versus Indirect Costs of Bankruptcy/Financial Distress without Bankruptcy/Debt and Incentives/Risk Shifting: The First Game/Refusing to Contribute Equity Capital: The Second Game/And Three More Games, Briefly/What the Games Cost/Costs of Distress Vary with Type of Asset/The Trade-Off Theory of Capital Structure

- 18-4** The Pecking Order of Financing Choices 495
Debt and Equity Issues with Asymmetric Information/Implications of the Pecking Order/The Trade-Off Theory vs. the Pecking-Order Theory—Some Evidence/The Bright Side and the Dark Side of Financial Slack/Is There a Theory of Optimal Capital Structure?

Summary 501 • Further Reading 502 • Problem Sets 503 • Finance on the Web 506

19 Financing and Valuation 507

- 19-1** The After-Tax Weighted-Average Cost of Capital 508
Review of Assumptions/Mistakes People Make in Using the Weighted-Average Formula
- 19-2** Valuing Businesses 512
Valuing Rio Corporation/Estimating Horizon Value/WACC vs. the Flow-to-Equity Method
- 19-3** Using WACC in Practice 517
Some Tricks of the Trade/Adjusting WACC When Debt Ratios and Business Risks Differ/Unlevering and Relevering Betas/The Importance of Rebalancing/The Modigliani–Miller Formula, Plus Some Final Advice
- 19-4** Adjusted Present Value 524
APV for the Perpetual Crusher/Other Financing Side Effects/APV for Entire Businesses/APV and Limits on Interest Deductions/APV for International Investments
- 19-5** Your Questions Answered 529
- Summary 531 • Further Reading 532 • Problem Sets 532 • Finance on the Web 537 • Appendix: Discounting Safe, Nominal Cash Flows 538

I Part Six: Options

20 Understanding Options 542

- 20-1** Calls, Puts, and Shares 543
Call Options and Position Diagrams/Put Options/Selling Calls and Puts/Position Diagrams Are Not Profit Diagrams

- 20-2** Financial Alchemy with Options 547
Spotting the Option
- 20-3** What Determines Option Values? 552
Risk and Option Values

Summary 557 • Further Reading 558
 Problem Sets 558 • Finance on the Web 562

21 Valuing Options 563

- 21-1** A Simple Option-Valuation Model 564
Why Discounted Cash Flow Won't Work for Options/Constructing Option Equivalents from Common Stocks and Borrowing/Valuing the Amazon Put Option
- 21-2** The Binomial Method for Valuing Options 568
Example: The Two-Step Binomial Method/The General Binomial Method/The Binomial Method and Decision Trees
- 21-3** The Black–Scholes Formula 573
Using the Black–Scholes Formula/The Risk of an Option/The Black–Scholes Formula and the Binomial Method
- 21-4** Black–Scholes in Action 577
Executive Stock Options/Warrants/Portfolio Insurance/Calculating Implied Volatilities
- 21-5** Option Values at a Glance 580
- 21-6** The Option Menagerie 582
- Summary 582 • Further Reading 583 • Problem Sets 583 • Finance on the Web 588 • Mini-Case: Bruce Honiball's Invention 588

22 Real Options 590

- 22-1** The Value of Follow-On Investment Opportunities 590
Questions and Answers about Blitzen's Mark II/Other Expansion Options
- 22-2** The Timing Option 594
Valuing the Malted Herring Option/Optimal Timing for Real Estate Development
- 22-3** The Abandonment Option 597
Bad News for the Perpetual Crusher/Abandonment Value and Project Life/Temporary Abandonment

22-4 Flexible Production and Procurement 600
Aircraft Purchase Options

22-5 Investment in Pharmaceutical R&D 604

22-6 Valuing Real Options 606
*A Conceptual Problem?/What about Taxes?/
Practical Challenges*

Summary 608 • Further Reading 609

Problem Sets 609

I Part Seven: Debt Financing

23 Credit Risk and the Value of Corporate Debt 614

23-1 Yields on Corporate Debt 614

What Determines the Yield Spread?

23-2 Valuing the Option to Default 618

*The Value of Corporate Equity/A Digression:
Valuing Government Financial Guarantees*

23-3 Bond Ratings and the Probability of Default 622

23-4 Predicting the Probability of Default 624
*Statistical Models of Default/Structural Models
of Default*

Summary 628 • Further Reading 628 • Problem
Sets 629 • Finance on the Web 630

24 The Many Different Kinds of Debt 631

24-1 Long-Term Bonds 632

*Bond Terms/Security and Seniority/Asset-Backed
Securities/Call Provisions/Sinking Funds/Bond
Covenants/Private Placed Bonds/Foreign Bonds
and Eurobonds*

24-2 Convertible Securities and Some Unusual
Bonds 641

*The Value of a Convertible at Maturity/
Forcing Conversion/Why Do Companies Issue
Convertibles?/Valuing Convertible Bonds/A
Variation on Convertible Bonds: The Bond-
Warrant Package/Innovation in the Bond Market*

24-3 Bank Loans 647

*Commitment/Maturity/Rate of Interest/Syndicated
Loans/Security/Loan Covenants*

24-4 Commercial Paper and Medium-Term Notes 650
Commercial Paper/Medium-Term Notes

Summary 652 • Further Reading 653 • Problem
Sets 653 • Mini-Case: The Shocking Demise of
Mr. Thorndike 658 • Appendix: Project Finance 660
Appendix Further Reading 662

25 Leasing 663

25-1 What Is a Lease? 663

25-2 Why Lease? 664

*Sensible Reasons for Leasing/Some Dubious
Reasons for Leasing*

25-3 Operating Leases 667

Example of an Operating Lease/Lease or Buy?

25-4 Valuing Financial Leases 669

*Example of a Financial Lease/Who Really Owns
the Leased Asset?/Leasing and the Internal
Revenue Service/A First Pass at Valuing a Lease
Contract/The Story So Far/Financial Leases When
There Is No Interest Tax Shield*

25-5 When Do Financial Leases Pay? 675

Leasing around the World

25-6 Leveraged Leases 676

Summary 677 • Further Reading 678 • Problem Sets 678

I Part Eight: Risk Management

26 Managing Risk 683

26-1 Why Manage Risk? 684

*Reducing the Risk of Cash Shortfalls or Financial
Distress/Agency Costs May Be Mitigated by Risk
Management/The Evidence on Risk Management*

26-2 Insurance 687

26-3 Reducing Risk with Options 689

26-4 Forward and Futures Contracts 690

*A Simple Forward Contract/Futures Exchanges/
The Mechanics of Futures Trading/Trading and*

Pricing Financial Futures Contracts/Spot and Futures Prices—Commodities/More about Forward Contracts/Homemade Forward Rate Contracts

26-5 Swaps 697

Interest Rate Swaps/Currency Swaps/Some Other Swaps

26-6 How to Set Up a Hedge 702

Hedging Interest Rate Risk/Hedge Ratios and Basis Risk

26-7 Is “Derivative” a Four-Letter Word? 705

Summary 707 • Further Reading 708 • Problem Sets 708 • Finance on the Web 714 • Mini-Case: Rensselaer Advisers 714

27 Managing International Risks 717

27-1 The Foreign Exchange Market 717

27-2 Some Basic Relationships 719

Interest Rates and Exchange Rates/The Forward Premium and Changes in Spot Rates/Changes in the Exchange Rate and Inflation Rates/Interest Rates and Inflation Rates/Is Life Really That Simple?

27-3 Hedging Currency Risk 728

Transaction Exposure and Economic Exposure

27-4 Exchange Risk and International Investment Decisions 731

The Cost of Capital for International Investments

27-5 Political Risk 734

Summary 736 • Further Reading 737 • Problem Sets 738 • Finance on the Web 741 • Mini-Case: Exacta, S.a. 742

I Part Nine: Financial Planning and Working Capital Management

28 Financial Analysis 743

28-1 Financial Ratios 743

28-2 Financial Statements 744

28-3 Home Depot’s Financial Statements 745

The Balance Sheet/The Income Statement

28-4 Measuring Home Depot’s Performance 748

Economic Value Added/Accounting Rates of Return/Problems with EVA and Accounting Rates of Return

28-5 Measuring Efficiency 752

28-6 Analyzing the Return on Assets: The Du Pont System 754

The Du Pont System

28-7 Measuring Leverage 756

Leverage and the Return on Equity

28-8 Measuring Liquidity 758

28-9 Interpreting Financial Ratios 760

Summary 763 • Further Reading 763 • Problem Sets 763 • Finance on the Web 769

29 Financial Planning 770

29-1 Links between Short-Term and Long-Term Financing Decisions 770

29-2 Tracing Changes in Cash 773

The Cash Cycle

29-3 Cash Budgeting 778

29-4 Dynamic’s Short-Term Financial Plan 780

Dynamic Mattress’s Financing Plan/Evaluating the Plan/A Note on Short-Term Financial Planning Models

29-5 Long-Term Financial Planning 784

Why Build Financial Plans?/A Long-Term Financial Planning Model for Dynamic Mattress/Pitfalls in Model Design/Choosing a Plan

29-6 Growth and External Financing 789

Summary 791 • Further Reading 791 • Problem Sets 792 • Finance on the Web 800

30 Working Capital Management 801

30-1 The Composition of Working Capital 802

30-2 Inventories 804

30-3 Credit Management 806

*Terms of Sale/The Promise to Pay/Credit Analysis/
The Credit Decision/Collection Policy*

30-4 Cash 812

*How Purchases Are Paid For/Speeding Up Check
Collections/International Cash Management/
Paying for Bank Services*

30-5 Marketable Securities 816

*Tax Strategies/Investment Choices/Calculating
the Yield on Money Market Investments/Returns
on Money Market Investments/The International
Money Market/Money Market Instruments*

Summary 822 • Further Reading 823 • Problem Sets
824 • Finance on the Web 829

I Part Ten: Mergers, Corporate Control, and Governance

31 Mergers 830

31-1 Sensible Motives for Mergers 831

*Economies of Scale/Economies of Vertical
Integration/Complementary Resources/Surplus Funds/
Eliminating Inefficiencies/Industry Consolidation*

31-2 Some Dubious Reasons for Mergers 836

*Diversification/Increasing Earnings per Share:
The Bootstrap Game/Lower Financing Costs*

31-3 Estimating Merger Gains and Costs 839

*Right and Wrong Ways to Estimate the Benefits
of Mergers/More on Estimating Costs—What If
the Target's Stock Price Anticipates the Merger?/
Estimating Cost When the Merger Is Financed by
Stock/Asymmetric Information*

31-4 The Mechanics of a Merger 844

*Mergers, Antitrust Law, and Popular Opposition/
The Form of Acquisition/Merger Accounting/Some
Tax Considerations/Cross-Border Mergers and Tax
Inversion*

31-5 Proxy Fights, Takeovers, and the Market for Corporate Control 847

*Proxy Contests/Takeovers/Valeant Bids for Allergan/
Takeover Defenses/Who Gains Most in Mergers?*

31-6 Merger Waves and Merger Profitability 853

*Merger Waves/Merger Announcements and the
Stock Price/Merger Profitability/Do Mergers
Generate Net Benefits?*

Summary 855 • Further Reading 856 • Problem
Sets 856 • Appendix: Conglomerate Mergers and
Value Additivity 861

32 Corporate Restructuring 863

32-1 Leveraged Buyouts 863

*The RJR Nabisco LBO/Barbarians at the Gate?/
Leveraged Restructurings/LBOs and Leveraged
Restructurings*

32-2 The Private-Equity Market 868

*Private-Equity Partnerships/Are Private-Equity
Funds Today's Conglomerates?*

32-3 Fusion and Fission in Corporate Finance 873

*Spin-Offs/Carve-Outs/Asset Sales/Privatization
and Nationalization*

32-4 Bankruptcy 878

*Is Chapter 11 Efficient?/Workouts/Alternative
Bankruptcy Procedures*

Summary 883 • Further Reading 884 • Problem Sets 885

33 Governance and Corporate Control around the World 888

33-1 Financial Markets and Institutions 888

*Investor Protection and the Development of
Financial Markets*

33-2 Ownership, Control, and Governance 892

*Ownership and Control in Japan/Ownership and
Control in Germany/European Boards of Directors/
Shareholders versus Stakeholders/Ownership and
Control in Other Countries/Conglomerates Revisited*

33-3 Do These Differences Matter? 902

*Risk and Short-Termism/Growth Industries and
Declining Industries/Transparency and Governance*

Summary 905 • Further Reading 906
Problem Sets 907

I Part Eleven: Conclusion

34 Conclusion: What We Do and Do Not Know about Finance 909

34-1 What We Do Know: The Seven Most Important Ideas in Finance 909

1. Net Present Value/2. The Capital Asset Pricing Model/3. Efficient Capital Markets/4. Value Additivity and the Law of Conservation of Value/5. Capital Structure Theory/6. Option Theory/7. Agency Theory

34-2 What We Do Not Know: 10 Unsolved Problems in Finance 912

1. What Determines Project Risk and Present Value?/2. Risk and Return—What Have We Missed?/3. How Important Are the Exceptions to

the Efficient-Market Theory?/4. Is Management an Off-Balance-Sheet Liability?/5. How Can We Explain the Success of New Securities and New Markets?/6. How Can We Resolve the Payout Controversy?/7. What Risks Should a Firm Take?/8. What Is the Value of Liquidity?/9. How Can We Explain Merger Waves?/10. Why Are Financial Systems So Prone to Crisis?

34-3 A Final Word 918

APPENDIX A-1

GLOSSARY G-1

INDEX I-1

Note: Present value tables are available in Connect.