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3rd Edition

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# finance

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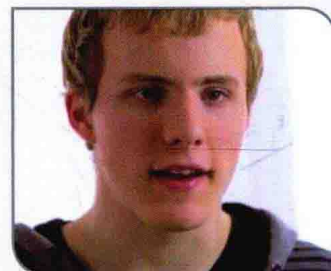
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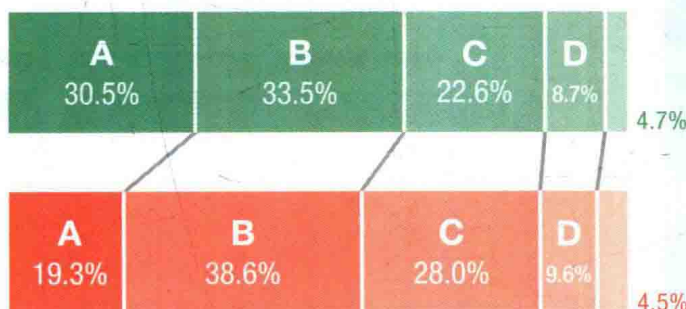
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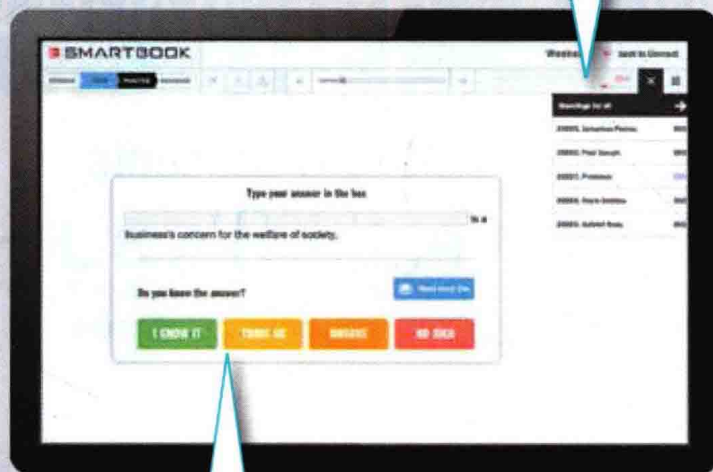
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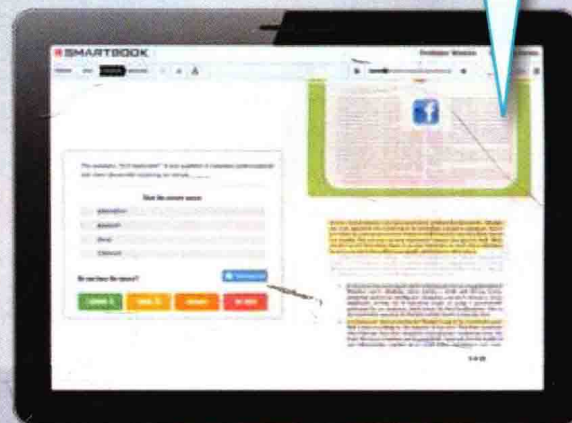


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# changes in the third edition

Based on feedback from users and reviewers, we undertook an ambitious revision in order to make the book follow your teaching strategy even more closely. Below are the changes we made for this edition, broken out by chapter.

## OVERALL

- Simplified figures where appropriate and added captions to emphasize the main “takeaways”
- Updated all data, company names, and scenarios to reflect latest available data and real-world changes
- Cross-referenced numbered examples with similar end-of-chapter problems so students can easily model their homework
- Updated the numbers in the end-of-chapter problems to provide variety and limit the transfer of answers from previous classes

## chapter one

### INTRODUCTION TO FINANCIAL MANAGEMENT

- Expanded discussion of agency relationships and problems between managers and stakeholders

## chapter two

### REVIEWING FINANCIAL STATEMENTS

- Added discussion of earnings before interest, taxes, depreciation, and assets (EBITDA) and net operating profit after taxes (NOPAT)
- Added discussion of EPS dilution, including new in-chapter example and end-of-chapter problem
- Added discussion of where to find financial statements for a firm
- Added a new Finance at Work on American Apparel delisting letter
- Added Appendix with financial statements in Excel format

## chapter three

### ANALYZING FINANCIAL STATEMENTS

- Added discussion of gross profit margin and operating profit margin
- Added explanation of debt-to-asset ratio transformed to equity multiplier and debt-to-equity ratios
- Expanded definition of debt management ratios to include coverage ratios
- Added additional end-of-chapter problems on interactions between ratios
- Added Excel file for calculating ratios from financial statements

## chapter four

### TIME VALUE OF MONEY 1: ANALYZING SINGLE CASH FLOWS

- Expanded introductory discussion
- Converted all tables to spreadsheet layout
- Clarified discussion of payment to cash flow
- Added PV and FV labels to all time line diagrams

## chapter five

### TIME VALUE OF MONEY 2: ANALYZING ANNUITY CASH FLOWS

- Converted all tables to spreadsheet layout
- Added PV and FV labels to all time line diagrams
- Updated and revised Finance at Work boxes
- Reduced derivation part of an equation
- Added new Math Coach to compute amortization in TVM calculators

## chapter six

### UNDERSTANDING FINANCIAL MARKETS AND INSTITUTIONS

- Updated all figures, tables, and examples
- Added Finance at Work box on JPMorgan, “London whale,” and derivative losses
- Added discussion on financial institutions’ move away from risk measurement and management to servicers of mortgages and other risky assets
- Added discussion of shadow banks
- Added new example on determinants of interest rates in individual securities
- Added new end-of-chapter problems
- Updated Appendix

## chapter seven

### VALUING BONDS

- Updated real data, real bonds, and real companies in examples and figures
- Converted all tables to spreadsheet layout
- Added a discussion of convertible bonds with margin definition
- Added PV and FV labels to all time line diagrams
- Added TVM calculator to Example 7-6
- Clarified and expanded discussion of the call price
- Updated Greek tragedy Finance at Work box

## chapter eight

### VALUING STOCKS

- Updated real data, real stocks, and real companies in examples and figures
- Converted all tables to spreadsheet layout
- Changed “specialist” to “designated market maker”
- New Example 8-1
- Clarified description of equation 8-6
- Simplified variable growth figure, equation, and discussion
- Added discussion of P/CF and P/B relative price ratios

## chapter nine

### CHARACTERIZING RISK AND RETURN

- Updated real data, real indexes, and real companies in examples, discussions, and tables
- Converted all tables to spreadsheet layout
- Improved discussion of dollar returns and percentage returns
- Moved geometric mean return equation from footnote into the text

## chapter ten

### ESTIMATING RISK AND RETURN

- Updated real data, indexes, betas, and companies in examples, discussions, and tables
- Converted all tables to spreadsheet layout
- Clarified description of equations 10-1 and 10-2
- Changed example from Boeing to General Electric
- New table and description for spreadsheet computation of computing beta

## chapter eleven

### CALCULATING THE COST OF CAPITAL

- Expanded discussion of WACC for projects versus WACC for firm
- Added discussion of WACC from the viewpoint of the investor versus that of the firm
- Expanded discussion of intuition underlying calculation of project WACC
- Enhanced intuitive explanation for the use of divisional WACCs
- Added details concerning flotation costs to the corporation

## chapter twelve

### ESTIMATING CASH FLOWS ON CAPITAL BUDGETING PROJECTS

- Enhanced intuitive explanation of why accelerated depreciation is preferred
- Added additional explanation of adjusting the project's initial cash flow to account for flotation costs
- Added additional end-of-chapter problems dealing with replacement projects' cash flows

## chapter thirteen

### WEIGHING NET PRESENT VALUE AND OTHER CAPITAL BUDGETING CRITERIA

- Changed calculation and discussion of profitability index to reflect a benchmark of 1
- Enhanced explanation of calculation of MIRR
- Enhanced discussion of payback
- Added additional clarifications concerning use of NPV profiles

## chapter fourteen

### WORKING CAPITAL MANAGEMENT AND POLICIES

- Added discussion of relationship between working capital management and operations management
- Enhanced explanation and example concerning use of Miller-Orr model

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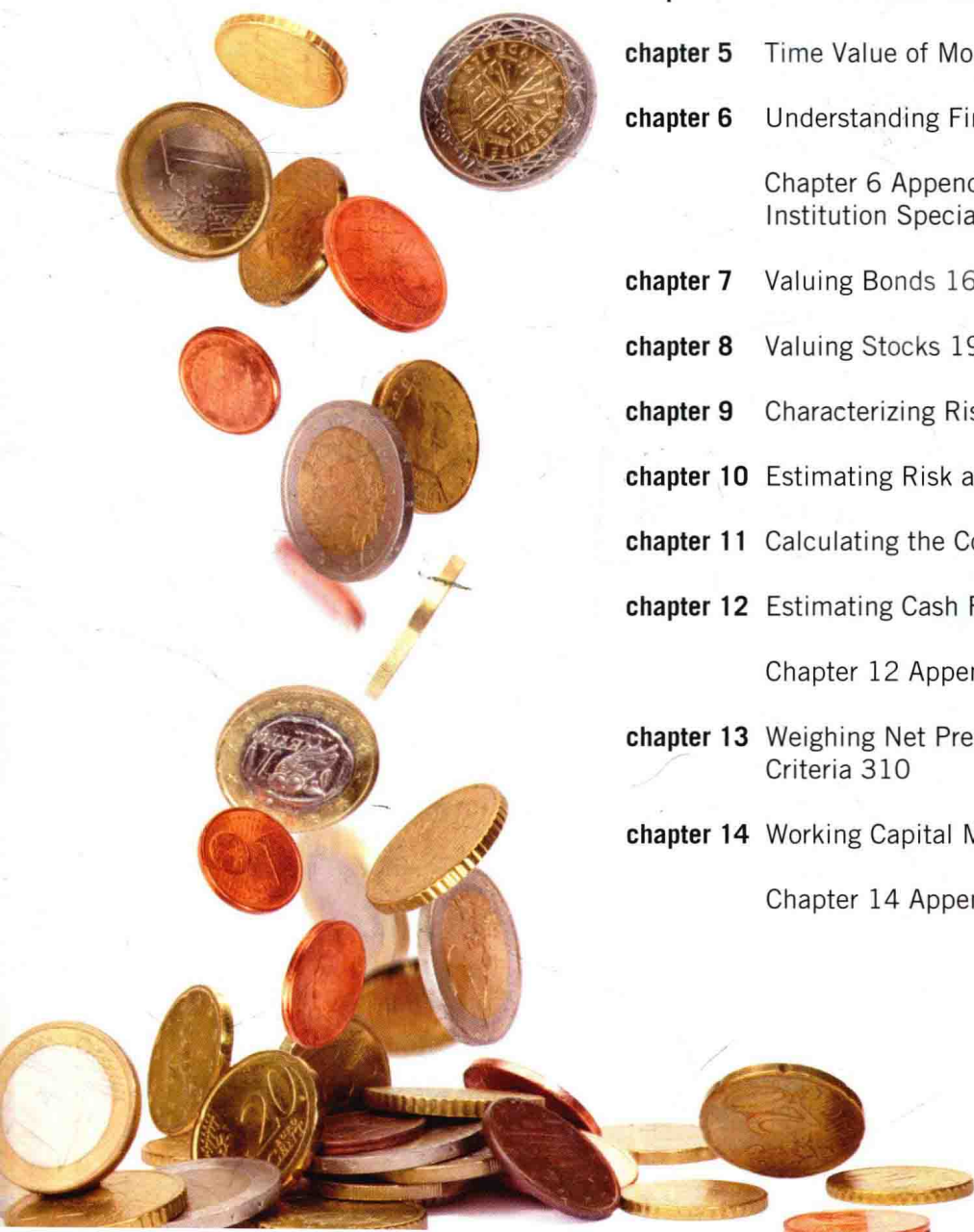
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# finance 3e



# introduction to financial management

**D**o you know: What finance entails? How financial management functions within the business world? Why you might benefit from studying financial principles? This chapter is the ideal place to get answers to those questions. **Finance** is the study of *applying specific value* to things we own, services we use, and decisions we make. Examples are as varied as shares of stock in a company, payments on a home mortgage, the purchase of an entire firm, and the personal decision to retire early. In this text, we focus primarily on one area of finance, **financial management**, which concentrates on valuing things from the perspective of a company, or firm.

Financial management is critically important to the success of any business organization, and throughout the text

we concentrate on describing the key financial concepts in corporate finance. As a bonus, you will find that many tools and techniques for handling the financial management of a firm also apply to broader types of financial problems, such as personal finance decisions.

In finance, *cash flow* is the term that describes the process of paying and receiving money. It makes sense to start our discussion of finance with an illustration of various financial cash flows. We use simple graphics to help explain the nature of finance and to demonstrate the different *subareas* of the field of finance.

After we have an overall picture of finance, we will discuss four important variables in the business environment that can and do have significant

*continued on p. 4*

## LEARNING GOALS

- LG1-1** Define the major areas of finance as they apply to corporate financial management.
- LG1-2** Show how finance is at the heart of sound business decisions.
- LG1-3** Learn the financial principles that govern your personal decisions.
- LG1-4** Examine the three most common forms of business organization in the United States today.
- LG1-5** Distinguish among appropriate and inappropriate goals for financial managers.
- LG1-6** Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.
- LG1-7** Discuss how ethical decision making is part of the study of financial management.
- LG1-8** Describe the complex, necessary relationships among firms, financial institutions, and financial markets.
- LG1-9** Explain the fundamental causes of the financial crisis that started in 2006.