

CONTENTS

Introduction	9
1 Background and Central Concepts	11
1.1 Firms and their Environment	13
1.2 Financial Characteristics of a Company	16
1.2.1 Accounting and its Relationship to Finance	17
1.2.2 Cash Flows	20
1.3 Theoretical Foundations of Corporate Finance	25
1.3.1 Consequences of the Efficient Market Assumption	25
1.3.2 Consequences of the Inefficient Market Assumption	28
1.3.3 Entrepreneurial Incentives and Value Creation	31
2 The Time Value of Money and its Applications	33
2.1 Present and Future Value	33
2.2 Valuing Multiple Future Values	35
2.2.1 Annuities	37
2.2.2 Perpetuities and Growth Perpetuities	39
2.3 Compounding	40
2.3.1 Discrete Compounding	40
2.3.2 Continuous Compounding	42
2.4 Incomplete Periods and Day Count Conventions	43
3 Risk and Return	45
3.1 Risk Diversification	47
3.2 Valuation of Equity Risk	49
3.2.1 Capital Asset Pricing Model	49
3.2.2 Alternative Equity Risk Valuation Models	50
3.3 Valuation of Debt Risk	52
3.4 Estimating the Parameters of Risk-Return Models	53
3.4.1 Risk-Free Rate	53
3.4.2 Market Risk Premium	54
3.4.3 Beta	54
3.4.4 Default Risk Premium	57
4 Intrinsic Valuation of Securities	58
4.1 Debt Securities	59
4.1.1 Debt Security Forms, Conventions and Terminology	59
4.1.2 Intrinsic Valuation of Debt Securities	62
4.1.3 Implied Estimation of Debt Parameters	65

Contents

4.2	Equity Securities	66
4.2.1	Forms, Conventions and Terminology of Stock	66
4.2.2	Intrinsic Valuation of Stock	67
4.2.3	Implied Estimation of Equity Parameters	70
5	Options and their Value	72
5.1	Financial Options	72
5.2	Embedded Options	78
5.3	Real Options	79
6	Cost of Capital	82
6.1	Weighted Average Cost of Capital Assessment	83
6.1.1	Estimating the Component Costs	83
6.1.2	Estimating the Target Capital Structure	86
6.2	Cost of Operating Capital Assessment	87
6.2.1	Estimating the Cost of Capital for Firms	87
6.2.2	Estimating the Cost of Capital for Particular Assets	88
7	Capital Budgeting	91
7.1	Capital Budgeting Criteria	92
7.1.1	Payback	92
7.1.2	Net Present Value	93
7.1.3	Internal Rate of Return	94
7.1.4	Profitability Index	96
7.2	Mutually Exclusive Projects	97
7.2.1	Capital Rationing	98
7.2.2	Operational Dependence	101
7.3	Estimating Capital Budgeting Cash Flows	104
7.3.1	Principles of Project Cash Flow Estimation	104
7.3.2	Project Cash Flow Characteristics	106
7.4	Addressing Cash Flow Uncertainty	108
7.4.1	Methods Using Sensitivity Analysis	109
7.4.2	Methods Using Scenario Analysis	112
7.5	Real Options in Projects	115
8	Financial Planning and Financial Analysis	118
8.1	Financial Planning Methods	119
8.1.1	Forecast Financial Statements Method	120
8.1.2	Additional Funds Needed Method	121
8.1.3	Forecasting Under Changing Ratio Assumptions	123
8.2	Firms' Strategic Financial Policies	124
8.2.1	Financing Decisions and the Capital Structure	124

8.2.2	Dividend and Distribution Decisions	128
8.3	Financial Analysis	132
8.3.1	Liquidity and Coverage Ratios	133
8.3.2	Profitability and Market Value Ratios	134
8.3.3	Asset Activity and Intensity Ratios	135
8.3.4	Leverage Ratios	135
9	Working Capital Management	138
9.1	Cash Conversion Cycle	138
9.1.1	Inventory Management	140
9.1.2	Receivable Management	143
9.1.3	Cash Management	146
9.2	Working Capital Financing	148
9.2.1	Accruals and Payables	148
9.2.2	Short-Term Loans	149
9.3	Working Capital Financing Policies	150
10	Corporate Valuation	153
10.1	Corporate Valuation	154
10.1.1	Future Free Cash Flow Estimation	155
10.1.2	Equity Valuation Approach	156
10.1.3	Firm Valuation Approach	157
10.2	Valuing Mergers and Acquisitions	160
10.3	Value-Based Management	163
10.3.1	Using MVA Value Drivers	163
10.3.2	Using Economic Value Added	165
	Concluding Remarks	168
	References	170
	Appendix	175
	List of Cases	177
	List of Figures	178
	Summary	179
	Anotace	180