

Thirteenth Edition

# Fundamentals of CORPORATE FINANCE

**Stephen A. Ross**

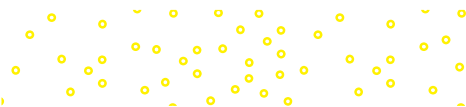
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Graw  
Hill**





## FUNDAMENTALS OF CORPORATE FINANCE, THIRTEENTH EDITION

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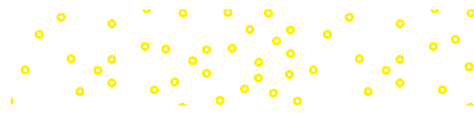
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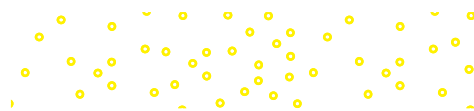
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To Stephen A. Ross and family

Our great friend, colleague, and coauthor Steve Ross passed away on March 3, 2017. Steve's influence on our textbook, like his influence on the field of finance, is seminal, deep, and enduring, and we miss him greatly.

**R.W.W. B.D.J.**



# About the Authors

## STEPHEN A. ROSS



Stephen A. Ross

The late Stephen A. Ross was the Franco Modigliani Professor of Finance and Economics at the Sloan School of Management, Massachusetts Institute of Technology. One of the most widely published authors in finance and economics, Professor Ross was known for his work in developing the Arbitrage Pricing Theory as well as his substantial contributions to the discipline through his research on signaling, agency theory, option pricing, and the theory of the term structure of interest rates, among other topics. A past president of the American Finance Association, he also served as an associate editor of various academic and practitioner journals. He was a trustee of CalTech.

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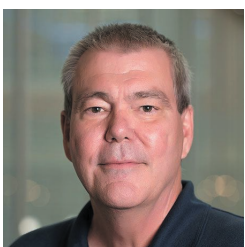


Randolph W. Westerfield

Randolph W. Westerfield is Dean Emeritus and the Charles B. Thornton Professor in Finance Emeritus at the University of Southern California's Marshall School of Business. Professor Westerfield came to USC from the Wharton School, University of Pennsylvania, where he was the chairman of the finance department and a member of the finance faculty for 20 years. He is a member of the board of trustees of Oaktree Capital mutual funds. His areas of expertise include corporate financial policy, investment management, and stock market price behavior.

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Bradford D. Jordan is Visiting Scholar in the Warrington College of Business at the University of Florida. He previously held the duPont Endowed Chair in Banking and Financial Services at the University of Kentucky, where he was department chair for many years. Professor Jordan has published numerous articles in top journals on issues such as cost of capital, capital structure, and the behavior of security prices. He is a past president of the Southern Finance Association, and he is coauthor of *Fundamentals of Investments: Valuation and Management*, 9e, a leading investments text, also published by McGraw Hill.



# Preface from the Authors

When the three of us decided to write a book, we were united by one strongly held principle: Corporate finance should be developed in terms of a few integrated, powerful ideas. We believed that the subject was all too often presented as a collection of loosely related topics, unified primarily by virtue of being bound together in one book, and we thought there must be a better way.

One thing we knew for certain was that we didn't want to write a "me-too" book. So, with a lot of help, we took a hard look at what was truly important and useful. In doing so, we were led to eliminate topics of dubious relevance, downplay purely theoretical issues, and minimize the use of extensive and elaborate calculations to illustrate points that are either intuitively obvious or of limited practical use.

As a result of this process, three basic themes became our central focus in writing *Fundamentals of Corporate Finance*:

## AN EMPHASIS ON INTUITION

We always try to separate and explain the principles at work on a commonsense, intuitive level before launching into any specifics. The underlying ideas are discussed first in very general terms and then by way of examples that illustrate in more concrete terms how a financial manager might proceed in a given situation.

## A UNIFIED VALUATION APPROACH

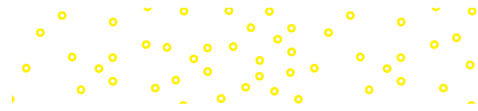
We treat net present value (NPV) as the basic concept underlying corporate finance. Many texts stop well short of consistently integrating this important principle. The most basic and important notion—that NPV represents the excess of market value over cost—often is lost in an overly mechanical approach that emphasizes computation at the expense of comprehension. In contrast, every subject we cover is firmly rooted in valuation, and care is taken throughout to explain how particular decisions have valuation effects.

## A MANAGERIAL FOCUS

Students shouldn't lose sight of the fact that financial management concerns management. We emphasize the role of the financial manager as decision maker, and we stress the need for managerial input and judgment. We consciously avoid "black box" approaches to finance, and, where appropriate, the approximate, pragmatic nature of financial analysis is made explicit, possible pitfalls are described, and limitations are discussed.

In retrospect, looking back to our 1991 first edition IPO, we had the same hopes and fears as any entrepreneurs. How would we be received in the market? At the time, we had no idea that almost 30 years later, we would be working on a thirteenth edition. We certainly never dreamed that in those years we would work with friends and colleagues from around the world to create country-specific Australian, Canadian, European, Indian, and South African editions; an International edition; Chinese, French, Polish, Portuguese, Thai, Russian, Korean, and Spanish (among others) language editions; and an entirely separate book, *Essentials of Corporate Finance*, now in its tenth edition.

Today, as we prepare to once more enter the market, our goal is to stick with the basic principles that have brought us this far. However, based on the enormous amount of feedback we have received from you and your colleagues, we have made this edition and its package even more flexible than previous editions. We offer flexibility in coverage, as customized editions of this text can be crafted in any combination through McGraw Hill's *CREATE* system, and flexibility in pedagogy, by providing a wide variety



of features in the book to help students learn about corporate finance. We also provide flexibility in package options by offering the most extensive collection of teaching, learning, and technology aids of any corporate finance text. Whether you use only the textbook, or the book in conjunction with our other products, we believe you will find a combination with this edition that will meet your current as well as your changing course needs.

**Stephen A. Ross**  
**Randolph W. Westerfield**  
**Bradford D. Jordan**

## **THE TAX CUTS AND JOBS ACT (TCJA) IS INCORPORATED THROUGHOUT ROSS FUNDAMENTALS OF CORPORATE FINANCE, 13E.**

There are six primary areas of change that are reflected in the 13th edition:

1. *Corporate tax.* The new, flat-rate 21 percent corporate rate is discussed and compared to the old progressive system. The new rate is used throughout the text in examples and problems. Entities other than C corporations still face progressive taxation, so the discussion of marginal versus average tax rates remains relevant and is retained.
2. *Bonus depreciation.* For a limited time, businesses can take a 100 percent depreciation charge the first year for most non–real estate, MACRS-qualified investments. This “bonus depreciation” ends in a few years and MACRS returns, so the MACRS material remains relevant and is retained. The impact of bonus depreciation is illustrated in various problems.
3. *Limitations on interest deductions.* The amount of interest that may be deducted for tax purposes is limited. Interest that cannot be deducted can be carried forward to future tax years (but not carried back; see next).
4. *Carrybacks.* Net operating loss (NOL) carrybacks have been eliminated and NOL carryforward deductions are limited in any one tax year.
5. *Dividends received tax break.* The tax break on dividends received by a corporation has been reduced, meaning that the portion subject to taxation has increased.
6. *Repatriation.* The distinction between U.S. and non-U.S. profits has been essentially eliminated. All “overseas” assets, both liquid and illiquid, were subject to a one-time “deemed” tax.

With the 13th edition, we’ve also included coverage of:

- COVID-19 and its impact on finance in multiple chapters.
- Clawbacks and deferred compensation.
- Fintech and the relationship between finance and other disciplines.
- Ratios in practice.
- Inversions.
- Negative interest rates.
- Corporate default rates in practice.
- Entrepreneurship and venture capital.
- Online Appendix on covariance and correlation.
- Direct listings and cryptocurrency initial coin offerings (ICOs).
- Regulation CF.
- Brexit.
- Repatriation.
- Changes in lease accounting.



# Coverage

This book was designed and developed explicitly for a first course in business or corporate finance, for both finance majors and non-majors alike. In terms of background or prerequisites, the book is nearly self-contained, assuming some familiarity with basic algebra and accounting concepts, while still reviewing important accounting principles very early on. The organization of this text has been developed to give instructors the flexibility they need.

The following grid presents, for each chapter, some of the most significant features as well as a few selected chapter highlights of the 13th edition of *Fundamentals*. Of course, in every chapter, opening vignettes, boxed features, in-chapter illustrated examples using real companies, and end-of-chapter material have been thoroughly updated as well.

Chapters	Selected Topics of Interest	Benefits to You
<b>PART 1 Overview of Corporate Finance</b>		
<b>CHAPTER 1</b> Introduction to Corporate Finance	Goal of the firm and agency problems.	Stresses value creation as the most fundamental aspect of management and describes agency issues that can arise.
	Ethics, financial management, and executive compensation.	Brings in real-world issues concerning conflicts of interest and current controversies surrounding ethical conduct and management pay.
	Sarbanes-Oxley.	Up-to-date discussion of Sarbanes-Oxley and its implications and impact.
	New: Finance and other disciplines, including fintech.	Discusses how finance interacts with other business disciplines. Also includes a discussion of fintech.
	Minicase: The McGee Cake Company.	Examines the choice of organization form for a small business.
<b>CHAPTER 2</b> Financial Statements, Taxes, and Cash Flow	Cash flow vs. earnings.	Clearly defines cash flow and spells out the differences between cash flow and earnings.
	New: COVID-19 and cash flows.	Discussion of how COVID-19 has affected cash flows.
	Market values vs. book values.	Emphasizes the relevance of market values over book values.
	Brief discussion of average corporate tax rates.	Highlights the variation in corporate tax rates across industries in practice.
	New: Personal tax rates.	Discusses how personal tax rates affect sole proprietorships, partnerships, and LLCs.
	Minicase: Cash Flows and Financial Statements at Sunset Boards, Inc.	Reinforces key cash flow concepts in a small business setting.

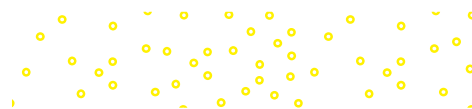


Chapters	Selected Topics of Interest	Benefits to You
<b>PART 2 Financial Statements and Long-Term Financial Planning</b>		
<b>CHAPTER 3</b> Working with Financial Statements	<p><i>New:</i> COVID-19 and financial ratios.</p> <p>Expanded DuPont analysis.</p> <p>DuPont analysis for real companies using data from <i>S&amp;P Market Insight</i>.</p> <p>Ratio and financial statement analysis using smaller firm data.</p> <p>Understanding financial statements.</p> <p>The enterprise value-EBITDA ratio.</p> <p><i>New:</i> Ratios for various industries.</p> <p><i>Minicase:</i> Ratio Analysis at S&amp;S Air, Inc.</p>	<p>Discussion of COVID-19 and its affect on ratios.</p> <p>Expands the basic DuPont equation to better explore the interrelationships between operating and financial performance.</p> <p>Analysis shows students how to get and use real-world data, thereby applying key chapter ideas.</p> <p>Uses firm data from <i>RMA</i> to show students how to actually get and evaluate financial statement benchmarks.</p> <p>Thorough coverage of standardized financial statements and key ratios.</p> <p>Defines enterprise value (EV) and discusses the widely used EV-EBITDA ratio.</p> <p>Discussion of ratios for various industries in practice.</p> <p>Illustrates the use of ratios and some pitfalls in a small business context.</p>
<b>CHAPTER 4</b> Long-Term Financial Planning and Growth	<p>Expanded discussion of sustainable growth calculations.</p> <p>Explanation of alternative formulas for sustainable and internal growth rates.</p> <p>Thorough coverage of sustainable growth as a planning tool.</p> <p>Long-range financial planning.</p> <p><i>Minicase:</i> Planning for Growth at S&amp;S Air.</p>	<p>Illustrates the importance of financial planning in a small firm.</p> <p>Explanation of growth rate formulas clears up a common misunderstanding about these formulas and the circumstances under which alternative formulas are correct.</p> <p>Provides a vehicle for examining the interrelationships between operations, financing, and growth.</p> <p>Covers the percentage of sales approach to creating pro forma statements.</p> <p>Discusses the importance of a financial plan and capacity utilization for a small business.</p>
<b>PART 3 Valuation of Future Cash Flows</b>		
<b>CHAPTER 5</b> Introduction to Valuation: The Time Value of Money	First of two chapters on time value of money.	Relatively short chapter introduces just the basic ideas on time value of money to get students started on this traditionally difficult topic.
<b>CHAPTER 6</b> Discounted Cash Flow Valuation	<p>Growing annuities and perpetuities.</p> <p>Second of two chapters on time value of money.</p> <p><i>Minicase:</i> The MBA Decision.</p>	<p>Covers more advanced time value topics with numerous examples, calculator tips, and Excel spreadsheet exhibits. Contains many real-world examples.</p> <p>Explores the financial pros and cons of pursuing an MBA degree.</p>





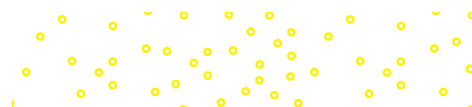
Chapters	Selected Topics of Interest	Benefits to You
<b>CHAPTER 7</b> Interest Rates and Bond Valuation	Negative interest rates.  Bond valuation.  Interest rates.  “Clean” vs. “dirty” bond prices and accrued interest.  TRACE system and transparency in the corporate bond market.  “Make-whole” call provisions.  Islamic finance.  <i>New:</i> COVID-19 and credit ratings  <i>New:</i> Corporate default rates.  <i>Minicase:</i> Financing S&S Air’s Expansion Plans with a Bond Issue.	Chapter explores the recent phenomenon of negative interest on government bonds.  Complete coverage of bond valuation and bond features.  Discusses real versus nominal rates and the determinants of the term structure.  Clears up the pricing of bonds between coupon payment dates and also bond market quoting conventions.  Up-to-date discussion of new developments in fixed income with regard to price, volume, and transactions reporting.  Up-to-date discussion of a relatively new type of call provision that has become very common.  Provides basics of some important concepts in Islamic finance.  Discussion of the negative impact of COVID-19 on credit ratings.  Provides a discussion of default rates by credit rating.  Discusses the issues that come up in selling bonds to the public.
<b>CHAPTER 8</b> Stock Valuation	Stock valuation.  NYSE market operations.  Valuation using multiples.  <i>New:</i> Valuation ratios for industries.  <i>Minicase:</i> Stock Valuation at Ragan, Inc.	Thorough coverage of constant and nonconstant growth models.  Up-to-date description of major stock market operations.  Illustrates using PE and price/sales ratios for equity valuation.  Provides a discussion of how valuation ratios vary between industries.  Illustrates the difficulties and issues surrounding small business valuation.
<b>PART 4 Capital Budgeting</b>		
<b>CHAPTER 9</b> Net Present Value and Other Investment Criteria	First of three chapters on capital budgeting.  NPV, IRR, payback, discounted payback, MIRR, and accounting rate of return.  <i>Minicase:</i> Bullock Gold Mining.	Relatively short chapter introduces key ideas on an intuitive level to help students with this traditionally difficult topic.  Consistent, balanced examination of advantages and disadvantages of various criteria.  Explores different capital budgeting techniques with nonstandard cash flows.
<b>CHAPTER 10</b> Making Capital Investment Decisions	Project cash flow.  Alternative cash flow definitions.  Special cases of DCF analysis.  <i>Minicase:</i> Conch Republic Electronics, Part 1.	Thorough coverage of project cash flows and the relevant numbers for a project analysis.  Emphasizes the equivalence of various formulas, thereby removing common misunderstandings.  Considers important applications of chapter tools.  Analyzes capital budgeting issues and complexities.



Chapters	Selected Topics of Interest	Benefits to You
<b>CHAPTER 11</b> Project Analysis and Evaluation	<p>Sources of value.</p> <p>Scenario and sensitivity “what-if” analyses.</p> <p>Break-even analysis.</p> <p><i>Minicase:</i> Conch Republic Electronics, Part 2.</p>	<p>Stresses the need to understand the economic basis for value creation in a project.</p> <p>Illustrates how to actually apply and interpret these tools in a project analysis.</p> <p>Covers cash, accounting, and financial break-even levels.</p> <p>Illustrates the use of sensitivity analysis in capital budgeting.</p>
<b>PART 5 Risk and Return</b>		
<b>CHAPTER 12</b> Some Lessons from Capital Market History	<p><i>New:</i> The stock market in 2020.</p> <p>Expanded discussion of geometric vs. arithmetic returns.</p> <p>Capital market history.</p> <p>Market efficiency.</p> <p>The equity risk premium.</p> <p>The 2008 experience.</p> <p><i>Minicase:</i> A Job at S&amp;S Air.</p>	<p>Discussion of the market turmoil in early 2020 caused by COVID-19.</p> <p>Discusses calculation and interpretation of geometric returns. Clarifies common misconceptions regarding appropriate use of arithmetic vs. geometric average returns.</p> <p>Extensive coverage of historical returns, volatilities, and risk premiums.</p> <p>Efficient markets hypothesis discussed along with common misconceptions.</p> <p>Discusses the equity premium puzzle and latest international evidence.</p> <p>Section on the stock market turmoil of 2008.</p> <p>Discusses selection of investments for a 401(k) plan.</p>
<b>CHAPTER 13</b> Return, Risk, and the Security Market Line	<p>Diversification and systematic and unsystematic risk.</p> <p>Beta and the security market line.</p> <p><i>New:</i> Covariance and correlation.</p> <p><i>Minicase:</i> The Beta for Colgate-Palmolive.</p>	<p>Illustrates basics of risk and return in a straightforward fashion.</p> <p>Develops the security market line with an intuitive approach that bypasses much of the usual portfolio theory and statistics.</p> <p>Online Appendix provides a more in-depth discussion of covariance and correlation.</p> <p>Detailed discussion of beta estimation.</p>
<b>PART 6 Cost of Capital and Long-Term Financial Policy</b>		
<b>CHAPTER 14</b> Cost of Capital	<p>Cost of capital estimation.</p> <p>Geometric vs. arithmetic growth rates.</p> <p>Firm valuation.</p> <p><i>Minicase:</i> Cost of Capital for Swan Motors.</p>	<p>Contains a complete, web-based illustration of cost of capital for a real company.</p> <p>Both approaches are used in practice. Clears up issues surrounding growth rate estimates.</p> <p>Develops the free cash flow approach to firm valuation.</p> <p>Covers pure play approach to cost of capital estimation.</p>



Chapters	Selected Topics of Interest	Benefits to You
<b>CHAPTER 15</b> Raising Capital	New: Entrepreneurship and venture capital. Dutch auction IPOs. Regulation CF. IPO “quiet periods.” Rights vs. warrants. IPO valuation. <i>Minicase:</i> S&S Air Goes Public.	Discussion of entrepreneurship and the venture capital market. Explains uniform price auctions. Explains the new Regulation CF for crowdfunding and provides some examples. Explains the SEC’s quiet period rules. Clarifies the optionlike nature of rights prior to their expiration dates. Extensive, up-to-date discussion of IPOs, including the 1999–2000 period. Covers the key parts of the IPO process for a small firm.
<b>CHAPTER 16</b> Financial Leverage and Capital Structure Policy	Basics of financial leverage. Optimal capital structure. Financial distress and bankruptcy. <i>Minicase:</i> Stephenson Real Estate Recapitalization.	Illustrates effect of leverage on risk and return. Describes the basic trade-offs leading to an optimal capital structure. Briefly surveys the bankruptcy process. Discusses optimal capital structure for a medium-sized firm.
<b>CHAPTER 17</b> Dividends and Payout Policy	New survey evidence on dividend policy. Effect of new tax laws. Dividends and dividend policy. Optimal payout policy. Stock repurchases. <i>Minicase:</i> Electronic Timing, Inc.	New survey results show the most important (and least important) factors considered by financial managers in setting dividend policy. Discusses implications of new, lower dividend and capital gains rates. Describes dividend payments and the factors favoring higher and lower payout policies. Extensive discussion of the latest research and survey evidence on dividend policy, including life-cycle theory. Thorough coverage of buybacks as an alternative to cash dividends. Describes the dividend/share repurchase issue for a small company.
<b>PART 7 Short-Term Financial Planning and Management</b>		
<b>CHAPTER 18</b> Short-Term Finance and Planning	Operating and cash cycles. Short-term financial planning. Purchase order financing. <i>Minicase:</i> Piepkorn Manufacturing Working Capital Management.	Stresses the importance of cash flow timing. Illustrates creation of cash budgets and potential need for financing. Brief discussion of PO financing, which is popular with small and medium-sized firms. Illustrates the construction of a cash budget and short-term financial plan for a small company.



Chapters	Selected Topics of Interest	Benefits to You
<b>CHAPTER 19</b> Cash and Liquidity Management	<i>New:</i> COVID and short-term finance.  Float management.  Cash collection and disbursement.  <i>Minicase:</i> Cash Management at Webb Corporation.	Discussion of the COVID-19 crisis on short-term planning.  Thorough coverage of float management and potential ethical issues.  Examination of systems used by firms to handle cash inflows and outflows.  Evaluates alternative cash concentration systems for a small firm.
<b>CHAPTER 20</b> Credit and Inventory Management	<i>New:</i> COVID-19 and inventory.  Credit management. Inventory management. <i>Minicase:</i> Credit Policy at Howlett Industries.	Discussion of excess inventory and inventory shortages due to COVID-19.  Analysis of credit policy and implementation.  Brief overview of important inventory concepts.  Evaluates working capital issues for a small firm.
<b>PART 8 Topics in Corporate Finance</b>		
<b>CHAPTER 21</b> International Corporate Finance	Foreign exchange.  International capital budgeting.  Exchange rate and political risk.  Brexit. Repatriation.  <i>Minicase:</i> S&S Air Goes International.	Covers essentials of exchange rates and their determination.  Shows how to adapt basic DCF approach to handle exchange rates.  Discusses hedging and issues surrounding sovereign risk.  Uses “Brexit” as an illustration of political risk.  Chapter opener and in-chapter discussion of the immense overseas cash holdings by U.S. corporations.  Discusses factors in an international expansion for a small firm.
<b>CHAPTER 22</b> Behavioral Finance: Implications for Financial Management	Behavioral finance.  Case against efficient markets.  <i>Minicase:</i> Your 401(k) Account at S&S Air.	Unique and innovative coverage of the effects of biases and heuristics on financial management decisions. “In Their Own Words” box by Hersh Shefrin.  Presents the behavioral case for market inefficiency and related evidence pro and con.  Illustrates the considerations to be taken when selecting investment options.
<b>CHAPTER 23</b> Enterprise Risk Management	Volatility and risk.  Hedging with forwards, options, and swaps. <i>Minicase:</i> Chatman Mortgage, Inc.	Illustrates need to manage risk and some of the most important types of risk.  Shows how many risks can be managed with financial derivatives.  Analyzes hedging of interest rate risk.



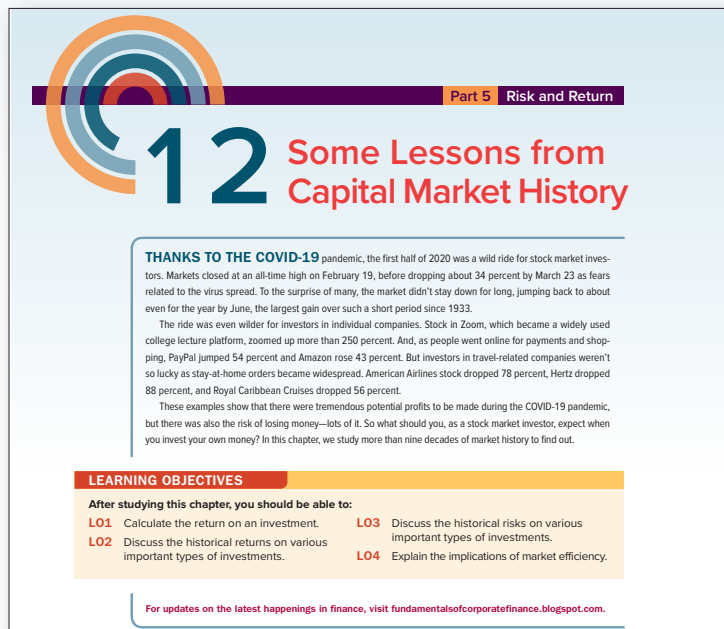
Chapters	Selected Topics of Interest	Benefits to You
<b>CHAPTER 24</b> Options and Corporate Finance	Stock options, employee stock options, and real options. Option-embedded securities. <i>Minicase:</i> S&S Air's Convertible Bond.	Discusses the basics of these important option types. Describes the different types of options found in corporate securities. Examines security issuance issues for a small firm.
<b>CHAPTER 25</b> Option Valuation	Put-call parity and Black-Scholes. Options and corporate finance. <i>Minicase:</i> Exotic Cuisines Employee Stock Options.	Develops modern option valuation and factors influencing option values. Applies option valuation to a variety of corporate issues, including mergers and capital budgeting. Illustrates complexities that arise in valuing employee stock options.
<b>CHAPTER 26</b> Mergers and Acquisitions	Alternatives to mergers and acquisitions. Defensive tactics. Divestitures and restructurings. Mergers and acquisitions. <i>Minicase:</i> The Birdie Golf–Hybrid Golf Merger.	Covers strategic alliances and joint ventures and why they are important alternatives. Expanded discussion of antitakeover provisions. Examines important actions such as equity carve-outs, spins-offs, and split-ups. Develops essentials of M&A analysis, including financial, tax, and accounting issues. Covers small business valuation for acquisition purposes.
<b>CHAPTER 27</b> Leasing	Changes in lease accounting. Leases and lease valuation. <i>Minicase:</i> The Decision to Lease or Buy at Warf Computers.	Discusses recent changes in lease accounting rules and the curtailment of “off-balance-sheet” financing. Examines essentials of leasing, good and bad reasons for leasing, and NPV of leasing. Covers lease-or-buy and related issues for a small business.

# In-Text Study Features

To meet the varied needs of its intended audience, *Fundamentals of Corporate Finance* is rich in valuable learning tools and support.

## CHAPTER-OPENING VIGNETTES

Vignettes drawn from real-world events introduce students to the chapter concepts.



**Part 5 Risk and Return**

## 12 Some Lessons from Capital Market History

**THANKS TO THE COVID-19** pandemic, the first half of 2020 was a wild ride for stock market investors. Markets closed at an all-time high on February 19, before dropping about 34 percent by March 23 as fears related to the virus spread. To the surprise of many, the market didn't stay down for long, jumping back to about even for the year by June, the largest gain over such a short period since 1933.

The ride was even wilder for investors in individual companies. Stock in Zoom, which became a widely used college lecture platform, zoomed up more than 250 percent. And, as people went online for payments and shopping, PayPal jumped 54 percent and Amazon rose 43 percent. But investors in travel-related companies weren't so lucky as stay-at-home orders became widespread. American Airlines stock dropped 78 percent, Hertz dropped 88 percent, and Royal Caribbean Cruises dropped 56 percent.

These examples show that there were tremendous potential profits to be made during the COVID-19 pandemic, but there was also the risk of losing money—lots of it. So what should you, as a stock market investor, expect when you invest your own money? In this chapter, we study more than nine decades of market history to find out.

**LEARNING OBJECTIVES**

After studying this chapter, you should be able to:

**LO1** Calculate the return on an investment.

**LO2** Discuss the historical returns on various important types of investments.

**LO3** Discuss the historical risks on various important types of investments.

**LO4** Explain the implications of market efficiency.

For updates on the latest happenings in finance, visit [fundamentalsofcorporatefinance.blogspot.com](https://fundamentalsofcorporatefinance.blogspot.com).

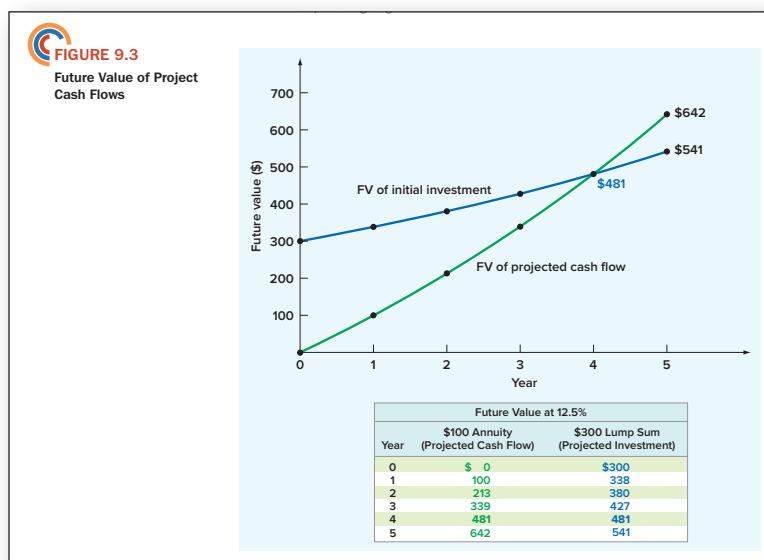
## CHAPTER LEARNING OBJECTIVES

This feature maps out the topics and learning goals in every chapter. Each end-of-chapter problem and test bank question is linked to a learning objective, to help you organize your assessment of knowledge and comprehension.



## PEDAGOGICAL USE OF COLOR

This learning tool continues to be an important feature of *Fundamentals of Corporate Finance*. In almost every chapter, color plays an extensive, nonschematic, and largely self-evident role. A guide to the functional use of color is on page xlvii of this front matter.





## IN THEIR OWN WORDS . . .

Robert C. Higgins on Sustainable Growth

**Most financial officers** know intuitively that it takes money to make money. Rapid sales growth requires increased assets in the form of accounts receivable, inventory, and fixed plant, which, in turn, require money to pay for assets. They also know that if their company does not have the money when needed, it can literally “grow broke.” The sustainable growth equation states these intuitive truths explicitly.

Sustainable growth is often used by bankers and other external analysts to assess a company’s creditworthiness. They are aided in this exercise by several sophisticated computer software packages that provide detailed analyses of the company’s past financial performance, including its annual sustainable growth rate.

Bankers use this information in several ways. Quick comparison of a company’s actual growth rate to its sustainable rate tells the banker what issues will be at the top of management’s financial agenda. If actual growth consistently exceeds sustainable growth, management’s problem will be where to get the cash to finance growth. The banker thus can anticipate interest in loan products. Conversely, if sustainable growth consistently exceeds actual, the banker had best be prepared to talk about investment products, because management’s problem will be what to do with all the cash that keeps piling up in the till.

Bankers also find the sustainable growth equation useful for explaining to financially inexperienced small business owners and overly optimistic entrepreneurs that, for the long-run viability of their business, it is necessary to keep growth and profitability in proper balance.

Finally, comparison of actual to sustainable growth rates helps a banker understand why a loan applicant needs money and for how long the need might continue. In one instance, a loan applicant requested \$100,000 to pay off several insistent suppliers and promised to repay in a few months when he collected some accounts receivable that were coming due. A sustainable growth analysis revealed that the firm had been growing at four to six times its sustainable growth rate and that this pattern was likely to continue in the foreseeable future. This alerted the banker to the fact that impatient suppliers were only a symptom of the much more fundamental disease of overly rapid growth, and that a \$100,000 loan would likely prove to be only the down payment on a much larger, multiyear commitment.

*Robert C. Higgins is a Professor Emeritus of Finance, at the Foster School of Business at the University of Washington. He pioneered the use of sustainable growth as a tool for financial analysis.*

## IN THEIR OWN WORDS BOXES

This series of boxes features popular articles on key topics in the text written by distinguished scholars and practitioners. Boxes include essays by Merton Miller on capital structure, Fischer Black on dividends, and Roger Ibbotson on capital market history. A complete list of In Their Own Words boxes appears on page xlv.

## WORK THE WEB BOXES

These boxes show students how to research financial issues using the web and then how to use the information they find to make business decisions. Work the Web boxes also include interactive follow-up questions and exercises.

## WORK THE WEB

As we discussed in this chapter, ratios are an important tool for examining a company’s performance. Gathering the necessary financial statements to calculate ratios can be tedious and time-consuming. Fortunately, many sites on the web provide this information for free. One of these is [www.reuters.com](http://www.reuters.com). We went there, entered the ticker symbol “HD” (for Home Depot), and then went to the “Key Metrics” page. Here is an abbreviated look at the results:



	Company	industry	sector
Quick Ratio (MRQ)	0.42	1.03	1.26
Current Ratio (MRQ)	1.34	1.91	1.58
LT Debt to Equity (MRQ)	397.33	84.80	34.40
Total Debt to Equity (MRQ)	406.99	98.04	64.39
Interest Coverage (TTM)	18.56	14.73	3.63

The website reports numerous ratios for each publicly traded company. We encourage you to have a look at your favorite company.

## Questions

1. Go to [www.reuters.com](http://www.reuters.com) and find the major ratio categories listed on this website. How do the categories differ from the categories listed in this textbook?
2. Go to [www.reuters.com](http://www.reuters.com) and look at the ratios. You will notice the ratios are reported for annual, quarterly, trailing twelve month, or 5-year numbers. Why might the ratios be calculated using different values?

REAL-WORLD EXAMPLES

Actual events are integrated throughout the text, tying chapter concepts to real life through illustration and reinforcing the relevance of the material. Some examples tie into the chapter-opening vignette for added reinforcement.

SPREADSHEET STRATEGIES

How to Calculate Present Values with Multiple Future Cash Flows Using a Spreadsheet

Just as we did in our previous chapter, we can set up a basic spreadsheet to calculate the present values of the individual cash flows as follows. Notice that we have calculated the present values one at a time and added them up:

	A	B	C	D	E
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
14					
15					
16					
17					
18					
19					
20					
21					
22					

SPREADSHEET STRATEGIES

This feature introduces students to Excel and shows them how to set up spreadsheets in order to analyze common financial problems—a vital part of every business student's education.

CALCULATOR HINTS

Brief calculator tutorials appear in selected chapters to help students learn or brush up on their financial calculator skills. These complement the Spreadsheet Strategies.

CALCULATOR HINTS

How to Calculate Present Values with Multiple Future Cash Flows Using a Financial Calculator

To calculate the present value of multiple cash flows with a financial calculator, we will discount the individual cash flows one at a time using the same technique we used in our previous chapter, so this is not really new. However, we can show you a shortcut. We will use the numbers in Example 6.3 to illustrate.

To begin, of course, we first remember to clear out the calculator! Next, from Example 6.3, the first cash flow is \$200 to be received in one year and the discount rate is 12 percent, so we do the following:

Enter

112200

NI/YPMTPVFV

Solve for

-178.57

Now, you can write down this answer to save it, but that's inefficient. All calculators have a memory where you can store numbers. Why not just save it there? Doing so cuts down on mistakes because you don't have to write down and/or rekey numbers, and it's much faster.

Next, we value the second cash flow. We need to change N to 2 and FV to 400. As long as we haven't changed anything else, we don't have to reenter I/Y or clear out the calculator, so we have:

Enter

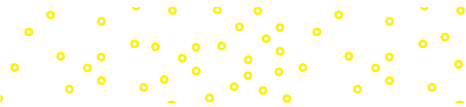
2400

NI/YPMTPVFV

Solve for

-318.88





CONCEPT BUILDING

Chapter sections are intentionally kept short to promote a step-by-step, building block approach to learning. Each section is then followed by a series of short concept questions that highlight the key ideas just presented. Students use these questions to make sure they can identify and understand the most important concepts as they read.

Concept Questions

3.3a

What are the five groups of ratios? Give two or three examples of each kind.

3.3b

Given the total debt ratio, what other two ratios can be computed? Explain how.

3.3c

Turnover ratios all have one of two figures as the numerator. What are these two figures? What do these ratios measure? How do you interpret the results?

3.3d

Profitability ratios all have the same figure in the numerator. What is it? What do these ratios measure? How do you interpret the results?

SUMMARY TABLES

These tables succinctly restate key principles, results, and equations. They appear whenever it is useful to emphasize and summarize a group of related concepts. For an example, see Chapter 3, page 72.

6.4

PV for a perpetuity =  $C/r$

For example, an investment offers a perpetual cash flow of \$500 every year. The return you require on such an investment is 8 percent. What is the value of this investment? The value of this perpetuity is:

$$\text{Perpetuity PV} = C/r = \$500/.08 = \$6,250$$

For future reference, Table 6.2 contains a summary of the annuity and perpetuity basic calculations we have described in this section. By now, you probably think that you'll just use online calculators to handle annuity problems. Before you do, see our nearby *Work the Web* box!

EXAMPLE 6.7

Preferred Stock

*Preferred stock* (or preference stock) is an important example of a perpetuity. When a corporation sells preferred stock, the buyer is promised a fixed cash dividend every period (usually every quarter) forever. This dividend must be paid before any dividend can be paid to regular stockholders—hence the term *preferred*.

Suppose the Fellini Co. wants to sell preferred stock at \$100 per share. A similar issue of preferred stock already outstanding has a price of \$40 per share and offers a dividend of \$1 every quarter. What dividend will Fellini have to offer if the preferred stock is going to sell?

LABELED EXAMPLES

Separate numbered and titled examples are extensively integrated into the chapters. These examples provide detailed applications and illustrations of the text material in a step-by-step format. Each example is completely self-contained so students don't have to search for additional information. Based on our classroom testing, these examples are among the most useful learning aids because they provide both detail and explanation.



## KEY TERMS

Key terms are printed in bold type and defined within the text the first time they appear. They also appear in the margins with definitions for easy location and identification by the student.

## EXPLANATORY WEB LINKS

These web links are provided in the margins of the text. They are specifically selected to accompany text material and provide students and instructors with a quick way to check for additional information using the internet.

1. A petition is filed in a federal court. Corporations may file a voluntary petition, or involuntary petitions may be filed against the corporation by several of its creditors.
2. A trustee-in-bankruptcy is elected by the creditors to take over the assets of the debtor corporation. The trustee will attempt to liquidate the assets.
3. When the assets are liquidated, after payment of the bankruptcy administration costs, the proceeds are distributed among the creditors.
4. If any proceeds remain, after expenses and payments to creditors, they are distributed to the shareholders.

The distribution of the proceeds of the liquidation occurs according to the following priority list:



The SEC has a good overview of the bankruptcy process in its "Online Publications" section at [www.sec.gov](http://www.sec.gov).

## KEY EQUATIONS

Called out in the text, key equations are identified by an equation number. The list in Appendix B shows the key equations by chapter, providing students with a convenient reference.

Based on our examples, we can now write the general expression for the value of a bond. If a bond has (1) a face value of  $F$  paid at maturity, (2) a coupon of  $C$  paid per period, (3)  $t$  periods to maturity, and (4) a yield of  $r$  per period, its value is:

$$\text{Bond value} = C \times [1 - 1/(1+r)^t]/r + F/(1+r)^t$$

<b>Bond value =</b>	<b>Present value</b>	<b>+</b>	<b>Present value</b>
	<b>of the coupons</b>		<b>of the face amount</b>

7.1

## HIGHLIGHTED CONCEPTS

Throughout the text, important ideas are pulled out and presented in a highlighted box—signaling to students that this material is particularly relevant and critical for their understanding. For examples, see Chapter 10, page 319; Chapter 13, page 441.

## EXCEL MASTER

Icons in the margin identify concepts and skills covered in our unique, RWJ-created Excel Master program. For more training in Excel functions for finance, and for more practice, log on to McGraw Hill's *Connect Finance* for *Fundamentals of Corporate Finance* to access the Excel Master files. This pedagogically superior tool will help get your students the practice they need to succeed—and to exceed expectations.



## 12.3 Average Returns: The First Lesson

As you've probably begun to notice, the history of capital market returns is too complicated to be of much use in its undigested form. We need to begin summarizing all these numbers. Accordingly, we discuss how to go about condensing the detailed data. We start out by calculating average returns.

### CALCULATING AVERAGE RETURNS

The obvious way to calculate the average returns on the different investments in Table 12.1 is to add up the yearly returns and divide by 94. The result is the historical average of the individual values.

For example, if you add up the returns for the large-company stocks in Figure 12.5 for the 94 years, you will get about 11.37. The average annual return is  $11.37/94 = .121$ , or 12.1%. You interpret this **12.1 percent** just like any other average. If you were to pick a year at random from the 94-year history and you had to guess what the return in that year was, the best guess would be 12.1 percent.

### AVERAGE RETURNS: THE HISTORICAL RECORD

Table 12.2 shows the average returns for the investments we have discussed. As shown, in a typical year, the small-company stocks increased in value by **16.3 percent**. Notice also how much larger the returns are for stocks, compared to the returns on bonds.

These averages are, of course, nominal because we haven't worried about inflation. Notice that the average inflation rate was **2.9 percent** per year over this 94-year span. The nominal return on U.S. Treasury bills was **3.4 percent** per year. The average real return on

## CHAPTER SUMMARY AND CONCLUSIONS

Every chapter ends with a concise, but thorough, summary of the important ideas—helping students review the key points and providing closure to the chapter.

### CHAPTER REVIEW AND SELF-TEST PROBLEM

- 2.1 Cash Flow for Mara Corporation** This problem will give you some practice working with financial statements and figuring cash flow. Based on the following information for Mara Corporation, prepare an income statement for 2021 and balance sheets for 2020 and 2021. Next, following our U.S. Corporation examples in the chapter, calculate cash flow from assets, cash flow to creditors, and cash flow to stockholders for Mara for 2021. Use a 21 percent tax rate throughout. You can check your answers against ours, found in the following section.

	2020	2021
Sales	\$4,203	\$4,507
Cost of goods sold	2,422	2,633
Depreciation	785	952
Interest	180	196
Dividends	275	352
Current assets	2,205	2,429
Net fixed assets	7,344	7,650
Current liabilities	1,003	1,255
Long-term debt	3,106	2,085

### CHAPTER REVIEW AND SELF-TEST PROBLEMS

Appearing after the Summary and Conclusions, each chapter includes a Chapter Review and Self-Test Problem section. These questions and answers allow students to test their abilities in solving key problems related to the chapter content and provide instant reinforcement.

## CONCEPTS REVIEW AND CRITICAL THINKING QUESTIONS


This successful end-of-chapter section facilitates your students' knowledge of key principles, as well as their intuitive understanding of the chapter concepts. A number of the questions relate to the chapter-opening vignette—reinforcing student critical thinking skills and the learning of chapter material.

### CONCEPTS REVIEW AND CRITICAL THINKING QUESTIONS

- Liquidity [LO1]** What does liquidity measure? Explain the trade-off a firm faces between high liquidity and low liquidity levels.
- Accounting and Cash Flows [LO2]** Why might the revenue and cost figures shown on a standard income statement not be representative of the actual cash inflows and outflows that occurred during a period?
- Book Values versus Market Values [LO1]** In preparing a balance sheet, why do you think standard accounting practice focuses on historical cost rather than market value?
- Operating Cash Flow [LO2]** In comparing accounting net income and operating cash flow, name two items you typically find in net income that are not in operating cash flow. Explain what each is and why it is excluded in operating cash flow.
- Book Values versus Market Values [LO1]** Under standard accounting rules, it is possible for a company's liabilities to exceed its assets. When this occurs, the owners' equity is negative. Can this happen with market values? Why or why not?
- Cash Flow from Assets [LO4]** Suppose a company's cash flow from assets is negative for a particular period. Is this necessarily a good sign or a bad sign?
- Operating Cash Flow [LO4]** Suppose a company's operating cash flow has been negative for several years running. Is this necessarily a good sign or a bad sign?
- Net Working Capital and Capital Spending [LO4]** Could a company's change in NWC be negative in a given year? (*Hint:* Yes.) Explain how this might come about. What about net capital spending?
- Cash Flow to Stockholders and Creditors [LO4]** Could a company's cash flow to stockholders be negative in a given year? (*Hint:* Yes.) Explain how this might come about. What about cash flow to creditors?
- Firm Values [LO1]** Referring back to the Procter & Gamble example used at the beginning of the chapter, note that we suggested that Procter & Gamble's stockholders probably didn't suffer as a result of the reported loss. What do you think was the basis for our conclusion?

## END-OF-CHAPTER QUESTIONS AND PROBLEMS

Students learn better when they have plenty of opportunity to practice; therefore, *Fundamentals*, 13e, provides extensive end-of-chapter questions and problems. The end-of-chapter support greatly exceeds typical introductory textbooks. The questions and problems are separated into three learning levels: Basic, Intermediate, and Challenge. Answers to selected end-of-chapter material appear in Appendix C. Also, most problems are available in McGraw Hill's Connect—see page xxiv for details.

QUESTIONS AND PROBLEMS	
<ol style="list-style-type: none"> <li><b>Building a Balance Sheet [LO1]</b> Bing, Inc., has current assets of \$5,400, net fixed assets of \$28,100, current liabilities of \$4,100, and long-term debt of \$10,600. What is the value of the shareholders' equity account for this firm? How much is net working capital?</li> <li><b>Building an Income Statement [LO1]</b> Nataro, Inc., has sales of \$742,000, costs of \$316,000, depreciation expense of \$39,000, interest expense of \$34,000, and a tax rate of 21 percent. What is the net income for this firm?</li> <li><b>Dividends and Retained Earnings [LO1]</b> Suppose the firm in Problem 2 paid out \$125,000 in cash dividends. What is the addition to retained earnings?</li> <li><b>Per-Share Earnings and Dividends [LO1]</b> Suppose the firm in Problem 3 had 75,000 shares of common stock outstanding. What is the earnings per share, or EPS, figure? What is the dividends per share figure?</li> <li><b>Calculating Taxes [LO3]</b> Timmy Tappan is single and had \$189,000 in taxable income. Using the rates from Table 2.3 in the chapter, calculate his income taxes. What is the average tax rate? What is the marginal tax rate?</li> <li><b>Calculating OCF [LO4]</b> Graff, Inc., has sales of \$49,800, costs of \$23,700, depreciation expense of \$2,300, and interest expense of \$1,800. If the tax rate is 22 percent, what is the operating cash flow, or OCF?</li> </ol>	 <b>BASIC</b> (Questions 1–11)

## END-OF-CHAPTER CASES

Located at the end of the book's chapters, these minicases focus on real-life company situations that embody important corporate finance topics. Each case presents a new scenario, data, and a dilemma. Several questions at the end of each case require students to analyze and focus on all of the material they learned from each chapter.

MINICASE																							
<b>Bullock Gold Mining</b>																							
<p>Seth Bullock, the owner of Bullock Gold Mining, is evaluating a new gold mine in South Dakota. Dan Dority, the company's geologist, has just finished his analysis of the mine site. He has estimated that the mine would be productive for eight years, after which the gold would be completely mined. Dan has taken an estimate of the gold deposits to Alma Garrett, the company's financial officer. Alma has been asked by Seth to perform an analysis of the new mine and present her recommendation on whether the company should open the new mine.</p> <p>Alma has used the estimates provided by Dan to determine the revenues that could be expected from the mine. She has also projected the expense of opening the mine and the annual operating expenses. If the company opens the mine, it will cost \$745 million today, and it will have a cash outflow of \$55 million nine years from today in costs associated with closing the mine and reclaiming the area surrounding it. The expected cash flows each year from the mine are shown in the table. Bullock Mining has a required return of 12 percent on all of its gold mines.</p>	<table border="1"> <thead> <tr> <th>Year</th> <th>Cash Flow</th> </tr> </thead> <tbody> <tr><td>0</td><td>–\$745,000,000</td></tr> <tr><td>1</td><td>127,000,000</td></tr> <tr><td>2</td><td>135,000,000</td></tr> <tr><td>3</td><td>145,000,000</td></tr> <tr><td>4</td><td>185,000,000</td></tr> <tr><td>5</td><td>225,000,000</td></tr> <tr><td>6</td><td>165,000,000</td></tr> <tr><td>7</td><td>155,000,000</td></tr> <tr><td>8</td><td>134,000,000</td></tr> <tr><td>9</td><td>– 55,000,000</td></tr> </tbody> </table>	Year	Cash Flow	0	–\$745,000,000	1	127,000,000	2	135,000,000	3	145,000,000	4	185,000,000	5	225,000,000	6	165,000,000	7	155,000,000	8	134,000,000	9	– 55,000,000
Year	Cash Flow																						
0	–\$745,000,000																						
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5	225,000,000																						
6	165,000,000																						
7	155,000,000																						
8	134,000,000																						
9	– 55,000,000																						
<b>QUESTIONS</b> <ol style="list-style-type: none"> <li>Construct a spreadsheet to calculate the payback period, internal rate of return, modified internal rate of return, and net present value of the proposed mine.</li> <li>Based on your analysis, should the company open the mine?</li> <li>Bonus question: Most spreadsheets do not have a built-in formula to calculate the payback period. Write a VBA script that calculates the payback period for a project.</li> </ol>																							

## WEB EXERCISES (ONLINE ONLY)

For instructors interested in integrating even more online resources and problems into their course, these web activities show students how to learn from the vast amount of financial resources available on the internet. In the 13th edition of *Fundamentals*, these web exercises are available to students and instructors through Connect.



# Comprehensive Teaching and Learning Package

This edition of *Fundamentals* has several options in terms of the textbook, instructor supplements, student supplements, and multimedia products. Mix and match to create a package that is perfect for your course!

## TEXTBOOK

Customize your version of *Fundamentals*, 13e, through McGraw Hill's *Create* platform. Teach the chapters you want in the order you want—your rep can show you how!

## INSTRUCTOR RESOURCES

Keep all the supplements in one place! Your Connect Library contains all the necessary supplements—Teaching Resource Manual, Solutions, Test Bank, Computerized Test Bank, and PowerPoint—all in one easy-to-find, easy-to-use, integrated place: Your *Connect Finance* course.

- **Teaching Resource Manual (TRM)**

The TRM is a full-service implementation guide designed to support you in the delivery of your curriculum and assist you in integrating Connect.

- **Solutions Manual (SM)**

*Prepared by Brad Jordan, University of Florida, and Joe Smolira, Belmont University*

The *Fundamentals* Solutions Manual provides detailed solutions to the extensive end-of-chapter material, including concept review questions, quantitative problems, and cases.

- **Test Bank**

*Prepared by Heidi Toprac*

Over 100 questions and problems per chapter! Each chapter includes questions that test the understanding of key terms in the book; questions patterned after learning objectives, concept questions, chapter-opening vignettes, boxes, and highlighted phrases; multiple-choice problems patterned after end-of-chapter questions at a variety of skill levels; and essay questions to test problem-solving skills and more advanced understanding of concepts.

- **Excel Simulations**

Expanded for this edition! With 180 Excel simulation questions now included in Connect, RWJ is the unparalleled leader in offering students the opportunity to practice using the Excel functions they will use throughout their careers in finance.

- **Corporate Finance Videos**

These brief and engaging conceptual videos (and accompanying questions) help students to master the building blocks of the Corporate Finance course.

- **PowerPoint Presentations**

The PowerPoint slides for the 13th edition have been revised to include a wealth of instructor material, including lecture tips, real-world examples, and international notes. Each presentation also includes slides dedicated entirely to ethics notes that relate to the chapter topics.

- **Test Builder in Connect**

Available within Connect, Test Builder is a cloud-based tool that enables instructors to format tests that can be printed or administered within a LMS. Test Builder offers a modern, streamlined interface for easy content configuration that matches course needs, without requiring a download.

Test Builder allows you to:

- Access all test bank content from a particular title.
- Easily pinpoint the most relevant content through robust filtering options.
- Manipulate the order of questions or scramble questions and/or answers.
- Pin questions to a specific location within a test.
- Determine your preferred treatment of algorithmic questions.
- Choose the layout and spacing.
- Add instructions and configure default settings.

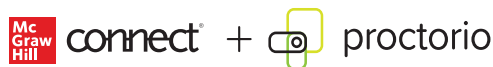
Test Builder provides a secure interface for better protection of content and allows for just-in-time updates to flow directly into assessments.

- **Tegrity: Lectures 24/7**

Tegrity in Connect is a tool that makes class time available 24/7 by automatically capturing every lecture. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio in a format that is easy to search, frame by frame. Students can replay any part of any class with easy-to-use, browser-based viewing on a PC, Mac, iPod, or other mobile device.

Educators know that the more students can see, hear, and experience class resources, the better they learn. In fact, studies prove it. Tegrity's unique search feature helps students efficiently find what they need, when they need it, across an entire semester of class recordings. Help turn your students' study time into learning moments immediately supported by your lecture. With Tegrity, you also increase intent listening and class participation by easing students' concerns about note-taking. Using Tegrity in Connect will make it more likely you will see students' faces, not the tops of their heads.

- **Remote Proctoring and Browser-Locking Capabilities**



New remote proctoring and browser-locking capabilities, hosted by Proctorio within Connect, provide control of the assessment environment by enabling security options and verifying the identity of the student.

Seamlessly integrated within Connect, these services allow instructors to control students' assessment experience by restricting browser activity, recording students' activity, and verifying students are doing their own work.

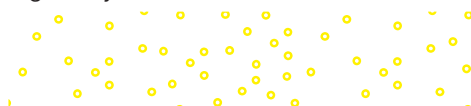
Instant and detailed reporting gives instructors an at-a-glance view of potential academic integrity concerns, thereby avoiding personal bias and supporting evidence-based claims.

## STUDENT RESOURCES

Student resources for this edition can be found through the Library tab in your *Connect Finance* course. If you aren't using Connect, visit us at [connect.mheducation.com](https://connect.mheducation.com) to learn more, and ask your professor about using it in your course for access to a great group of supplement resources!

- **Excel Resources**

For those seeking additional practice, students can access Excel template problems and Excel Master, designed by Brad Jordan and Joe Smolira.



- **Narrated Lecture Videos**

Updated for this edition, the Narrated Lecture videos provide real-world examples accompanied by step-by-step instructions and explanations for solving problems presented in the chapter. The Concept Checks from the text are also integrated into the slides to reinforce the key topics in the chapter. Designed specifically to appeal to the different learning methods of students, the slides provide a visual and audio explanation of topics and problems.

## TEACHING SUPPORT

Along with having access to all of the student resource materials through the Connect Library tab, you also have password-protected access to the Instructor's Manual, solutions to end-of-chapter problems and cases, Instructor's PowerPoint, Excel Template Solutions, video clips, and video projects and questions.

## HOW THE MARKET WORKS

Students receive free access to this web-based portfolio simulation with a hypothetical brokerage account to buy and sell stocks and mutual funds. Students can use the real data found at this site in conjunction with the chapters on investments. They can also compete against students in their class and around the United States to run the most successful portfolio. This site is powered by Stock-Trak, the leading provider of investment simulation services to the academic community.

## AVAILABLE FOR PURCHASE AND PACKAGING

### *FinGame Online 5.0*

*By LeRoy Brooks, John Carroll University*

(ISBN 10: 0077219880/ISBN 13: 9780077219888)

Just \$15.00 when packaged with this text. In this comprehensive simulation game, students control a hypothetical company over numerous periods of operation. The game is now tied to the text by exercises found on the Connect Student Library. As students make major financial and operating decisions for their company, they will develop and enhance their skills in financial management and financial accounting statement analysis.

## MCGRAW HILL CUSTOMER CARE CONTACT INFORMATION

At McGraw Hill, we understand that getting the most from new technology can be challenging. That's why our services don't stop after you purchase our products. You can chat with our Product Specialists 24 hours a day to get product training online. Or you can search our knowledge bank of Frequently Asked Questions on our support website. For Customer Support, call **800-331-5094**, or visit **mpss.mhhe.com**. One of our Technical Support Analysts will be able to assist you in a timely fashion.

### **Assurance of Learning Ready**

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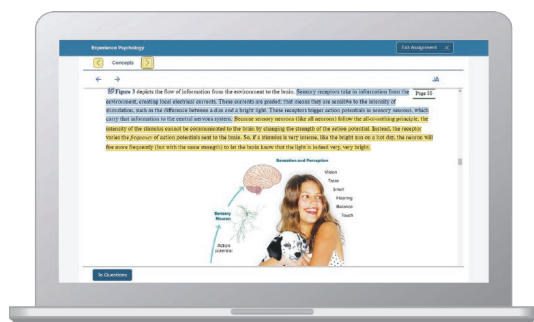


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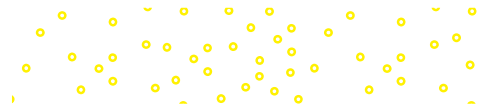
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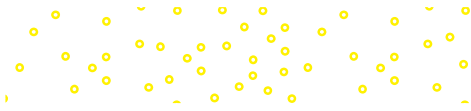
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Throughout the development of this edition, we have taken great care to discover and eliminate errors. Our goal is to provide the best textbook available on the subject. To ensure that future editions are error-free, we gladly offer \$10 per arithmetic error to the first individual reporting it as a modest token of our appreciation. More than this, we would like to hear from instructors and students alike. Please write and tell us how to make this a better text. Forward your comments to Dr. Brad Jordan, c/o Editorial—Finance, McGraw Hill, 1120 S. Riverside Plaza, Chicago, IL 60606.

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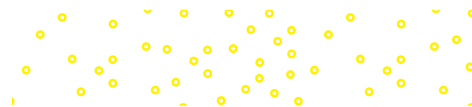
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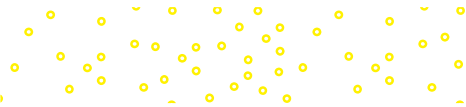
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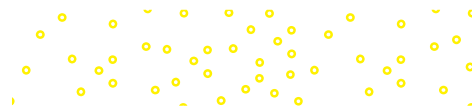
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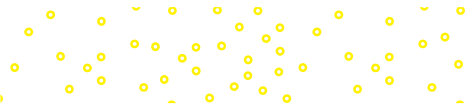
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On Behavioral Finance

## CHAPTER 24

Erik Lie University of Iowa  
On Option Backdating

Robert C. Merton Harvard University, Massachusetts Institute of Technology  
On Applications of Options Analysis

# Pedagogical Use of Color

Throughout the 13th edition of *Fundamentals of Corporate Finance*, we make color a functional dimension of the discussion. In almost every chapter, color plays an extensive and largely self-evident role. Color in these chapters alerts students to the relationship between numbers in a discussion and an accompanying table or figure.

## CHAPTER 2

**Blue:** Identifies net capital spending and change in net working capital

**Green:** Identifies cash flow numbers

## CHAPTERS 3 AND 4

*Throughout the chapter*

**Blue:** Identifies income statements

**Green:** Identifies balance sheets (Also see all 23 ratios in Chapter 3)

## CHAPTER 7

*Section 7.4*

**Blue:** Identifies the implicit interest expense

**Green:** Identifies the straight-line interest expense

## CHAPTER 9

*Section 9.5*

**Blue:** Identifies Project A

**Green:** Identifies Project B

## CHAPTER 13

*Sections 13.1 and 13.2*

**Blue:** Identifies Stock L

**Green:** Identifies Stock U

*Section 13.7*

**Blue:** Identifies Asset B

**Green:** Identifies Asset A

## CHAPTER 14

*Section 14.2*

**Blue:** Identifies dollar and percentage changes in dividends

**Green:** Identifies dividends

## CHAPTER 15

*Section 15.9*

**Blue:** Identifies values of shares with and without dilution

**Green:** Identifies original values of shares

## CHAPTER 16

*Section 16.2*

**Blue:** Identifies the proposed capital structure

**Green:** Identifies the current capital structure

*Section 16.4*

**Blue:** Identifies Firm L

**Green:** Identifies Firm U

## CHAPTER 18

*Section 18.4*

**Blue:** Identifies total cash collections

**Green:** Identifies total cash disbursements

**Bold Black:** Identifies the net cash inflows

## CHAPTER 19

*Section 19.2*

**Blue:** Receipts and deposits

**Green:** Total float

*End-of-chapter Appendix*

**Blue:** Identifies contributing costs

**Green:** Identifies the opportunity, trading, and total costs

## CHAPTER 20

*Section 20.8*

**Blue:** Identifies numbers exceeding the cost-minimizing restock quantity

**Green:** Identifies numbers falling below the cost-minimizing restock quantity

**Bold Black:** Identifies cost-minimizing quantity

## CHAPTER 21

*Section 21.5*

**Blue:** Identifies cash flows

**Green:** Identifies expected exchange rates

## CHAPTER 23

*Sections 23.2, 23.3, and 23.6*

**Blue:** Identifies the payoff profile

**Green:** Identifies the risk profile

**Magenta:** Identifies the hedge position

## CHAPTER 24

*Section 24.1*

**Blue:** Identifies puts

**Green:** Identifies calls

*Section 24.2*

**Blue:** Identifies stock value

**Green:** Identifies portfolio value

## CHAPTER 26

*Sections 26.3 and 26.5 (See Tables 26.1 and 26.2)*

**Blue:** Identifies Firm A and Global Resources

**Green:** Identifies Firm B and Regional Enterprises

**Bold Black:** Identifies the merged firm, Firm AB, and the merged identity of Global Resources

## CHAPTER 27

*Tables 27.2 and 27.3*

**Blue:** Identifies cash flow components

**Green:** Identifies total cash flow