Contents at a Glance

Introduction 1

Part 1: What's Unique about Corporate Finance 5

CHAPTER 1: The Tale of Corporate Finance 7
CHAPTER 2: Introducing Finance Land 15
CHAPTER 3: Pitching Your Story for Money 35

Part 2: Making a Statement 45

CHAPTER 4: Staying Balanced 47
CHAPTER 5: Incoming Income 59
CHAPTER 6: Going with the (Cash) Flow 67
CHAPTER 7: Mastering Metrics 75
CHAPTER 8: Calculating Capital 97

Part 3: Valuations on the Price Tags of Business 115

CHAPTER 9: Determining Present and Future Values: Time Is Money 117
CHAPTER 10: Calling in the Cavalry 125
CHAPTER 11: Bonding Over Business 143
CHAPTER 12: Savvy Stock Sales 159
CHAPTER 13: Pricing Probability from Derived Value 173

Part 4: A Wonderland of Risk Management 183

CHAPTER 14: Managing Uncertainty 185
CHAPTER 15: Through the Looking Glass of Modern Portfolio Theory 197
CHAPTER 16: Financially Engineering Yourself Deeper Down the Rabbit Hole 217
CHAPTER 17: Weighing Capital 233

Part 5: Financial Management 243

CHAPTER 18: Assessing Financial Performance 245
CHAPTER 19: Forecasting Finances 263
CHAPTER 20: Getting the Deets on M&A 277

Part 6: The Part of Tens 295

CHAPTER 21: Ten Things You Need to Know about International Finance 297
CHAPTER 22: Ten Things You Need to Understand about Behavioral Finance 313

Index 325

COPYRIGHTED MATERIAL

Table of Contents

INTRODUCTION 1
About This Book 1
Foolish Assumptions 2
Icons Used in This Book 3
New to this Edition 4
Beyond the Book 4
Where to Go from Here 4

PART 1: WHAT'S UNIQUE ABOUT CORPORATE FINANCE 5

CHAPTER 1: The Tale of Corporate Finance 7
Telling a Story with Numbers 7
Characterizing Motivations 10
The role of financial institutions 11
Defining investing 11
Setting the Stage 12

CHAPTER 2: Introducing Finance Land 15
Visiting the Main Attractions in Finance Land 15
Corporations 16
Depository institutions 17
Insurance companies 18
Securities firms 20
Underwriters 21
Funds 22
Financing institutions 23
Exchanges 25
Regulatory bodies 25
Federal Reserve and U.S. Treasury 26
Getting a Job in Finance Land 28
Accounts payable and/or receivable 28
HR and payroll 29
Analysts 29
Auditors 29
Adjusters 29
Bookkeepers and accountants 29
Modelers and scientists 30
Economists and consultants 30
Traders 30
Treasurers 30
Bankers and more 31

Visiting the Finance Land Information Center 31
Internet sources 31
Print sources 32
Human sources 33

CHAPTER 3: **Pitching Your Story for Money** 35
Raising Capital 35
Diving into Debt 36
Asking the right people for money 37
Making sure the loan pays off in the long run 38
Looking at loan terms 39
Schmoozing Investors 40
Selling stock to the public 40
Looking at the different types of stock 42
Having Your Wish Granted 43

PART 2: MAKING A STATEMENT 45

CHAPTER 4: **Staying Balanced** 47
Introducing the Balance Sheet 47
Evaluating the Weights on the Balance Scale 48
Understanding Assets 49
Current assets 49
Long-term assets 51
Intangible assets 53
Other assets 54
Learning about Liabilities 54
Current liabilities 54
Long-term liabilities 56
Eyeing Owners' Equity 56
Preferred shares 56
Common shares 57
Treasury shares 57
Additional paid-in capital 57
Retained earnings 58
Finding Financial Zen 58

CHAPTER 5: **Incoming Income** 59
Adding It Up 59
Gross profit 60
Operating income 62
Earnings before interest and taxes (EBIT) 63
Net income 64
Earnings per share 65
Supplemental notes 66
Putting the Income Statement to Good Use 66

CHAPTER 6: **Going with the (Cash) Flow** 67
Moving Along Three Smooth Flows 67
Operating cash flows 68
Investing cash flows 69
Financing cash flows 70
Combining the three types of operations to get the net change in cash 71
Reaching Your Destination 72

CHAPTER 7: **Mastering Metrics** 75
Paying the Bills 75
Days sales in receivables 76
Accounts receivables turnover 77
Accounts receivables turnover in days 78
Days sales in inventory 78
Inventory turnover 79
Inventory turnover in days 80
Operating cycle 80
Working capital 81
Current ratio 82
Acid test ratio (aka Quick Ratio) 82
Cash ratio 83
Sales to working capital 83
Operating cash flows to current maturities 84
Working Your Assets 85
Net profit margin 85
Total asset turnover 86
Return on assets 86
Operating income margin 87
Operating asset turnover 88
Return on operating assets 88
Return on total equity 89
Return on common equity 89
DuPont equation 90
Fixed asset turnover 91
Return on investment 91
Gross profit margin 92
Operating ratio 93
Percent earned on operating property 93
Operating revenue to operating property ratio 94
Long-term debt to operating property ratio 95

CHAPTER 8: **Calculating Capital** 97
Sizing Up Shareholders 97
Financial leverage 98
Earnings per common share 98

Operating cash flows per share 99
Price to earnings ratio 100
Percentage of earnings retained 101
Dividend payout 102
Dividend yield 102
Book value per share 103
Cash dividend coverage ratio 104
Banking on Metrics 104
Earning assets to total assets ratio 105
Net interest margin 105
Loan loss coverage ratio 106
Equity to total assets ratio 107
Deposits times capital 107
Loans to deposits ratio 108
Keeping Debt Healthy 109
Times interest earned 109
Fixed charge coverage 110
Debt ratio 110
Debt to equity ratio 111
Debt to tangible net worth 111
Operating cash flows to total debt 112
Equity multiplier 113

PART 3: VALUATIONS ON THE PRICE TAGS OF BUSINESS 115

CHAPTER 9: **Determining Present and Future Values: Time Is Money** 117
Losing Value over Time 118
Inflation 118
Interest rates 119
Predicting Future Value 120
Simple interest 120
Compound interest 121
Calculating the Present Value 121
A closer look at earnings 122
Discounted cash flows 123

CHAPTER 10: **Calling in the Cavalry** 125
Budgeting Capital 126
Rating Your Returns 127
Looking at costs 128
Calculating revenue 128
Calculating the accounting rate of return 128
Making the most of the internal rate of return through modification 130

Netting Present Values 132
Calculating NPV over time 132
Managing the project's value 133
Paying It Back 134
Allocating Capital 134
Calculating the equivalent annual cost 135
Considering liquid assets 136
Managing Projects 137
Value schedule metrics 137
Budget metrics 139

CHAPTER 11: **Bonding Over Business** 143
Exploring the Different Types of Bonds 143
Considering corporate bonds 144
Gauging government bonds 144
Clipping coupon bonds 147
Backing up with assets 147
Converting bonds 148
Calling it in with callable bonds 149
Putting in the effort: puttable bonds 149
Registering the bearer 150
Counting on forgiveness with catastrophe bonds 150
Junking bad bonds 150
Reviewing Bond Rates 151
Reading Bond Information 153
Understanding Bond Valuation 156

CHAPTER 12: **Savvy Stock Sales** 159
Exchanging Stocks 159
Looking at the Different Types of Orders 160
Market order 161
Stop and limit orders 161
Pegged order 162
Time-contingent order 163
Comparing Long and Short Stocks 163
Buying long 163
Buying on margin 164
Selling short 164
Defining Caps and Sectors 165
Caps 165
Sectors 166
Raging Bulls and Grizzly Bears 167
Beating Stock Indices? 168
Imagining the Value of Stocks 168

Surveying equity valuation models 169
Checking out corporate analysis 170
Evaluating industry performance 170
Factoring in stock market fluctuations 171
Considering macroeconomics 171

CHAPTER 13: **Pricing Probability from Derived Value** 173
Deriving Value 173
Keeping Your Options Open 174
Choosing between put and call 175
Valuing an option 176
Paying It Forward 177
Agreeing to forward 177
Valuing a forward 178
Standardizing the Future 179
Predicting futures 179
Valuing futures 180
Swapping Numbers 180
Managing risk with swaps 181
Generating revenue with swaps 182
Valuing a swap 182

PART 4: A WONDERLAND OF RISK MANAGEMENT 183

CHAPTER 14: **Managing Uncertainty** 185
Understanding that Risk Is Unavoidable 185
Risking Your Interest with Inflation 186
Minimizing Market Risk 187
Giving Credit Where It's Due 188
Getting Shady with Off-Balance-Sheet Risk 190
Factoring in Foreign Exchange Risk 190
Transaction risk 191
Translation risk 191
Other foreign exchange risk 192
Identifying Operating Risk 193
Looking at Liquidity Risk 194
Sorting Your Customer's Laundry 195

CHAPTER 15: **Through the Looking Glass of Modern Portfolio Theory** 197
Delving into Portfolio Basics 198
Surveying portfolio management strategies 198
Looking at modern portfolio theory 199
Understanding passive versus active management 200

Joking about Market Efficiency 200
Risking Returns 202
Looking at the trade-off between risk and return 202
Diversifying to maximize returns and minimize risk 203
Considering risk aversion 205
Measuring risk 208
Optimizing Portfolio Risk 212
Reaching the efficient frontier 213
Innovating risk management 214

CHAPTER 16: **Financially Engineering Yourself Deeper Down the Rabbit Hole** 217
Making Securities Out of Anything 218
You can securitize everything 218
Slicing securities into tranches 219
Splicing Hybrids 220
The mixed-interest class of hybrids 220
Single asset class hybrids 221
Indexed-back CDs 222
Bundling Assets 222
Pass-through certificates 223
Multi-asset bundles 223
Unbundling 224
Exploring Exotics 224
Options 225
Swaps contracts 225
Loans 226
Engineering Finances 226
Moving into Computational Finance 228
Changing the face of trading 229
Banking from beyond 230
Building quantitative algorithms 230

CHAPTER 17: **Weighing Capital** 233
Calculating the Cost of Capital 233
Measuring cost of capital, the WACC way 235
Factoring in the cost of debt 235
Looking at the cost of equity 236
Dividend policy 237
Choosing the Proper Capital Structure 240

PART 5: FINANCIAL MANAGEMENT 243

CHAPTER 18: **Assessing Financial Performance** 245
Analyzing Financial Success 245
Using Common-Size Comparisons 246

Vertical common-size comparisons 247
Horizontal common-size comparisons. 248
Cross comparisons 250
Performing Comparatives 252
Comparison over time 252
Comparison against the industry 254
Determining the Quality of Earnings 256
Accounting concerns. 256
Sources of cash flows 258
Assessing Investment Performance 260
Conventional evaluations. 260

CHAPTER 19: **Forecasting Finances**. 263
Seeing with Analytical Eyes 264
Collecting data 264
Finding an average 266
Measuring distribution 267
Calculating probability 269
Viewing the Past as New. 270
Finding trends and patterns 271
Looking at regression 272
Seeing the Future Unclouded: Forecasting 274
Using statistics and probability 274
Using reference class forecasting 276
Evaluating forecast performance 276

CHAPTER 20: **Getting the Deets on M&A** 277
Dissecting M&A 277
Diversification 279
Geographic expansion 280
Economies of scale 280
Economies of scope 281
Vertical integration 281
Horizontal integration. 282
Conglomerate integration 282
Elimination of competitors. 282
Manager compensation 283
Synergistic operations 283
Moving Beyond the M and the A. 284
Mergers. 284
Acquisitions 285
Buyouts. 287
Factoring. 287
Joint ventures. 288

Partnerships 288
Licensing agreements 288
Hostile takeovers 288
Divesting Is Investing 289
Measuring What a Business Is Worth to You 290
Future cash flows 291
Control premiums 291
Company worth by comparison 292
Cash-flow evaluation 292
Measures of market share 293
Financing M&A 293

PART 6: THE PART OF TENS 295

CHAPTER 21: Ten Things You Need to Know about International Finance 297
There's No Such Thing as a Trade Imbalance 298
Purchasing Power and Exchange Rates Are Different Things 300
Interest Rates and Exchange Rates Have a Muddled Relationship 300
Spot Rate Isn't the Only Type of Currency Transaction 302
Diversification Can't Completely Eliminate Risk Exposure 303
Cross-Listing Allows Companies to Tap the World's Resources 304
Outsourcing Is a Taxing Issue 306
Politics Complicate Your Life 307
Cultural Understanding Is Vital 309
Cryptocurrencies Come with Risk 310

CHAPTER 22: Ten Things You Need to Understand about Behavioral Finance 313
Making Financial Decisions Is Never Rational 314
Being Irrational Can Be Entirely Rational 315
Framing Affects Your Decision-Making Prowess 316
Making Sound Financial Decisions Involves Identifying Logical Fallacies 317
Getting Emotional about Financial Decisions Can Leave You Crying 318
Financial Stampeding Can Get You Trampled 319
Letting Relationships Influence Finances Can Be Ruinous 320
Satisficing Is Good Enough 321
Prospect Theory Explains the Improbable 322
Being Biased Is Human Nature 323

INDEX 325