

# **Corporate Finance**

---

3<sup>rd</sup> Edition

Steven M. Bragg

# Table of Contents

---

<b>Chapter 1 – Overview of Corporate Finance .....</b>	<b>1</b>
Learning Objectives .....	1
Introduction.....	1
The Nature of Finance .....	1
Corporate Finance Topics.....	1
Financial Management.....	3
External Players.....	5
The Balancing Act of Corporate Finance .....	6
Summary.....	7
Review Questions.....	8
Review Answers .....	9
<b>Chapter 2 – Capital Structure.....</b>	<b>11</b>
Learning Objectives .....	11
Introduction.....	11
Optimal Capital Structure .....	11
Capital Structure Analysis .....	12
The Financial Leverage Concept.....	13
Leverage Risk.....	15
Impact of Compensation on Leverage .....	16
Line of Credit Issues .....	16
Tax Shield Effects.....	16
Future Financing Flexibility.....	17
Market Timing.....	17
Loan Covenant Issues .....	17
Maturity Structure of Debt .....	17
Creditor Position Considerations .....	18
Debt Paydown .....	18
Cost of Capital Reduction .....	19
Market Signals.....	19
Planning for a Bond Rating .....	19
Timing of Changes to the Capital Structure .....	21
Summary.....	21
Review Questions.....	22
Review Answers .....	23
<b>Chapter 3 – Financial Planning.....</b>	<b>25</b>
Learning Objectives .....	25
Introduction.....	25
The Cash Forecast .....	25
The Short-Term Cash Forecast.....	26
The Medium-Term Cash Forecast.....	29
The Use of Averages .....	29
The Reliability of Cash Flow Information .....	30
The Impact of Special Events.....	31
The Master Budget .....	31
The Budgeted Income Statement.....	32
Components of the Budgeted Balance Sheet .....	32
Additional Estimation Elements .....	37
The Cash Line Item .....	38
The Budgeted Balance Sheet .....	39
The Financing Budget.....	40
Summary.....	41
Review Questions.....	42
Review Answers .....	43

## Table of Contents

<b>Chapter 4 – Early-Stage Financing .....</b>	<b>45</b>
Learning Objectives .....	45
Introduction.....	45
Angel Investors.....	45
Venture Capital.....	45
Dangers of Venture Capital.....	46
Summary.....	47
Review Questions.....	48
Review Answers .....	49
<b>Chapter 5 – The Initial Public Offering.....</b>	<b>51</b>
Learning Objectives .....	51
Introduction.....	51
Reasons for and Against an IPO .....	51
Preparation for the IPO .....	52
The Initial Public Offering.....	54
Share Lockup Period .....	58
Blue Sky Laws .....	58
Summary.....	59
Review Questions.....	60
Review Answers .....	61
<b>Chapter 6 – Other Capital Raising Alternatives.....</b>	<b>63</b>
Learning Objectives .....	63
Introduction.....	63
Regulation D Stock Sales .....	63
Regulation D Rules.....	63
Regulation D Process Flow.....	63
The Form D Filing .....	65
Rule 506(c).....	66
The Accredited Investor.....	66
Regulation A+ Overview .....	67
Private Investments in Public Equity.....	68
Crowdfunding .....	68
Requirements .....	68
Disclosures.....	69
Limits on Advertising and Promoters.....	70
Restrictions on Resale .....	71
Exemption from Section 12(g).....	71
Bad Actor Disqualification .....	71
Seasoned Equity Offerings .....	72
The Rights Offering.....	72
Dilution .....	73
Summary.....	74
Review Questions.....	75
Review Answers .....	76
<b>Chapter 7 – Debt Financing.....</b>	<b>77</b>
Learning Objectives .....	77
Introduction.....	77
Overview of Debt Financing .....	77
Customer Advances.....	77
The Line of Credit .....	78
The Borrowing Base .....	78
Invoice Discounting.....	80
Factoring .....	80
Receivables Securitization .....	81
Inventory Financing .....	81

## Table of Contents

Loan Stock .....	82
Purchase Order Financing .....	82
Working Capital Loans .....	83
Hard Money Loans .....	83
Mezzanine Financing .....	83
The Long-Term Loan .....	84
Bonds .....	85
Agency Financing .....	86
Debt for Equity Swaps .....	86
Summary .....	87
Review Questions .....	88
Review Answers .....	89
<b>Chapter 8 – Leasing.....</b>	<b>91</b>
Learning Objectives .....	91
Introduction.....	91
The Lease Arrangement .....	91
The Lease or Buy Decision .....	91
Leasing Concerns.....	92
Leasing Advantages .....	93
Summary .....	94
Review Questions.....	95
Review Answers .....	96
<b>Chapter 9 – The Cost of Capital.....</b>	<b>97</b>
Learning Objectives .....	97
Introduction.....	97
Cost of Capital Derivation .....	97
Cost of Debt .....	97
Cost of Preferred Stock.....	97
Cost of Common Stock.....	98
Weighted Average Cost of Capital .....	98
Variations in the Cost of Capital .....	99
Adjustments to the Cost of Capital .....	101
Cost of Capital as a Threshold Value .....	102
Summary.....	102
Review Questions.....	103
Review Answers .....	104
<b>Chapter 10 – Discounted Cash Flows.....</b>	<b>105</b>
Learning Objectives .....	105
Introduction.....	105
Time Value of Money .....	105
Present and Future Value Tables.....	106
Net Present Value.....	108
Internal Rate of Return.....	109
Incremental Internal Rate of Return.....	110
Terminal Value .....	110
Inclusions in Cash Flow Analysis .....	111
Summary .....	111
Review Questions.....	112
Review Answers .....	113
<b>Chapter 11 – Working Capital Management.....</b>	<b>115</b>
Learning Objectives .....	115
Introduction.....	115
The Impact of Working Capital on Corporate Finance.....	115
Accounts Receivable Enhancements .....	115

## Table of Contents

Credit Enhancements .....	116
Billing Enhancements .....	116
Collection Enhancements .....	117
Accounts Receivable Policies .....	118
Summary .....	118
<b>Inventory Enhancements .....</b>	<b>118</b>
Product Design .....	119
Product Record Keeping .....	119
Inventory Acquisition .....	120
Inventory Ownership .....	120
Manufacturing Process Flow .....	121
Fulfillment .....	121
Inventory Disposition .....	121
Inventory Policies .....	122
Departmental Cooperation .....	122
Summary .....	122
<b>Accounts Payable Enhancements .....</b>	<b>122</b>
Terms Renegotiation .....	123
Early Payment Discounts .....	123
Payment Processing Frequency .....	124
Accounts Payable Policies .....	124
<b>Researching Working Capital Enhancements .....</b>	<b>124</b>
<b>Working Capital Forecasting .....</b>	<b>125</b>
<b>Working Capital Strategy .....</b>	<b>125</b>
<b>Summary .....</b>	<b>125</b>
<b>Review Questions .....</b>	<b>127</b>
<b>Review Answers .....</b>	<b>128</b>
<b>Chapter 12 – Capital Expenditures .....</b>	<b>129</b>
Learning Objectives .....	129
Introduction .....	129
Overview of Capital Expenditures .....	129
Net Present Value Analysis .....	130
Breakeven Analysis .....	132
The Profitability Index .....	132
The Payback Method .....	133
Real Options .....	135
Constraint Analysis .....	136
Capital Expenditure Proposal Analysis .....	137
The Outsourcing Decision .....	138
Complex Systems Analysis .....	139
Summary .....	139
Review Questions .....	140
Review Answers .....	141
<b>Chapter 13 – Investment Alternatives .....</b>	<b>143</b>
Learning Objectives .....	143
Introduction .....	143
Investment Guidelines .....	143
Cash Availability Scenarios .....	145
Investment Strategy .....	146
Types of Investments .....	148
Repurchase Agreements .....	148
Time Deposits .....	148
Certificates of Deposit .....	148
Bankers' Acceptances .....	149
Commercial Paper .....	149
Money Market Funds .....	149

## Table of Contents

U.S. Government Debt Instruments.....	149
State and Local Government Debt .....	150
Bonds .....	150
The Primary and Secondary Markets .....	151
The Effective Interest Rate.....	151
The Discounted Investment Formula .....	151
Summary .....	152
Review Questions.....	153
Review Answers .....	154
<b>Chapter 14 – Dividends and Other Payouts .....</b>	<b>155</b>
Learning Objectives .....	155
Introduction.....	155
Dividend Mechanics.....	155
Types of Dividends .....	156
The Investor Viewpoint .....	156
The Company Viewpoint.....	157
The Stock Buyback Option.....	158
Deciding Between a Dividend and a Buyback.....	159
The Stock Dividend.....	160
Summary .....	160
Review Questions.....	161
Review Answers .....	162
<b>Chapter 15 – Mergers and Acquisitions .....</b>	<b>163</b>
Learning Objectives .....	163
Introduction.....	163
Acquisition Strategy .....	163
The Sales Growth Strategy .....	163
The Geographic Growth Strategy.....	164
The Product Supplementation Strategy.....	164
The Full Service Strategy.....	165
The Vertical Integration Strategy.....	165
The Adjacent Industry Strategy.....	165
The Diversification Strategy .....	165
The Market Window Strategy .....	166
The Bolt-on Strategy.....	166
The Low-Cost Strategy .....	167
The Industry Roll-up Strategy.....	167
Valuation of a Target Company.....	167
Liquidation Value .....	168
Real Estate Value .....	168
Relief-from-Royalty Method.....	168
Enterprise Value .....	169
Multiples Analysis .....	169
Discounted Cash Flows .....	171
Replication Value.....	173
Comparison Analysis .....	174
The Strategic Purchase.....	175
The Control Premium.....	175
The Valuation Floor and Ceiling .....	175
Payment Structures .....	176
The Stock-for-Stock Exchange.....	176
The Exchange Ratio .....	177
Issues Impacting the Stock Payment Decision .....	178
Stock Payment Based on Fixed Share Count or Fixed Price.....	178
The Debt Payment.....	179
The Cash Payment.....	180

## Table of Contents

Practical Considerations .....	180
Summary .....	181
Review Questions .....	182
Review Answers .....	183
<b>Chapter 16 – Foreign Exchange Risk Management .....</b>	<b>185</b>
Learning Objectives .....	185
Introduction .....	185
Foreign Exchange Risk Overview .....	185
Foreign Exchange Risk Management .....	186
Take No Action .....	186
Avoid Risk .....	187
Shift Risk .....	187
Time Compression .....	188
Payment Leading and Lagging .....	188
Build Reserves .....	188
Maintain Local Reserves .....	189
Hedging .....	189
Summary .....	190
Types of Foreign Exchange Hedges .....	190
Loan Denominated in a Foreign Currency .....	190
The Forward Contract .....	190
The Futures Contract .....	191
The Currency Option .....	192
The Cylinder Option .....	193
Swaps .....	193
Netting .....	194
Summary .....	194
Review Questions .....	195
Review Answers .....	196
<b>Chapter 17 – Interest Rate Risk Management .....</b>	<b>197</b>
Learning Objectives .....	197
Introduction .....	197
Interest Risk Overview .....	197
Interest Rate Risk Management .....	197
Take No Action .....	197
Avoid Risk .....	198
Asset and Liability Matching .....	198
Hedging .....	198
Types of Interest Rate Hedges .....	198
The Forward Rate Agreement .....	198
The Futures Contract .....	200
The Interest Rate Swap .....	202
Interest Rate Options .....	203
Interest Rate Swaptions .....	205
Summary .....	206
Review Questions .....	207
Review Answers .....	208
<b>Chapter 18 – Supply Chain Financing .....</b>	<b>209</b>
Learning Objectives .....	209
Introduction .....	209
Supply Chain Financing .....	209
Summary .....	210
Review Questions .....	211
Review Answers .....	212

## Table of Contents

<b>Chapter 19 – Corporate Finance Measurements</b> .....	<b>213</b>
Learning Objectives .....	213
Introduction.....	213
Corporate Finance Metrics.....	213
Cash Conversion Cycle.....	213
Days Sales in Accounts Receivable .....	214
Days Sales in Inventory .....	215
Days Payables Outstanding.....	215
Actual Cash Position versus Forecast .....	216
Earnings on Invested Funds.....	217
Ability to Pay Measurements.....	217
Interest Coverage Ratio.....	217
Debt Service Coverage Ratio.....	218
Fixed Charge Coverage Ratio.....	218
Cash Coverage Ratio.....	219
Debt to Equity Ratio .....	220
Average Cost of Debt.....	220
Borrowing Base Usage .....	221
Summary.....	222
Review Questions.....	223
Review Answers .....	224
<b>Glossary</b> .....	<b>225</b>
<b>Index</b> .....	<b>229</b>