Finance (Basic)

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Corporate Finance

Corporation – *Stock holders*

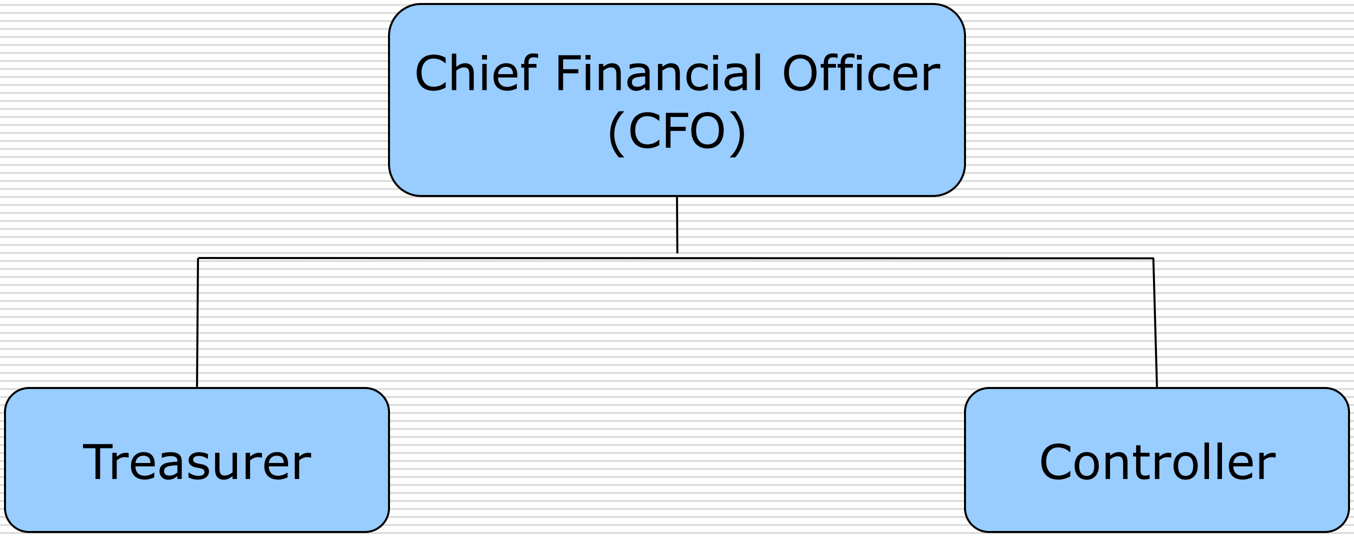
- Closely held
- Public Companies

Financial Manager

- The role of FM:
  - » Investment decision
  - » Financing decision

- FM is a person responsible for a significant investment or financing decision

Senior Financial managers in large corporations



Flow of Cash between FMs and the Firm's Operations

1…

2…

3…

4a…

4a…

The main objective of Financial Management

..to maximize the Shareholders Value!

The Financing Decision

Capital structure:

- Equity (stock, r_e)
- Debt (loan, bond, r_d)
- Hybrid securities

The Optimal Capital Structure

- MM *(irrelevance of CS)*
- Trade-off theory *(tax benefit, bankruptcy costs)*
- Pecking order theory *(priority in capital sources)*

WACC

$$WACC = \frac{E}{V} * re + \frac{D}{V} * rd * (1 - t)$$

The Dividend Policy

- Free Cash Flow *(surplus cash)*
- Dividend Clienteles *(different client preferences)*
- Information Signaling *(future development)*

Working Capital Policy

WC = Current Assets – Current Liabilities

Criteria for WC-Management:

- *Liquidity (CF)*
- *Profitability (ROC)*

Working Capital Management

- *Cash Management*
- *Inventory Management*
- *Debtor Management*
- *Short-term Financing*

The Investment Decision

Capital allocation

↓

Estimating Value of Project

(Future CF)

↓

Capital Budgeting

Project Valuation

DCF → PV → NPV

Other Methods for Valuating a Project

The Payback Period

IRR $$NPV = \sum_{n=0}^{N} \frac{CFn}{(1+r)^n} = 0$$

MIRR $$MIRR = \sqrt[n]{\frac{FV\ (positive\ CFs, reinvestment\ rate)}{-PV\ (negative\ CFs, finance\ rate)}} - 1$$

Example for valuating a project

Decide which project is preferable for investors.
The initial costs of investment for the project A are $ 90,000.00, and in the fourth year it is required to pay the repairing costs of $ 30,000.00. Project implementation is planned for five years with the generation of the following cash flows after one year: $ 10,000.00, $ 17,000.00, $ 34,000.00, $ 41,000.00, $ 38,000.00. All cash flows are definite. Furthermore, it is known, that the price of the foreign capital is 6%, and shareholders require interest at minimal rate of 7,5%. The total debt is up to 70% in the capital structure.
The project B has the following structure of investments: $ 10,000.00 as initial costs and $2,000.00 as annual additional costs. Estimated life of the project is 3 years. Project might generate different payoff: $ 2,000.00, $ 3,000.00, $ 7,000.00 with 30% probability, $ 4,000.00, $ 6,000.00, $ 9,000.00 with 50% probability, and $ 5,000.00, $7,000.00, $ 10,000.00 with 20% probability.
The inclusion of income tax (15%) into the calculations is required.

Thank you for your attention