

# Finance (Basic)

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# Corporate Finance

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Corporation – *Stock holders*

- Closely held
- Public Companies

# Financial Manager

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- The role of FM:

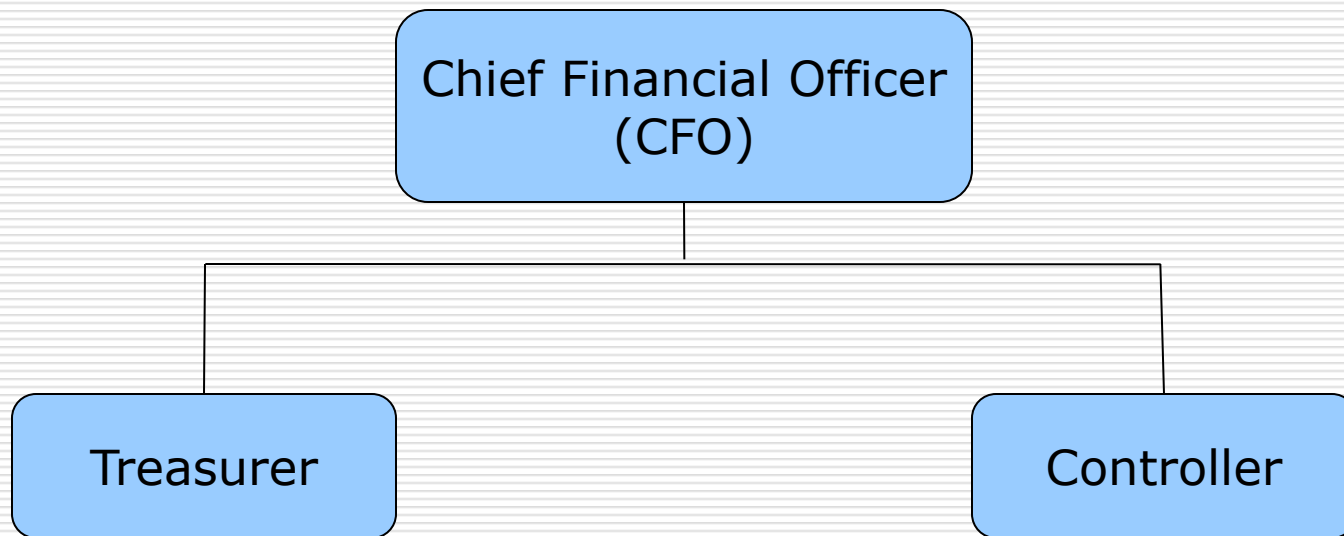
- » Investment decision

- » Financing decision

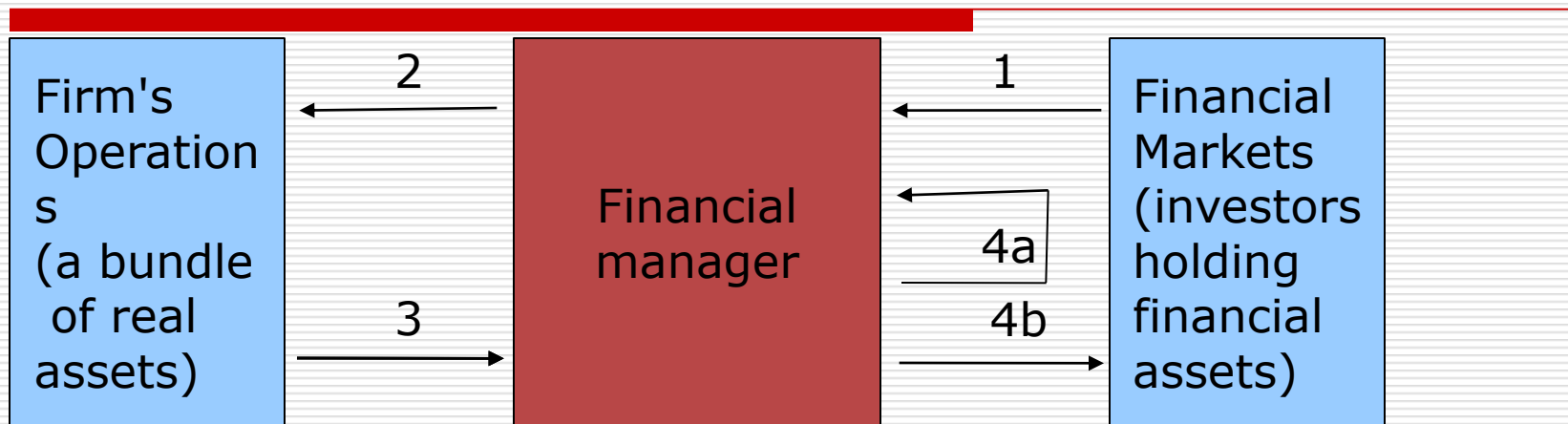
- FM is a person responsible for a significant investment or financing decision

# Senior Financial managers in large corporations

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# Flow of Cash between FMs and the Firm's Operations



1...

2...

3...

4a...

4a...

# The main objective of Financial Management

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..to maximize the Shareholders  
Value!

# The Financing Decision

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## Capital structure:

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

# The Optimal Capital Structure

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



# WACC

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

# The Dividend Policy

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

# Working Capital Policy

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*WC = Current Assets – Current Liabilities*

## **Criteria for WC-Management:**

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

# Working Capital Management

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*Cash Management*

*Inventory Management*

*Debtor Management*

*Short-term Financing*

# The Investment Decision

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Capital allocation



Estimating Value of Project  
*(Future CF)*



**Capital Budgeting**

# Project Valuation

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# Other Methods for Valuating a Project

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## The Payback Period

IRR

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

MIRR

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

# Example for valuating a project

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## **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

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