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# FINANCIAL MANAGEMENT

*Principles and  
Applications*

7TH EDITION



ALWAYS LEARNING

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# FINANCIAL MANAGEMENT

*Principles and  
Applications*

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7TH EDITION

The seventh edition of *Financial Management: Principles and Applications*  
is dedicated to our families—the ones who love us the most.

*To my parents, wife (Meg), and sons (Trevor, Elliot, and Gordon)*

**SHERIDAN TITMAN**

*To my wife, Minerva, and my son, Josh*

**TONY MARTIN**

*Barb, Emily, and Artie*

**ARTHUR J. KEOWN**

*To the Martin women (my wife Sally and daughter-in-law Mel),  
men (sons David and Jess), and boys (grandsons Luke and Burke)*

**JOHN D. MARTIN**

*Sheridan Titman*  
*Tony Martin*  
*Arthur J. Keown*  
*John D. Martin*

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*Principles and  
Applications*

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7TH EDITION



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# BRIEF CONTENTS

Teaching students the Logic of Finance	xvii
Preface	xix
Making the most of your resources	xxix
Acknowledgements	xxxi

## **PART 1** INTRODUCTION TO FINANCIAL MANAGEMENT

Chapter 1	Getting started—Principles of finance	2
Chapter 2	Firms and the financial market	18
Chapter 3	Understanding financial statements, taxes and cash flows	38
Chapter 4	Financial analysis—Sizing up firm performance	80

## **PART 2** VALUATION OF FINANCIAL ASSETS

Chapter 5	The time value of money—The basics	130
Chapter 6	The time value of money—Annuities and other topics	160
Chapter 7	An introduction to risk and return—History of financial market returns	192
Chapter 8	Risk and return—Capital market theory	222
Chapter 9	Debt valuation and interest rates	254
Chapter 10	Share valuation	300

## **PART 3** CAPITAL BUDGETING

Chapter 11	Investment decision criteria	330
Chapter 12	Analysing project cash flows	376
Chapter 13	Risk analysis and project evaluation	412
Chapter 14	The cost of capital	446

## **PART 4** CAPITAL STRUCTURE AND DIVIDEND POLICY

Chapter 15	Capital-structure policy	482
Chapter 16	Dividend policy	526



**PART 5** LIQUIDITY MANAGEMENT  
AND SPECIAL TOPICS IN FINANCE

Chapter 17	Financial forecasting and planning	556
Chapter 18	Working capital management	578
Chapter 19	International business finance	608
Chapter 20	Corporate risk management	636
Glossary		671
Organisation index		681
Subject index		683

# CONTENTS

Teaching students the Logic of Finance  
 Preface  
 Making the most of your resources  
 Acknowledgements

xvii	<i>Principle 2: There is a risk–return trade-off</i>	12
xix	<i>Principle 3: Cash flows are the source of value</i>	12
xxix	<i>Principle 4: Market prices reflect information</i>	13
xxxii	<i>Principle 5: Individuals respond to incentives</i>	14
	Chapter Summary	15
	Study Questions	17

## PART 1

### Introduction to financial management

#### Chapter 1



#### Getting started—Principles of finance

- P** PRINCIPLE 1: Money has a time value
- P** PRINCIPLE 2: There is a risk–return trade-off
- P** PRINCIPLE 3: Cash flows are the source of value
- P** PRINCIPLE 4: Market prices reflect information
- P** PRINCIPLE 5: Individuals respond to incentives

#### Finance Spotlight

#### Welcome to the world of finance

##### 1.1 Finance: An overview

*What is finance?*  
*Why study finance?*

##### 1.2 Three types of business organisations

*Sole proprietorship*  
*Partnership*  
*Corporation*  
*How does finance fit into the firm's organisational structure?*

##### 1.3 The goal of the financial manager

*Maximising shareholder wealth*  
*Ethical considerations in corporate finance*

#### Finance Spotlight

#### Bond issues and ethical considerations

##### 1.4 The five basic principles of finance

*Principle 1: Money has a time value*

#### Chapter 2



#### Firms and the financial market

<b>2</b>	<b>P</b> PRINCIPLE 2: There is a risk–return trade-off	<b>19</b>
<b>3</b>	<b>P</b> PRINCIPLE 4: Market prices reflect information	<b>19</b>
<b>3</b>	<b>P</b> PRINCIPLE 5: Individuals respond to incentives	<b>19</b>
<b>3</b>	Finance Spotlight	
<b>3</b>	<b>Defined benefit versus defined contribution superannuation</b>	<b>19</b>
<b>2.1</b>	The basic structure of the Australian financial markets	<b>20</b>
<b>4</b>	<b>2.2 The financial marketplace: Financial institutions</b>	<b>20</b>
<b>4</b>	<i>Commercial banks: Everyone's financial marketplace</i>	<b>21</b>
<b>4</b>	<i>Non-bank financial intermediaries</i>	<b>21</b>
<b>5</b>	<i>Investment companies</i>	<b>23</b>
<b>5</b>	Finance Spotlight	
<b>5</b>	<b>Controlling costs in managed funds</b>	<b>24</b>
<b>2.3</b>	The financial marketplace:	
<b>8</b>	Securities markets	<b>25</b>
<b>9</b>	<i>How securities markets bring corporations and investors together</i>	<b>26</b>
<b>9</b>	<i>Types of securities</i>	<b>27</b>
<b>11</b>	Finance Spotlight	
<b>11</b>	<b>Where's the money around the world?</b>	<b>31</b>
<b>12</b>	Chapter Summary	<b>34</b>
<b>12</b>	Study Questions	<b>36</b>



## Chapter 3



### Understanding financial statements, taxes and cash flows

- P** PRINCIPLE 1: Money has a time value 38
- P** PRINCIPLE 3: Cash flows are the source of value 39
- P** PRINCIPLE 4: Market prices reflect information 39
- P** PRINCIPLE 5: Individuals respond to incentives 39

#### Finance Spotlight

#### Accounting is the language of business 40

##### 3.1 An overview of the firm's financial statements 40

- Basic financial statements* 40
- Why study financial statements?* 40
- What are the accounting principles used to prepare financial statements?* 41

##### 3.2 The income statement 42

- Income statement of H. J. Boswell Ltd* 42
- Connecting the income statement and balance sheet* 44
- Interpreting firm profitability using the income statement* 44
- IFRS and earnings management* 45

#### Checkpoint 3.1 46

#### Constructing an income statement 47

##### 3.3 Corporate tax and dividend imputation 47

- Computing taxable income and company tax payable* 47
- Dividend imputation* 47

#### Checkpoint 3.2 49

#### Comparison between a classical tax system and a dividend imputation tax system 49

##### 3.4 The balance sheet 51

- The balance sheet of H. J. Boswell Ltd* 51
- Firm liquidity and net working capital* 54
- Debt and equity financing* 55

#### Checkpoint 3.3 56

#### Constructing a balance sheet 57

- Book values, historical costs and market values* 57

#### Finance Spotlight 58

#### Your personal balance sheet and income statement 60

##### 3.5 The cash flow statement 60

- Sources and uses of cash* 60
- H. J. Boswell's cash flow statement* 62

#### Finance Spotlight IFRS versus GAAP 64

#### Checkpoint 3.4 67

#### Interpreting the statement of cash flows 67

- Chapter Summary 69
- Study Questions 73
- Study Problems 74
- Mini-Case 77

## Chapter 4



38

39

39

39

39

40

40

40

41

42

42

44

44

45

46

47

47

47

49

49

51

51

54

55

56

57

58

58

60

60

62

#### Financial analysis—Sizing up firm performance 80

- P** PRINCIPLE 3: Cash flows are the source of value 81
- P** PRINCIPLE 4: Market prices reflect information 81
- P** PRINCIPLE 5: Individuals respond to incentives 81

#### Finance Spotlight 82

#### Financial ratios and business 82

- 4.1 Why do we analyse financial statements? 82
- 4.2 Common-size statements: Standardising financial information 82
  - The common-size income statement: H. J. Boswell Ltd* 83
  - The common-size balance sheet: H. J. Boswell Ltd* 83
- 4.3 Using financial ratios 85
  - Liquidity ratios* 85

#### Checkpoint 4.1 89

#### Evaluating Primary Health Care Ltd's (PRY) liquidity 89

- Capital structure ratios* 91
- Asset management efficiency ratios* 92

#### Checkpoint 4.2 93

#### Comparing the financing decisions of Wesfarmers Ltd (WES) and Woolworths Ltd (WOW) 93

- Profitability ratios* 96

#### Checkpoint 4.3 99

#### Evaluating the return on assets (ROA) for Wesfarmers Ltd (WES) and Woolworths Ltd (WOW) 99

- Market value ratios* 103

#### Finance Spotlight 104

#### Your cash budget and personal savings ratio 104

Checkpoint 4.4  
**Comparing the valuation of Ramsay Health Care Ltd (RHC) to Sonic Healthcare Ltd (SHL) using market value ratios**

*Summing up the financial analysis of H. J. Boswell Ltd*

Finance Spotlight

**Ratios and international accounting standards**

4.4 Selecting a performance benchmark

*Trend analysis*  
*Peer-firm comparisons*

4.5 Limitations of ratio analysis

Chapter Summary  
 Study Questions  
 Study Problems  
 Mini-Case

**PART 2**

**Valuation of financial assets**

**Chapter 5**



**The time value of money—The basics**

**P** PRINCIPLE 1: Money has a time value

Finance Spotlight

**A dollar saved is two dollars earned**

5.1 Using timelines to visualise cash flows

Checkpoint 5.1

**Creating a timeline**

5.2 Compounding and future value

*Compound interest and time*  
*Compound interest and the interest rate*  
*Techniques for valuing cash flows at different points in time*  
*Applying compounding to things other than money*  
*Compound interest with shorter compounding periods*

Checkpoint 5.2

**Calculating the future value of a cash flow**

Checkpoint 5.3

**Calculating future values using non-annual compounding periods**

Finance Spotlight

**Saving for your first house**

5.3 Discounting and present value

*The mechanics of discounting future cash flows*

Checkpoint 5.4

**Solving for the present value of a future cash flow**

*Discounting with shorter discounting periods*  
*Two additional types of discounting problems*

Checkpoint 5.5

**Solving for the number of periods,  $n$**

*The Rule of 72*

Checkpoint 5.6

**Solving for the interest rate,  $i$**

5.4 Making interest rates comparable

*Calculating the interest rate and converting it to an EAR*

Checkpoint 5.7

**Calculating an effective annual rate or EAR**

*To the extreme: Continuous compounding*

Chapter Summary

Study Questions

Study Problems

Mini-Case

**Chapter 6**



**The time value of money—Annuities and other topics**

**P** PRINCIPLE 1: Money has a time value

**P** PRINCIPLE 3: Cash flows are the source of value

Finance Spotlight

**Annuities we all know**

6.1 Annuities

*Ordinary annuities*

Checkpoint 6.1

**Solving for an ordinary annuity payment**

*Amortised loans*

Checkpoint 6.2

**The present value of an ordinary annuity**

*Annuities due*

Checkpoint 6.3

**Determining the outstanding balance of a loan**

Finance Spotlight

**Saving for retirement**

6.2 Perpetuities	175
<i>Calculating the present value of a level perpetuity</i>	175
Checkpoint 6.4	
<b>The present value of a level perpetuity</b>	<b>175</b>
<i>Calculating the present value of a growing perpetuity</i>	176
Checkpoint 6.5	
<b>The present value of a growing perpetuity</b>	<b>176</b>
6.3 Complex cash-flow streams	177
Checkpoint 6.6	
<b>The present value of a complex cash-flow stream</b>	<b>179</b>
Chapter Summary	181
Study Questions	182
Study Problems	183
Mini-Case	191

**Chapter 7**



<b>An introduction to risk and return—History of financial market returns</b>	<b>192</b>
<b>P</b> PRINCIPLE 2: There is a risk–return trade-off	193
<b>P</b> PRINCIPLE 4: Market prices reflect information	193
Finance Spotlight	
<b>Using statistics</b>	<b>194</b>
7.1 Realised and expected rates of return and risk	194
<i>Calculating the realised return from an investment</i>	194
<i>Calculating the expected return from an investment</i>	195
<i>Measuring risk</i>	196
Checkpoint 7.1	
<b>Evaluating an investment's return and risk</b>	<b>200</b>
7.2 A brief history of financial market returns	202
<i>Australian financial markets: Domestic investment returns</i>	202
<i>Lessons learned</i>	204
<i>Australian shares versus other categories of investments</i>	204
<i>Global financial markets: International investing</i>	205
Finance Spotlight	
<b>Determining your tolerance for risk</b>	<b>207</b>
7.3 Geometric versus arithmetic average rates of return	207
<i>Computing the geometric or compound average rate of return</i>	208
<i>Choosing the right 'average'</i>	208

Checkpoint 7.2	
<b>Calculating the arithmetic and geometric average rates of return</b>	<b>209</b>
7.4 What determines share prices?	211
<i>The efficient markets hypothesis</i>	211
<i>Do we expect financial markets to be perfectly efficient?</i>	212
<i>Market efficiency: What does the evidence show?</i>	213
Chapter Summary	214
Study Questions	217
Study Problems	218
Mini-Case	221

**Chapter 8**



<b>Risk and return—Capital market theory</b>	<b>222</b>
<b>P</b> PRINCIPLE 2: There is a risk–return trade-off	223
<b>P</b> PRINCIPLE 4: Market prices reflect information	223
Finance Spotlight	
<b>Risk and your personal investment plan</b>	<b>224</b>
8.1 Portfolio returns and portfolio risk	224
<i>Calculating the expected return of a portfolio</i>	224
<i>Evaluating portfolio risk</i>	225
Checkpoint 8.1	
<b>Calculating a portfolio's expected rate of return</b>	<b>226</b>
<i>Calculating the standard deviation of a portfolio's returns</i>	228
Finance Spotlight	
<b>International diversification</b>	<b>231</b>
Checkpoint 8.2	
<b>Evaluating a portfolio's risk and return</b>	<b>231</b>
8.2 Systematic risk and the market portfolio	233
<i>Diversification and unsystematic risk</i>	234
<i>Diversification and systematic risk</i>	234
<i>Systematic risk and beta</i>	235
<i>Calculating portfolio beta</i>	237
8.3 The security market line and the CAPM	238
<i>Using the CAPM to estimate expected rates of return</i>	241
Checkpoint 8.3	
<b>Estimating the expected rate of return using the CAPM</b>	<b>241</b>
Chapter Summary	243
Study Questions	245
Study Problems	246
Mini-Case	253

**Chapter 9**



**Debt valuation and interest rates 254**

- P** PRINCIPLE 1: Money has a time value 255
- P** PRINCIPLE 2: There is a risk–return trade-off 255
- P** PRINCIPLE 3: Cash flows are the source of value 255

Finance Spotlight

**Borrow now, pay later 256**

- 9.1 Overview of government and corporate debt 256**
  - Borrowing money in the private financial market 256*
  - Private debt placements 257*
  - Borrowing money in the public financial market 258*

Checkpoint 9.1

**Calculating the rate of interest on a floating-rate loan 260**  
*Basic bond features 262*

Finance Spotlight

**Fixed- and variable-rate mortgages 263**

- 9.2 Valuing bonds 265**
  - Valuing bonds by discounting future cash flows 265*
  - Step 1: Determine bondholder cash flows 266*
  - Step 2: Estimate the appropriate discount rate 266*

Checkpoint 9.2

**Calculating the yield to maturity on a corporate bond 267**  
*Step 3: Use discounted cash flow to value bonds 270*

Checkpoint 9.3

**Valuing a bond issue 271**

Checkpoint 9.4

**Valuing a bond issue that pays semi-annual interest 273**

- 9.3 Bond valuation: Four key relationships 275**
  - First relationship 275*
  - Second relationship 276*
  - Third relationship 276*
  - Fourth relationship 277*

**9.4 Types of bonds 279**

- Secured versus unsecured 279*
- Priority of claims 279*
- Initial offering market 279*
- Abnormal risk 279*

- Coupon level 279*
- Amortising or non-amortising 280*
- Convertibility 280*

Finance Spotlight

**International bonds 281**

- 9.5 Determinants of interest rates 281**
  - Inflation and real versus nominal interest rates 281*

Checkpoint 9.5

**Solving for the real rate of interest 283**  
*Interest rate determinants: Breaking it down 283*

Checkpoint 9.6

**Solving for the nominal rate of interest 284**  
*The maturity-risk premium and the term structure of interest rates 286*

- Chapter Summary 290
- Study Questions 294
- Study Problems 295
- Mini-Case 298

**Chapter 10**



**Share valuation 300**

- P** PRINCIPLE 1: Money has a time value 301
- P** PRINCIPLE 2: There is a risk–reward trade-off 301
- P** PRINCIPLE 3: Cash flows are the source of value 301
- P** PRINCIPLE 4: Market prices reflect information 301
- P** PRINCIPLE 5: Individuals respond to incentives 301

Finance Spotlight

**Getting your fair share 302**

- 10.1 Ordinary shares 302**
  - Characteristics of ordinary shares 302*

Finance Spotlight

**Does a share by any other name smell as sweet? 303**

- Agency costs and ordinary shares 304*
- Valuing ordinary shares using the discounted dividend model 305*

Checkpoint 10.1

**Valuing ordinary shares 308**

- 10.2 The comparables approach to valuing ordinary shares 311**
  - Defining the price–earnings (P/E) ratio valuation model 311*
  - What determines the P/E ratio for a share? 312*

Checkpoint 10.2  
**Valuing ordinary shares using the P/E ratio** 314  
*An aside on managing for shareholder value* 315  
*A word of caution about P/E ratios* 315

10.3 Preference shares 316  
*Features of preference shares* 316  
*Valuing preference shares* 317

Checkpoint 10.3  
**Valuing preference shares** 319  
*A quick review: Valuing bonds, preference shares and ordinary shares* 321

10.4 The stock market 321  
*Organised exchanges* 322  
*Over-the-counter (OTC) market* 322

Chapter Summary 323  
 Study Questions 326  
 Study Problems 327  
 Mini-Case 329

**PART 3**  
**Capital budgeting**

**Chapter 11**



**Investment decision criteria** 330

- P** PRINCIPLE 1: Money has a time value 331
- P** PRINCIPLE 2: There is a risk–return trade-off 331
- P** PRINCIPLE 3: Cash flows are the source of value 331
- P** PRINCIPLE 5: Individuals respond to incentives 331

Finance Spotlight  
**Making personal investment decisions** 332

11.1 An overview of capital budgeting 332  
*The typical capital budgeting process* 333  
*What are the sources of good investment projects?* 333  
*Types of capital investment projects* 333

11.2 Net present value 335  
*Why is NPV the right criterion?* 335  
*Calculating an investment's NPV* 335  
*Independent versus mutually exclusive investment projects* 336

Checkpoint 11.1  
**Calculating the NPV for Project Long** 337

Checkpoint 11.2  
**Calculating the equivalent annual cost (EAC)** 340

11.3 Other investment criteria 343  
*Profitability index* 344  
*Internal rate of return* 345

Checkpoint 11.3  
**Calculating the profitability index for Project Long** 345

Checkpoint 11.4  
**Calculating the IRR for Project Long** 347

Checkpoint 11.5  
**The problem of multiple IRRs for projects** 351  
*Modified internal rate of return* 354

Checkpoint 11.6  
**Calculating the modified internal rate of return (MIRR)** 355

Finance Spotlight  
**Higher education as an investment in yourself** 357  
*Payback period* 357  
*Discounted payback period* 359  
*Summarising the alternative decision rules* 360

11.4 A glance at actual capital budgeting practices 362  
 Chapter Summary 364  
 Study Questions 367  
 Study Problems 367  
 Mini-Cases 374

**Chapter 12**



**Analysing project cash flows** 376

- P** PRINCIPLE 3: Cash flows are the source of value 377
- P** PRINCIPLE 5: Individuals respond to incentives 377

Finance Spotlight  
**The Internet on airline flights—making it happen** 378

12.1 Identifying incremental cash flows 378  
*Guidelines for forecasting incremental cash flows* 378

12.2 Forecasting project cash flows 380  
*Dealing with depreciation expense, tax and cash flow* 381  
*Four-step procedure for calculating project cash flows* 381

Checkpoint 12.1  
**Forecasting a project's operating cash flow** 382  
*Computing project NPV* 386

12.3 Inflation and capital budgeting 387  
*Estimating nominal cash flows* 388

12.4 Replacement project cash flows 389  
*Category 1: Initial outlay, CF<sub>0</sub>* 389  
*Category 2: Annual cash flows* 389  
*Changes in depreciation and tax* 389



*Changes in working capital*  
*Changes in capital spending*  
*Replacement example*

**Checkpoint 12.2**  
**Calculating free cash flows for a replacement investment**

Finance Spotlight  
**Entering new markets**

Chapter Summary  
 Study Questions  
 Study Problems  
 Mini-Cases  
 Appendix: The diminishing value depreciation method  
 Study Problems

**Chapter 13**



**Risk analysis and project evaluation** **412**

**P** PRINCIPLE 1: Money has a time value 413  
**P** PRINCIPLE 2: There is a risk–return trade-off 413  
**P** PRINCIPLE 3: Cash flows are the source of value 413

Finance Spotlight  
**Project risk for entrepreneurs**

13.1 The importance of risk analysis

13.2 Tools for analysing the risk of project cash flows  
*Key concepts: Expected values and value drivers*  
*Expected values*

**Checkpoint 13.1**  
**Forecasting revenue using expected values** **416**  
*Sensitivity analysis* 417

**Checkpoint 13.2**  
**Project risk analysis: Sensitivity analysis** **419**  
*Scenario analysis* 421

**Checkpoint 13.3**  
**Project risk analysis: Scenario analysis** **422**  
*Simulation analysis* 423

Finance Spotlight  
**Currency risk**

13.3 Break-even analysis **425**  
*Accounting break-even analysis* 426

390 **Checkpoint 13.4**  
 390 **Project risk analysis: Accounting break-even analysis** **428**  
 390 *NPV break-even analysis* 430  
 390 *Operating leverage and the volatility of project cash flows* 431

**390** 13.4 Real options in capital budgeting **434**  
**394** *The option to delay the launch of a project* 435  
 395 *The option to expand a project* 435  
 397 *The option to reduce the scale and scope of a project* 435

398 **Checkpoint 13.5**  
 407 **Analysing real options: Option to expand** **436**  
 410 Chapter Summary 437  
 411 Study Questions 439  
 Study Problems 440  
 Mini-Case 445

**Chapter 14**



**The cost of capital** **446**

**P** PRINCIPLE 1: Money has a time value 447  
**P** PRINCIPLE 2: There is a risk–return trade-off 447  
**P** PRINCIPLE 3: Cash flows are the source of value 447  
**P** PRINCIPLE 4: Market prices reflect information 447  
**P** PRINCIPLE 5: Individuals respond to incentives 447

Finance Spotlight  
**Understanding the role of the cost of capital** **448**

14.1 The cost of capital: An overview **448**  
*Investor's required return and the firm's cost of capital* 449  
*WACC equation* 449  
*Three-step procedure for estimating the firm's WACC* 450

14.2 Determining the firm's capital-structure weights **451**

**Checkpoint 14.1**  
**Calculating the WACC for Templeton Extended Care Facilities Ltd** **453**

14.3 Estimating the cost of individual sources of capital **454**  
*The cost of debt* 454  
*The cost of preference shares* 455  
*The cost of ordinary shares* 458

Checkpoint 14.2  
**Estimating the cost of ordinary shares for Pearson plc using the dividend growth model** 460

Checkpoint 14.3  
**Estimating the cost of ordinary shares for Pearson plc using the CAPM** 462

14.4 Summing up: Calculating the firm's weighted average cost of capital 464  
*Use market-based weights* 464  
*Use market-based opportunity costs* 464  
*Use forward-looking weights and opportunity costs* 464

14.5 Estimating project costs of capital 465  
*The rationale for using multiple discount rates* 465  
*Why don't firms typically use project costs of capital?* 465  
*Estimating divisional WACCs* 466  
*Divisional WACC: Estimation issues and limitations* 467

Finance Spotlight  
**Why do interest rates differ among countries?** 469

14.6 Flotation costs and project NPV 469  
*WACC, flotation costs and NPV* 469

Checkpoint 14.4  
**Incorporating flotation costs into the calculation of NPV** 470

Chapter Summary 472  
 Study Questions 475  
 Study Problems 476  
 Mini-Case 481

**PART 4**  
**Capital structure and dividend policy**

**Chapter 15**



**Capital-structure policy** 482

**P** PRINCIPLE 2: There is a risk–return trade-off 483  
**P** PRINCIPLE 3: Cash flows are the source of value 483  
**P** PRINCIPLE 5: Individuals respond to incentives 483

Finance Spotlight  
**Capital structure matters to you!** 484

15.1 A glance at capital-structure choices in practice 484  
*Defining a firm's capital structure* 484  
*Financial leverage* 487  
*How do firms in different industries finance their assets?* 487

15.2 Capital-structure theory 488  
*A first look at the Modigliani and Miller Capital Structure Theorem* 488

*Yogi Berra and the M&M Capital Structure Theorem* 490  
*Capital structure, the cost of equity and the weighted average cost of capital* 490  
*Why capital structure matters in reality* 491  
*Making financing choices when managers are better informed than shareholders* 498  
*Managerial implications* 499

15.3 Why do capital structures differ across industries? 500

15.4 Making financing decisions 501  
*Benchmarking the firm's capital structure* 501

Checkpoint 15.1  
**Benchmarking a financing decision** 502  
*Evaluating the effect of financial leverage on firm earnings per share* 504

Checkpoint 15.2  
**Evaluating the effect of financing decisions on EPS** 507  
*Can the firm afford more debt?* 509  
*Survey evidence: Factors that influence CFO debt policy* 510

Finance Spotlight  
**Capital structures around the world** 511

Chapter Summary 512  
 Study Questions 515  
 Study Problems 516  
 Mini-Case 521  
 Appendix: Demonstrating the Modigliani and Miller Theorem 522

**Chapter 16**



**Dividend policy** 526

**P** PRINCIPLE 1: Money has a time value 527  
**P** PRINCIPLE 3: Cash flows are the source of value 527  
**P** PRINCIPLE 4: Market prices reflect information 527

Finance Spotlight  
**Firms rarely decrease their dividend** 528

16.1 How do firms distribute cash to their shareholders? 528  
*Cash dividends* 530  
*Share buybacks* 530  
*Personal tax considerations: Dividend versus capital gains income* 531

*Non-cash distributions: Bonus shares and share splits* 532

**16.2 Does dividend policy matter?** 533

*The irrelevance of the distribution choice* 534

Checkpoint 16.1

**Share price and the timing of dividend payments** 536

*Why dividend policy is important* 542

Finance Spotlight

**The importance of dividends** 543

**16.3 Cash-distribution policies in practice** 544

*Stable payout* 544

*Residual dividend payout policy* 546

*Other factors playing a role in how much to distribute* 547

Finance Spotlight

**Dividends at home and abroad** 548

Chapter Summary 549

Study Questions 551

Study Problems 552

Mini-Case 554

**PART 5**

**Liquidity management and special topics in finance**

**Chapter 17**



**Financial forecasting and planning** 556

**P** PRINCIPLE 2: There is a risk–return trade-off 557

Finance Spotlight

**Developing a financial plan for the firm engages everyone** 558

17.1 An overview of financial planning 558

17.2 Developing a long-term financial plan 559

*Financial forecasting example: Ziegen Ltd* 560

Finance Spotlight

**Your personal budget** 565

Checkpoint 17.1

**Estimating discretionary financing needed** 565

17.3 Developing a short-term financial plan 568

*Example cash budget: Melco Furniture Ltd* 568

*Uses of the cash budget* 568

Chapter Summary 570

Study Questions 571

Study Problems 572

Mini-Case 577

**Chapter 18**



**Working capital management** 578

**P** PRINCIPLE 2: There is a risk–return trade-off 579

Finance Spotlight

**Conflicting objectives lead to problems in managing a firm's working capital** 580

18.1 Working capital management and the risk–return trade-off 580

*Measuring firm liquidity* 580

*Managing firm liquidity* 581

*Risk–return trade-off* 581

Checkpoint 18.1

**Measuring firm liquidity** 581

18.2 Working capital policy 583

*The principle of self-liquidating debt* 583

*A graphic illustration of the principle of self-liquidating debt* 584

18.3 Operating cycle and cash conversion cycle 585

*Measuring working capital efficiency* 586

*Calculating the operating cycle and cash conversion cycle* 587

Checkpoint 18.2

**Analysing the cash conversion cycle** 588

18.4 Managing current liabilities 590

*Calculating the cost of short-term financing* 590

*Evaluating the cost of trade credit* 591

*Evaluating the cost of bank loans* 592

Checkpoint 18.3

**Calculating the APR for a line of credit** 592

18.5 Managing the firm's investment in current assets 594

*Cash and marketable securities* 594

*Managing accounts receivable* 595

Finance Spotlight

**Credit scoring** 597

*Managing inventories* 599

Chapter Summary 600

Study Questions 602

Study Problems 603

Mini-Case 607



**Chapter 19**



**International business finance 608**

**P** PRINCIPLE 2: There is a risk–return trade-off 609

**P** PRINCIPLE 3: Cash flows are the source of value 609

Finance Spotlight

**Working in a flat world**

19.1 Foreign exchange markets and currency exchange rates 610  
*Foreign exchange rates* 611

Checkpoint 19.1

**Exchanging currencies 613**  
*Types of foreign exchange transactions* 616

Checkpoint 19.2

**Determining the percentage-per-annum premium or discount 617**

19.2 Interest rate and purchasing-power parity 619  
*Interest rate parity* 619  
*Purchasing-power parity and the law of one price* 620

Finance Spotlight

**International investing**

*The International Fisher Effect* 623

19.3 Capital budgeting for direct foreign investment 624

Checkpoint 19.3

**International capital budgeting 626**  
*Foreign investment risks* 628

Chapter Summary 629  
 Study Questions 631  
 Study Problems 632  
 Mini-Case 634

**Chapter 20**



**Corporate risk management 636**

**P** PRINCIPLE 1: Money has a time value 637

**P** PRINCIPLE 2: There is a risk–return trade-off 637

Finance Spotlight

**Welcome to a risky world 638**

20.1 Five-step corporate risk-management process 638

*Step 1: Identify and understand the firm's major risks* 638

*Step 2: Decide which types of risks to keep and which to transfer* 639

*Step 3: Decide how much risk to assume* 639

*Step 4: Incorporate risk into all the firm's decisions and processes* 640

*Step 5: Monitor and manage the risks the firm assumes* 641

20.2 Managing risk with insurance contracts 641

*Types of insurance contracts* 641

*Why purchase insurance?* 641

Finance Spotlight

**Do you need life insurance? 642**

20.3 Managing risk by hedging with forward contracts 643

*Hedging commodity-price risk using forward contracts* 643

*Hedging currency risk using forward contracts* 643

Checkpoint 20.1

**Hedging crude-oil price risk using forward contracts 645**

20.4 Managing risk with exchange-traded financial derivatives 648

*Futures contracts* 648

*Options contracts* 650

Checkpoint 20.2

**Determining the break-even point and profit or loss on a call option 654**

20.5 Valuing options and swaps 656

*The Black–Scholes option pricing model* 656

Checkpoint 20.3

**Valuing a call option using the Black–Scholes model 659**

*Swap contracts* 661

*Credit default swaps* 663

Chapter Summary 664

Study Questions 667

Study Problems 667

Mini-Case 670

Glossary 671

Organisation Index 681

Subject Index 683

## Teaching students the

# Logic of Finance

## The five principles of finance

Many finance textbooks show students only the mechanics of finance problem solving, but students learn better when given the intuition behind complex concepts. *Financial Management* shows students the reasoning behind financial decisions and connects all topics in the book to five key principles—the **five principles of finance**: **P** PRINCIPLE 1, **P** PRINCIPLE 2, **P** PRINCIPLE 3, **P** PRINCIPLE 4 and **P** PRINCIPLE 5.



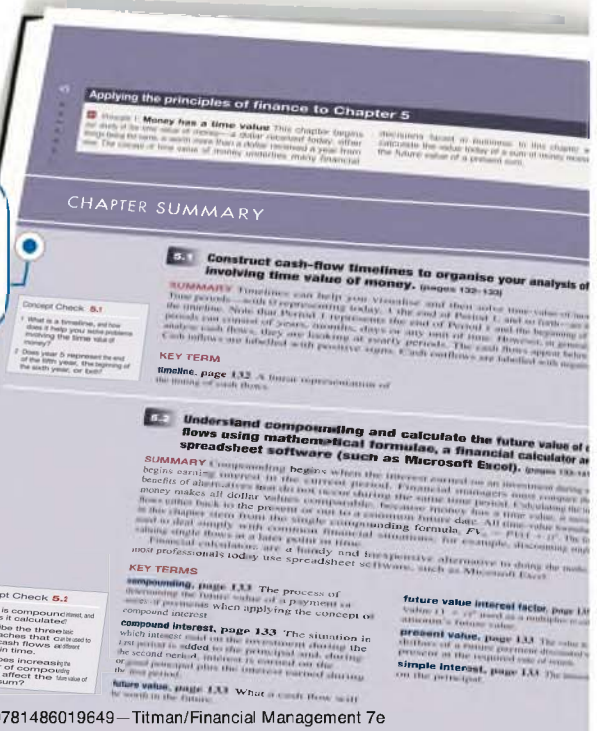
Each chapter opens with a helpful preview of the **principles** that are illustrated in the coming chapter so students can see the underlying and connecting themes and learn to recognise patterns. Principles are colour-coded for quick recognition.

The chapter-opening vignette provides a **real-world example** of the five principles applied in the chapter, many times reinforcing the rule by showing how 'forgetting' a principle might lead to financial troubles.

Each chapter-concluding **Summary** reviews the principles of finance in context for a deeper understanding and retention of chapter concepts.

Within the chapter, the authors draw on the five principles to illustrate concepts and explain the rationale behind financial decision-making. Look for: **P** **P** **P** **P** **P**

- P** PRINCIPLE 1: Money has a time value
- P** PRINCIPLE 2: There is a risk–return trade-off
- P** PRINCIPLE 3: Cash flows are the source of value
- P** PRINCIPLE 4: Market prices reflect information
- P** PRINCIPLE 5: Individuals respond to incentives



## Tools for developing study skills

To be successful, finance students need hands-on practice opportunities that help them go beyond rote memorisation of formulae to a true understanding of the dynamics of solving finance problems.

### Checkpoint 3.1

#### Constructing an income statement

Use the following information to construct an income statement for Myer Holdings Ltd (Myer), Australia's largest department store retailer, for the financial year ended 30 June 2016. Calculate the firm's gross profit, operating profit and net profit for the year ended 30 June 2016. Assume the firm has no other income.

Interest expense	\$21 906 000	Revenue (sales)	\$2 747 292 000
Cost of goods sold	\$1 455 066 000	Ordinary share dividends	\$99 470 000
Operating expenses	\$1 131 922 000	Tax	\$39 856 000
Shares outstanding	585 253 946		

#### STEP 1: Picture the problem

The income statement can be visualised as a mathematical equation using equation (3-1) as follows:

$$\text{Revenue (or sales)} - \text{Expenses} = \text{Profit} \quad (3-1)$$

However, this equation belies the level of detail normally included in the income statement. That is, expenses are typically broken down into multiple categories, including cost of goods sold, operating expenses (interest), and income tax. After subtracting each of these general categories of expenses, a new profit number is calculated. The following template provides a useful guide for reviewing the format of the income statement:

**Revenue**  
**Less:** Cost of goods sold  
**Equals:** Gross profit  
**Less:** Operating expenses  
**Equals:** Operating profit  
**Less:** Interest expense  
**Equals:** Profit before tax  
**Less:** Tax  
**Equals:** Net profit

#### STEP 2: Decide on a solution strategy

Given the account balances provided, constructing the income statement simply entails substituting the appropriate balances into the template above.

#### STEP 3: Solve

**Revenue** = \$2 747 292 000  
**Less:** Cost of goods sold = \$1 455 066 000  
**Equals: Gross profit** = \$1 292 226 000  
**Less:** Operating expenses = \$1 131 922 000  
**Equals: Operating profit** = \$1 660 304 000  
**Less:** Interest expense = \$21 906 000  
**Equals: Profit before tax** = \$1 338 398 000  
**Less:** Tax = \$39 856 000  
**Equals: Net profit** = \$88 542 000  
**Earnings per share** (\$88 542 000 net profit ÷ 585 253 946 shares) = \$0.168 or 16.8 cents  
**Dividends per share** (\$99 470 000 dividends ÷ 585 253 946 shares) = \$0.170 or 17.0 cents

**Checkpoints** model a consistent problem-solving technique which walks through each problem in five steps, including an analysis of the solution reached. Each Checkpoint concludes with an additional practise problem, with answer provided, on the same topic so students can test their mastery of the problem-solving approach. Then, students can take their knowledge to the test by completing the linked end-of-chapter problem(s).

'Tools of financial analysis' boxes provide the student reader with a quick reference source for the decision tools used in financial analysis. This new boxed feature appears throughout the book and names each calculation or formula, displays it in equation form, and summarises 'What it tells you'.

Annual every year until the end of 2020, when it would drop to zero (i.e. the firm would then be fully depreciated). However, the depreciation expense the firm uses reflects accounting and tax rules rather than actual changes in market values. As a consequence, the adjusted book value can sometimes have little resemblance to market values.

Figure 3.3

#### Your personal income statement

**Your take-home pay**

A. Total income \_\_\_\_\_  
 B. Total income tax \_\_\_\_\_  
 C. After-tax income available for living expenses, or take-home pay (line A minus line B) \_\_\_\_\_

**Your living expenses**

D. Total housing expenditure (rent or mortgage repayment) \_\_\_\_\_  
 E. Total food expenditure \_\_\_\_\_  
 F. Total clothing and personal care expenditure \_\_\_\_\_  
 G. Total transportation expenditure \_\_\_\_\_  
 H. Total recreation expenditure \_\_\_\_\_  
 I. Total medical expenditure \_\_\_\_\_  
 J. Total insurance expenditure \_\_\_\_\_  
 K. Total other expenditure \_\_\_\_\_  
 L. Total living expenditure (add lines D-K) \_\_\_\_\_

**Total available for savings and investment**

C. After-tax income available for living expenses, or take-home pay \_\_\_\_\_  
 L. Less: Total living expenditure \_\_\_\_\_  
 M. Equals: Income available for savings and investment (line C minus line L) \_\_\_\_\_

#### TOOLS OF FINANCIAL ANALYSIS Financial statement relationships

Name of tool	Formula	What it tells you
Balance sheet equation	Total assets = Total liabilities + Shareholders' equity	<ul style="list-style-type: none"> <li>The sum of the dollar cost of the firm's investment in assets</li> <li>The sources of financing used to acquire the firm's assets</li> </ul>
Shareholders' equity equation	Shareholders' equity = Total assets - Total liabilities	<ul style="list-style-type: none"> <li>The amount of money invested in the firm by its shareholders</li> <li>Because most of the firm's assets are recorded in the balance sheet at their historical cost, shareholders' equity is not a measure of the market value of the equity.</li> </ul>

#### Concept Check 3.4

- 10 Describe the basic categories of assets and liabilities reported in a firm's balance sheet.  
 11 What does the term *net working capital* mean, and how is it computed?



# PREFACE

The seventh edition of *Financial Management: Principles and Applications* is more than a revision of its predecessors. Sheridan Titman was added to the previous US edition author team, and with his energy and insight leading the way, the entire US version of this textbook was rewritten from the ground up, incorporating insights from recent academic research as well as noteworthy events, while retaining the student focus of prior editions. In this edition, we refined our approach further, making a number of pedagogical improvements that should make the material much more engaging to the undergraduate student. Tony Martin has then adapted the US version of the textbook for Australian students, retaining the basic structure and pedagogical approach of the US text but using recent Australian research and citing real-life Australian examples throughout the text, and adapting the content as needed for an Australian legal and business context.

## Our approach to financial management

The first-time student of finance will find that corporate finance builds upon both economics and accounting. Economics provides much of the theory that underlies our techniques, whereas accounting provides the input or data on which decision making is based. Unfortunately, it is all too easy for students to lose sight of the logic that drives finance and to focus instead on memorising formulae and procedures. As a result, students have a difficult time understanding the relationships among the topics covered. Moreover, later in life when the problems encountered do not fit neatly into the textbook presentation, the student may have problems abstracting from what was learned. To overcome this problem, the opening chapter presents five basic principles of finance which are woven throughout the book. What results is a text tightly bound around these guiding principles. In essence, the student is presented with a cohesive, interrelated subject from which future, as yet unknown, problems can be approached.

Teaching an introductory finance class while faced with an ever-expanding discipline puts additional pressures on the instructor. What to cover, what to omit and how to make these decisions while maintaining a cohesive presentation are inescapable questions. In dealing with these questions, we have attempted to present the chapters in a stand-alone fashion so that they can easily be rearranged to fit almost any desired course structure and course length. Because the principles are woven into every chapter, the presentation of the text remains tight regardless of whether or not the chapters are rearranged. Again, our goal is to provide an enduring understanding of the basic tools and fundamental principles upon which finance is based. This foundation will give a student beginning his or her studies in finance a strong base on which to build future studies and it will give the student who takes only one finance class a lasting understanding of the basics of finance.

Although historical circumstances continue to serve as the driving force behind the development and practice of finance, the underlying principles that guide our discipline remain the same. These principles are presented in an intuitively appealing manner in Chapter 1 and thereafter are tied to all that follows. With a focus upon the big picture, we provide an introduction to financial decision making grounded in current financial theory and the current state of world economic conditions. This focus can be seen in a number of ways, perhaps the most obvious being the attention paid both to valuation and to the

capital markets, as well as their influence on corporate financial decisions. What results is an introductory treatment of a discipline rather than the treatment of a series of isolated finance problems. The goal of this text is to go beyond teaching the tools of a discipline or a trade and help students gain a complete understanding of the subject. This will give them the ability to apply what they have learned to new and yet unforeseen problems—in short, to educate students in finance.

## A total learning package

*Financial Management* is not simply another introductory finance text. It is a total learning package which reflects the vitality of an ever-expanding discipline. Specifically, the seventh edition of *Financial Management: Principles and Applications* has been revised to include features with benefits designed to address seven key criteria:

CHALLENGE	SOLUTION
1 Finance textbooks often show the mechanics of finance but do not present the intuition.	<ul style="list-style-type: none"> <li>The seventh edition utilises five key principles to help students understand financial management so that they can focus on the intuition behind the mechanics of solving problems.</li> </ul>
2 Students learn best when they are actively engaged.	<ul style="list-style-type: none"> <li>A five-step problem-solving technique is used in fully worked-out examples called Checkpoints. These Checkpoints give students an opportunity to pause and test their comprehension of the key quantitative concepts as they are presented. The fifth step is a worked example, followed by a practise problem ('Check yourself') for students to try out a similar problem on their own.</li> </ul>
3 Student understanding and motivation are improved when concepts are applied to topics that have relevance to their lives.	<ul style="list-style-type: none"> <li>'Finance spotlight' boxed features bring in examples from other disciplines in the business school so that students can see the applicability of finance topics to their own chosen professions, link important finance concepts to personal finance matters of high interest to students, and highlight international examples of corporate finance concepts.</li> <li>End-of-chapter questions are linked to these boxed features to ensure that students have the opportunity to actively engage with the ideas presented.</li> </ul>
4 An undergraduate textbook should provide meaningful pedagogical aids to ensure student comprehension and retention.	<ul style="list-style-type: none"> <li>'Tools of financial analysis' boxes are provided throughout the text which 'Name the tool', provide the 'Formula' and then tell the student 'What it tells you'.</li> <li>Each pedagogical feature in the chapter has significance and relevance to the chapter topics, and students are held accountable for the information therein.</li> <li>Designated end-of-chapter problems key off the examples used in the chapter-opening vignettes and in the in-chapter boxed features.</li> <li>Company scenarios used in chapter-opening vignettes are woven into the chapter body itself.</li> <li>The end-of-chapter problems are labelled by the major chapter section headings to guide students to the relevant chapter content.</li> </ul>

**CHALLENGE****SOLUTION**

- |   |  |
|---|--|
| <p><b>5</b> Students often struggle with the mathematical rigour of this course and need an accessible presentation of the mathematics.</p> | <ul style="list-style-type: none"> <li>• The use of 'Tools of financial analysis' boxes provides the student with a clearly stated description of what the equation or formula tells us.</li> <li>• We minimise the use of formulae when we can spell things out in plain English.</li> <li>• We use a five-step procedure in our problem examples (called 'Checkpoints') which begins by visualising the problem graphically, describes a solution methodology, lays out all the necessary steps in the solution, and then interprets the solution by analysing the underlying content of the problem situation. The fifth step is a practise problem ('Check yourself') for students to try out a similar problem on their own.</li> <li>• Financial management is a problem-solving course, so we provide many worked-out examples and have sorted the end of chapter materials by major chapter section to guide the student to the relevant segment of the chapter.</li> <li>• Figures are enhanced with notes and 'talking boxes' which step students through the graphs and highlight key points.</li> </ul>  |
| <p><b>6</b> Instructors find assigning and grading homework too time-consuming.</p>   | <ul style="list-style-type: none"> <li>• MyFinanceLab gives students boundless opportunities to test their understanding of all of the book's learning objectives, and in the majority of cases gives them unlimited opportunities to practise and learn using <i>algorithmic</i> questions—questions that change every time the student attempts them.</li> <li>• MyFinanceLab then provides a sophisticated assessment tool for instructors: it handles the grading and allows instructors to create and assign tests, quizzes or graded assignments with ease.</li> </ul>   |
| <p><b>7</b> Students often miss the big picture, viewing finance as a presentation of several loosely connected topics.</p>                 | <ul style="list-style-type: none"> <li>• The opening chapter presents five underlying principles of finance which serve as a springboard for the chapters and topics that follow. In essence, the student is presented with a cohesive, interrelated perspective from which future problems can be approached.</li> <li>• The core of finance involves trying to assess the valuation consequences of business decisions in a wide variety of situations. Unfortunately, students often become so enmeshed in the details of a business problem that they have difficulty identifying the valuation consequences of its choices. To give students a guide for their analysis, we use five guiding principles that underlie the valuation of any investment.</li> <li>• With a focus on the big picture, we provide an introduction to financial decision making grounded in current financial theory and in the current state of world economic conditions. What results is an introductory treatment of a discipline rather than the treatment of a series of isolated problems that face the financial manager. The goal of this text is not merely to teach the tools of a discipline or trade but also to enable students to abstract what is learned to new and yet unforeseen problems—in short, to educate the student in finance.</li> </ul> |

## Learning aids in the text

**An updated and refined organisational framework: The five principles of finance** In this edition, we have refined the number of principles that underlie the text to five. They embody the 10 principles used in the previous sixth Australian edition, but in a tighter, more succinct way. This refinement is based on the US edition, however we have added a fifth principle, 'Principle 5: Individuals respond to incentives', to the original four basic principles used in the US text: 'Money has a time value'; 'There is a risk-return trade-off'; 'Cash flows are the source of value'; and 'Market prices reflect information'. Together, these five principles represent the economic theory that makes up the foundation of financial decision making and are woven throughout the chapters of the book, providing the basis for focusing the reader on understanding the economic intuition rather than just the mechanics of solving problems. They are integrated throughout the text in the following ways:

- introduced in Chapter 1 using examples that students can relate to personally
- revisited in the chapter openers with reference to their application to each chapter's content
- specific reference is made throughout the text where the principles come to bear on the discussion.

## A focus on valuation

Although many professors and instructors make valuation the central theme of their course, students often lose sight of this focus when reading their text. We have revised this edition to reinforce this focus in the content and organisation of our text in some very concrete ways:

- First, as we mentioned earlier, we build our discussion around five finance principles that provide the foundation for the valuation of any investment.
- Second, new topics are introduced in the context of 'What is the value proposition?' and 'How is the value of the enterprise affected?.'

**NEW! A brand new principle of finance has been added: Principle 5: Individuals respond to incentives** This principle looks at the power of incentives and the conflict of interest between the firm's managers and its shareholders. This principle appears repeatedly throughout the book, bringing the student's attention back to this problem and how it can be solved.

**NEW! Tools of financial analysis** A new boxed feature, 'Tools of financial analysis', has been introduced which provides the student reader with a quick reference source for the decision tools used in financial analysis. This boxed feature appears throughout the book and names each calculation or formula, displays it in equation form and summarises 'What it tells you'.

**NEW! Expanded coverage of the ongoing world financial crisis** Chapter 2 provides extensive coverage of the financial crisis that began in 2007, its causes, and where we stand today, linking this discussion to the principles of finance.

**NEW! Expanded problem set** Focusing on chapters with high problem usage, the problem sets have been strategically expanded to provide better problem choices by the instructor. As in the previous edition, all problem sets are organised by chapter section so that both the instructor and student can readily align text and problem materials.

**NEW! Expanded coverage of interest rates and the yield curve** Chapter 9 now contains a new section, 'The shape of the yield curve', to help the student better understand how the yield curve is impacted by the inflation premium and maturity-risk premium during times of increasing or decreasing inflation. Much of this discussion is provided using a graphical approach.

**NEW! Greatly expanded coverage of investment banking** The role and functions of the investment banker are now presented in a much more complete manner, providing the student with an understanding of the role the investment banker plays in the fund-raising process.

**NEW! Expanded use of real-world examples** We provide ASX stock symbols in brackets following the names of real Australian companies throughout the text. This makes it possible for students to easily identify when the example deals with an actual company and for the keen student to look further into that company if they so desire.

**A multi-step approach to problem-solving and analysis** As anyone who has taught the core undergraduate finance course knows, there is a wide range in students' maths comprehension and skill. Students who do not have the maths skills needed to master the subject end up memorising formulae rather than focusing on the analysis of business decisions using maths as a tool. We address this problem in terms of both content and pedagogy.

- First, we present maths only as a tool to help us analyse problems, and only when necessary. We do not present maths for its own sake.
- Second, finance is an analytical subject and requires that students be able to solve problems. To help with this process, numbered chapter examples called 'Checkpoints' appear throughout the book. Each of these examples follows a very detailed and multi-step approach to problem solving that helps students develop their own problem-solving skills.
  - 1 Step 1: Picture the problem.** For example, if the problem involves a cash flow, we will first sketch the timeline. This step also entails writing down everything you know about the problem, which includes any relationships such as what fraction of the cash flow is distributed to each of the parties involved and when it is to be received or paid.
  - 2 Step 2: Decide on a solution strategy.** For example, what is the appropriate formula to apply? How can a calculator or spreadsheet be used to 'crunch the numbers'?
  - 3 Step 3: Solve.** Here, we provide a completely worked out, step-by-step solution. We first present a description of the solution in prose and then a corresponding mathematical implementation.
  - 4. Step 4: Analyse.** We end each solution with an analysis of what the solution means. This emphasises the point that problem solving is about analysis and decision making. Moreover, at this step we emphasise the fact that decisions are often based on incomplete information, which requires the exercise of managerial judgment, a fact of life that is often learned on the job.
  - 5. Step 5: Check yourself.** Immediately following the presentation of each new problem type we include a practise problem that gives the student the opportunity to practise the type of calculation used in the example.

**Content-enriched tables and figures** Students today are visual learners. They are used to scanning Internet sites to learn at a glance without the need to ferret out the meaning of a printed page. Rather than see this as a negative, we think, instead, that students (and we) are all the beneficiaries of a media revolution which allows us to learn quickly and easily using graphic design and interactive software. Textbooks have been slow to respond to this new way of absorbing information. In this text, the key elements of each chapter can quite literally be gleaned (reviewed) from the chapter tables, figures and examples. This means that all tables and figures are 'content enriched'. They are captioned, labelled in detail, and carefully linked so as to make them useful as a stand-alone tool for reviewing the chapter content.

**Finance Spotlight** boxes apply the chapter concepts to personal financial problems that students encounter in their daily lives and/or demonstrate how the chapter content applies to international business.

**Figures** include floating call-outs with descriptive annotations designed to highlight key points in the figures and facilitate student learning.



**Figure and table captions** describe the objective of the figure or table and necessary background information so that its content can be easily understood. This allows students to review the chapter content by scanning the figures and tables directly.

**Equations** are written out in plain English with minimal use of acronyms and abbreviations.

**Calculators** have been integrated throughout the text. Thus students have access to both methods of problem solving.

**Chapter summaries** have been rewritten and are organised around the chapter objectives.

**Study Questions** on the main concepts in the chapter are listed in the order in which the materials were discussed in the chapter for easy student reference.

## New to this edition

### Content updating

In response to the continued development of financial thought, reviewer comments and the recent economic crisis, changes have been made in the text. Content has been reordered to allow for a more intuitive breakdown into five parts. The large number of learning objectives from the previous Australian edition has been restructured and simplified to enable the student to more clearly focus on the key learning objectives of his or her course. A more streamlined list of learning objectives allows for clearer links between the learning objectives, the chapter content, the end-of-chapter questions and problems and MyFinanceLab questions and problems.

One or more mini-cases have been added to the end of all chapters to provide a more comprehensive example of how to implement the principles and concepts discussed in the chapter to real-life situations. End-of-chapter questions and problems have been revised and expanded.

The following list highlights some of the important changes that were made in each of the book's 20 chapters.

#### Chapter 1

##### GETTING STARTED—PRINCIPLES OF FINANCE

- The 10 principles used in the previous Australian edition have been condensed into five principles, facilitating a more concise and focused approach to an understanding of the basic principles of finance.
- The discussion of the five principles has been revised, increasing the currency of the discussion.
- The chapter has been updated and revised to make it as intuitive as possible.
- A new section on 'Ethical considerations in finance' has been added, including a real-life Finance Spotlight example.
- In addition, new examples have been added.

#### Chapter 2

##### FIRMS AND THE FINANCIAL MARKET

- This chapter has been significantly revised to reflect the recent changes in the financial markets. It has been renumbered from Chapter 3 to Chapter 2 in order to continue Chapter 1's introduction of firms and show their role in, and how they are affected by, financial markets.
- A new section, 'Financial markets and the financial crisis', was added.
- The discussion of securities markets has been revised to reflect the recent technological advances coupled with deregulation and increased competition, which have blurred the difference between an organised exchange and the over-the-counter market.

**Chapter 3**

## UNDERSTANDING FINANCIAL STATEMENTS, TAXES AND CASH FLOWS

- Chapter 2 from the Australian edition has been renumbered Chapter 3 and substantially revised, resulting in a comprehensive chapter which focuses on the relationship between a firm's financial statements, tax and cash flow.
- A discussion of the role of independent outside audits of a firm's financial statements to address principal-agent problems related to new Principle 5 ('Individuals respond to incentives') has been added.
- A detailed explanation of Australia's dividend imputation taxation system is provided, with worked examples, and the discussion includes a comparison with 'classical' taxation systems.
- Company tax and personal income tax are introduced in Chapter 3, but a detailed discussion of the difference between tax on personal income and tax on capital gains is deferred to Chapter 16, where they are discussed in the context of their potential effects on dividend policy.
- The concept of 'quality of firm earnings' has been added to the discussion of firm earnings and cash flow.

**Chapter 4**

## FINANCIAL ANALYSIS—SIZING UP FIRM PERFORMANCE

- Updated Checkpoint examples have been added to reflect current financial statements of example companies.
- In this chapter, the 'Tools of financial analysis' boxed feature is used to summarise each type of financial ratio and serve as a single point of reference for students when reviewing the material.

**Chapters 5 and 6**

## THE TIME VALUE OF MONEY—THE BASICS, and

## THE TIME VALUE OF MONEY—ANNUITIES AND OTHER TOPICS

- Chapter 4 from the previous Australian edition has been split into two chapters in this edition (Chapters 5 and 6) in order to introduce and explain the concept of the time value of money before delving deeper into the financial mathematics tools needed to make decisions in light of the time value of money.
- The chapters have been revised with an eye toward making the content more accessible to 'maths-phobic' students.
- The problem set has been expanded, with emphasis on time value of money problems with a complex stream of cash flows.

**Chapter 7**

## AN INTRODUCTION TO RISK AND RETURN—HISTORY OF FINANCIAL MARKET RETURNS

- Chapter 9 from the previous Australian edition has been split into two chapters (Chapters 7 and 8) in order to introduce students to the concepts of risk and return and examine historic rates of return in Australia and world markets, before delving further into the calculation of the risk and return of a portfolio, the security market line and the CAPM.
- Updated tables and figures have been added, comprising data on the rates of returns that investors have earned over the long term for different types of security investments.
- Revised discussion of the geometric and arithmetic means has been added to make the importance of the type of mean used in our analysis of historical returns more transparent.

**Chapter 8**

## RISK AND RETURN—CAPITAL MARKET THEORY

- A revised discussion of beta and its estimation from historical return data has been added.
- The capital asset pricing model is now presented in a 'Tools of financial analysis' boxed feature which provides the student reader with a quick reference source for this critical tool.
- Portfolio mean-variance and portfolio beta 'Tools of financial analysis' features display and explain relevant formulae.

**Chapter 9**

## DEBT VALUATION AND INTEREST RATES

- Chapters 10, 18 and 19 from the previous Australian edition have been reorganised and divided into two chapters (Chapters 9 and 10) in order to deal comprehensively, but separately, with the nature and value of bonds on the one hand and shares on the other.
- A major discussion of the role and functions of the investment banker has been added to the section on borrowing money in the public financial market.
- A new section on 'The shape of the yield curve' has been added to help the student better understand how the yield curve is impacted by the inflation premium and maturity-risk premium during times of increasing or decreasing inflation.
- Bond valuation is now also presented in a 'Tools of financial analysis' boxed feature, providing the student reader with a quick reference source for the calculation of bond value with annual and semi-annual interest payments, along with calculation of the expected yield to maturity. The section titled 'Determinants of interest rates' has undergone a major re-write and expansion.

**Chapter 10**

## SHARE VALUATION

- Ordinary share valuation is now also presented in a 'Tools of financial analysis' boxed feature, providing the student reader with a quick reference source for the general formula for an ordinary share, assuming a constant dividend growth rate; the investor's required rate of return using the CAPM; and a calculation for the dividend growth rate.

**Chapter 11**

## INVESTMENT DECISION CRITERIA

- 'Tools of financial analysis' boxed features incorporate pros and cons of using each tool as well as a definition of the concept and description of its use.
- The discussion of the equivalent annual cost (EAC) metric has been totally revised in an effort to simplify the discussion and link it more closely to net present value (NPV).
- The modified internal rate of return (MIRR) discussion has been expanded, and the various techniques for calculating it are described in detail along with a careful listing of the limitations of the measure.
- 'Tools of financial analysis' boxed features are used to summarise each tool of capital-budgeting analysis and provide the student reader with a ready point of reference for reviewing the chapter.
- The importance of Principle 5 ('Individuals respond to incentives') is emphasised as it pertains to the evaluation of significant new investments by the firm's management.

**Chapter 12**

## ANALYSING PROJECT CASH FLOWS

- New Principle 5 ('Individuals respond to incentives') is highlighted as it impacts the estimates managers make of the cash flows of pet projects and the distortion this can bring to the capital-budgeting process.
- An expanded 'Tools of financial analysis' boxed feature has been added.

- New introductory free cash-flow calculation problems have been added. These problems were designed to be used as a first assignment after reading the chapter and are very straightforward exercises.

### **Chapter 13**

#### RISK ANALYSIS AND PROJECT EVALUATION

- The conflict of interest that underlies Principle 5 ('Individuals respond to incentives') is used to discuss the reluctance of firms to use multiple discount rates for divisions or business units.
- 'Tools of financial analysis' boxed features provide discussion of the break-even tool and an explanation of the degree of operating leverage definition.

### **Chapter 14**

#### THE COST OF CAPITAL

- The chapter includes discussion of new Principle 5 'Individuals respond to incentives' as it relates to division budgets and manager incentives.
- A new study problem has been added which focuses on the limitations of the percent of sales forecast method.
- All rates-of-return data have been updated to current rates. This includes the bond spread data used to evaluate the cost of debt financing.
- New graphs for CAPM problems have been added.
- Cost-of-debt problems have been added which utilise the spread to Treasury data provided in the chapter. In addition, 12 existing problems have been revised to clarify the issues involved in the exercise.

### **Chapter 15**

#### CAPITAL-STRUCTURE POLICY

- Chapters 15 and 16 from the previous Australian edition have been combined into a comprehensive discussion of the issues relating to capital structure theory.
- 'Tools of financial analysis' boxed features are used to summarise both capital structure ratios and coverage ratios, and provide the student reader with a ready point of reference for reviewing the chapter.
- The concept of enterprise value as an alternative measure of firm value has been introduced and explained.

### **Chapter 16**

#### DIVIDEND POLICY

- The number of learning objectives has been reduced from six to three, which reflects the simplified presentation of the chapter materials.

### **Chapter 17**

#### FINANCIAL FORECASTING AND PLANNING

- Chapter examples and 'Checkpoint' exercises have been added.
- The equation for discretionary financing needed (DFN) is now summarised in a 'Tools of financial analysis' boxed feature.

### **Chapter 18**

#### WORKING CAPITAL MANAGEMENT

- Chapters 7 and 8 from the previous Australian edition have been combined into a comprehensive chapter on working capital management, including sections on the management of current liabilities and current assets
- A 'Tools of financial analysis' boxed feature has been added to explain the cost of forgoing a cash discount.

## Chapter 19

### INTERNATIONAL BUSINESS FINANCE

- This chapter has been revised dramatically and updated to reflect changes in exchange rates and in the global financial markets in general and to allow for the presentation of the material in a more intuitive and simple manner.
- The discussion of currency cross rates has been simplified and made more intuitive.

## Chapter 20

### CORPORATE RISK MANAGEMENT

- This chapter has been revised to reflect changes in the tools of corporate risk management and to allow for a more intuitive presentation.
- The Black–Scholes option pricing equation is now summarised in new 'Tools of financial analysis' boxed features which highlight the equation and its components as well as provide an intuitive discussion of the variables important in determining the value of an option.

## Learning aids supplemental to the text

*Financial Management* integrates the most advanced technology available to assist the student and the instructor. Not only does it make their *Financial Management* come alive with the most current information, but it also enhances a total understanding of all tools and concepts necessary in mastering the course.

A suite of resources is provided to assist with delivery of the text, as well as to support teaching and learning.

### Solutions Manual

The Solutions Manual provides educators with detailed, accuracy-verified solutions to all the in-chapter and end-of-chapter problems in the book (except for the Concept Check Questions, which are covered by all other questions).

### Test Bank

The Test Bank provides a wealth of accuracy-verified testing material. Updated for the new edition, each chapter offers a wide variety of multiple-choice questions, arranged by heading and tagged by AACSB standards.

*Every question is available in TestGen<sup>®</sup> software for both Windows<sup>®</sup> and Macintosh<sup>®</sup> computers. This easy-to-use testing software is a valuable test preparation tool that allows educators to customise, save, and generate classroom tests.*

### PowerPoint Lecture Slides

A comprehensive set of PowerPoint slides can be used by educators for class presentations or by students for lecture preview or review. They include key figures and tables, as well as a summary of key concepts and examples from the text.

### Digital Image PowerPoint Slides

All the diagrams and tables from the text are available for lecturer use.

# MAKING THE MOST OF YOUR RESOURCES

MyFinanceLab for Titman/Martin/Keown/Martin

*Financial Management: Principles and Applications, 7th edition*

A guided tour for students and educators

[www.pearson.com.au/titman7](http://www.pearson.com.au/titman7)

The screenshot shows the 'Study Plan' page in MyFinanceLab. The header includes the course title 'Titman: Financial Management 7e' and the MyFinanceLab logo. A navigation menu on the left lists options like 'Course Home', 'Course Materials', 'Assignments', and 'Results'. The main content area is titled 'Study Plan Recommendations' and shows 'Study Plan Recommendations' with a progress indicator 'You have earned 0 of 129 mastery points (MP)'. Below this, a section 'What to work on next' lists several topics with 'Practice' and 'Quiz Me' buttons: '0.1 Tutorial Examples for Students', '1.2 Three Types of Business Organisations', '1.3 The Goal of the Financial Manager', '1.4 The Five Basic Principles of Finance', and '2.1 The Basic Structure of Australian Financial Markets'.

## Study Plan

A Study Plan is generated from each student's results on a pre-test. Students can clearly see which topics they have mastered and, more importantly, which they need to work on.

The screenshot shows two panels from the MyFinanceLab interface. The left panel, 'My Upcoming Assignments', lists 'Chapter 1 Revision quiz', 'Chapter 2 Test', and 'Chapter 3 homework'. Below this is an 'Announcements' section with a 'Welcome to MyFinanceLab' message and links for 'Adaptive Study Plan', 'Browser Check', and 'Here for self-study?'. The right panel, 'My Results', shows an 'Overall Score' of 0%, a 'Course Timeline' graph, and a 'My Progress' section with progress bars for 'Homework', 'Quizzes', 'Tests', and 'Study Plan', each showing a 1/2 completion status.

## Learning Resources

To further reinforce understanding, Study Plan and Homework problems link to the following learning resources:

- the relevant section of the eText, so students can review key concepts
- Help Me Solve This, which walks students through the problem with step-by-step help and feedback without giving away the answer.