afin1002 cheat sheet

A quick reference guide covering essential concepts in corporate finance, financial markets, and investment decisions. Perfect for students, professionals, and anyone seeking a concise overview.

Core Principles

Financial Goals

Financial Assets
 Firms pay for these real assets by selling claims on then and the cash flows they will
generate. These claims are called financial assets.
o Examples
 Debt – Bank loan: A bank provides a firm with cash in exchange for the firm
repaying the loan with interest
 Debt – Bond: A firm sells (issues) a bond to investors in exchange for
promising to pay interest payments and principal at maturity
 Equity – Shares: A firm sells (issues) shares in exchange for ownership in the
company and residual cash flows
 The two key decisions faced by financial managers are:

1. Investment decision

- Purchase of real assets

2. Financing decision

- Issue of financial assets

Maximizing Shareholder Wealth: The primary goal of corporate finance. Achieved through strategic investment and financing decisions.

Efficient Capital Allocation: Deploying capital to projects that generate the highest risk-adjusted returns.

Time Value of Money

Present Value (PV): Value of future cash flows discounted to today.	$PV = \frac{FV}{(1+r)^n}$
Future Value (FV): Value of an asset at a specified date in the future based on the rate of growth.	$FV = PV(1+r)^n$
Annuity: A series of equal payments made at equal intervals.	$PV = PMT * \frac{1-(1+r)^{-n}}{r}$

Risk and Return

Risk: The uncertainty of future returns.

Return: The gain or loss on an investment over a period.

Diversification: Reducing risk by investing in a variety of assets.

Capital Asset Pricing Model (CAPM): A model used to determine the required rate of return for an asset.

Capital Budgeting

Investment Criteria

Net Present Value (NPV): The sum of the present values of all cash flows from a project, minus the initial investment. Accept projects with NPV > 0.

Internal Rate of Return (IRR): The discount rate that makes the NPV of all cash flows from a project equal to zero. Accept projects with IRR > cost of capital.

Payback Period: The time it takes for a project to recover its initial investment. Shorter payback periods are generally preferred.

Cash Flow Estimation

Incremental Cash Flows: The changes in a company's cash flows that are a direct consequence of accepting a project.

Sunk Costs: Costs that have already been incurred and cannot be recovered. These should *not* be included in capital budgeting decisions.

Opportunity Costs: The potential benefits a company misses out on when choosing one alternative over another. These *should* be included.

Project Analysis

Sensitivity Analysis: Examining how changes in one variable affect the NPV of a project.

Scenario Analysis: Evaluating the NPV of a project under different scenarios (e.g., best case, worst case, most likely case).

Simulation Analysis (Monte Carlo): Using computer simulations to model the uncertainty of project cash flows.

Capital Structure

Sources of Financing

Debt: Borrowing money that must be repaid with interest. Examples include bonds, loans.

Equity: Ownership in a company. Examples include common stock, preferred stock.

Internal Funds: Profits that are reinvested in the company.

Optimal Capital Structure

Trade-off Theory: Balancing the tax benefits of debt with the costs of financial distress.

Pecking Order Theory: Firms prefer internal financing first, then debt, and lastly equity.

Agency Costs: Costs associated with conflicts of interest between managers and shareholders (or between debt and equity holders).

Cost of Capital

Weighted Average Cost of Capital (WACC): The average rate of return a company is expected to pay to finance its assets.	$WACC = (E/V) * Re + (D/V) * Rd * (1 - Tc) Where: .$

Working Capital Management

Key Components

Cash Management: Optimizing cash balances to meet short-term obligations.

Accounts Receivable Management: Managing credit policies and collection efforts to minimize bad debts.

Inventory Management: Balancing inventory levels to meet customer demand while minimizing storage and obsolescence costs.

Accounts Payable Management: Optimizing payment terms with suppliers to maximize cash flow.

Working Capital Metrics

Current Ratio: Current Assets / Current Liabilities. Measures a company's ability to pay short-term obligations.

Quick Ratio (Acid Test): (Current Assets - Inventory) / Current Liabilities. A more conservative measure of liquidity.

Cash Conversion Cycle: The length of time between a company's outlay of cash for raw materials and the inflow of cash from collecting accounts receivable.