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FINANCIAL MANAGEMENT

Principles and Applications

8th EDITION

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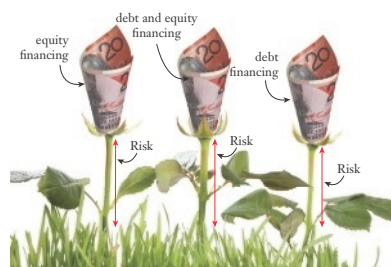
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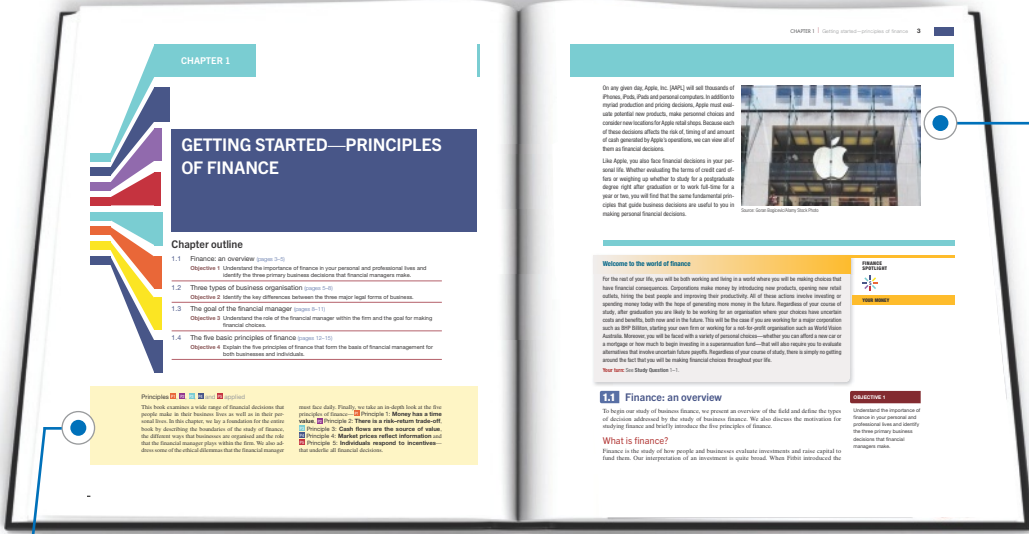
As a final word, I express my sincere thanks to those who are using *Financial Management: Principles and Applications* in the classroom. Thank you for making this eighth edition a part of your teaching/learning experience. Please feel free to contact me, Tony Martin, should you have questions or needs. You can email me at t.martin@latrobe.edu.au or contact me via Pearson Australia.

TONY MARTIN

Logic of Finance

The five principles of finance

Many finance books 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**.



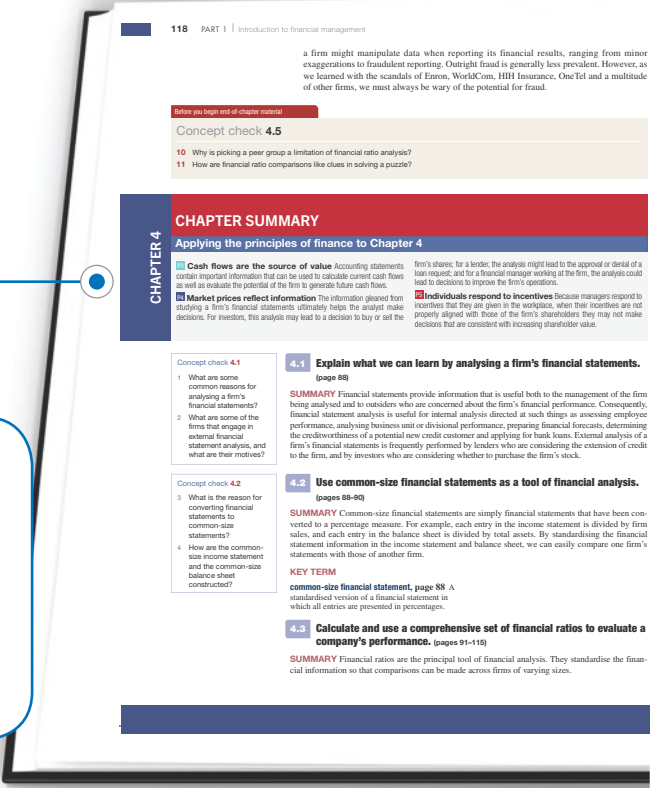
The chapter-opening vignette provides a **real-world example** of the principles of finance applied in the chapter, many times reinforcing them by showing how 'forgetting' a principle might lead to financial troubles.

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

The **summaries** that conclude each chapter review the principles of finance in context, promoting deeper understanding and greater retention of chapter concepts.

Within the chapter, the authors draw on the five principles of finance to illustrate concepts and explain the rationale behind financial decision making. Look for **P1**, **P2**, **P3**, **P4** and **P5**.

- P1** PRINCIPLE 1: Money has a time value
- P2** PRINCIPLE 2: There is a risk–return trade-off
- P3** PRINCIPLE 3: Cash flows are the source of value
- P4** PRINCIPLE 4: Market prices reflect information
- P5** PRINCIPLE 5: Individuals respond to incentives



Tools for developing study skills

To be successful, finance students need hands-on opportunities to apply what they have learned in ways that go beyond rote memorisation of formulae. By focusing on basic principles of finance, students develop the skills needed to extend their understanding of finance tools beyond formulae and canned answers. The authors' objective is to equip students, no matter what their major or business responsibility might be, to contribute to an analysis of the financial implications of practical business decisions.



Checkpoints provide a consistent problem-solving technique that walks through each problem in five steps, including an analysis of the solution reached. Each Checkpoint concludes with an additional practice problem (and its solution) on the same topic so that students can test their mastery of the problem-solving approach. Then students can put their knowledge to the test by completing the linked end-of-chapter study problem(s).

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





PREFACE

The eighth edition of *Financial Management: Principles and Applications* updates our material and further refines our pedagogical approach in ways that make the material much more engaging to all undergraduate students, regardless of their major.

Our approach to financial management

First-time students of finance will find that financial management builds on 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, they have a difficult time understanding how the various topics covered in an introductory course tie together, and they do not appreciate how the financial insights might be useful for them personally. More importantly, later in life when students encounter problems that do not fit neatly into the textbook presentation, they may not be able to apply what they have learned.

Our book is designed to overcome these problems. The opening chapter presents five basic principles of finance which are woven throughout the book, creating a text that is tightly bound around these guiding principles. In essence, students are presented with a cohesive, inter-related subject that they can use when approaching future, as yet unknown, problems. We also recognise that most students taking introductory financial management are not majoring in finance, and we include two features that help keep them engaged. At the beginning of each chapter, we include a 'Finance Spotlight' feature box which explains why the issues raised in the chapter are relevant to those students who are not majoring in finance. In addition, throughout the book we have additional 'Finance Spotlight – Your Money' feature boxes that address issues like how to construct a personal investment plan and illustrate how students will be using the tools of financial analysis for personal decisions throughout their lives.

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 on which finance is based. This foundation will give students beginning their studies in finance a strong base on which to build future studies, and will give students who take only one finance subject a lasting understanding of the basics of finance.

Although historical developments, like the 2008 financial crisis, influence the topics that are included in an introductory finance class, the underlying principles that guide financial analysis 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 on these principles, we provide an introduction to financial decision making that is rooted in financial theory. 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. Our goal is to go beyond teaching the tools of financial analysis and help students gain a complete understanding of the subject so that they will be able to apply what they have learned to new and unforeseen problems—in short, to educate students in finance.

For this eighth edition, Tony Martin has carefully updated and refined the seventh edition, which was the original adaptation of the US version of the Titman textbook for Australian students. The local adaptation retains the basic structure and pedagogical approach of the US text but uses recent Australian research and cites real-life Australian examples throughout, drawing on Australian content from previous local editions of this book, and revising the content as needed to reflect an evolving Australian legal and business context.

New to this edition

The eighth edition includes the following key updates:

- updated 'Finance Spotlight' feature boxes that analyse the text discussion of financial management using real-world examples
- updated end-of-chapter study problem sets
- examples that use actual Australian companies and reflect current conditions
- expanded coverage of the impact of changes in exchange rates
- a new chapter on the analysis and impact of leverage, which brings together all of the issues relating to the use of leverage
- data and current event updates throughout

A total learning package

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

Challenge	Solution
1 Finance books often show the mechanics of finance but do not present the intuition.	<ul style="list-style-type: none"> • The eighth 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.
2 Students learn best when they are actively engaged.	<ul style="list-style-type: none"> • 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. In the fifth step ('Check yourself'), students are given a practice problem similar to the preceding example to attempt on their own.
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"> • The 'Finance Spotlight – Your Money' feature boxes link important finance concepts to personal finance decisions that will be relevant throughout students' lives. • The opening 'Finance Spotlight' feature boxes in each chapter illustrate that financial decision making often requires a team which includes not only financial analysts but also engineers, operations people, marketing people and accountants. Just as those majoring in finance need to know more than just finance, students pursuing these other disciplines need to know basic financial management to serve effectively on these teams. • The 'Finance Spotlight – International' feature boxes highlight international examples of financial management concepts. • End-of-chapter study questions are linked to these feature boxes to ensure that students have the opportunity to actively engage with the ideas presented.

Challenge	Solution
<p>4 An undergraduate textbook should provide meaningful pedagogical aids to ensure student comprehension and retention.</p>	<ul style="list-style-type: none"> • ‘Tools of financial analysis’ feature boxes are provided throughout the text; they name the tool being studied, provide its formula and then explain what it tells students. • Each pedagogical feature in the chapter has significance and relevance to the chapter topics, and students are held accountable for the information therein. • Designated end-of-chapter study questions key off the in-chapter feature boxes. • Company scenarios used in chapter-opening vignettes are woven into the chapter body itself. • The end-of-chapter study problems are grouped by major chapter section heads to guide students to the relevant chapter content.
<p>5 Students often struggle with the mathematical rigour of the introductory finance course and need an accessible presentation of the mathematics.</p>	<ul style="list-style-type: none"> • The ‘Tools of financial analysis’ feature boxes provide students with clearly stated descriptions of what the essential equations or formulae tell them. • We minimise the use of formulae when we can spell things out in plain English. • 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. • Financial management is a problem-solving course, so we provide lots of worked examples and have grouped the end-of-chapter materials by major chapter sections to guide students to the relevant segment of the chapter. • Figures are enhanced with notes and ‘talking boxes’ that step students through the graphs and highlight key points.
<p>6 Instructors find assigning and grading homework too time-consuming.</p>	<ul style="list-style-type: none"> • MyFinanceLab allows instructors to create and assign tests, quizzes or graded assignments with ease. • MyFinanceLab handles the grading.
<p>7 Students often miss the big picture, viewing finance as a presentation of several loosely connected topics.</p>	<ul style="list-style-type: none"> • The opening chapter presents five underlying principles of finance that serve as a springboard for the chapters and topics that follow. In essence, students are presented with a cohesive, inter-related perspective from which future problems can be approached. • 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 context for their analysis, we use five guiding principles that underlie the valuation of any investment. • With a focus on the big picture, we provide an introduction to financial decision making that is rooted 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 which 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 apply what is learned to new and as yet unforeseen problems—in short, to educate students in finance.

Learning aids in the text

The five principles of finance Together, the five principles—**P1** Money has a time value, **P2** There is a risk–return trade-off, **P3** Cash flows are the source of value, **P4** Market prices reflect information, and **P5** Individuals respond to incentives—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 students on understanding the economic intuition rather than just the mechanics of solving problems. They are integrated throughout the text in the following ways:

- The five principles are introduced in Chapter 1 using examples that students can relate to personally.

- They are 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 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 have built our discussion around five finance principles which provide the foundation for the valuation of any investment.
- Second, we have introduced new topics in the context of 'What is the value proposition?' and 'How is the value of the enterprise affected?'

Finance Spotlight – Your Money New feature boxes have been introduced to provide students with analysis that is parallel to the text discussion of financial management but uses examples that they are likely to experience in their personal lives. Once again, this pedagogical tool is designed to make the study of finance relevant to all students, regardless of their course.

Real-world examples To enhance the relevance of the topics discussed, we have made extensive use of real-world examples. In addition, stock symbols are provided in square brackets following the names of companies listed on Australian or overseas stock exchanges. This enables students to easily recognise examples that deal with actual listed companies, and to look up stock information themselves if they wish.

NEW! Expanded coverage of the impact of changes in exchange rates A new section titled 'What does a change in the exchange rate mean for business?' examines how exchange rate changes affect imports and exports and the profitability of multinational firms.

NEW! Chapter on the analysis and impact of leverage Content that relates to leverage has been reorganised into a single chapter in order to give a comprehensive analysis of the impact of leverage on a firm.

A multi-step approach to problem solving and analysis As anyone who has taught the core undergraduate finance course knows, students vary across a wide range in terms of their maths comprehension and skills. 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 text 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, multi-step approach to problem solving that helps students develop their own problem-solving skills.

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 we know about the problem, which includes any relationships such as what fraction of the cash flow is to be distributed to each of the parties involved and when it is to be received or paid.

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'?

Step 3: Solve. Here we provide a complete, step-by-step worked solution. We first present a description of the solution in prose and then provide a corresponding mathematical implementation.

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.

Step 5: Check yourself. Immediately following the presentation of each new problem type, we include a practice problem that gives students 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 seeing this as a negative, we instead believe that students (and we) are all the beneficiaries of a media revolution that 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 in the book 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 – Your Money These feature boxes apply the chapter concepts to personal financial problems that students encounter in their daily lives.

Finance Spotlight – International These feature boxes demonstrate how the chapter content applies to international business.

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

Figure and table captions Detailed captions describe the objective of each figure or table and provide 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 Equations are written in plain English with minimal use of acronyms and abbreviations. In addition, 'Tools of financial analysis' feature boxes are used throughout the book to provide a quick review and reference guide for critical equations used to support financial decision making.

Financial spreadsheets and calculators The use of financial spreadsheets and calculators has been integrated throughout the text. Thus, students have access to both methods of problem solving.

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

Study questions These end-of-chapter questions review the main concepts in the chapter and are presented in the order in which these concepts were discussed in the chapter, for easy student reference.

NEW! Expanded study problem sets Focusing on chapters with high problem usage, the end-of-chapter study problem sets have been strategically expanded to provide better problem choices for the instructor. As in the previous edition, all study problems are grouped by chapter section so that both instructors and students can readily align text and problem materials. Where actual company examples are used, problems have been updated to reflect current conditions. In most chapters, the problem set concludes with a 'mini-case' which brings together many of the themes covered in the chapter in a single, comprehensive, hypothetical or real-world example.

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. The following list highlights some of the important changes that were made in each of the book's 21 chapters.

Chapter 1

GETTING STARTED—PRINCIPLES OF FINANCE

- The discussion of the five principles of finance has been revised, increasing its currency.
- This chapter has been updated and revised to make it as intuitive as possible.
- New Australian examples have been added.

Chapter 2

FIRMS AND THE FINANCIAL MARKET

- This chapter has been revised to reflect the recent changes in interest rates and in the financial markets.
- The discussion of how securities markets bring corporations and investors together has been revised to reflect the current financial markets.
- The study questions have been updated and revised.

Chapter 3

UNDERSTANDING FINANCIAL STATEMENTS, TAXES AND CASH FLOWS

- Checkpoints within the chapter content have been updated to include current data and rewritten to reflect changing financial conditions.
- Company examples used in the problem exercises have been updated to reflect current information.
- The section on company tax has been augmented with a detailed discussion of the calculation of personal income tax and capital gains tax.

Chapter 4

FINANCIAL ANALYSIS: SIZING UP FIRM PERFORMANCE

- Checkpoints within the chapter have been updated to include current data and rewritten to reflect changing conditions.

Chapter 5

THE TIME VALUE OF MONEY—THE BASICS

- The coverage of payday loans and of the equivalent annual return have been updated, reflecting a current example.
- This chapter has been revised with an eye towards making it more accessible to maths-phobic students.
- The study questions have been updated and revised.

Chapter 6

THE TIME VALUE OF MONEY—ANNUITIES AND OTHER TOPICS

- The chapter discussion has been reworked to make it more accessible to those students who are maths-phobic.

Chapter 7

RISK AND RETURN—AN INTRODUCTION: HISTORY OF FINANCIAL MARKET RETURNS

- All tables and figures have been updated to reflect historical rates of return that investors have earned for different types of security investment.

- The discussion of the geometric and arithmetic means has been revised to make the importance of the type of mean used in our analysis of historical returns more transparent.
- Selected study problems have been revised.

Chapter 8

RISK AND RETURN—CAPITAL MARKET THEORY

- The discussion of beta and its estimation from historical return data has been revised. The example company used for this discussion is now Woolworths Ltd [WOW].
- Selected study problems have been revised.

Chapter 9

DEBT VALUATION AND INTEREST RATES

- The examples have been updated and revised to reflect the current level of interest rates with new examples of borrowing.
- This chapter has been revised to incorporate the very low interest rate levels in the financial markets.
- The discussion of the bond valuation relationship has been revised.

Chapter 10

SHARE VALUATION

- The discussion of the stock market, which is covered in Chapter 2, has been dropped due to its redundancy.
- The study questions have been updated and revised.

Chapter 11

INVESTMENT DECISION CRITERIA

- The modified internal rate of return (MIRR) discussion has been revised to focus on the origins of the situations in which the analyst will find the MIRR helpful in making an investment decision.
- The study problem set has been substantially revised.

Chapter 12

ANALYSING PROJECT CASH FLOWS

- The 'Quick Reference' tool for free cash flow has been replaced with an expanded 'Tools of financial analysis' feature box.
- The study problem set has been substantially revised.

Chapter 13

RISK ANALYSIS AND PROJECT EVALUATION

- The study problem set has been substantially revised.

Chapter 14

THE COST OF CAPITAL

- The study problem set has been substantially revised.

Chapter 15

ANALYSIS AND IMPACT OF LEVERAGE

- This new chapter reorganises all content relating to leverage to give a comprehensive overview of the impact of leverage on a firm.

Chapter 16

CAPITAL-STRUCTURE POLICY

- The study problem set has been substantially revised.

Chapter 17

DIVIDEND AND SHARE-BUYBACK POLICY

- Figure 17.1, which looks at corporate earnings, cash dividends and share buybacks for a broad cross-section of Australian firms, has been updated and now covers the period between 2009 and 2015.
- A number of the chapter's study problems have been revised.

Chapter 18

FINANCIAL FORECASTING AND PLANNING

- The study problem set has been substantially revised.

Chapter 19

WORKING CAPITAL MANAGEMENT

- The study problem set has been substantially revised.

Chapter 20

INTERNATIONAL BUSINESS FINANCE

- This chapter has been revised and updated to reflect dramatic changes in exchange rates and in the global financial markets in general.
- A new section titled 'What does a change in the exchange rate mean for business?' has been added.

Chapter 21

CORPORATE RISK MANAGEMENT

- This chapter has been revised to reflect changes in the area of corporate risk management and to allow for a more intuitive presentation.

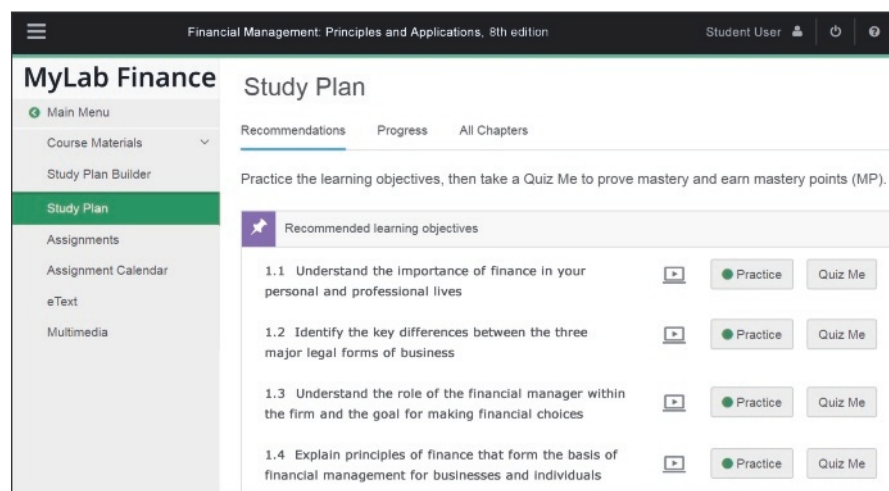
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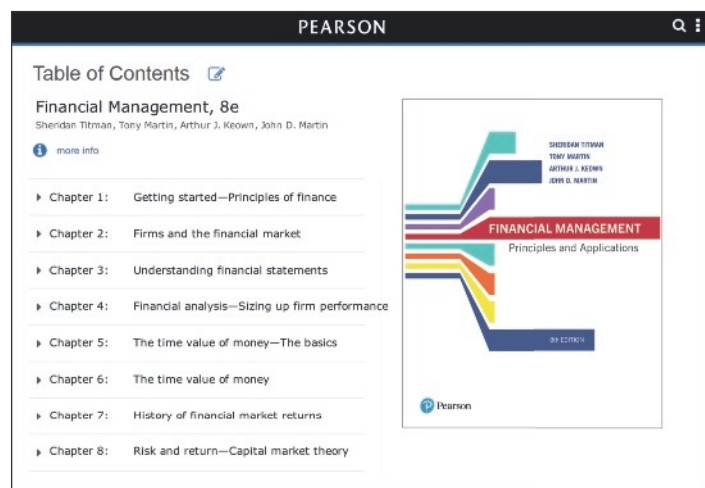


The screenshot shows the MyLab Finance interface for a student user. The page title is "Study Plan" under the heading "Financial Management: Principles and Applications, 8th edition". The left sidebar contains a navigation menu with options: Main Menu, Course Materials, Study Plan Builder, Study Plan (highlighted), Assignments, Assignment Calendar, eText, and Multimedia. The main content area is titled "Study Plan" and has tabs for "Recommendations", "Progress", and "All Chapters". Below the tabs, there is a message: "Practice the learning objectives, then take a Quiz Me to prove mastery and earn mastery points (MP)." A section titled "Recommended learning objectives" lists four objectives, each with a "Practice" button and a "Quiz Me" button:

- 1.1 Understand the importance of finance in your personal and professional lives
- 1.2 Identify the key differences between the three major legal forms of business
- 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices
- 1.4 Explain principles of finance that form the basis of financial management for businesses and individuals

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 the Pearson Table of Contents for "Financial Management, 8e" by Sheridan Titman, Tony Martin, Arthur J. Keown, and John D. Martin. The table of contents lists the following chapters:

- Chapter 1: Getting started—Principles of finance
- Chapter 2: Firms and the financial market
- Chapter 3: Understanding financial statements
- Chapter 4: Financial analysis—Sizing up firm performance
- Chapter 5: The time value of money—The basics
- Chapter 6: The time value of money
- Chapter 7: History of financial market returns
- Chapter 8: Risk and return—Capital market theory

To the right of the table of contents is a graphic of the book cover, which features the title "FINANCIAL MANAGEMENT Principles and Applications" and the authors' names: "SHERIDAN TITMAN, TONY MARTIN, ARTHUR J. KEOWN, JOHN D. MARTIN". The Pearson logo is visible at the bottom left of the cover graphic.

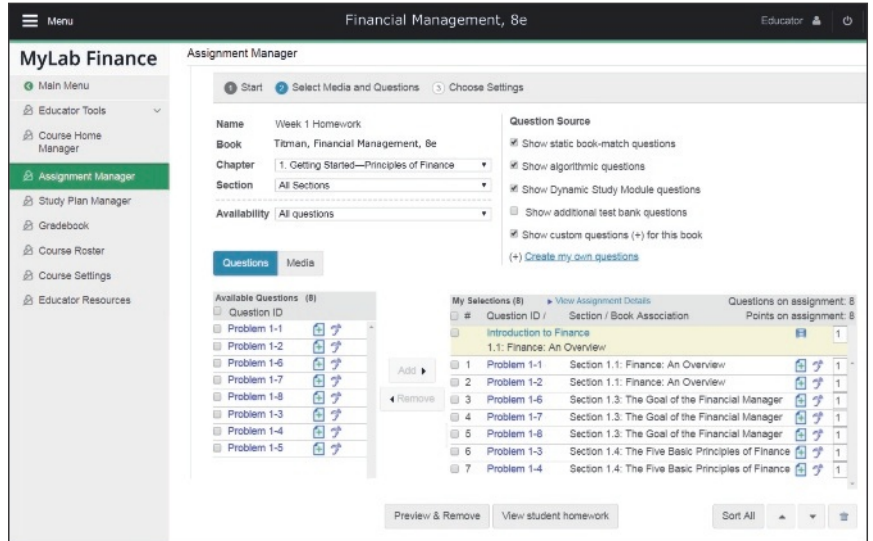
Learning resources

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.

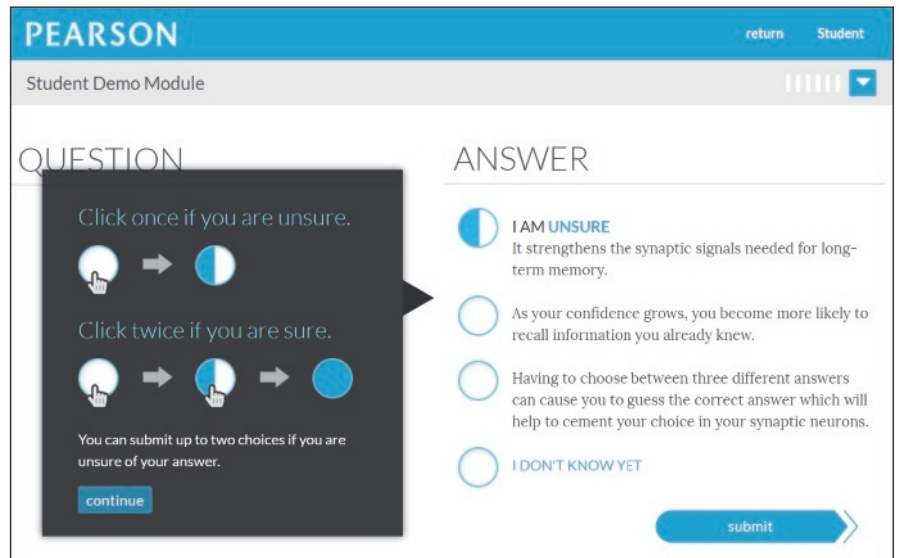
Assignable content

Educators can select content from the Study Plan and/or Test Bank and assign to students as homework or quizzes.



Dynamic Study Modules

Using a highly-personalised process, Dynamic Study Modules continuously assess students' performance and provide additional practice in the areas where they struggle the most. Students can then review material and retest themselves until they 'master' the information. Each Dynamic Study Module, accessed by computer, smartphone or tablet, promotes fast learning and long-term retention.



Learning aids supplemental to the text

Financial Management integrates the most advanced technology available to assist students and instructors. Not only does this make Financial Management come alive with the most current information, but it also fosters total understanding of all the tools and concepts necessary to master the course. Financial Management's complete support package for students and instructors includes the following essentials.

Solutions Manual The Solutions Manual provides educators with detailed, accuracy-verified solutions to in-chapter and end-of-chapter problems in the book.

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 question types, arranged by learning objective and tagged by AACSB standards.

Questions can be integrated into Blackboard, Canvas or Moodle Learning Management Systems.

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 course content.

Digital image PowerPoints These slides include all the diagrams and tables from the course content for lecturer use.