

Corporate Finance, Module 24: "Financial Analysis and Planning"

Corporate finance module 24: Readings for Eleventh Edition

(The attached PDF file has better formatting.)

The page numbers here are for the *eleventh* edition of Brealey and Myers. You may also use the seventh, eighth, ninth, or tenth editions of this text. The page numbers for earlier editions are in separate postings. The substantive changes in the textbook are slight among these editions, but the final exam problems are based on the eleventh edition.

{The Brealey and Myers textbook is excellent. We say to read certain sections and to skip others. This does not mean that certain sections are better; it means that the homework assignments and exam problems are based on the sections that you must read for this course. Some of the skipped sections are fascinating, but they are not tested.}

Read Section 28.1, "financial ratios," on pages 719-720 and Section 28.2, "financial statements," on pages 720-721. If you have never had an accounting course and have not picked up basic accounting at work, these sections are good introducers. They explain financial statements (balance sheet and income statement) and financial ratios; they help you in general actuarial work, not just in the VEE course.

Read section 28.8, "Home Depot's Financial Statements" on pages 721-723. Firms have three major financial statements: the balance sheet, the income statement, and the sources and uses of funds. Financial statements *articulate*, meaning that certain relations connect them. Debit and credits appear on the balance sheet and the income statement, and the form in which they appear affects the change in equity over the year.

As you study this chapter from the Brealey and Myers text, look at the financial statements of your employer (or of a client, if you work for a consulting firm). You learn insurance accounting for the actuarial exams; mastery of this module will save you hours later on.

Read section 28.4, "Measuring Home Depot's Performance," on pages 724-729. Focus on economic value added and rates of return on pages 725-729. Most of the financial ratios in the textbook apply to manufacturers, not to insurers, but economic value added and rates of return apply to all firms.

Review problem 4(c) and 4(d) on page 742. Economic value added and return on capital use the capital at the beginning of the year (or the capital at the end of the previous year). Some analysts use the average capital during the year; don't do this on the final exam.

Review problem 25 on page 746. The tax shield is deducted from the weighted average cost of capital, so it must be deducted from income. Simply deducting the cost of equity from net income does not give the same result if book and market values of debt differ.