Contents

Preface ix

Purpose of the Book ix

Target Audience x A Note to Students x

Organization of the Book xi

Outstanding Features xii

Pedagogical Features xii Supplements xiii

Typography Conventions xiii

Changes from the 8th Edition xiv

A Note on the Internet xiv

Acknowledgments xiv

CHAPTER 1 INTRODUCTION TO EXCEL

Spreadsheet Uses 2

Starting Microsoft Excel 2

Parts of the Excel Screen 3

The File Tab and Quick Access Toolbar 3 The Home Tab 4

The Formula Bar 6 The Worksheet Area 6

Sheet Tabs 7

Status Bar 8

Navigating the Worksheet 8

Selecting a Range of Cells 9

Using Defined Names 10

Entering Text and Numbers 11

Formatting and Alignment Options 12

Formatting Numbers 13

Adding Borders and Shading 15

Entering Formulas 15

Copying and Moving Formulas 18

Mathematical Operators 19

Parentheses and the Order of Operations 19

Using Excel's Built-In Functions 21

Using the Insert Function Dialog Box 22

Array Functions 24

"Dot Functions" in Excel 25

Using User-Defined Functions 27

Creating Graphics 28

Creating Charts in a Chart Sheet 29

Creating Embedded Charts 30

Formatting Charts 31

Changing the Chart Type 32

Creating Sparkline Charts 34

Printing 35

Using Excel with Other Applications 36

Quitting Excel 37

Best Practices for Spreadsheet Models 38

Summary 39

Problems 39

Internet Exercise 43

CHAPTER 2 THE BASIC FINANCIAL STATEMENTS 45

The Income Statement 46

Building an Income Statement in Excel 46

The Balance Sheet 51

Building a Balance Sheet in Excel 52

Improving Readability: Custom Number Formats 53

Common-Size Financial Statements 56

Creating Common-Size Income Statements 56 Creating a Common-Size Balance Sheet 58

Building a Statement of Cash Flows 59

Using Excel's Outliner 64

Common-Size Statement of Cash Flows 66

Summary 70

Problems 71

Internet Exercise 73

CHAPTER 3 FINANCIAL STATEMENT ANALYSIS TOOLS 75

Liquidity Ratios 76

The Current Ratio 77

The Quick Ratio 78

Efficiency Ratios 79

Inventory Turnover Ratio 79

Accounts Receivable Turnover Ratio 80

Average Collection Period 80

Fixed Asset Turnover Ratio 82

Total Asset Turnover Ratio 82

Leverage Ratios 83

The Total Debt Ratio 84
The Long-Term Debt Ratio 84
The Long-Term Debt to Total Capitalization Ratio 85
The Debt to Equity Ratio 85
The Long-Term Debt to Equity Ratio 86

Coverage Ratios 87

The Times Interest Earned Ratio 87
The Cash Coverage Ratio 88

Profitability Ratios 88

The Gross Profit Margin 89
The Operating Profit Margin 89
The Net Profit Margin 90
Return on Total Assets 90
Return on Equity 91
Return on Common Equity 91
DuPont Analysis 92
Analysis of EPI's Profitability Ratios 94

Financial Distress Prediction 95

The Original Z-Score Model 95
The Z-Score Model for Private Firms 97

Using Financial Ratios 97

Trend Analysis 97
Comparing to Industry Averages 98
Company Goals and Debt Covenants 100
Automating Ratio Analysis 100

Economic Profit Measures of Performance 103

Summary 105 Problems 108 Internet Exercise 110

CHAPTER 4 THE CASH BUDGET 111

The Worksheet Area 113

Using Date Functions 113
Calculating Text Strings 114
Sales and Collections 115
Purchases and Payments 117

Collections and Disbursements 118

Calculating the Ending Cash Balance 120

Repaying Short-Term Borrowing 123 Using the Cash Budget for What-If Analysis 124 The Scenario Manager 126

Adding Interest and Investment of Excess Cash 130

Calculating Current Borrowing 132
Using the Formula Auditing Tools to Avoid Errors 133
Calculating Current Investing 137
Working Through the Example 139

Summary 142

Problems 143

CHAPTER 5 FINANCIAL STATEMENT FORECASTING 149

The Percent of Sales Method 150

Forecasting the Income Statement 150
Forecasting Assets on the Balance Sheet 154
Forecasting Liabilities on the Balance Sheet 156
Discretionary Financing Needed 158

Using Iteration to Eliminate DFN 159

Other Forecasting Methods 163

Linear Trend Extrapolation 163 Regression Analysis 167 Statistical Significance 171

Summary 175 Problems 175 Internet Exercises 177

CHAPTER 6

FORECASTING SALES WITH TIME SERIES METHODS 179

Time Series Decomposition 180

Smoothing a Time Series with Moving Averages 181 Isolating the Seasonality of a Time Series 183 Extracting the Irregular Component 185

Time Series Forecasting Techniques 186

Measuring Forecast Errors 186
Exponential Smoothing Methods 187
Simple Exponential Smoothing 187
Holt's Linear Trend Exponential Smoothing Model 190
Forecasting Time Series with Both Trend and
Seasonality 192
Holt-Winters Additive Seasonal Model 193
Using the Built-in ETS Model 195
Holt-Winters Multiplicative Seasonal Model 197

Time Series Forecasting Using Regression Analysis 199
Forecasting the Trend Using Regression 199

Using Seasonal Dummy Variables to Account for Seasonality 202

Summary 205

Problems 206

Internet Exercise 207

CHAPTER 7 BREAK-EVEN AND LEVERAGE ANALYSIS 209

Break-Even Points 210

Calculating Break-Even Points in Excel 211 Other Break-Even Points 213

Using Goal Seek to Calculate Break-Even Points 215

Leverage Analysis 216

The Degree of Operating Leverage 217
The Degree of Financial Leverage 219
The Degree of Combined Leverage 221
Extending the Example 222

Linking Break-Even Points and Leverage Measures 224

Summary 225

Problems 226

Internet Exercise 228

CHAPTER 8 THE TIME VALUE OF MONEY 229

Future Value 230

Using Excel to Find Future Values 231

Present Value 232

Annuities 234

Present Value of an Annuity 234
Future Value of an Annuity 237
Solving for the Annuity Payment 238
Solving for the Number of Periods in an Annuity 239
Solving for the Interest Rate in an Annuity 241
Deferred Annuities 242

Graduated Annuities 245

Present Value of a Graduated Annuity 245
Future Value of a Graduated Annuity 248
Solving for the Graduated Annuity Payment 249

Uneven Cash Flow Streams 249

Solving for the Yield in an Uneven Cash Flow Stream 252

Nonannual Compounding Periods 253

Continuous Compounding 256

Summary 258

Problems 259

CHAPTER 9 COMMON STOCK VALUATION 26

What Is Value? 264

Fundamentals of Valuation 265

Determining the Required Rate of Return 266

A Simple Risk Premium Model 267 CAPM: A More Scientific Model 267

Valuing Common Stocks 270

The Constant-Growth Dividend Discount Model 272
The Two-Stage Growth Model 277
Three-Stage Growth Models 279

Alternative Discounted Cash Flow Models 284

The Earnings Model 284
The Free Cash Flow Model 288

Relative Value Models 292

Preferred Stock Valuation 293

Summary 295

Problems 297

Internet Exercise 299

CHAPTER 10 BOND VALUATION 301

Bond Valuation 302

Valuing Bonds Between Coupon Dates 304
Using Excel's Advanced Bond Functions 307

Bond Return Measures 310

Current Yield 310
Yield to Maturity 311
Yield to Call 313
Returns on Discounted Debt Securities 315

Metarris on Discounted Debt Securities

The U.S. Treasury Yield Curve 316

Bond Price Sensitivities 318

Changes in the Required Return 319
Changes in Term to Maturity 321
Comparing Two Bonds with Different
Maturities 324

Comparing Two Bonds with Different Coupon Rates 326

Duration and Convexity 327

Duration 327

Modified Duration 328

Visualizing the Predicted Price Change 330

Convexity 332

Summary 335 Problems 337 Internet Exercise 339

CHAPTER 11 THE COST OF CAPITAL 341

The Appropriate "Hurdle" Rate 342
The Weighted Average Cost of Capital 343
Determining the Weights 344

WACC Calculations in Excel 345
Calculating the Component Costs 346

The Cost of Common Equity 347
The Cost of Preferred Equity 348
The Cost of Debt 349

Using Excel to Calculate the Component Costs 350

The After-Tax Cost of Debt 350
The Cost of Preferred Stock 352
The Cost of Common Stock 352

The Role of Flotation Costs 353

Adding Flotation Costs to Our Worksheet 354

The Cost of Retained Earnings 355

The Marginal WACC Curve 356
Finding the Break-Points 356
Creating the Marginal WACC Chart 361

Summary 362
Problems 363
Internet Exercise 365

CHAPTER 12 CAPITAL BUDGETING 367

Estimating the Cash Flows 368

The Initial Outlay 369

The Annual After-Tax Operating Cash Flows 370

The Terminal Cash Flow 371

Estimating the Cash Flows: An Example 372

Calculating the Relevant Cash Flows 378

Making the Decision 379
The Payback Method 379
The Discounted Payback Period 383
Net Present Value 384
The Profitability Index 387
The Internal Rate of Return 388
Problems with the IRR 389
The Modified Internal Rate of Return 391

Sensitivity and Scenario Analysis 393 NPV Profile Charts 394 Scenario Analysis 395

The Optimal Capital Budget 398

Optimal Capital Budget Without Capital Rationing 399

Optimal Capital Budget Under Capital Rationing 401

Other Techniques 407

Summary 407 Problems 408

CHAPTER 13 RISK AND CAPITAL BUDGETING

Review of Some Useful Statistical Concepts 414
The Expected Value 414
Measures of Dispersion 416

Using Excel to Measure Risk 419
The Freshly Frozen Fish Company Example 419

Introducing Uncertainty 423
Sensitivity Analysis 423
Scenario Analysis 429
Calculating the Expected NPV from the Scenarios 431
Calculating the Variance and Standard Deviation 431
Calculating the Probability of a Negative NPV 433
Monte Carlo Simulation 435
The Risk-Adjusted Discount Rate Method 442
The Certainty-Equivalent Approach 443

Summary 445 Problems 447

CHAPTER 14 PORTFOLIO STATISTICS AND DIVERSIFICATION 451

Portfolio Diversification Effects 452
Determining Portfolio Risk and Return 455

Portfolio Standard Deviation 455 Changing the Weights 459

Portfolios with More Than Two Securities 460 Creating a Variance/Covariance Matrix 461

Calculating the Portfolio Standard Deviation 465

The Efficient Frontier 466

Locating Portfolios on the Efficient Frontier in Excel 467

Charting the Efficient Frontier 471

The Capital Market Line 472
Charting the Capital Market Line 476
Identifying the Market Portfolio 477

Utility Functions and the Optimal Portfolio 480
Charting Indifference Curves 481

The Capital Asset Pricing Model 483
The Security Market Line 484

Summary 486
Problems 487
Internet Exercise 490

CHAPTER 15 WRITING USER-DEFINED FUNCTIONS WITH VBA 491

What Is a Macro? 492 Two Types of Macros 493

The Visual Basic Editor 494
The Project Explorer 495
The Code Window 496

The Parts of a Function 497

Writing Your First User-Defined Function 498

Writing More Complicated Functions 503

Variables and Data Types 503
The If-Then-Else Statement 505
Looping Statements 507
Using Worksheet Functions in VBA 511
Using Optional Arguments 511
Using ParamArray for Unlimited Arguments 513

Debugging VBA Code 514

Breakpoints and Code Stepping 514

The Watch Window 516
The Immediate Window 517

Creating Excel Add-Ins 518
Best Practices for VBA 519

Summary 520 Problems 521

CHAPTER 16 ANALYZING DATASETS WITH TABLES AND PIVOT TABLES 523

Creating and Using an Excel Table 524
Removing Duplicate Records from the Table 526
Filtering the Table 527
Sorting and Filtering Numeric Fields 529
Structured Referencing for Formulas in Tables 530

Using Get & Transform 532

Cleaning the Dataset 533

An Example Data Query 534

Using Pivot Tables 536

Creating a Pivot Table 536

Formatting the Pivot Table 538

Rearranging the Pivot Table and Adding Fields 540

Transforming the Data Field Presentation 542

Calculations in Pivot Tables 543

Pivot Tables for Financial Statements 545
Grouping Data by Date 546
Using Pivot Charts to Show Trends Over Time 549
Displaying Multiple Subtotals 550
Using Calculated Fields for Financial Ratios 551
Filtering Data with Slicers and Timelines 553

Extracting Data from a Pivot Table 555
Summary 556
Problems 556

Internet Exercise 560

APPENDIX Directory of User-Defined Functions in FameFncs.xlam **561**

INDEX 565