Chapter 12 Notes

Capital Budgeting Descisions

- FCF = [EBIT(1-T)+ Dep. and Amortizaiton] -[Cap. Expenditures + Net Operating Working Capital]
- Taxes Paid on Salvaged Assets = Tax rate x (Salvage Value - Book Value)
- Incremental Cash flows - Occur if and only if some event occurs
- Sunk Costs - were made in the past and cannot be reovered in the future
- Externalities - effects ofa project on other parts of the firm
  - Negative Within-Firm Externalities
    - Canabalization - opening stores too close to other stores that take customers away from your other stores
  - Positive within-firm externalities
    - Complementary, will increase the value of other products
  - environmental externalities

Calculating Risk

1. Stand alone risk - Projects risk assuming its the only asset owned by a firm. This ignores diversification.
2. Corperate risk - How much risk there is to the corperation eliminating risk caused by lack of diversification
3. Market risk - the riskiness of a project seen by a well diversified stockholder, measured by how it affects the firms beta

Analyzing Risk:

1. Sensitivity Analysis - Changing variables 1 by one to see how much a % change in a component variable changes other variables
2. Scenario Analysis - analyzes different conditions against one another (good market, bad market, neutral market)
3. Monte Carlo Simulation