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CHEAT SHEET

CFA® Program Level I

Corporate Finance Cheat Sheet

2027 curriculum · 7 readings · 18 formulas

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ABOUT THIS EDITION

CredGuild · CFA® Program Level I · Corporate Finance Cheat Sheet
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The revision summary of the CredGuild notes for the 2027 CFA® Program Level I curriculum, Corporate Finance: for each reading, the bottom line of every module, the exam shortcuts and the formulas. Use it in the last weeks before the exam, after you have studied the readings.

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CFA® PROGRAM LEVEL I · CHEAT SHEET

Corporate Finance

Exam weight 6–9% · 7 readings · 18 formulas

20 Organizational Forms, Corporate Issuer Features, and Ownership

- Organizational forms differ in whether the law treats the business as distinct from its owners, whether owners also operate it, whether owner liability is limited, how profits are taxed and how easily it can raise capital.
- In a sole proprietorship and a general partnership the owners run the business, have unlimited liability and pay personal income tax on its profits.
- A limited partnership needs at least one general partner, who runs the business with unlimited liability, and at least one limited partner, whose liability is capped at the amount invested and who usually takes no part in management.
- A corporation exists as a legal person distinct from its owners and managers, all shareholders have limited liability, the shareholders elect a board that hires managers, and it has the widest access to debt and equity capital.
- Where both corporate earnings and dividends are taxed, the effective rate on distributed profit is $t_c + t_d(1 - t_c)$, and paying out less of the profit reduces the double-taxation burden.
- Most public companies are listed, so their shares trade on an exchange, and they must meet compliance and reporting requirements, while private companies disclose less, raise equity through private placements to accredited investors and offer investors no easy exit.
- Free float is the actively traded part of the shares outstanding, which excludes holdings of insiders, sponsors and strategic investors.
- A private company goes public through an IPO, a direct listing or acquisition by a SPAC, and a public company goes private when an acquirer, as in a management or leveraged buyout, buys all its shares and delists it.

EXAM SHORTCUTS

- To decide whether going public raises money for the company, ask whether new shares are issued: new shares in an IPO raise capital, while existing shares sold in an IPO pay the selling shareholders, and under the exam convention a direct listing raises no new capital (current practice also allows a primary direct listing that sells new shares).

FORMULAS

Key features of corporate issuers	$\text{effective tax rate on distributed profit} = t_c + t_d(1 - t_c)$
Public versus private companies	$\text{free float (\%)} = \frac{\text{shares outstanding} - \text{shares held by insiders, strategic investors and s}}{\text{shares outstanding}}$

21 Investors and Other Stakeholders

- Lenders have a contractual claim to promised interest and principal and rank ahead of shareholders, whose claim is residual, so debt is less risky than equity and the cheaper form of capital.

- Lenders and shareholders can each lose their whole investment but no more, yet lenders can receive at most the promised payments while equity has theoretically unlimited upside, so shareholders may favor risk-increasing growth that lenders resist with covenants.
- Shareholder theory focuses governance on maximizing the market value of common equity and on the conflict between shareholders and managers, while stakeholder theory balances the interests of shareholders and all other affected groups.
- Private lenders such as banks may see nonpublic information, which makes them a key funding source for small and medium-sized firms, while bondholders rely on public information and have little influence over operations.
- Independent directors better protect shareholders than inside directors; a two-tier board has a supervisory board overseeing a management board, and a staggered board makes a rapid overhaul by shareholders harder.
- Investors evaluate ESG factors because regulation increasingly targets climate and social issues, ESG problems can cause lost goodwill, fines and judgments, poor governance lets managers exploit shareholders, and many younger investors want ESG considered.
- Climate change brings physical risk from severe weather and transition risk from regulation or consumer choices, and assets made unviable by these changes are stranded assets.
- Adverse ESG outcomes fall most heavily on equity investors, debt investors are hurt mainly if losses cause default, and holders of longer-maturity debt may be more exposed than short-term lenders.

EXAM SHORTCUTS

- Compare the return on assets with the cost of debt before computing ROE: if the firm earns more on its assets than it pays on its debt, leverage raises ROE, and if it earns less, leverage lowers ROE.
- Classify a climate risk by its channel: damage done by the weather itself is physical risk, while a carbon tax, a new rule or a shift in demand toward low-carbon products is transition risk.

22 Corporate Governance: Conflicts, Mechanisms, Risks, and Benefits

- A principal-agent conflict arises when an agent's interests differ from the principal's, and its agency costs are direct, such as monitoring, or indirect, such as business lost.
- Shareholders are the principals and managers and directors their agents; typical conflicts are insufficient effort, the wrong risk appetite, empire building, entrenchment and self-dealing, and information asymmetry makes them harder to monitor.
- Controlling shareholders may act against minority shareholders, and a dual-class structure gives one class more votes than its economic claim, which CFA Institute opposes.
- Because creditors' upside is capped, shareholders may want more business risk, and new debt or larger dividends can shift value from creditors to shareholders, a risk greatest for long-term debtholders.
- Corporate governance is the set of internal controls and procedures defining the rights, roles and responsibilities of groups within a company to manage conflicts among stakeholders, and proxy voting is the main shareholder mechanism.
- Ordinary resolutions such as electing directors or appointing the auditor need a simple majority of votes cast, while bylaw changes, mergers, special board elections and liquidation go to extraordinary general meetings.
- The audit committee recommends the external auditor and oversees reporting and internal controls, and the compensation committee should consist of independent directors only, since managers should not set their own pay.
- Poor governance brings weak controls, related-party transactions, legal, reputational and default risk, while effective governance improves efficiency, lowers default risk and the cost of debt, and raises performance and company value.

EXAM SHORTCUTS

- Match the symptom to the conflict: too little risk-taking, copying competitors or projects that depend on the manager's own knowledge point to entrenchment, excessive risk-taking points to option-heavy pay, and unnecessary acquisitions point to pay tied to company size.

23 Working Capital and Liquidity

- The cash conversion cycle is $\text{CCC} = \text{DOH} + \text{DSO} - \text{DPO}$; the operating cycle is DOH + DSO, and the CCC is the part of it the company must finance itself.
- With a 365-day year, DOH, DSO and DPO equal 365 divided by inventory turnover, receivables turnover and payables turnover.
- A lower CCC is generally better; it rises with DOH or DSO and falls with DPO, and each lever has a cost: production bottlenecks, lost sales or forgone early-payment discounts.
- Forgoing a discount on terms a/b net c costs $(1 + a/(1-a))^{365/(c-b)} - 1$ per year.
- CCCs vary by industry, so compare a firm with its industry or its own history; net working capital removes cash and marketable securities and short-term and current debt, which ties it closely to the CCC.
- Primary liquidity sources are cash and marketable securities, bank borrowings and cash generated by the business, while secondary sources such as suspending dividends, delaying capital investment or selling assets are costlier and send a negative signal.
- A drag on liquidity delays inflows (higher DOH or DSO), a pull accelerates outflows (lower DPO), and the quick ratio excludes inventories while the cash ratio also excludes receivables.
- A conservative approach holds more short-term assets financed long term, an aggressive approach holds fewer financed with short-term debt, and a moderate approach funds permanent current assets long term and seasonal ones short term.

EXAM SHORTCUTS

- Compare the EAR of skipping the discount with the bank rate: if the EAR is higher, borrowing from the bank to take the discount is cheaper.
- Scaling every CCC component by the same factor scales the CCC by that factor, but a percentage change in one component is not the CCC's percentage change, so recompute the CCC in days.

FORMULAS

The cash conversion cycle	$\text{CCC} = \text{DOH} + \text{DSO} - \text{DPO}$
Trade credit and its cost	$\text{EAR of supplier financing} = \left(1 + \frac{a}{1-a}\right)^{365/(c-b)} - 1$
Comparing CCCs	$\text{total working capital} = \text{current assets} - \text{current liabilities}$ $\text{net working capital} = (\text{current assets} - \text{cash and marketable securities}) - (\text{current liabilities} - \text{short-term and current debt})$
Liquidity ratios	$\text{current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$ $\text{quick ratio} = \frac{\text{cash and marketable securities} + \text{receivables}}{\text{current liabilities}}$ $\text{cash ratio} = \frac{\text{cash and marketable securities}}{\text{current liabilities}}$

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24 Capital Investments and Capital Allocation

MODULE 24.1 · CAPITAL INVESTMENTS AND PROJECT MEASURES

- Capital investments are going concern, regulatory/compliance, expansion and other projects, and the last two, which aim to grow the business, need the most analysis.
- The capital allocation process is idea generation (the most important step), analysis of proposals, the firm-wide capital budget, and monitoring with a post-audit that exposes systematic forecasting errors.
- NPV is the sum of a project's incremental after-tax cash flows discounted at its required rate of return, $\sum CF_t/(1+r)^t$, and an independent project is accepted when NPV > 0.
- The IRR is the discount rate at which NPV = 0, an independent project is accepted when the IRR exceeds the hurdle rate, and for a conventional independent project the NPV and IRR rules agree.
- NPV measures the expected increase in firm value and assumes reinvestment at the required return, while the IRR assumes reinvestment at the IRR and can give multiple values for unconventional cash flows.
- ROIC = NOPAT ÷ average invested capital = after-tax operating margin × capital turnover, with NOPAT = net income + interest × $(1-t)$; under the exam convention invested capital is long-term debt plus equity excluding working capital, while current practice usually counts all interest-bearing debt plus equity.

EXAM SHORTCUTS

- For a conventional independent project, NPV is positive exactly when the discount rate is below the IRR, so once the IRR is compared with the required return the sign of the NPV is known.

MODULE 24.2 · CAPITAL ALLOCATION PRINCIPLES AND REAL OPTIONS

- Capital allocation uses after-tax incremental cash flows rather than accounting income, including the tax savings from depreciation and amortization.
- Sunk costs are excluded, while opportunity costs, cannibalization and positive externalities are included in project cash flows.
- Financing costs are reflected in the required rate of return and are not also deducted from the project's cash flows.
- Cognitive errors include poor forecasting, ignoring the cost of internal funds (the cost of equity) and mixing real and nominal terms, while behavioral biases include pet projects, inertia in the capital budget, decisions based on EPS or ROE and failure to generate alternatives.
- Real options give the right but not the obligation to act and so never have negative value; they include timing, abandonment, expansion, flexibility (price-setting and production-flexibility) and fundamental options.
- A project with real options is worth its NPV without options plus the value of the options minus their cost.

EXAM SHORTCUTS

- Test each cost by asking whether the firm's total cash flows change if the project is accepted: amounts already spent are sunk and excluded, while forgone rent, cannibalized sales and extra sales of other products are included.
- If a project's NPV without options is already positive, it can be accepted without valuing its real options, because an option can only add value.

FORMULAS

Net present value (NPV)

$$NPV = CF_0 + \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \cdots + \frac{CF_n}{(1+r)^n} = \sum_{t=0}^{n} \frac{CF_t}{(1+r)^t}$$

Internal rate of return (IRR)

$$0 = \sum_{t=0}^{n} \frac{CF_t}{(1+IRR)^t}$$

Return on invested capital (ROIC)	$ROIC = \dfrac{\text{NOPAT}}{\text{average book value of invested capital}} = \underbrace{\dfrac{\text{NOPAT}}{\text{Sales}}}_{\text{operating margin after tax}} \times \underbrace{\dfrac{\text{Sales}}{\text{average invested capital}}}_{\text{capital turnover}}$
Real options	$\text{Project value} = NPV_{\text{without options}} + \text{value of options} - \text{cost of options}$

25 Capital Structure

MODULE 25.1 · WEIGHTED-AVERAGE COST OF CAPITAL

- With debt and common equity only, $WACC = w_d r_d(1-t) + w_e r_e$, where each weight is that source's share of total capital; preferred stock adds $w_p r_p$ with no tax adjustment.
- Debt costs less than equity because debtholders have a prior claim, and because interest is tax-deductible in most jurisdictions the cost of debt enters the WACC after tax, while the cost of equity does not.
- WACC weights can be target or market value weights, and market values are the right basis for today's opportunity cost of capital.
- The WACC is the discount rate for a project that mirrors the existing business and is financed in the firm's normal proportions.
- Capital structure reflects the capacity to service debt, shaped by internal factors (business characteristics, life cycle stage, existing leverage, tax rate) and external factors (market and business cycle conditions, regulation, industry norms).
- Stable or growing revenue and cash flow, low business risk, low operating leverage and liquid tangible assets owned outright support more debt, so start-ups are financed almost entirely with equity, growth firms use some debt and mature firms significant debt.

MODULE 25.2 · CAPITAL STRUCTURE THEORIES

- The MM propositions assume perfectly competitive markets with no taxes, transactions or bankruptcy costs, homogeneous expectations, borrowing and lending at the risk-free rate, no agency costs, and operating income unaffected by financing.
- Without taxes, MM Proposition I gives $V_L = V_U$, and Proposition II gives $r_e = r_0 + (D/E)(r_0 - r_d)$, so the cost of equity rises with leverage while the WACC is unchanged.
- With taxes, $V_L = V_U + tD$, firm value is maximized and the WACC minimized at 100% debt, and the cost of equity rises more slowly, $r_e = r_0 + (D/E)(r_0 - r_d)(1-t)$.
- Expected costs of financial distress combine the direct and indirect costs of distress with its probability, which rises with operating and financial leverage and weak management or governance, and they discourage heavy use of debt.
- Under the static trade-off theory $V_L = V_U + tD - PV(\text{costs of financial distress})$, so the optimal capital structure, where firm value is highest and the WACC lowest, lies below 100% debt; analysts without a stated target estimate it from the current market-value structure, its trend or industry averages.
- Pecking order theory ranks internal funds first, then debt, then new external equity, by how visible and negative a signal each sends, and under the free cash flow hypothesis more debt reduces the agency costs of equity.

EXAM SHORTCUTS

- Match the theory to its conclusion: MM without taxes makes capital structure irrelevant, MM with taxes points to 100% debt, the static trade-off theory gives an optimum below 100% debt, and pecking order theory has no target, with internal funds used first.

FORMULAS

Calculating and interpreting the WACC	$WACC = w_d\, r_d(1-t) + w_e\, r_e$

MM Proposition II (no taxes): cost of equity and leverage	$r_e = r_0 + \frac{D}{E}(r_0 - r_d)$
MM with taxes	$V_L = V_U + tD$ $r_e = r_0 + \frac{D}{E}(r_0 - r_d)(1 - t)$
Static trade-off theory	$V_L = V_U + tD - PV(\text{costs of financial distress})$

26 Business Models

- A business model covers who the customers are, what the product is, how the firm operates (key assets and suppliers), where it sells (channels) and how much it charges, while detailed revenue and expense forecasts belong in a financial plan.
- The channel strategy covers how the firm sells, whether directly or through intermediaries, and how it delivers; an omnichannel strategy combines digital and physical channels, and B2B or B2C describes the customers.
- Commodity producers are price takers, firms with few competitors or highly differentiated products have pricing power, and price discrimination takes the forms of tiered, dynamic, value-based and auction pricing.
- Pricing models include bundling, razors-and-blades and add-on pricing for multiple products, penetration, freemium and hidden-revenue models, and subscription, licensing and franchising as alternatives to outright purchase.
- The value proposition is how customers value the product given competing products and prices, and the value chain is how the firm executes it; the exam convention lists Porter's activities as inbound logistics, operations, outbound logistics, marketing, and sales and service, while Porter's own list groups the last two as marketing and sales, and service.
- Besides industry-specific conventional models, firms can be private label (contract) manufacturers, license their brand to others for a fee, or act as value-added resellers that add installation, service or customization to complex equipment.
- Network effects raise a network's value as its user base grows and favor initial penetration pricing, while crowdsourcing models benefit from content or improvements contributed by users.

EXAM SHORTCUTS

- Classify a price difference by what triggers it: the quantity bought means tiered pricing, the time of purchase means dynamic pricing, and the value customers perceive means value-based pricing.
- For a free product, a paid upgrade means freemium pricing and revenue from advertisers or user data means hidden revenue; for extras, options offered after the purchase decision mean add-on pricing, while a package priced from the start is bundling.

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