NOTES

1 For Hennes & Mauritz, we will call the fiscal year ending November 2016 as the year 2016, and the fiscal year ending November 2017 as the year 2017. For Inditex, we will call the fiscal year ending January 2017 as the year 2016, and the fiscal year ending January 2018 as the year 2017.

2 A spreadsheet containing the three versions of the financial statements of Hennes & Mauritz and Inditex as well as all ratios described throughout this chapter is available on the companion website of this book. This spreadsheet also shows how we capitalized omitted operating lease assets on Hennes & Mauritz's and Inditex's balance sheet before calculating all ratios.

3 We discuss in greater detail in Chapter 8 how to estimate a company's cost of equity capital. Analysts following Hennes & Mauritz and Inditex estimated their equity betas at around 0.7 to 0.9 in 2017. The historical return on long-term treasury bonds was approximately 4 percent. If one assumes a risk premium of 5 percent, the two firms' cost of equity is between 7.5 and 8.5 percent. Lower assumed risk premiums will, of course, lead to lower estimates of equity capital.

4 Both Hennes & Mauritz and Inditex have a solid financial position and a relatively low cost of debt. Given the level of leverage, the weighted average cost of capital will be lower than the cost of equity. We will discuss in Chapter 8 how to estimate a company's weighted average cost of capital.

5 See *Taxes and Business Strategy* by Myron Scholes and Mark Wolfson (Englewood Cliffs, NJ: Prentice-Hall, 1992).

6 Average revenue (or average cost of sales) is calculated as annual revenue (or annual cost of sales) divided by the

number of days in the year. There are a number of issues related to the calculation of turnover ratios in practice. First, in calculating all the turnover ratios, the assets used in the calculations can either be beginning of the year values, year-end values or an average of the beginning and ending balances in a year. We use the average values in our calculations. Second, strictly speaking, one should use credit sales to calculate trade receivables turnover and days' receivables. But since it is usually difficult to obtain data on credit sales, total sales are used instead. Similarly, in calculating trade payables turnover or days' payables, cost of sales (or cost of materials) is substituted for purchases for data availability reasons. Third, the ratios for income statements classified by function differ from those for income statements classified by nature. Turnover ratios for the two types of statements are therefore not perfectly comparable.

7 See Christian Leuz, Dominic Deller, and Michael Stubenrath, "An international comparison of accounting-based payout restrictions in the United States, United Kingdom, and Germany," *Accounting and Business Research* 28 (1998): 111–129.

8 Changes in cash and cash equivalents are excluded because this is the amount being explained by the cash flow statement. Changes in current debt and the current portion of non-current debt are excluded because these accounts represent financing flows, not operating flows.