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# Capital Budgeting For EPS Maximizers*

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**Abstract**

To increase a company's earnings, a project must generate enough income next year to pay for its own financing. Hence, a manager who wants to maximize EPS (earnings per share) should only invest in accretive projects that have income yields above the firm's cheapest financing option. This is the max EPS analog to the positive-NPV (net present value) rule. Maximizing EPS ≠ minimizing investment. EPS maximizers use real investment to arbitrage between asset and capital markets. This framework rationalizes the pervasive use of IRRs (internal rates of return) and payback periods. An IRR effectively measures how accretive a project will be. A payback period expresses the project's income yield as a multiple. Empirically, our simple max EPS model explains M&A payment method and investment-cash flow sensitivity. It also predicts which firms have higher proportions of convertible debt and capitalized interest expense.

**Keywords:** Earnings Per Share (EPS), Capital Budgeting, Net Present Value (NPV), Internal Rate of Return (IRR), Payback Period, M&A Payment Method, Investment-Cash Flow Sensitivity, Convertible Bonds, Capitalized Interest

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