

Hong Kong University of Science and Technology  
School of Business and Management  
FINA 514 - Advanced Topics in Financial Management  
Fall 2007

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**Course Objectives:** FINA514 covers advanced topics in corporate finance, with the focus on optimal corporate financial decisions. In particular, the course will cover: project evaluation; real options; capital structure; bankruptcy and financial distress; firm's payout policy, executive compensation; initial public offerings; and corporate governance.

**Prerequisites:** You would feel much more comfortable taking this class, if you have taken a class in Investments. Knowledge of basic derivatives is also helpful. I will also assume that you are familiar with Excel spreadsheets.

**Textbooks:**

1. Corporate Finance, by Jonathan Berk and Peter DeMarzo (2007) (main text)
2. Financial Markets and Corporate Strategy, Second Edition, by Grinblatt and Titman (2002) (supplementary text, a bit more advanced, will be available in library on reserve).
3. There is a reader packet for the course containing case studies. We will distribute it after the end of drop class period.

**Grading Policy:** Your grade will be calculated as follows:

Problem Sets: 24%  
Case Analysis: 24%  
Final Exam: 45%  
Class Participation: 7%

*Problem Sets:* The problem sets have to be done individually. Each problem set will be worth 8% of your final grade (with three problems sets in total). Working on these problem sets will help you to understand the class material better and will give you a solid preparation for the final exam. A hard copy of your solution (clearly indicating your student number and the student name in the upper right corner) has to be handed in at the beginning of class on the due dates. All pages have to be stapled together. No electronic submissions will be accepted.

*Case Write-Ups:* There will be a total of two cases assigned (each worth 12% of your grade). You can work on cases in groups of 4-5 people. Case write-ups have to be turned in at the beginning of each class at the due dates. Late submissions will not be graded. One or two groups will present case solution in class in 15 minutes. At the end of the course, you will assess your group members on the contribution they made to the group assignments. Your group members' assessment of your contribution will enter into your case grade.

*Final Exam:* The final exam is a closed book exam but I will provide you with a cheat sheet that will contain all necessary formulas. I will give you the cheat sheet couple of days before the exam so that you can familiarize yourself with layout. You will need a simple calculator for the exam. You cannot take the final exam early and there will be NO MAKEUP exam for those who miss it.

*Class Participation and Attendance:* Your class participation will count 7% towards your final grade. An important pre-requisite for getting participation points is attending the class. You can not participate if you are frequently absent. You can contribute by asking questions in class, by participating actively in discussion of cases, by answering the question I pose in class.

Please be on-time for the class. Coming to class late will lower your participation grade and I may call you more frequently to answer the questions in class.

Please switch off your cell-phones completely for the class time. It is very disruptive for the whole class and disrespectful to your classmates when your phone rings during the lecture.

### **Teaching Assistant**

Teaching assistant for this course is Mao Lei. His Email is [maolei@ust.hk](mailto:maolei@ust.hk) and office room is 3220. Mao will answer questions via E-mail and will meet with you by appointment.

### **Administrative Information**

*Office hours:* I will hold office hours on Saturdays after the class 6-7 pm (or later if needed) and also by appointment.

*Auditing:* Students may not audit this class. If you want to take this class you have to be registered for a letter grade. Once registered, you can not expect to convert your status to auditing or expect to get an incomplete.

*Name Cards:* I would like you to have your name cards in front of your seat each time you come to class. Please be attentive during the class, occasionally I will use cold calling using your name.

*Email-List:* Occasionally, we will send E-mails to the class E-mail list. If you are registered for this course, you should be automatically on the list. The E-mail should go to your HKUST e-mail account.

*Class Webpage:* The URL for the class page is <http://lmes2.ust.hk> . We will post important class information and materials there, including lecture notes, problem sets, solutions, handouts, etc.

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### **Detailed Course Outline (subject to change)**

1. (*September 8, 2006*) Overview of Financial Decisions, What is the corporation and what is its objective?

#### **Project Evaluation**

The NPV Rule and Valuation of Riskless Cash Flows, Estimating Cash Flows from Financial Statements, Valuation of Risky Cash Flows Using Market Prices (Valuation by Comparison)

Read: BD Chapters 1, 4 (review), and Chapters 7.1-7.2, 19.1

Fun reading: "Pasta- and Meatballs," Jesse Eisinger, Wall Street Journal, June 17, 2003 (p. C1)

2. (*September 15, 2006*) Valuation of Risky Cash Flows in Absence of Taxes (Certainty Equivalence method, Risk-Adjusted Discount method), Taxes and Project Evaluation (Weighted Average Cost of Capital)

#### **Problem Set 1 Due**

Read: BD Chapter 18.1-18.2, also GT Chapters 11, 13

Fun reading: "Valuing Google is a Shot in the Dark", Wall Street Journal, October 14, 2006

3. (*September 22, 2006*) Estimating the Cost of Capital: Divisional Cost of Capital (Case Discussion), Taxes and Project Evaluation (Adjusted Present Value, Example of ACME, Flow-to-Equity Method)

**Case Due & Class Presentations:** Marriot Corporation, the Cost of Capital, HBS Case #9-298-101

Read: BD Chapter 18.3-18.4, also GT Chapter 13

Read: "Using APV: A Better Tool for Valuing Operations" by Timothy Luehrman

4. (*September 29, 2006*) Real Options (Timing Options, Growth Options, Abandonment Options)

#### **Problem Set 2 Due**

Read: BD Chapter 22, also GT Chapter 12

Read: "Capital Projects as Real Options: An Introduction" by Timothy Luehrman

5. *(October 6, 2007)* Real Options (Continued)

### **Project Financing**

Capital Structure (When Does Capital Structure Matter? Modigliani and Miller Theorem)

Read: BD Chapters 14-15

6. *(October 13, 2006)* Capital Structure (Corporate and Individual Taxes)

**Case Due & Class Presentations:** Laura Martin: Real Options and the Cable Industry, HBS Case #9-201-004

7. *(October 20, 2006)* Capital Structure (Bankruptcy Costs and Financial Distress, Underinvestment, Risk-Shifting, Liquidation Decisions)  
Review of class material.

### **Problem Set 3**

Read: BD Chapter 16, also GT Chapter 16

Fun reading: "Motorola May Find Itself on the Hook for Debt of Failed Venture Iridium," Wall Street Journal, September 27, 2006

8. *(October 27, 2006)* Final Exam