

**Hong Kong University of Science & Technology  
School of Business and Management**

**FINA 321 – Advanced Financial Management**

Spring 2004

Instructor: Joseph P.H. Fan

Office: Room 2445; Phone: 2358-8016; Email: [pjfan@ust.hk](mailto:pjfan@ust.hk)

Webpage: <http://home.ust.hk/~pjfan>

Office hours: You are welcome to come by my office to discuss questions. If I am busy at that time, we can make an appointment.

Demonstrator: Yuanto Kusnadi

Office: Room 4381; Phone: 91799651; Email: [yuanto@ust.hk](mailto:yuanto@ust.hk)

Office hours: Tuesday and Thursday: 2.30-3.30pm

### **COURSE DESCRIPTION**

This course introduces the concepts and techniques of valuation, and how to use these tools to guide managerial decisions. Through team-based case studies and projects, we will learn to apply the concepts and techniques to real-world situations. We will examine how financial statements are used in valuation; how to value cash flows; how to estimate cost of capital; how to estimate the value of a firm, and how to value assets or companies in emerging markets. We will apply the valuation techniques to mergers and acquisitions and discuss the causes and effects of these transactions. Topics on capital structure, dividend policy, and corporate governance will also be discussed. Students planning to pursue a career in the corporate finance sector (investment banking, financial analysis, management consulting, etc.) should find this course interesting and useful.

**PRE-REQUISITES:** Finance 111, Finance 221.

**COURSE WEB SITE:** <https://www.bm.ust.hk/~fina321/index.htm>. Please visit the web site regularly for announcements. Lecture notes, case questions, and assignments will be posted there prior to class discussion. You will need a password (to be provided) to access the web site.

### **READINGS**

The required text is *Principles of Corporate Finance* (BM hereafter) by Brealey and Myers, 7ed., McGraw-Hill, 2003.

There are cases and articles to be discussed during the semester. All of the cases and articles are reserved in the library.

It is expected that you will be an aggressive reader of business publications, including *The Asian Wall Street Journal*, *The South China Morning Post* (the business section), *The Economist*, *Fortune*, *Business Week*, *Far Eastern Economic Review*, and so

forth. Please look for opportunities to apply class material to your reading of the business press and volunteer your observations in class.

Topics will be discussed by lectures and case analysis. To derive maximum benefit, it is essential that prior to each class you read the assigned chapters / articles, and read and prepare case assignments.

## STUDY GROUP

As an important part of the course requirement, you will form study group to analyze cases and conduct a project. You are responsible for selecting members of your group. Each group should have 5 or 6 members. Please submit your group member list as soon as you can but no later than **February 11**. Students who are not a part of a group of size 5 or 6 on February 11 will be combined in an arbitrary manner into groups.

## GRADING

Your course grade will be determined by your performance in a mid-term examination (40%), class participation (10%), an individual-based case report (10%), and a group project (40%).

*Mid-term examination:* The exam will be close-book, close-note, covering all materials discussed. More details will be given later in the semester.

*Class participation:* Your grade on class participation depends on the quality of your questions and answers in lectures and case discussion. We will keep track of the level of your participation throughout the course.

*Case Report:* You are required to write a report of a designated case **on your own**, not with your group members. Instruction of writing up the case report is detailed later in this course outline.

*Project:* Your grade on the project will be adjusted according to a peer evaluation scheme. Suppose out of a maximum of 40, your group obtained 30 points on the project. These 30 points constitute the basic grade on the project. Suppose your group has 6 (or 5) members. Each member of your group will be asked to score every other member on a scale of 1 to 5 (or 4 in case of a 5-member group), indicating their evaluation of each member's relative contribution to the group's efforts (excluding himself/herself). A score of 5 (or 4 in case of a 5-member group) is the best possible, and 1 is the lowest possible. The average score of each group member will then be computed. Each of the group members will then be ranked from 1 (the best) to 6 (the worst) according to the average score that he/she receives. Suppose the rank for an individual is  $x$ , and there are  $n$  group members share the same rank  $x$ . Then the eventual case and project grade will be determined by the following formula:

$$\text{Case and Project Grade} = (\text{Basic Grade}) + (0.15) * (\text{Basic Grade}) * \max \{ [(3-x)/2]/n, 0 \}$$

Thus, if your rank is 2 ( $x=2$ ), you are the only one who rank 2 in your group ( $n=1$ ), and the basic grade is 40 for your group, then your case and project grade is  $(30) + (0.15)*(30)*\max\{[(3-2)/2]/1, 0\} = 32.25$ .

If two (or more) individuals have the same rank (1 or 2), their bonus points will be equally shared. Following the above example, if another member of your group ranks 2 (i.e.,  $n=2$ ), then your case and project grade is 31.125.

The peer evaluation will be confidential, and will be done at the end of the semester. Note that you will NOT be allowed to give the same score to any two people in your group. If you do, or if you do not score someone in your group, those individuals will be assigned a score of 2.5 from you. Also, as a penalty to you, your average score will be lowered by 1.

Here is an example of how the score for the entire course will be computed. Suppose your group of 6 members gets the following points on the case and project reports:

Case: 8/10

Project: 32/40

Your peer evaluation rank: 1 (and no other member rank 1)

Class discussion of case question: 7/10

Mid-term exam: 35/40

Your total score:  $8 + (32) + (0.15)(32)*\max\{[(3-1)/2]/1, 0\} + 7 + 35 = 86.8$

## **COURSE POLICIES**

*Seating:* This course has fixed seat assignments. Once you join a group, you will be sitting with your group members in a designated area of the classroom. The position is fixed and no changes are allowed later. We have prepared name cards for each one of you; these name cards would be placed in front of your seat at the beginning of each class session. Please do not take the cards away; it is our responsibility to remove them at the end of each session. To help us knowing you, we will request you to provide your basic information and provide a small photograph of yourself. More instruction will be given in class.

*Deadlines:* The project and case report are due on the dates indicated in the Course Schedule. Late submission will not be accepted or subject to grade penalty in case of preliminary project reports (see Group Project for details).

*Exam:* During the exam you have to rely entirely on your own intellectual endowments. There are serious consequences including failing grade and additional sanctions for engaging in unethical conduct. Do not miss the exam. No make-up exam will be given, unless for emergency reasons (such as sickness) and certification documents (such as doctor's diagnosis) are presented.

## CASE ANALYSIS

A case provides factual details and organizational circumstances surrounding a particular managerial situation. The essence of case analysis is to examine the facts by applying the concepts discussed in the class in arriving at your recommendations. A significant portion of case analysis grade depends on the justification of your recommendations. In general, the following guidelines will apply to all case studies:

- We will discuss 6 cases in this class. Each student is required to submit a written case analysis of **the Boeing 777 case** and be ready to present the case in class.
- The case report should not exceed five double-spaced typed pages. This limit excludes spreadsheets, tables, charts and graphs. It is helpful if you think of you as a representative of a consulting firm and the case company as your client. The suggested questions (to be provided) are to get you started. However, like any consulting assignment, your report should be organized and structured as if you were actually presenting it to your client. Merely answering the questions is not adequate and, therefore, unacceptable.
- The written case (and project) report will be graded based on the following criteria:

Weight	Category
30%	Written presentation, organization, readability, grammar and relevance
30%	Logic and justification underlying your recommendations
40%	Numerical Analysis and scientific evidence

- I will do all the remaining cases. Although you are not required to submit reports for these cases, you should read the cases thoroughly and actively participate in case discussion. There will be assigned questions on these cases. Be prepared to answer questions during class discussion of the cases. Your individual performance in case discussion will affect your participation grade.
- Finally, the following seven steps can be very helpful in dealing with case studies in general:
  1. Read the case through rather quickly for familiarity of facts and other details
  2. Read the case a second time to select salient facts, issues etc.
  3. Study all the exhibits carefully—in Finance cases the real story most often is in numbers
  4. Determine the major and minor issues
  5. Analyze the issues using concepts and techniques discussed in class
  6. Resolve conflicts regarding validity of data and assumptions
  7. Make and justify your recommendations

## GROUP PROJECT

The project is a comprehensive analysis of a business group in the greater China area (Hong Kong, Mainland China, or Taiwan). It requires you to respond to the following set of issues.

### A. Basic Information

1. *Group history*: Describe the history of the business group.
2. *Business portfolio*: Illustrate the business structure of the group. What are the main businesses of the group, including its affiliated public and private companies? Describe the group's competitive position in its main business segments. Identify major competitors in these business segments. Does the group or its affiliated companies hold a dominant position in each of their respective business categories? What is the contribution of each of the business segments to the overall sales and profits of the group?
3. *Ownership structure*: Illustrate the ownership structure of the business group. Who is the controlling owner? How does the owner achieve effective control of the group's affiliated companies (through direct ownership, stock pyramids or cross shareholdings)? How much ownership and control the controlling owner possesses on each of the affiliated companies?
4. *Management and boards of directors*: Describe the management and the boards of directors of the group's listed affiliated companies. Are top managers or directors family members or outside professionals? How independent are the boards? Do the boards compose of mostly inside directors? Is there any independent director?
5. *Corporate transparency*: Evaluate the group's disclosure practices. How informative are the group's annual reports and financial statements? Do you find any inconsistencies or irregularities in the disclosed reports? Was the group investigated or punished by government agencies for accounting frauds or corporate crimes?

### B. Strategies

6. *Strategies for growth*: Describe the group's growth strategy during the past 10 year. Did it invest and grow certain businesses, or divest and downsize certain businesses? Did it engage in vertical integration (disintegration) or diversification (refocusing) strategies?
7. *Financial policies*: Describe the financing and payout strategies of the group and its individual listed companies. Are there similarities or differences among the affiliated companies' financial policies?
8. *Strategies for succession*: If applicable, describe the group's arrangement and process of CEO/chairman succession. The succession could be completed or in process. Was the succession associated with changes in the group's

structures of governance and ownership and control? Were there changes in investment, financing, or payout policies in the succession process? How did these changes affect the performance of the group? What are the specific factors resulting in these changes in policy and performance in the succession process?

### C. Case study

9. *Case study*: Perform a case study of the group's growth, financing, payout, corporate governance, or CEO/chairman succession practices. Select an event (or a series of related events) and analyze how the event(s) created or destroyed value for shareholders. That may involve an analysis of the market reactions of the event(s), and/or conduct a valuation using the discounted cash-flow technique.
10. *Recommendations*: Provide your recommendations on the group's future growth, financing, payout, corporate governance, and/or CEO/chairman succession policies. Your recommendation should be justified with scientific evidence. It would be informative if you show how much value can be created if the suggested changes are implemented?

### Important notes:

- *Deadlines*: You will be assigned a business group, through a lucky draw. You should begin to collect and analyze data soon. The project has several deadlines. By **March 24**, you will submit the first preliminary report addressing the first 8 issues. All preliminary reports will be returned for revision under my close supervision. By **April 19**, you will submit the second preliminary report that revises the first 7 issues based on my comments and further addresses remaining issues (the 8<sup>th</sup> and 9<sup>th</sup> issues). After my comments of your second preliminary report, you will continue to revise the report that addresses all the issues and submit the third report no later than **May 5**.
- *Presentation and final revision*: All of you will present your project on **May 10 or 12**. After your presentation, you have a few days to make a final revision. The final version of the report is due on **May 19**. Your grade of the project will depend on this final version.
- *Project focus*: You have the flexibility to determine the central issue of the project and the weight of each of the 10 issues in the project report. For example, if you focus on corporate governance practices, you may want to perform more analysis on the group's ownership and governance structures, or policy on CEO/chairman succession. If your focus is the group's financial policies, you may want to provide more analysis on the financing pattern of the group.
- *Documents*: The report should be double-spaced with a maximum length of 30 pages. Illustrate important issues with charts, figures, and tables whenever possible. You should also prepare an MS-Powerpoint file for presentation. The submitted hard-copy report should be accompanied with a CD (or floppy

disk) containing the report in an MS-Word file, the Powerpoint presentation file, and all the data and spreadsheets that you used to write the report. The CD (disk) should also include a read-me file listing and explaining the data files and spreadsheets.

- *Grading:* The grading criteria of the project report are similar to those of the case report (see Case Analysis for details). However, there is a serious consequence of failing to submit any of the preliminary reports. Failing to submit a preliminary report will result in a deduction of 10 points from the maximum 40 points of your project grade. That is, if you miss the deadline of the first preliminary report, your maximum grade of the project is reduced to 30. If you fail to submit both the first and the second preliminary report by their deadlines, your maximum project grade is 20.

## **COURSE SCHEDULE**

### Week 1: February 2 & 4

#### **Course Overview**

#### **Corporate Governance: A Prerequisite to Valuation**

- Stijn Claessens and Joseph Fan, 2002, "Corporate Governance in Asia: A Survey", *International Review of Finance*, Vol. 3, 71-103.

### Week 2: February 9 & 11

#### **Corporate Governance: A Prerequisite to Valuation**

- Case study 1: New World Development Group

#### **What Determine Value?**

- Bennett Stewart, "Market Myths," *Journal of Applied Corporate Finance*, Fall 1989.

### Week 3: February 16 & 18

#### **Review of Financial Mathematics**

- BM 2.1, 3.1 – 3.4, 5.1 – 5.3
- Assignment

#### **Valuation by Discount Cash Flow**

- BM 4.5, 6.1 – 6.2
- Assignment

### Week 4: February 23 & 25

## **Forecasting and Sensitivity Analysis**

- BM: 10.1, 11.1 – 11.3

## **Searching for Company Information**

- To be held on February 25 at the Library Computer Lab (LG 1332 on LG1, Library; next to Media Resources)

### Week 5: March 1 & 3

#### **Cost of Capital Estimation (1)**

- BM: 3.5, 9.1 – 9.6, 19.1 – 19.3
- Chapter 10 and 14 of Tom Copeland, Tim Koller, and Jack Murrin, *Valuation: Measuring and Managing the Value of Companies*, Third Edition, McKinsey & Company, Inc., 2000

### Week 6: March 8 & 10

#### **Cost of Capital Estimation (2)**

- Case study 2: Grand Metropolitan PLC

### Week 7: March 15 & 17

- Case study 3: The Boeing 777 (**Case report due on March 17**)

#### **Valuation in Emerging Market (1)**

- Tom Copeland, Tim Koller, and Jack Murrin, *Valuation: Measuring and Managing the Value of Companies* chapter 18, Valuation outside the U.S.
- Tom Copeland, Tim Koller, and Jack Murrin, *Valuation: Measuring and Managing the Value of Companies* chapter 19, Valuation in Emerging Markets

### Week 8: March 22 & 24

#### **Valuation in Emerging Market (2)**

- The first preliminary group project report due on **March 24**
- Case study 4: China.com

### Week 9: March 29 & 31

#### **Capital Structure (1)**

- BM 17, 18

## **Mid-term Examination (March 31)**

Week 10: April 5 & 7

## **Mid-semester break**

Week 11: April 12 & 14

**April 12 holiday (no class)**

## **Capital Structure (2)**

- BM 15

Week 12: April 19 & 21

- The second group project report due on **April 19**
- Cast Study 5: Du Pont

## **Dividend Policy**

- BM 16

Week 13: April 26 & 28

## **Mergers, Acquisitions, and Restructuring (1)**

- BM 33, 34

Week 14: May 3 & 5

## **Mergers, Acquisitions, and Restructuring (2)**

- The third group project report due on **May 5**
- Case study 6: Time-Warner
- Robert Monks and Nell Minow, Corporate Governance, 2<sup>nd</sup> Edition, Blackwell, Chapter 6, pp. 350 – 361.

Week 15: May 10 & 12

## **Project Presentation**

- The final group project report due on **May 19**

## **LIST OF CASES**

- [1] New World Development Group
- [2] Grant Metropolitan PLC, Case 13 of Robert Brunner, *Case Studies in Finance*, 3<sup>rd</sup> Edition, Richard Irwin, 1999, pp. 180-197.
- [3] “The Boeing 777”, Case 14 of Robert Brunner, *Case Studies in Finance*, 3<sup>rd</sup> Edition, Richard Irwin, 1999, pp. 198-215.
- [4] China.com
- [5] “E.I. du Pont de Nemours and Company (1983)”, in Carl Kester et al. Ed., *Case Problems in Finance*, 11<sup>th</sup> Edition, Irwin, 1997, pp. 153-164; originally *Harvard Business School case* 284-062.
- [6] Time Inc.’s Entry into the Entertainment Industry (A), in Carl Kester et al Ed., *Case Problems in Finance*, 11<sup>th</sup> Edition, Irwin, 1997, 683-704; originally *Harvard Business School case* 293-117.

## **LIST OF ARTICLES**

- [1] Stijn Claessens and Joseph Fan, 2002, “Corporate Governance in Asia: A Survey”, *International Review of Finance*, Vol. 3, 71-103.
- [2] Bennett Stewart, "Market Myths," *Journal of Applied Corporate Finance*, Fall 1989.
- [3] Tom Copeland, Tim Koller, and Jack Murrin, Valuation: Measuring and Managing the Value of Companies chapter 10, Valuation outside the U.S.
- [4] Tom Copeland, Tim Koller, and Jack Murrin, Valuation: Measuring and Managing the Value of Companies chapter 14, Valuation in Emerging Markets
- [5] Tom Copeland, Tim Koller, and Jack Murrin, Valuation: Measuring and Managing the Value of Companies chapter 18, Valuation outside the U.S.
- [6] Tom Copeland, Tim Koller, and Jack Murrin, Valuation: Measuring and Managing the Value of Companies chapter 19, Valuation in Emerging Markets
- [7] Robert Monks and Nell Minow, Corporate Governance, 2<sup>nd</sup> Edition, Blackwell, Chapter 6, pp. 350 – 361.