

Finance 321

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Required Text: *Corporate Finance*, by Ross, Westerfield and Jaffe, McGraw Hill, 7th Edition.

Course Objectives: The purpose of this course is to give the students an advanced and hands-on exposure to key issues in corporate finance that are either not covered or only briefly touched upon in Finance 111. Topics that are emphasized are: capital budgeting decisions, finding the cost of capital, how capital structure decisions affect firm value, valuation of companies using DCF and other techniques, and M&A (merger and acquisition) decisions. Students taking this course should be well prepared to pursue careers in investment banking, financial analysis, and consulting.

Pre-requisites: Finance 111, Finance 221.

Course Web Site: Please check the web site under WebCT regularly for course materials and announcements. Also, please make a note of the office hours. You should make it a point to see me at least once during the term. Asking questions face-to-face is much more effective than posting questions on the website.

Sources of Material:

There are three sources of material for the topics covered in this course.

- (a) I would encourage you to read through quickly a set of notes that I have prepared on the material contained in the relevant chapters of the text book. These notes are contained in the file "lecturenotes.pdf" available at the course website. Not everything will be clear at first reading; however, if you are able to read through the notes quickly, you should have a good idea about the content of the course, and you will also know where you need to pay extra attention when a particular topic comes up for discussion in class.
- (b) The lectures themselves will be organized around a set of PowerPoint presentations that will be available at the course website.
- (c) Finally, the textbook constitutes a third source of material.

For several topics, we will illustrate concepts using some selected cases from the Harvard case book, *Case Problems in Finance*, 11th Edition and *Case Studies in Finance: Managing for Corporate Value Creation* by Robert F. Bruner. Copies of the cases to be

discussed will be held in reserve in the library, and it is not necessary for you to buy these books.

Course Structure and Pedagogy

Groups:

You are required to form groups in the first week of class. Each group will consist of 6 members. The names of group members must be handed in by February 10.

Group members will be required to sit together at all times and work together on in-class group exercises. They will also work together on the group project (see below).

There will be FIVE in-class exercises that will be graded. Your group will be asked to solve these exercises in class, and for each group exercise, I will randomly pick a group to present its solution before the class. Sometimes, more than one group may be called for a particular exercise.

Be sure that on each such date, at least one member of your group is able to bring a laptop computer to the class. This will be very helpful in working out the cases, as well as the in-class exercises.

Students who are not a part of a group of size 6 on February 10 will be combined in an arbitrary manner into groups. If the number of students enrolled in your section is not divisible by 6, one group of size smaller than 6 will be necessary.

Projects:

There will be two projects – one an individual project and the other a group project – both due at the end of term.

The group project will consist of a series of questions based on some cases that will be discussed in class. The details of the individual project will be announced later.

The course outline and timetable (see below) indicates the date/dates a particular case will be discussed and the in-class group exercises will be held.

Tutorials for Individual Project:

There will be 2-3 tutorials from the third to the fifth week of class to provide you with some guidance on the individual projects. These tutorials will be held on Fridays. We are checking on scheduling to determine how many sections need to be offered each of these Fridays. Attendance is optional; however, needless to say, it will benefit you greatly if you attend. Please stay tuned – the dates and times will be announced soon.

Seating Plan:

There will be a seating plan for the course. Each group must seat in one row, and every member of the group will have a designated seat. This is important because otherwise, we cannot keep track of your class performance.

To make sure that we can match names to faces (especially in the early part of the course), you need to give us a small photograph of yourself by February 10, with your name and student I.D. number written at the back.

Points to remember about the Group Case Report due at the end of the term:

1. Please note that *you need to turn in a hard copy of both the group and the individual project reports*. Soft copies of reports (disks or e-mail attachments) cannot be graded. Please follow the following instructions in preparing the Group Project. Instructions about the Individual Project will be given later.
2. For each question, there must be a section called “Key Assumptions” where you need to indicate the list of important assumptions you have made to answer the questions.
3. You must have a detailed written answer to each question. Charts or tables cannot constitute an answer – they are considered as supporting material for your answers.
4. All tables and charts should appear at the end. The discussion in the report should make very clear references to the charts and tables.
5. There must be a section called “Explanatory Notes to Tables and Charts” where the calculations in the tables are explained in complete detail.
6. Excluding the Tables and Explanatory Notes, the Group Project Report should not exceed 10 pages.

Grading:

The course grade will be determined on the basis of

	Weight
(i) mid-term examination	20%
(ii) final examination	30%
(iii) five in-class group exercises	20%
(iv) end-of-term group project report	15%
(v) end-of-term individual project report	15%

For the in-class group exercises and the end-of-term Group Project report, all group members will receive the same Basic Grade to begin with. The Basic Grade will then be adjusted according to a peer evaluation scheme.

Each member of your group will be asked to rank every other member on a scale of 1 to 5, indicating their evaluation of each member's relative contribution to the group's efforts (excluding himself/herself). A rank of 5 is the best possible, and 1 is the lowest possible. The average rank of each group member will then be computed. Suppose this average rank for an individual is x (a number between 1 and 5). Then the eventual Group Project Grade for that individual will be determined by the following formula:

$$\text{Group Project Grade} = (\text{Basic Grade}) + (0.15) (\text{Basic Grade}) * (x - 3) / 2$$

Thus, if your average rank is 5 and the Basic Grade is 130 for your group, your Group Project Grade is $(130) + (0.15)(130)(2/2) = 149.5$

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

If the number of group members is less than six, then the formula will be adjusted accordingly. Thus, if the number of group members is 5, the best possible rank is 4. In this case, the formula will be

$$\text{Group Project Grade} = (\text{Basic Grade}) + (0.15) (\text{Basic Grade}) * (x - 2.5) / 1.5$$

(the number subtracted is the mid point of the highest possible and lowest possible ranks).

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

Class Exercise 1: 15/20
Class Exercise 2: 11/20
Class Exercise 3: 10/20
Class Exercise 4: 13/20
Class exercise 5: 17/20

Total (Class Exercise) 66/100

Group Project Report 60/75

Total from Group Projects 126/175

Your peer evaluation score: 3.5

Your Group Project Grade: $126 + (0.15)(0.5/2)(126) = 130.725$

Midterm: 75/100

Final Exam: 110/150

Individual Project: 60/75

TOTAL (out of 500): $130.725+75+110+60 = 375.725$

Policy on Attendance and Make-ups

Attendance is mandatory on the days scheduled for the in-class group exercises. If you fail to show up for any of these group exercises, your score will be zero for that particular exercise, irrespective of the score obtained by your group. Only absences due to health reasons – and supported by a certificate from the medical clinic – will be considered as legitimate reasons for absence. Only *one* absence due to health reasons will be allowed, and in such a case, you will be assigned the average score on the remaining in-class exercises.

For the mid-term examination, only absences due to health reasons will be allowed, and supporting documentation must be provided. **No make-up exams will be offered for the midterm.** Instead, the weight will be (either partially or fully) shifted to the final, but the increased risk will be compensated by the following option. After the final exam results are known, we will calculate two different scores, one which puts a weight of 50% on the final, and one which puts a weight of 40% on the final. We will then pick the one that is better for the student. This option will mitigate the increased risk due to the absence of any weight on the midterm.

Please note in particular that job-interviews will not be considered valid reasons for absence for either the midterm or the in-class exercises. Since these dates are announced well in advance, you should be able to avoid any conflicts.

Course Outline and Time Table:

<u>Week of</u>	<u>Topic</u>	<u>Reference</u>	<u>Comments</u>
Feb 1	Introduction; NPV, IRR and Alternative Investment Rules Lockheed Tri Star Case ¹	Chapters 6	Read Lockheed Case
Feb 8	NPV etc. continued.		
Feb 15	Lockheed TriStar continued. Group Class Exercise 1 on February 17².		
Feb 22	Financing projects with equity – Information Asymmetry and Overvaluation	Notes	
March 1	Ratio Analysis and Valuation Do Managers Destroy Value? – Interco Case	Notes	Read Interco Case
March 8	Project Cash Flows Super Project Case	Chapter 7,8.	Read Super Project Case
March 15	Super Project Case. Group Class Exercises 2 on March 17		Read Beta Management Case
March 22	Review of Risk and Return CAPM and SML Beta Management Case	Chapters 9,10	
March 29	Group Class Exercise 3 on March 29 Midterm Exam on March 31		
April 5	Discount Rates, Certainty Equivalents and Risk-Neutral Valuation	Chapter 12 ³ Notes	
April 12	M&M Theorem and Capital Structure	Chapter 15	
April 19	M&M Theorem and Capital Structure Taxes, WACC and Firm Value	Chapter 15	

¹ Class discussion. Questions on the Group project will be based on these cases, so it will be helpful for you to read the case before coming to class. Also, please make sure that at least one group member brings a notebook computer to class.

² Please make sure that at least one group member brings a notebook computer to class. Attendance on these days is mandatory. If you fail to attend, your score for this exercise will be marked to be zero irrespective of the group score.

³ This discussion will rely more heavily on supplementary material not in the text.

April 26	Taxes, WACC and Firm Value Group Class Exercise 4 on April 28	Chapter 15	Read Appendix 17A
May 3	APV Method of Valuation APV and NPV	Chapter 17 Chapter 17	
May 10	Bankruptcy and Limits on Debt Group Class Exercise 5 on May 12	Chapter 16	

Case Reports Due: May 18.