

# Corporate Finance FINA 512

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Sat, 9:00 am - 12:30 pm (section 1), and 2:30 pm - 6:00 pm (section 2)

Class Venue: room 3219

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**Course Objectives:** The course covers on the introductory level the topics in corporate finance, with the focus on optimal corporate financial decisions prior to special topics. My goal is to present a very simple material, while advanced students can benefit from the scaled-up textbook and the suggested readings.

In particular, the course will cover: project evaluation; cost of capital; alternative projects, optimal timing and real options; introduction to issuance of securities and capital structure. Additional in-depth topics: firm's payout alternatives; initial public offerings; mergers & acquisitions, convertible (hybrid) securities, currency hedging; executive compensation and selected issues in corporate governance.

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

**1. Required Text:** Ross/Westerfield/Jaffe, *Corporate Finance*, McGraw-Hill, Seventh edition

**2. Recommended Text:** Grinblatt, M., and Titman, S., *Financial Markets and Corporate Strategy*, Irwin/McGraw Hill, 2<sup>nd</sup> edn, 2001. ISBN [0072294337](https://www.isbn-international.org/product/0072294337) This is a more advanced textbook and treats some issues that we can not discuss in detail in class. I strongly recommend reading it. Some of my lectures and examples are based on this text.

**3. Additional Reading:** Optional

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

Problem Sets: 21%

Case Analysis: 18%

Final Exam: 56%

Class Participation: 5%

*Problem Sets:* There will be a total of three problem sets assigned (each worth 7% of your final grade). The problem sets have to be done individually. 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. To understand the material better, you can also try solving some problems from the end of relevant chapters of the textbook.

*Case Write-Ups:* There will be a case assigned (one or more). You can work on cases in groups of 4-5 people. I prefer that you choose your group partners yourself, the MBA office will assign all students that could not find the group. Case write-ups have to be turned in at the beginning of each class at the due dates. Late submissions will not be graded. You should be ready to present your case solution in class in a 15-minute presentation. We will draw couple of groups at random to do their presentations. 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 5% 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.

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.

### **Administrative Information**

*Office hours:* I will hold regular office hours; we will conduct a poll to determine what time is suitable for everybody. I will also be generally available after class to answer your questions.

*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. Your only option is to drop the class during the allowed period.

*Name Cards:* Please put 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.  
*Class Webpage:* We will post important class information and materials on the webpage, including lecture notes, problem sets, solutions, handouts, etc.

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

1. (*week 1*) Introduction to Corporate Finance: Overview of Financial Decisions  
Introduction to Corporate Finance: What is Corporate Finance? Investing, raising capital and managing cash. Read: RWJ Chapter 1

The NPV Rule and Valuation of Riskless Cash Flows: One-period, compounding, annuities, valuation of bonds. Read: RWJ Chapter 4, additionally: GT Chapter 9, 10  
Bonds: RWJ Chapter 5.1-5.3

Alternative investment rules: IRR, Payback period and Average accounting return methods. Read: RWJ Chapter 6.

2. (*week 2*) Forecasting Expected Cash Flows and Firm Valuation

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

Estimating Cash Flows from Financial Statements: Free Cash Flows, growth rates. Read RWJ Chapter 2, 3.

Application of the Discount Cash Flows method to valuing stocks. Read RWJ Chapter 5.4-5.8 Valuation by comparison and replication. Read: GT Chapter 13

Capital Budgeting issues: Sunk costs, opportunity costs, inflation, optimal replacement problem. Read RWJ Chapter 7.

Introduction to risk. Read RWJ Chapter 9.

Reading: **Accounting and Valuation: How Helpful Are Recent Accounting Rule Changes?**

by Bradford Cornell, California Institute of Technology, and Wayne R. Landsman, University of North Carolina\*

**Handling Valuation Models** by Stephen H. Penman, Columbia University

3. (*week 3*) Estimating Cost of Capital: Risk

#### **CASE due: Ocean Carriers**

Risk and simple measures of risk, portfolios, diversification. Certainty Equivalence Method. GT Chapter 11.

Risk-neutral valuation. Read RWJ Chapter 23, GT Chapter 7.

Introduction to Capital Asset Pricing Model. Read RWJ Chapter 9 and 10.

Introduction to Arbitrage Pricing Theory. Read RWJ Chapter 11.

Estimating Cost of Capital, WACC. Read: RWJ Chapter 12 (peek into future lectures: some of Chapter 15) additionally: GT Chapter 13

4. (*week 4*) Alternative Projects, Real Options. Introduction to Capital Structure

## **Problem Set 2 Due**

The option to wait, invest, abandon. Valuing the Real Options. Read RWJ Chapter 8.  
Long Term Financing with Debt and Equity Read RWJ Chapter 14.  
Introduction to Capital Structure. Read RWJ Chapter 15, GT Chapter 14  
Distress Costs and Agency costs of Debt. Read RWJ Chapter 16, GT Chapter 16

Reading : **The Role of Real Options in Capital Budgeting: Theory and Practice** by Robert L. McDonald, Northwestern University

5. (*week 5*) Valuing the Levered Firm, Distribution policy

**Case Due & Class Presentations** : Arundel Partners and the Sequel Project,

APV and WACC methods. Read: RWJ Chapter 17, additionally: GT Chapter 13

Taxes and Distribution Policy. Read: RWJ Chapter 18, GT Chapter 15

Financing a firm with hybrid securities: Convertibles and Warrants. Read: RWJ Chapter 24

Reading : **Canadian Business Trusts: A New Organizational Structure** by Paul Halpern, University of Toronto, and Oyvind Norli, Norwegian School of Management

6. (*week 6*) Issuing Securities

### **Problem Set 3 Due**

Issuing Securities. Information Conveyed by Financial Decisions. Initial Public Offerings, Rights Issue, Repurchases: RWJ Chapter 19, GT Chapters 1 and 19.

Issuing Long-Term Debt. RWJ Chapter 20. Leasing vs. Debt. Read RWJ Chapter 21  
Options. Read RWJ Chapters 22 and 23.

Reading : **Evidence on What CFOs Think About the IPO Process: Practice, Theory, and Managerial Implications** by James C. Brau and Stanley E. Fawcett, Brigham Young University  
**Public vs. Private Equity\*** by John J. Moon, Metalmark Capital LLC

7. (*week 7*) Further Topics

### **CASE: Kohler Co.**

Cash Management, RWJ Chapter 26 & 27

Corporate Governance. Read relevant topics from: RWJ Chapter 29&23, GT Chapter 18.

Mergers and Acquisitions. Read RWJ Chapter 29

Hedging. Read RWJ Chapter 25.

Reading : **Hedging and Value in the U.S. Airline Industry** by David A. Carter, Oklahoma State University, Daniel A. Rogers, Portland State University, and Betty J. Simkins, Oklahoma State University

**Leveraged Buyouts in the U.K. and Continental Europe: Retrospect and Prospect**

by Mike Wright, Nottingham University, Luc Renneboog, Tilburg University, Tomas Simons, McKinsey & Company, and Louise Scholes, Nottingham University

**Avoiding the "Synergy Trap": Practical Guidance on M&A Decisions for CEOs and Boards**  
by Mark L. Sirower, New York University, and Sumit Sahni, Boston Consulting Group

8. (*week 8*) **Final Exam**