

Finance 512 (Spring, 2010).

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Required Text

Modern Financial Management (Eighth Edition), by Ross, Westerfield Jaffe and Jordan), McGraw Hill.

Course Objectives

The purpose of this course is to give the students an exposure to key *conceptual tools* in corporate finance. Topics covered include capital budgeting decisions and project analysis, finding the cost of capital, valuation of financial assets, how capital structure decisions affect firm value, valuation of companies using DCF and other techniques, and M&A (merger and acquisition) decisions. Students interested in building further on, and especially to see more applications of, the tools developed here are encouraged to take elective courses on offer such as Strategic Value Creation.

Course Web Site

Please check the web site regularly for announcements. Class lecture notes, solutions to exercises, and additional helpful reading materials will be posted there.

Course Structure and Pedagogy

Please try to read through my “Notes to the Textbook”. In these notes, I have extracted the essential concepts from the relevant chapters in the text book and presented them in a way that should be easy to follow.

My own lectures will follow roughly the same sequence of topics as in these notes (and the relevant chapters from the textbook). However, sometimes, the emphasis will be somewhat different. Except for the first lecture, I will use a set of PowerPoint slides for my class lectures. These are going to be printed out and made available to you.

You need to be very familiar with the material from these sources: (a) Notes to the Textbook (b) Lecture PowerPoint slides, and (c) problems assigned for practice.

Chapters in the textbook (Ross, Westerfield, Jaffe and Jordan)) provide additional examples and more explanation for many of the concepts. I encourage you to read the textbook chapters.

Laptop Computers

You may find it helpful to bring a laptop computer to class, although it is by no means essential. **Especially on the days a case is discussed, and on the days the pre-assigned practice problems are discussed, a laptop would be helpful.** You are encouraged to download all excel spreadsheets and PowerPoint slides posted on the course website into your laptops.

Grading

Exams: There will be one mid-term and one final examination.

The mid-term will be a 90-minute **in-class group exercise**. A part of the group exercise will be a take-home assignment due on the last day of class (April 10).

The final will be a 3–hour exam. The final will include concept questions as well as problems (similar to the home-work assignments).

The mid-term exam will carry 1/3 weight and the final 2/3 weight towards the final grade. There will be a peer evaluation of each group member – details are provided below.

Dates

Mid-term examination: March 13

Final examination: April 10

Make-Ups

Please note that I DO NOT allow make-up examinations for the mid-term. If you do not show up on March 13, all the weight will be shifted to the final examination.

The only circumstance under which a make-up for the final examination will be considered is illness, accompanied by a note from a Doctor which explicitly states that the student could not have taken the exam in his/her current condition of health.

Group Formation and Peer Evaluation

You are required to form groups in the first day of class. Each group will consist of 7 members. The names of group members must be handed in by the end of the first day.

For the group exercises, 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.

Suppose your group consists of 7 members. Each member of your group will be asked to rank every other member on a scale of 1 to 6, indicating their evaluation of each member's relative contribution to the group's efforts (excluding himself/herself). A rank of 6 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 6). Then the eventual Group Project Grade for that individual will be determined by the following formula:

$$\text{Group Project Grade} = (\text{Basic Grade}) + (0.10) (\text{Basic Grade}) \times (x - 3.5)/2.5$$

This implies a 10% upward adjustment for a group member with an average rank of 6 (rated highest by all), a downward adjustment of 10% for a player ranked 1 (lowest) by all, and no adjustment for a player with the average rank of 3.5. The formula will be changed in a consistent manner for groups with less than or more than 7 members in case that becomes necessary.

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 3.5 from you. Also, as a penalty to you, your average rank will be lowered to 1.

Course Outline

Chapter numbers refer to relevant chapters in the Textbook and Notes to Textbook

Day 1

Hour 1	Time-Value of Money	} Chapter 4 (No PPT files for this topic)
Hour 2	Explaining PV formulae	
Hour 3	(a) Applications of PV (b) Discounting risky cash flows	

Do Practice Problem Set #1.

Day 2

Hour 1	Discuss Problem Set # 1. Bond prices and yields	} Chapter 5 (No PPT files)
Hour 2	Stock prices: dividend growth model	
Hour 3	(a) Concept of returns on a financial asset (b) Internal Return on a project (IRR) (c) real and nominal returns	} Chapter 6 PPT: Chapters_6-7_A

Reminder to students: Please read the Lockheed Tri-Star and Super Project cases.

Day 3

Hour 1	(a) NPV vs. IRR (b) Other capital budgeting concepts (ARR, Payback)	} Chapters 6, 7 PPT: Chapters_6-7_B
Hour 2	(a) NPV and stock price (b) Lockheed Tri-Star case	
Hour 3	(a) Project Cash Flows (b) Some special NPV examples	} Chapter 8 PPT: Chapter_8_A PPT: Chapter_8_B

Do Practice Problem Set #2.

Please read the Beta Management Company case.

Day 4

Hour 1	Discussion of Problem Set # 2.	
Hour 2	Risk and Return, CAPM and SML review	} Chapters 9-10 PPT File: Chapters_9-10_A PPT File: Chapters_9-10_B
Hour 3	Beta Management Company Case	

Reminder to students: Please read the Marriott Case and do Problem Set # 3.

Day 5

First half	Modigliani and Miller Theorem and Capital Structure	} Chapter 15 PPT File: Chapter_15_A
Second Half	Midterm Examination (In-Class Group Exercise)	

Day 6

Hour 1	Debt, Taxes and the WACC	} Chapter 15 PPT File: Chapter_15_B
Hour 2	Costs of Debt: (a) Financial Distress Costs (b) Debt Overhang (c) Risk-Shifting	} Chapter 16 PPT Files: Chapter_16_bankruptcy Chapter_16_OtherCosts

Day 7

Hour 1	Valuation: APV method and WACC method	} Chapter 17 PPT File: Chapter_17_Valuation_ Methods
Hour 2	Merger Valuation: Class handout Valuation by Multiples: PPT File: Valuation_by_Multiples	
Hour 3	Issuing securities: IPO, SEO (public offers, rights issues) and Debt	} PPT Files: Chapter_19_Information_Asymmetry Chapter_19_Rights_Issues

Do Problem Set # 4.

Day 8

In-Class Final Exam (3 hours).