

## **Finance 321**

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Required Text: *Corporate Finance*, by Ross, Westerfield and Jaffe, McGraw Hill, Sixth 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: short-term financial policy of companies, 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: A course web site in the process of being set up. Details will be announced in class.

Course Structure and Pedagogy: The discussion of the various topics will be organized around some selected cases from the Harvard case book, *Case Problems in Finance*, 11<sup>th</sup> 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.

The cases are illustrative of the important role some of the concepts developed in the course play in the context of corporate decision making. Chapters in the textbook (Ross, Westerfield and Jaffe), supplemented in many instances with class lectures, will provide essential background for the concepts. Please see the course outline and timetable below for the appropriate chapter references.

**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 13.**

Group members will work together on group projects that will involve writing a report on **four** assigned cases. In addition, there will be assigned questions on the remaining cases

that will come up during class discussion of these cases. On each case, one member of each group will be picked to answer a particular question in class.

Students who are not a part of a group of size 6 on February 13 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. In this case, we will try to maintain the workload per student the same as for other groups.

**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 13, with your name and student I.D. written at the back.

**Course Format:** The course outline and timetable indicates the date/dates a particular case will be discussed. On that date, you and your group have two responsibilities:

1. For **four** of the cases, written reports will be required to be submitted. Submit written answers to the questions on the case to be discussed (the Case Report). Questions for two of the cases are given at the end of the syllabus. Questions for other cases will be assigned later **Each group needs to turn in one report only.** The Case Report must be uniform in terms of format, and the answers must also be mutually consistent. All group members will get exactly the same basic marks on a particular Case Report. However, this basic mark will be adjusted according to a peer evaluation scheme, to be explained below. The case reports are important for your final grade. Out of the maximum of 100 points for the course, the case reports will account for 40 points.
2. For the remaining cases, no written reports are necessary. However, be prepared to answer questions during class discussion of the case. **This applies to the four cases for which reports will be required as well.** You can expect to spend 5-7 minutes answering a particular question if your turn comes up. Out of the maximum of 100 points for the course, 10 points will be set aside for this part.
3. If you give satisfactory answers to questions not originally directed towards you, we will keep track of your performance. If you have a good record of regularly answering questions, you can get up to a maximum of 10 points **in addition to** whatever you get out of the maximum of 100 points for the course. **Speak up!** Otherwise, you will not get any credit on this 10%, and that can make a big difference to your grade! Also, note that this is an opportunity for you to make up if you could not answer satisfactorily when your turn came up.
4. It will not be possible to ask every group member in a particular session, but your turn will come up at least once during the course, so you need to be ready!

5. Since you have only 5-7 minutes, you will need to be very prepared for every case. Ideally, you should have Excel spread sheets ready for each case (whether or not it is one of the cases for which a case report is due). If you want to display numbers or calculations, or explain steps, then you can use the whiteboard, the overhead projector, or a projector for typed or handwritten material (you do not need transparencies if you are using this device). You can also e-mail your file to your e-mail account, access it from the classroom PC, and project the file to the screen. You will be allowed a maximum set up time of 2 minutes.

**Points to remember about the Case Reports:**

1. Please note that the Case Report is due at the beginning of class on the date the case is to be discussed. *It goes without saying that because the case will be discussed in class, under no circumstances will it be possible to accept the report after this due date.* If you fail to submit the report on the due date, you will not get any marks on that particular assignment.
2. Please also note that *you need to turn in a hard copy of the report.* Soft copies of reports (disks or e-mail attachments) cannot be graded.
3. Each case report must have a section titled “Key Assumptions” where you need to indicate the list of important assumptions you have made to answer the questions. Assumptions may be specific to particular questions and in that case you need to indicate in this section for which particular question an assumption was relevant.
4. All tables and charts should appear at the end. The discussion in the report should make very clear references to the tables.
5. There must be a section called “Explanatory Notes to Tables and Charts” where the calculations in the tables need to be explained in complete detail.
6. Excluding the Tables and Explanatory Notes, the Case Report should not exceed 5 pages.

**Grading:** The course grade will be determined on the basis of the Case Report grades, answers and class participation during case discussion, and a final examination.

The Basic Grade on the Case reports will be adjusted according to a peer evaluation scheme. Suppose out of a maximum of 40, your group obtained 30 points on the Case Reports. These 30 points constitute the Basic Grade on the Case Report.

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  $x$ . Then the eventual Case Grade will be determined by the following formula:

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

Thus, if your average rank is 5 and the Basic Grade is 30 for your group, your Case Grade is  $(30) + (0.15)(30)(2/2) = 34.5$

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 by 1.

If the group size is smaller than 6, then the formula will be correspondingly adjusted. Thus, if the group size is 5, the formula will be

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

(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:

Case I	8/10
Case II	7/10
Case III	10/10
Case IV	9/10
Total	34

Your peer evaluation score: 3.5

Class discussion of case question: 7/10

Bonus for class participation: 5/10

Final exam 35/50

Your total score:  $(34) + (0.15)(34)(0.5/2) + 7 + 5 + 35 = 82.275$

Course Outline and Time Table:

<u>Week of</u>	<u>Topic</u>	<u>Reference</u>	<u>Comments</u>
Feb 4	Introduction		
Feb 11	Alternative Investment Rules & Net Present Value	Chapters 6,7 <sup>1</sup>	
Feb 18	NPV contd. + Lockheed Tri Star Case  Butler Lumber Company Case		Practice Case  Prepare Assigned Questions
Feb 25	Project Cash Flows	Notes	
March 4	Discount Rates/Inflation Adjustment Beta Management Company: Tutorial		
March 11	Valuing a Project: <b>Super Project Case Due</b> (March 11) Valuing a Company – A Framework		Prepare Assigned Questions
March 18	WACC Capital Structure (M&M Theorem)	Chapter 12 Chapter 15	
March 25	Capital Structure	Chapters 16,17	
April 1	Capital Structure <b>Marriott Corporation Case Due</b> (April 3)		Prepare Assigned Questions
April 8	Valuation and Capital Budgeting of a Levered Firm: The APV Approach & Other Valuation Methods  Advanced Topics on Capital Structure:	Appendix 17A  Chapter 17	
April 15	Moral Hazard and Asymmetric Information Brown-Forman Case (April 17)		Prepare Assigned Questions
April 22	Mini-Case on Asymmetric Information (April 24-No class on April 22)		Prepare Assigned Questions
April 29	<b>Capital Structure Case Report Due (TBA)</b> (April 29)		Prepare Assigned Questions

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<sup>1</sup> This should be review of what you learned in Finance 111.

	(No class on May 1)	
May 6	Mergers and Acquisitions	
	(No class on May 8)	
May 13	Mergers and Acquisitions <b>M&amp;A Case Due (TBA)</b> (May 15)	Prepare Assigned Questions

## Assigned Questions on Cases

### Lockheed Tri Star

The questions are all given in the case.

Specifically, please answer

- (i) Example 1 (Rainbow Products) a ,b and c on Rainbow Products
- (ii) Example 2 (hot-dog stand) questions in italics.
- (iii) Example 3 (MBATech. Inc.) questions in italics.
- (iv) Example 4 (Value-Added Industries) questions in italics.
- (v) Lockheed Tri Star (4 questions at the end of the case).

### Butler Lumber Company:

1. Produce a flow-of-funds statement for Butler Lumber Company for the period December 31, 1988 to December 31, 1990.
  - (i) What factors have been most responsible for Butler's urgent need for funds?
  - (ii) What have been the main sources of funds for Butler?
  - (iii) Assuming that the ratio of inventory to sales and receivables to sales for Butler in 1990 were at the 1988 levels, by how much would the requirement of funds have increased? From this, what can you conclude about the main factor behind Butler's growing need for funds?
2. (i) Assuming that suppliers extend trade credit on terms mentioned in the case, what implicit rate of interest is Mr. Butler paying by not taking advantage of the 2% discount for payments made within 10 days?  
(ii) Should Mr. Butler offer a 2% discount to his customers for repaying in 10 days?

3. Assume the following:

- (i) Sales volume in 1991 will be \$3.6 million.
- (ii) All purchase discounts for the period April 1-December 1, 1991 will be taken.
- (iii) The ratio of other accounting numbers to sales for 1991 will be at their average levels for the 1988-1990 period.

Now estimate whether a maximum line of bank credit of \$465,000 will meet Mr. Butler's needs for 1991. How much funding will he need?

4. Assume now that Mr. Butler does not take the purchase discounts for 1991. Estimate his funding needs. If he could get the line of credit that he wanted, should Mr. Butler take advantage of the purchase discounts by repaying his suppliers more promptly?
5. What advice would you give Mr. Butler regarding his business strategy?
6. If you were the banker, would you extend Mr. Butler the loan that he requested?

Questions on other cases will be assigned later.