

**UNIVERSITY OF PENNSYLVANIA**  
**The Wharton School**  
**WEMBA EAST**

**FNCE 726701: ADVANCED CORPORATE FINANCE**

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### **Course Objective**

The objective of this course is to teach students how to apply modern financial theory to the investment and financing decisions of a modern corporation.

### **Course Content**

This course is designed for finance majors who will pursue careers in major corporations, the financial sector, and consulting firms. We extend the core theory introduced in Financial Analysis for applications to the strategic financial decision areas of a firm.

The theme of this course is value-based management. However, as with all scientific disciplines, the theoretical framework explains the real world with abstract and simplified models. Such conceptual models, while based on sound theory, are never sufficiently rich for dealing with all the complexities of the real world. Value based management introduces coherence and consistency in dealing with real world problems. Despite their limitations, decisions based on financial theory and models are superior to ad hoc alternatives. Concepts and techniques introduced in this course help discipline managers by expressing key decisions in terms of their predictable impact on firm value.

This course consists of seven sections. The first four sections focus on a range of financial issues that confront managers in their ordinary course of doing business, mainly financial planning, capital budgeting, and the interaction between investment and financing decisions. The options approach to investment decisions are in Section IV. Section IV deals with financing decisions, and security issuance and dividend policy is introduced in Section VI. The last section of the course focuses on corporate restructuring, mergers, and acquisitions.

### **Course Format**

This course is taught mostly with cases and a few review lectures.

The case method of instruction offers some distinct benefits. In preparing cases, you learn more than just the financial theory required to analyze a case. You learn about the agents, institutions, and transactions that comprise the modern financial system. You also learn to contribute effectively to fast paced discussions about complex financial issues and test your understanding and your solutions to these issues that are rarely black and white.

These benefits come with a substantial cost, however. Discussion-based classes succeed only if all students come prepared to discuss the case material. To foster mutual trust and respect, it is imperative that students attend each class, arrive on time, and minimize subsequent class disruptions. Class participation is vital to your learning as well as the learning of others.

The case method helps you use financial theory to arrive at coherent and defensible conclusions when faced with real world problems. One should keep in mind that there is not necessarily “the right” answer to a case; different assumptions may lead to different solutions and decisions. There is, however, always a theoretically correct and sound approach to the problems encountered in cases.

## Study Groups

You should form groups of no more than four students. You should leverage your strengths with other team members for a more comprehensive case analysis. Suggested study questions often require extensive calculations and/or valuations. Your team members also enable you to try out your own ideas prior to class discussion. Each student is responsible for these questions. All questions are fair game if you are cold called to open class discussion.

## Textbooks

The only required reading materials in this course are the cases. For some cases, explanatory teaching notes on your reading list might be useful. If you need to review the prerequisite background materials for the cases, you may refer to the relevant chapters indicated in the following two or any similar texts:

R. Brealy, S. Myers, and F. Allen, *Principles of Corporate Finance*, 8th Edition, Irwin, McGraw-Hill, 2006. (Henceforth, BMA)

T. Koller, M. Goedhart, and D. Wessels, *Valuation: Measuring and Managing the Value of Companies*, McKinsey & Company, Inc., John Wiley & Sons, Inc., 4<sup>th</sup> Edition, 2005. (Henceforth KGW)

The text by Koller et al. is a valuation book written from practitioners' perspective. Copies of both texts will be on reserve in the Lippincott Library.

## Course Pack

The course pack from Wharton Reprographics contains all of the cases and other recommended readings. Any additional reading will be posted on the webCafé.

## webCafé

The course site at Wharton webCafé contains suggested questions for cases; Excel files for exhibits for most cases and lecture notes and handouts distributed in class. You will find the most updated information and announcements for the course, such as office hours and rooms for the teaching assistants, review sessions, exams, and guest speakers. webCafé is the information center for the course. Please check the course site regularly.

## Grades

Final grade for the course will be based on:

- |                        |       |
|------------------------|-------|
| 1. Class Participation | (20%) |
| 2. Group Case Reports  | (20%) |
| 3. Individual Report   | (20%) |
| 4. Final Exam          | (40%) |

### 1. Class Participation and Presentations

This course will provide you with the opportunity to learn how to best contribute to discussions about complex financial issues. In a teaching environment, a well articulated expression of confusion is in some instances equally valuable as an abruptly delivered “right” answer. Not having a background in finance, therefore, does not put you at a disadvantage with regard to class participation.

I will mark your class participation for each class on a scale from 0 to 4 points to maintain fairness and to minimize subjectivity in grading. In determining your grades, I consider the degree to which your comments advance everyone's learning. Your comment's impact on our overall understanding of the problem under discussion is more important than the right answer per se. I assess your class participation on this metric, not on “air time” or the number of comments you make.

Cold calling is the only incentive strong enough to ensure adequate preparation. I will start the class by cold calling a student to open the case discussions. Failure to prepare for class reflects an unacceptable disregard for your fellow students. Everyone's learning is dependent on everyone's preparation.

If circumstances arise that leave you with insufficient time to prepare, I ask you only to inform me of this prior to class. Students will be excused for absences due to illness or that are necessary to observe religious holidays. Unexcused absences will have a significant impact on your final grade.

You are welcome to make a 10 minute presentation of any case other than those required at the beginning of class to improve your class participation.

## **2. Case write-ups**

You should hand in six case assignments throughout the semester as written reports, five with your team and one as an individual write up. Three of these write ups, including the individual one, are required and indicated on page 8. You can choose any other three. Your reports will be graded on a scale from 1 to 5. Groups that provide a competent report will get a full credit, i.e., 3. Exceptionally good reports will get bonus credit of 4 or 5. Your case report should be in the form of an executive summary of 4 pages at most. You may include your supporting computations and tables in an appendix. We will grade your reports for your honest effort, not necessarily for “the correct” answers. Specifically, we will use the following criteria for grading the case write ups:

- a. ability to identify the main issues,
- b. theoretical and analytical soundness of your approach to your decision and/or conclusions,
- c. clarity and succinctness of the report.

You are welcome to submit more than 6 cases for extra credit.

## **3. Individual Write-up: American Chemical Corporation**

Purpose of this individual write up is to give each student to review her own progress. I will provide more detailed questions for this exercise.

## **4. The Final Exam**

Final will be given on December 19<sup>th</sup> in class. Final exam will consist of problems similar to those in the cases, but they will be shorter and more focused. No laptops are allowed in the exams. You will need a financial calculator and be able to use it.

All graded materials will be returned to your mail folders. Please indicate your section and group number on all of your written assignments.

## **Review Sessions and Office hours over the Phone by Teaching Assistant**

Your teaching assistant will offer periodic review sessions depending on your schedule. She will also hold office hours by request either over the phone or in person to answer your questions for clarification on pending cases or course material. TA office hours will be posted on webCafé.

## **Correspondence by e-mail**

Best way to reach me is by e-mail. I will do my best to respond to your brief e-mails. I will not be able to provide lengthy discussions or tutorial sessions by e-mail. Please cc all your e-mails to my TA as well. She will respond to you at times when I am out of reach. If your question is interesting for everyone, we will post them with the answers on the webCafé. Please indicate explicitly if your question is private and it should not be posted.

## Workload

The subject matter of this course is technical and quantitative and the pace is fast. Furthermore, case preparations require a more time and dedication than lecture-based courses.

Unlike an introductory finance course, this course uses real world cases where the information is seldom complete to make a decision or solve a problem. Your results may differ depending on the initial set of assumptions you have to make in the absence of complete information. If you have difficulty with ambiguity of the subject matter and the teaching style, this course may not be for you.

## Academic Integrity and Code of Ethics:

Most case materials in this course are based on real events and companies. In preparing for class discussions or for your reports, you may use any publicly available past or current information about the companies dealt in cases. You are strongly encouraged to study cases with members of your group. Submitted assignments for grading should be your own or your group's joint work only. Each member of your group is expected to contribute equally to the group reports. Do not allow specialization in your team. This is your opportunity to develop new skills.

Learning in this course will be a direct function of the amount of time you spend on case analyses. Reliance on the work of others is self defeating. The grading system is designed so that all "good faith efforts" on the group reports will result in full credit.

There are a limited number of good cases in finance and only a few new ones are produced each year. Thus, many cases remain on the course syllabus for few years. I distribute all materials used in class in hard copy and post them on webCafé. Any use of such previously distributed materials is considered plagiarism and will not be tolerated in any way.

*You cannot use work completed by other students, old notes or handouts, or solutions to the cases from previous years or other sections of this course at Wharton or similar courses at other business schools or elsewhere for your written reports and class discussions. Violation of this rule will result in an automatic failing grade for the course. Furthermore, the violators will be reported to the Wharton Graduate Division for further disciplinary action.*

*If you use materials from any public or private source, including those sources on the internet, private company presentations, etc. in your submitted work for any reason, you should properly cite them. Otherwise, it may be considered plagiarism.*

If you register for this course, you agree with the principles of academic integrity described above in conjunction with the Wharton Graduate Division Code of Ethics.

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### \* Acknowledgements:

I would like to acknowledge the contributions of many colleagues and friends to the development of this course. They provided course outlines, teaching notes, reading materials, software, and assistance for case writing; and some shared their expertise as guest lecturers. I would like to thank:

Simon Benninga, Marshall E. Blume, Richard Bower, Guido Cipelli, Desmond Conner, Ignacio de Orue, Steve DesJardines, Sonia Dula, Eugene F. Fama, Adam Frieman, William F. Fruhan, Hulya Eraslan, Ozer Ertuna, Benjamin C. Esty, Jr., Robert Gerry-Wade, Stuart C. Gilson, Robert R. Glauber, Mario Gobbo, Michael Goldstein, Mustafa Gultekin, Robert Hamada, Joel Hasbrouck, Gabriel Hawawini, Trent Hickman, Robert W. Holthousen, Mat Ide, Jeff Jaffe, Peter Jones, Donald Keim, Ronald Koenig, Maria C. Kosloski, Roger Leeds, Dennis E. Logue, Herwig Langohr, Inga Marie-Davis, Matthew McBrady, Morris Mendelson, Ian Murray, Ewa Morowska, Enrique Lavina, John Nellis, George Oldfield, John Percival, Thomas R. Piper, Lee Remmer, Richard J. Rogalski, Steven Ross, Mitch Scherzer, Jeremy Seddon, Arnold Shipp, Seymour Schmidt, Robert Stambaugh, Hans Stoll, Toshi Taga, Seha Tinic, Selim Topaloglu, Ed Travisani, Mete Tuncel, Derek Utter, Claude Viallet, Charles Vuylsteke, Richard West, Randolph Westerfield, Gavin Wilson, J. Peter Williamson, Mimi Xue, Oktay Yenal, Bilge Yilmaz, Unal Zenginobuz, and Joseph Zimmer.

I fondly remember the great contributions of Isik Inselbag, Irwin Friend, James Walter, and Merton Miller. I owe a special debt to Isik Inselbag with whom we developed and taught this course for two decades at the Wharton School.

## **I. INTRODUCTION and VALUATION THEORY AND CAPITAL STRUCTURE**

### **A. DCF Methods for Valuation**

#### **1.1** Lecture: Capital Structure and Valuation Theory

Readings: Brealy & Myers, Review Chapter 17-19  
Class Notes #3&4 (posted in the Course Materials Folder at WebCafé)  
HBS Teaching Note: "Alternative Methods for Estimating Terminal Value"  
HBS Teaching Note: "An Introduction to Cash Flow Valuation Methods"  
HBS Teaching Note: "The Adjusted Present Value Method for Capital Assets"  
HBS Teaching Note: "Valuing Equity Cash Flows"

#### **1.2** Case: M&M Incorporated (posted in Course Materials folder at WebCafé)

### **B. Capital Structure, Cost of Capital, and Interaction Between Investment and Financing Decisions**

Readings: Brealy & Myers, Chapters 7-9, and 19  
Koller, et al., Chapters 8-11, and 22  
"Best Practices" in Estimating the Cost of Capital: Survey and Synthesis" by R. Bruner  
"What Practitioners Should Know About Future Value" by M. Kritzman  
"The Market Risk Premium and the Cost of Capital" by Cipelli and Bulchandani

#### **2.1/2.2** Case: Galveston Fishing Company (posted in Course Materials folder at WebCafé)

#### **3.1** Case: Empirical Chemicals A&B

#### **3.2** Case: Marriott Corporation

#### **4.1/4.2** Case: Southport Minerals

Readings: Incorporating Country Risk in the Evaluation of Projects by D.R. Lessard

#### **5.1** Case: Kennecott Copper Corporation

## **II. CORPORATE FINANCING DECISIONS and REVIEW**

Readings: Brealy and Myers Chapters 13-15 and 23-26  
"An Introduction to Debt Policy and Value" by R. Bruner  
"Structuring Corporate Financial Policy..." by R. Bruner

#### **5.2** Case: MCI

#### **6.1/6.2** Review Case: American Chemical

### **III. OPTION VALUATION APPROACH TO CAPITAL INVESTMENTS**

- 7.1/7.2** Lecture: Review of Black and Schole's Model for Option Valuation I
- Reading: Brealy & Myers, Chapters 20-23  
Koller, et al., Chapter 20  
Class Notes: Review of Option Pricing Theory (WebCafe, Course Materials Folder)  
Capital Projects as Real Options: An Introduction (9-295-074)  
The Options Approach to Capital Investments (Dixit and Pindyck)
- 8.1** Case: Chrysler's Warrants
- 8.2** Case: MW Petroleum

### **IV. MERGERS AND ACQUISITIONS AND CORPORATE RESTRUCTURING**

- Reading: Brealy & Myers, Chapters 33 and 34  
Koller, et al., Chapter 15 and 16  
Valuation by Multiples" by Benninga and Sarig  
Koller, et. al., chapter 12
- 9.1** Case: Conrail A&B
- 9.2** Case: Privatization of SFM in Poland
- 10.1** Case: Philip Morris
- 10.2** Case: Philip Morris

**FNCE 726: AVANCED CORPORATE FINANCE COURSE SCHEDULE:  
FALL 2009**

<b>Session #</b>	<b>Date</b>	<b>Topic</b>	<b>Assignment</b>
1.1	Sep 04	Capital Structure and Valuation I	Lecture (Class Notes #3-4)
1.2	Sep 04	M&M Incorporated	Lecture
2.1	Sep 05	Galveston Fishing Co.	<b>Required written assignment: 1</b>
2.2	Sep 05	Galveston Fishing Co.	<b>Required written assignment: 1</b>
3.1	Oct 02	Empirical Chemicals	Case discussion
3.2	Oct 02	Marriott Corporation	Case discussion
4.1	Oct 03	Southport Minerals	Case discussion
4.2	Oct 03	Southport Minerals	Case discussion
5.1	Oct 16	Kennecott	Case discussion
5.2	Oct 16	MCI	Case discussion
6.1	Oct 17	<b>American Chemical</b>	<b>Individual written assignment (Required written assignment: 2)</b>
6.2	Oct 17	<b>American Chemical</b>	<b>Individual written assignment (Required written assignment: 2)</b>
7.1	Oct 30	Option Pricing Review	Lecture (Class Notes on Options)
7.2	Oct 30	Option Pricing Review	Lecture (Class Notes on Options)
8.1	Dec 04	Chrysler	Case discussion
8.2	Dec 04	MW Petroleum	Case discussion
9.1	Dec 05	Conrail	Case discussion
9.2	Dec 05	SFM	Case discussion
10.1	Dec 18	<b>Philip Morris</b>	<b>Required written assignment: 3</b>
10.2	Dec 18	<b>Philip Morris</b>	<b>Required written assignment: 3</b>
11	Dec 19	<b>FINAL EXAM</b>	<b>In class</b>