

UNIVERSITY OF PENNSYLVANIA
The Wharton School
MBA for Executives Program/Philadelphia Campus
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FNCE 726:701 ADVANCED CORPORATE FINANCE

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Course Objective

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

Course Content

This course is designed for finance majors and/or those who want to go beyond the core Financial Analysis course. It extends the theory introduced in the core course and allows applications of financial theory to the strategic financial decision areas of a firm. This is not a remedial course and it assumes that students know the basics taught in core Financial Analysis courses.

The theme of this course is value-based management. There has been remarkable progress in financial theory over the past three decades. The theory in financial economics often provides answers by stylized and simplified models of the real world. Value based management provides coherence and consistency in dealing with complex real world problems despite the inherent limitations of financial techniques. Decisions based on financial models are superior to ad hoc financial decisions without any theoretical basis. The theory and techniques surveyed in this course should discipline managers by expressing key decisions in terms of their predictable impact on firm value.

This course consists of four sections. The first two 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. Section III deals with the valuation of securities with option features. The last section of the course focuses on “organizational transitions” initiated by management or induced by structural or regulatory changes in an industry or an economy. This section illustrates the importance and the role of finance in facilitating and, in some cases, precipitating major organizational changes through mergers and acquisitions and corporate restructuring.

The case studies review and supplement the techniques learned in Financial Analysis. More sophisticated valuation techniques, which are the basis for value based management, are introduced as they become necessary for tackling the managerial problems of each case in a progressive fashion. You will begin with simple capital budgeting techniques using weighted average cost of capital (WACC) valuations as in Financial Analysis. You will then value projects with highly levered capital structures using adjusted present value (APV) and equity cash flows, real options, and a method of multiples applied to mergers and acquisitions along with traditional valuation techniques. During the semester, you will use virtually all valuation techniques as used on Wall Street. By encountering these techniques in the context of specific managerial problems, you should emerge from the course knowing how and when to use them.

Course Format

This course is taught entirely with cases except for a few review lectures on valuation theory and option pricing. 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 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 and as well as the learning of all others.

The objective of the case method in finance is to use the logic of financial theory to arrive at coherent and defensible conclusions when faced with real world problems presented in cases. One should keep in mind that there is no “the right” answer to a case; different assumptions may lead to different solutions and decisions. There is, however, always a theoretically correct methodology or a paradigm that is proper for the problems encountered in a case.

Study Teams

To help manage your workload, you are encouraged to form study teams of four students during the first week of class. Teams offer an opportunity to leverage your skills in order to analyze the study questions. They also enable you to try out ideas prior to class discussion. The suggested study questions often require full blown calculations and/or valuations. Each student is responsible for these questions. All questions are fair game if you are cold called to open class.

Course Materials

Texts

The only required reading materials in this course are the cases. For some cases, the explanatory teaching notes in 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 texts:

J. Berk and P. DeMarzo, *Corporate Finance*, 3rd ed., Pearson - Prentice Hall, 2014. (Henceforth BD)

Robert C. Higgins, *Analysis for Financial Management*, 10th edition, McGraw-Hill, 2012

T. Koller, M. Goedhart, and D. Wessels, *Valuation: Measuring and Managing the Value of Companies*, McKinsey & Company, Inc., John Wiley & Sons, Inc.

If you own another corporate finance textbook, that will suffice as well, although you have to figure out the relevant chapters.

Higgins gives an intuitive description of corporate finance for those with less familiarity with finance. Text by and Koller et. al. is a valuation book written from a practitioners' perspective.

Bulkpack

The Study.net should contain all of the cases and other recommended readings.

Course website

The course web site at Wharton Canvas contains suggested questions for cases, exhibits for most cases, lecture notes and handouts distributed in class. You will find the most updated information and announcements for the course. I will add some readings that might be of interest to you during the semester.

Course Prerequisites

Students are expected to be thoroughly familiar with the materials covered in the core courses. The minimum prerequisites of the course are:

- a. Financial Analysis
- b. Introductory Financial Accounting
- c. Introductory Statistics or Econometrics
- d. A basic knowledge of EXCEL or similar spreadsheet package.

Grades

Your final grade will be based on:

- | | | |
|----|--------------------------------|-------|
| 1. | Class Participation | (20%) |
| 2. | Written Case Reports by Groups | (25%) |
| 3. | Midterm Exam | (25%) |
| 4. | Final exam | (30%) |

1. Class Participation

A goal of this course is to provide you with an opportunity to analyze and discuss complex financial issues. Corporate financial decisions are inevitably made in groups. In a group setting, a well articulated expression of confusion is in some instances more valuable than an abruptly delivered “right” answer.

I will mark your class participation *daily* on a 0 to 4 point scale to maintain fairness and objectivity in grading. In determining your grades, I consider the degree to which your comments advance everyone’s learning. The quality of your comments and discussions are much more important than quantity. Your comment’s impact on our overall understanding of the managerial decision at hand is more important than the right answer per se. I assess your class participation on this metric, not on “air time”, or the questions you ask.

Cold calling is the only incentive strong enough to ensure adequate preparation. I will cold call at least one student to open each case discussion. Failure to prepare for class reflects an unacceptable disregard for your fellow students. Everyone’s learning is dependent on everyone’s preparation. Inevitably, circumstances will arise that leave you with insufficient time to prepare. If so, 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.

2. Group Case write-ups

There are 5 required written case assignments during the semester and they are shown on page 8. There is one optional case write up if you want to replace your lowest write up grade. The purpose of these write ups is to motivate high class preparation; they are not to test your knowledge. Your case report should be in the form of a short executive summary with not more than 4 pages. You may include your supporting computations and tables in an appendix. These reports will be graded on a scale from 1-10. Groups that provide a competent report will get a passing grade, i.e., 7. Few exceptional reports will get bonus credit of 8, 9, and 10.

Since you are preparing your reports in advance of class discussions, I will not grade your write ups for “the correct” answer. I will use the following criteria:

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

3. Midterm Exam

The midterm exam will be in class on **Saturday, October 15**

4. Final Exam

The final requirement of the course is a comprehensive final examination on **Saturday, December 17**. Details be announced later.

Exams are “closed book”. They will consist of problems similar to those in the cases, but they will be shorter and more focused. No laptops or any other electronic devices other than a calculator are allowed in the exams. You will need a calculator with NPV and IRR features. You are allowed to bring one page (two-sided) “cheat sheet” to the exam.

All graded materials will be returned to your mail folders.

Attendance and Class Etiquette

Students are expected to arrive on time for class. Once in class, students should remain until the class is completed. Arrivals and departures during class time interfere with the educational process and are not fair to the other students.

Seating Chart and Name Cards

Please display your name cards in class at all times so that I get to know you and am able to evaluate your class participation. Please write your name in large, dark letters on the name cards. Please choose your seat during the first week and use the same seat for the remainder of the term.

Correspondence by e-mail

The 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. My TA 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 Canvas. Please indicate explicitly if your question is private and should not be posted.

Workload

The subject matter of this course is very technical and quantitative and the pace is very fast. Case preparations require substantial amount of time and dedication. Student evaluations in past years indicate that the work load for this course is *very* heavy and the subject matter is very difficult.

Unlike introductory courses, this course deals with real world cases where the information is not complete to make a decision to 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, this course is not for you.

Academic Integrity and Code of Ethics:

Most case materials in this course are based on real companies and transactions. In preparing for class discussions or presentations, you may use any publicly available past or current information about the companies covered in cases. You are strongly encouraged to study cases in a study group. Any submitted assignments for grading should be your own. In case of group work, it should be your group's joint work only. Each member of your group is expected to contribute equally to group work.

Any use of previously distributed graded materials from this course, including old exams are, however, not allowed. 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 any purpose. Furthermore, you are not allowed to see old exams unless provided by your professor. 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.

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:

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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 TO VALUATION THEORY AND CAPITAL STRUCTURE

A. DCF Methods for Valuation

1.1&1.2 Lecture: Capital Structure and Valuation Theory

Readings: BD, Chapters 10-16 and 31
Class Notes #3&4 (posted in the Course Materials Folder at Canvas)
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"

2.1&2.2 Case: M&M Incorporated (On Canvas: Syllabus Courses & Teaching Notes)

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

Readings: BD Chapters 4-9
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
Higgins, Chapters 7-9

- 3.1** Case: Empirical Chemicals A&B
3.2 Case: Marriott Corporation
4.1 Case: Galveston Fishing Company (On Canvas: Syllabus Courses & Teaching Notes)
4.2 Case: Southport Minerals

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

II. CORPORATE FINANCING DECISIONS

Readings: Higgins, Chapter 5 and 6
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

- 5.1** Case: American Chemical
5.2 Case: American Chemical

6.1/6.2	MIDTERM EXAM
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III. OPTION VALUATION APPROACH TO CAPITAL INVESTMENTS

- 7.1/7.2** Lecture: Review of Black and Schole's Model for Option Valuation I
- Reading: BD, Chapters 20-22
Koller, et al., Chapter 20
Class Notes: Review of Option Pricing Theory (Posted on Canvas)
"Teaching Note, Capital Projects as Real Options: An Introduction"
"The Options Approach to Capital investments" by Dixit and Pindyck
- 8.1** Case: Chrysler's Warrants
- 8.2** Case: MW Petroleum

IV. MERGERS AND ACQUISITIONS AND CORPORATE RESTRUCTURING

- Reading: BD, Chapters 18, 28-29
Koller, et al., Chapter 15 and 16
- 9.1/9.2** Case: Philip Morris
- Readings: "Valuation by Multiples" by Benninga and Sarig
Koller, et. al., Chapter 12
- 10.1** Case: RJR Nabisco
- 10.2** Case: Conrail A&B
- 11.1 Case: Privatization of SFM in Poland
- 11.2 Lecture: Review

12.1/12.2	FINAL EXAM
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FNCE 726.701: AVANCED CORPORATE FINANCE COURSE SCHEDULE:
FALL 2016
(As of August 9, 2016)

Session #	Date	Topic	Assignment
1.1	Sep 01	Capital Structure and Valuation Theory	Lecture (Class Notes #3-4)
1.2	Sep 01	Capital Structure and Valuation Theory	Lecture (Class Notes #3-4)
2.1	Sep 02	M&M Incorporated	Lecture and Case discussion
2.2	Sep 02	M&M Inc. and Asset Pricing Models	Lecture and Case discussion
3.1	Sep 30	Empirical Chemicals	Case Discussion
3.2	Sep 30	Marriott	Required written assignment 1
4.1	Oct 01	Galveston Fishing Co.	Required written assignment 2
4.2	Oct 01	Southport Minerals	Case discussion
5.1	Oct 14	American Chemical	Required written assignment 3
5.2	Oct 14	American Chemical	Required written assignment 3
6.1	Oct 15	MIDTERM EXAM	In Class
6.2	Oct 15	MIDTERM EXAM	In class
7.1	Oct 28	Option Pricing Review	Lecture (Class Notes on Options)
7.2	Oct 28	Option Pricing Review	Lecture (Class Notes on Options)
8.1	Nov 11	Chrysler	Required written assignment 4
8.2	Nov 11	MW Petroleum	Case discussion
9.1	Nov 12	Philip Morris	Case discussion
9.2	Nov 12	Philip Morris	Case discussion
10.1	Nov 18	RJR Nabisco	Required written assignment 5
10.2	Nov 18	Conrail A&B	Case discussion
11.1	Dec 03	SFM	Case discussion
11.2	Dec 03	Review	Lecture
12.1	Dec 17	FINAL EXAM	In Class
12.2	Dec 17	FINAL EXAM	In Class