

SYLLABUS FOR CORPORATE FINANCE

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COURSE DESCRIPTION

Welcome to *Corporate Finance* at Peking University HSBC Business School! In this course, we will focus on “valuation,” i.e., understanding the value implications of investment and financing decisions that firms make. By the end of this course, you should be able to:

- Evaluate corporate projects and make decisions based on financial data.
- Analyze a firm's financial statements and value the firm.
- Understand how investment and financing decisions impact the value of the firm.
- Develop complex spreadsheet models in Excel.

We will build on the time value of money concepts and risk and return concepts that you have learned in earlier finance courses. However, this class is much more detailed and practical. As you will see, a significant component of the grade comes from real-life projects, which require complex spreadsheet modeling in Excel. Even the in-class exercises and exams will focus on applications of concepts to solving real-life problems faced by businesses. We will also make extensive use of some of the accounting concepts. So it's a good idea to brush up on your accounting concepts, specifically, the organization of the balance sheet and the income statement.

COURSE MATERIAL

- “Corporate Finance” by Ross, Westerfield and Jaffe, McGraw-Hill Inc., 9th edition (RWJ)
- “Excel Modeling and Estimation in Corporate Finance (Third Edition),” by Craig W. Holden.
- Lecture notes, assignments, and other useful information will be posted on the course web page at <http://www.danskim.com/cf.html>. You are expected to download and print the required material before coming to the class.
- Course packet: Administrative office (Room 113) has a copy of the course packet. You are required to make a photocopy of the course packet.

CLASS FORMAT

The course is a mix of lecture and discussion. Lecture notes and excel files must be downloaded from the course website before class. I expect students to come to class prepared for active participation. Class attendance is strongly encouraged and is required during group presentations. To make the most efficient use of limited class time, students who miss a class or are late are responsible themselves for getting notes, assignments, and announcements from their classmates. It is your responsibility to keep yourself informed of important developments pertaining to the course. Keeping your University email account updated is important. We do problems in class, so bring a calculator. A basic financial calculator is best, though a good basic scientific calculator that does powers is fine. Solutions to in-class exercises will not be distributed or posted.

Please remember to turn off your cell phone before class. No notebook computers are allowed in the classroom.

GRADING

The grades for this course are determined on a relative basis (i.e., your grade will depend on where you stand with respect to the rest of the class). Grades will be determined as follows:

| Component | Weightage |
|---|------------------|
| Two Group Projects: | |
| Project 1 | 10% |
| Project 2 | 20% |
| Presentation of Project 2 | 10% |
| In-class group assignments & participation: | 20% |
| Exams: | |
| Mid-term Exam | 20% |
| Final Exam | 20% |
| Total | 100% |

EXAMS

You will be required to take two exams -- one mid-term exams and a final exam. All of these are **closed-book, closed-notes exams**, and will only focus on material covered in class since the last exam (i.e., all exams including the final exam are **non-cumulative**). You will be provided with a sheet containing the important formulae. You must bring your own calculators though.

Two remarks on exams. First, no computers or programmable calculators are allowed. Second, you may use a financial calculator, but you must nevertheless convince me that you know what you are doing: just writing down a result or the variables you keyed in is not convincing, you should write down both the correct formula and the correct result. **If your answer seems unconvincing, you won't get full credit, even if the numbers are right.**

If you anticipate any conflicts with the exam times, you must inform me by the end of the second week of the course so that I can schedule an *early* exam for you. *Do not make any travel plans or schedule job interviews that conflict with exam times, especially the final exam; I will not accept that as a legitimate conflict.* You have to take the final exam at the designated time and place.

What if you miss an exam?

- I do not offer make-up exams. If you miss the mid-term exam because of a valid reason (described below), the credit for that exam *will be redistributed over the final exam*.
- Please understand that I am **not offering you an option** to miss a mid-term exam that you can exercise at will. You may miss a mid-term only for a valid reason: *family or health emergency, backed by documentary evidence*¹ (phone calls from parent(s) will not suffice).
- If you miss a mid-term exam, you must notify me immediately (by email) and provide the necessary documentation within a week's time. If you fail to do so or if you miss a mid-term for non-valid reasons, you will get a score of 0 on it, without any grade redistributions.
- Missing the final exam will automatically result in the course grade of 0 no matter how good you performed prior to the final exam.

Even if some medical/family problem does arise, you should try and resist the temptation of missing a mid-term exam because:

- You diversify your risks better if you take two exams.

¹ At a minimum, a signed note from the doctor/ nurse on an official letterhead attesting that you were advised a day's rest. It is not enough to show me a slip proving that you visited a clinic.

- We cover more and more difficult topics as we progress through the semester. You might find the Final more difficult than Mid-Term.

PROJECTS

You have to complete two group projects as part of this course. In Project 1, you will analyze a corporate project and determine the best investment for a firm. In Project 2, you will value a firm of your group's choice. Both projects require spreadsheet modeling using Excel.

For Project 2, each group will value a different firm. You will get a chance to indicate a choice of a firm (from a list of firms that I will make available) that your group would like to value. You will get to value a firm of your choice as long as your preference doesn't clash with anybody else's. In case of a clash of preferences, I will do the allocation of firms.

These projects are expected to be professional work, and presentation is as important as the content. At a minimum:

- All text should be typed and presented in a case-like format. You should include a cover page with project title, and names of group members. The project report should be stapled or submitted in a folder.
- Apart from a *one-paragraph abstract* summarizing your findings, the report should have at least *three sections*:
 1. *Introduction*: Explain and motivate your research project. Discuss expected results. The reader should get the big picture about your project after reading the introduction.
 2. *Data and Analysis*: Discuss the project and procedures used in detail. This part can consist of several subsections. These subsections should be labeled, and must contain a brief description immediately preceding the spreadsheet and qualitative analysis.
 3. *Conclusion*: Summarize your results; keep it brief.
- Tables and figures must be clearly labeled, and must contain a description of the analysis. Each table or figure must fit on one page, or be separated in a logical manner. Tables and figures may either be incorporated into the text or included separately in the Appendix. Make sure you refer to each table and figure within the text.
- An Excel formula sheet attached in an appendix (i.e. re-print with formulas showing by using Tools/Options/View/Formulas and lengthening cells). You should also print this to expose the column and row headings (letters and numbers in Excel).
- *Submit a CD containing all your Excel files* along with the project report. The grader will use this to verify that your analysis has been done correctly.

Each group will get around 15 minutes to make its presentation of Project 2. Presentations must be concise, and must focus on analysis and results. Your presentation grade will depend on how well you defend your valuation technique. *Attendance on all presentation days is mandatory (even if your group is not presenting), and will be reflected in your Project 2 grade.*

Groups: Projects will be done in *groups of 5 members*. Please note that I will not adjudicate any intra-group disputes. Learning to cope with intra-group conflicts is part of your training.² Of course, you will get an opportunity to submit *confidential evaluations of your group members*, when you take your final exam (Specific guidelines for the evaluation will be provided along with the final exam). Each student's project grade will be adjusted to reflect these evaluations.

Following are the *important deadlines* pertaining to the projects. To receive full credit, submit the project at the beginning of class on the date it is due; late projects will be penalized **significantly**.

² Once groups are assigned, it is your responsibility to figure out who your group members are, how to contact them, etc. I will only grade one report submitted by the entire group, and will not accept multiple reports by factions within groups.

| Task | Deadline |
|--------------------------------------|----------------------------|
| Submission of requests for Project 2 | September 15 th |
| Submission of Project 1 report | September 22 th |
| Submission of Project 2 report | October 27 th |
| Presentations of Project 2 | November 2 nd |

CASES AND READINGS

There are two cases and nine academic papers assigned for this course this year. You are required to read, understand, and discuss the cases with your group members before you come to the case discussion day. Active participation is expected on the case discussion day, and those who do not participate will be penalized. The nine academic papers assigned to this course will help you understand the corporate finance topics we will be learning this module. You are not required to thoroughly understand the papers, however, it is highly recommended that you read at least the abstract and the introduction part of the papers. We will touch upon these papers if time permits, and if you participate in the discussions on these papers, you will get extra credits. For those of you who intend to write thesis on corporate finance, it might be a good choice to read the whole paper to get a better idea how to write your thesis.

IN-CLASS GROUP ASSIGNMENTS AND PARTICIPATION

There is only one way to learn valuation concepts, and that is by repeatedly applying them to solve real-life problems faced by businesses. Every new concept we learn will be applied to a real-life example (a small numerical problem, a mini-case, or a full-fledged case), which we will collectively solve in the class. You are expected to attend the class, actively participate in this exercise, and take down notes; *I will not post any solutions to in-class examples on the web page.*

Every now and then, I will assign one of these examples as an in-class group assignment, and will give each group 10-15 minutes to collectively solve the problem on a piece of paper. I will then grade your submissions, which will contribute to the “in-class group assignments and participation” component (5% weight) of your overall grade.

Note that the in-class assignment is not a surprise quiz; it is only meant to be an active participation exercise, and will be graded accordingly. *Needless to say, if you miss a class, you will miss out on any in-class assignments assigned that day. Regardless of the reasons for your absence, there will be no make-up assignments.*

MISCELLANEOUS INFORMATION

Integrity and Academic Dishonesty: All students enrolled in a course taught through the Peking University HSBC Business School are expected to uphold the highest standard of academic honesty. Activities violating the standards will result in a **Fail**. I wish to specifically draw your attention to the plagiarism: *“Plagiarism is defined as presenting someone else’s work, including the work of other students, as one’s own. Any ideas or materials taken from another source for either written or oral use must be fully acknowledged...”* It is very important to keep this in mind as you submit your project reports. Please ensure that you cite every source of information you use (say analyst reports, Wikipedia, etc.).

CLASS SCHEDULE

This is a tentative schedule, and is subject to change (not the exam or submission dates, though).

| <i>Class Number</i> | <i>Topics Covered</i> | <i>Required Reading and Assignments</i> |
|---------------------|--|---|
| 1 (Sep 1) | <u>Introduction</u> <ul style="list-style-type: none"> • Syllabus • Organizational Forms <u>Review Financial Tools</u> <ul style="list-style-type: none"> • Valuation Basics • Time Value of Money • Inflation | Syllabus RWJ Ch 1 RWJ Ch 6 |
| 2 (Sep 4) | <u>Cash Flow Analysis</u> <ul style="list-style-type: none"> • Effects of Accrual Accounting • Free Cash Flow | |
| 3 (Sep 10) | <u>Capital Budgeting</u> <ul style="list-style-type: none"> • Incremental Project Cash Flow • Net Present Value & others <u>Comparing Projects</u> <ul style="list-style-type: none"> • Projects of Equal Life • Equivalent Annual Cost • Setting the Bid Price <u>Explanation of Project 1</u> | RWJ Ch 10 |
| 4 (Sep 11) | <u>Project Analysis</u> <ul style="list-style-type: none"> • Managerial Options • Scenario Analysis • Sensitivity Analysis • Spreadsheet Modeling | RWJ Ch 10 & 11 Holden Ch 12 & 13 |
| 5 (Sep 15) | <u>Discounted Cash Flow Valuation</u> <ul style="list-style-type: none"> • Sequential Valuation <u>Projecting Sales Growth</u> <ul style="list-style-type: none"> • Trends in sales growth • Relation to Industry • Economic Analysis: Regressions <u>Explanation of Project 2</u> | PROJECT 2 COMPANY REQUESTS DUE ON SEPTEMBER 15 |
| 6 (Sep 18) | <u>Financial Statement Analysis</u> <ul style="list-style-type: none"> • Ratio Analysis • Dupont Identity • Operating Leverage <u>Multiples Valuation</u> <ul style="list-style-type: none"> • Definition of Market Ratios • Price-Earnings Ratio | RWJ Ch 3 Holden Ch 15.4 & 16 |

| <i>Class Number</i> | <i>Topics Covered</i> | <i>Required Reading and Assignments</i> |
|---------------------|--|---|
| 7 (Sep 22) | <u>Financial Modeling</u> <ul style="list-style-type: none"> • Relation between Financial Statements • Solving by iterations • Financing with Debt • Maintaining debt-equity ratios • Using Cash Reserves | Holden Ch 15 Download files from web for class PROJECT 1 DUE |
| 8 (Sep 25) | <u>Cost of Capital</u> <ul style="list-style-type: none"> • WACC without taxes • WACC with taxes • Divisional WACC <u>Capital Structure (I): Perfect Market</u> <ul style="list-style-type: none"> • Assumptions • Proposition I: WACC • Proposition II: Cost of Equity • Business and Financial Risk • Unlevering Beta <u>Discuss Midterm</u> | RWJ Ch 15 Graham and Harvey (2001) |
| 9 (Sep 29) | <u>Capital Structure (II): Imperfect Market</u> <ul style="list-style-type: none"> • WACC with Taxes • WACC with Bankruptcy Costs • Incorporating Changes in Leverage • Value of Levered Firm • Dollar gain from Tax Benefit • Dollar cost due to Bankruptcy <u>Capital Structure (III): The Real World</u> <ul style="list-style-type: none"> • Agency Costs: Debtholders and Shareholders • Agency Costs: Managers and Shareholders • Discuss <i>Capital Structure Puzzle</i> | RWJ Ch 15 RWJ Ch 16 RWJ Ch 17 Graham and Leary (2011) |
| 10 (Oct 9) | <u>Raising Capital</u> <ul style="list-style-type: none"> • IPOs • Private Equity Market • Rights • Corporate Bond | RWJ Ch 20 HBS Case: IPO Process Ritter (2001) |
| 11 (Oct 12) | <u>Mergers and acquisitions</u> <ul style="list-style-type: none"> • Forms of acquisitions • Synergy and coinsurance effects • Financing acquisitions • Empirical evidence | RWJ Ch 29 Golubov et al (2012) |
| (Oct 16) | MIDTERM | In the classroom, during class time |

| <i>Class Number</i> | <i>Topics Covered</i> | <i>Required Reading and Assignments</i> |
|-----------------------------|---|---|
| 12 (Oct 22) | <u>Payout Policy</u> <ul style="list-style-type: none"> • Types of Dividends • Irrelevancy of Dividends • Taxes • Stock Repurchases • Dividend Clienteles • Signaling | RWJaffe Ch 18 Brav et al (2005) |
| 13 (Oct 23) | <u>Agency cost and Information Asymmetry</u> <ul style="list-style-type: none"> • Debt Holder-Equity Holder Conflicts • Equity Holder-Manager • Convertibles • Capital Structure • Payout Policy | Lecture notes Malmendier and Tate (2005) |
| 14 (Oct 27) | <u>Introduction to VC and PE</u> <ul style="list-style-type: none"> • Fund Structure • Geography of VC/PE • Financial Contracting • Exit Strategy | Google Case Linear Technology Case PROJECT 2 DUE |
| 15 (Oct 30) | <u>Case Discussion: Google</u> <u>Case Discussion: Linear Technology</u> | Lecture notes Hochberg et al (2007) Metrick and Yasuda (2010) |
| (Nov 2) 2:00-6:00 | Group Presentations MANDATORY ATTENDANCE DAY | |