

Master in Finance

Corporate Finance (Investment Appraisal)

Fall 2018

1. FACULTY

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2. COURSE DESCRIPTION

This course presents the foundations of corporate finance with an emphasis on applications that are vital for corporate managers who are responsible for making significant strategic financial decisions.

Capital investments, corporate financial structure and dividends policies are part of those strategic finance decisions that significantly affect the company's operations, financials, returns and risk. The concept of net present value is used to analyze how these decisions affect the value of the firm.

The course covers topics that interact with other areas of the company such as operations management, marketing and corporate strategy.

The course is not designed to dwell on theory and abstraction, however the basics of financial theory is a prerequisite to a competent analysis, intellectual discussion and appropriate decision.

We will emphasize the development of problem-solving skills based on the business environment, using case-studies for this development, as opposed to pure theory and mindless exercises.

Students will be exposed to the real world and from there be able to get critical information for corporate financial decisions.

3. LEARNING GOALS

The students will be able to:

1. Estimate the cost of capital of companies (both quoted and private) and investment projects;
2. Evaluate capital budget projects based on sound financial theory;
3. Decide the allocation of capital considering the existing of the portfolio investment opportunity;
4. Analyze, discuss and decide on the capital structure adequate to the strategy and risk appetite of the firm.
5. Define a dividend policy in the context of the corporate strategy
6. Evaluate a company's operating and financial risk.
7. Assessing the performance of the company

4. COURSE OUTLINE

1. Introduction
 - 1.1 The finance function and the CFO
 - 1.2 Time value of money and the goal of the firm

2. Assessing Business Performance (Financial Statement Analysis)
 - 2.1. The managerial balance sheet
 - 2.2. Traditional measures of liquidity
 - 2.3. Liquidity based on the funding structure of working capital
 - 2.4. Improving liquidity through better management of the operating cycle
 - 2.5. Financing strategies
 - 2.6. Assessing profitability
 - 2.7. Assessing operating and financial risk
 - 2.8. Analyze the shareholders' value creation

Case study assigned for evaluation: UNILEVER, PLC

3. Estimating the Cost of Capital
 - 3.1. Identifying proxy or pure-play firms
 - 3.2. Debt Ratings
 - 3.3. Estimating the cost of debt
 - 3.4. Estimating the cost of equity using dividend discount model
 - 3.5. Estimating the cost of equity using capital assets pricing model
 - 3.6. Estimating beta and determining a project beta
 - 3.7. Country risk
 - 3.8. Levered and unlevered beta
 - 3.9. Estimating the cost of capital of a firm (levered and unlevered)
 - 3.10. Estimating the cost of capital of a project
 - 3.11. Marginal cost of capital schedule
 - 3.12. Flotation costs
 - 3.13. What is the most common practices by CFOs?

Case Study on the Cost of Capital: TELUS

Case study assigned for evaluation: APPOLO TYRES

4. Capital Budgeting
 - 4.1. The capital investment process
 - 4.2. Investment appraisal metrics: Payback period, NPV, IRR, Modified IRR, Profitability Index and Equivalent Annual Annuity
 - 4.3. Why inflation matters
 - 4.4. Special cases of capital budgeting: Comparing projects with unequal cash timings, unequal sizes, unequal life spans, unequal risks, corporate budget constraints
 - 4.5. Why NPV is more reliable than other metrics: Measures value creation, Adjusts for timing of cash flows, Adjusts for risks of projects cash flow and is Additive

- 4.6. Replacement decisions
- 4.7. Identifying and estimating a project's relevant cash flows
- 4.8. Which NPV model to use: WACC,
- 4.9. Risk analysis methods: Sensitivity analysis, NPV break-even analysis, Scenario analysis, Monte Carlo simulations, Tornado analysis
- 4.10. Limitations of NPV criterion: Managerial or real options embedded in investment projects

Case Study on Capital Investment Analysis: New Heritage Doll

5. Designing a Capital Structure

- 5.1. Difference between financial structure and capital structure
- 5.2. The analysis of financial structure and capital structure
- 5.3. The capital structure decision in a world without taxes and financial distress costs
- 5.4. The capital structure decision in a world with corporate income taxes but without financial distress costs
- 5.5. The capital structure decision when financial distress is costly
- 5.6. Formulating a capital structure policy: Exploring the trade-off model, costs of asymmetric information, pecking order theory, agency costs and tax shield
- 5.7. Evaluating capital structure policy: Balancing equity and debt; short term and long term debt; currencies; and variable and fixed rate
- 5.8. Leverage in an international setting

Case Study on Designing a Capital Structure: RM Furniture Kraft (A) and (B)

6. Dividend policy and share repurchasing

- 6.1. Analysis of the dividends policy
- 6.2. Dividends policy, capital structure and sustainable growth rate
- 6.3. Comparison between of dividends and share repurchasing
- 6.4. The tax disadvantage of dividends
- 6.5. The clientele effect
- 6.6. Payout versus cash retention
- 6.7. Signaling with dividends policy
- 6.8. Share dividends, splits and spin-offs

Case Study on Dividends Policy: Strong Motors

5. TEACHING METHODOLOGY

The course uses analytical framework and case studies to introduce key issues of corporate finance.

Students have to explore real data for writing up two cases studies in syndicated group. One on cost of capital and other assessing the business performance of a company..

6. BIBLIOGRAPHY

CFA READINGS

Corporate Finance - Level I:

- Reading 35 – Capital Budgeting
- Reading 36 – Cost of Capital

- Reading 37 – Measures of Leverage
- Corporate Finance - Level II:
- 21 – Capital Budgeting
 - 22 – Capital Structure Policy
 - 23 – Dividend Policy and Share Repurchasing

BOOKS

Any widely accepted Corporate Finance textbook is accepted, as they cover reasonably well the course content. A sample would be:

Berk and DeMarzo, Corporate Finance, 4th Ed., Pearson, 2017.

Brealey, Myers and Allen, Principles of Corporate Finance, 12th Ed., McGraw-Hill, 2017.

Hawawini and Viallet, Finance for Executives: Managing for Value Creation, 5th Edition, Cengage Learning, 2015.

Hillier, Ross, Westerfield, Jaffe and Jordan, Corporate Finance, 1st European Edition, 2010.

Ross, Westerfield, Jaffe and Jordan, Corporate Finance, 11st Ed., 2016.

Notes:

1. Berk and Demarzo is also used in the course “Corporate Financial Planning”.
2. Hawawini and Viallet, is very practical oriented with a modern approach to corporate finance.

ARTICLES

Kester, C. and Luehrman, T. (1992), The Myth of Japan's Low-Cost Capital, *Harvard Business Review*, May-Jun, Vol. 70 Issue 3,130-138.

Luehrman, T. (1997), What's it Worth?: A General Manager's Guide to Valuation., *Harvard Business Review*, Mai-Jun, 132-142.

Luehrman, T. (1997), Using APV: A Better Tool for Valuing Operations?, *Harvard Business Review*, Mai-Jun, 145-154.

Luehrman, T. (1998), Investment Opportunities as Real Options: Getting Started on the Numbers, *Harvard Business Review*, Jul-Aug, Vol. 76 Issue 4, 51-67.

Luehrman, T. (1998), Strategy as a Portfolio of Real Options, *Harvard Business Review*, Sep-Oct, Vol. 76 Issue 5, 89-99.

7. COURSE ASSESSEMENT

In the **Continuous Evaluation System**, the final grade is based on multiple criteria weighting as follow:

- Two Group Case Write-Up (15% each) 30%
- Final Exam (Época Normal) 70%

Case studies for evaluation consists of analyzing, solving and writing up two case studies. Students are organized in syndicated groups of three to five members and will prepare a written report (hard copy), together with an Excel spreadsheet (sent by email to jcneves@isegulisboa.pt). The hard copy can be in Word or a self-explaining PowerPoint presentation. Students must be prepared for discussion if needed.

It is a requirement to pass to get a minimum of 9.5 out of 20 in the final exam.

The Final Exam (Época Normal/First Sit) is for those students in the Continuous Evaluation System, as those that do not submit the cases, are graded 0 (zero) for the cases.

The final grade is the highest between the final exam and the weighting of the continuous evaluation system.

The Final Exam (Época de Recurso/Second Sit) is for all students and the final grade is based exclusively in this exam.

Students with a higher grade than 17 (under any evaluation system) may be required to defend their grades in an oral exam.

FINAL EXAM DATES

Época Normal/First Sit: 8th January 2019 at 09:00 a.m.

Rooms: Floor 0 of the Library Building and Room 101 of Francesinhas Building 1

Época de Recurso/Second Sit: 1st February 2019 at 09:00 a.m.

Room: 214 of Francesinhas Building 1.

CLASSES:

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| Group S42 | Mondays and Wednsdays from 10:00-11:30
Room Anf 22 (1 st Floor, Francesinhas Building 1) |
| Group S12 | Mondays and Wednsdays from 11:30-13:00
Room Anf 21 (1 st Floor, Francesinhas Building 1) |