

Master in Finance

Corporate Investment Appraisal/Corporate Finance

Fall 2020

1. FACULTY

João Carvalho das Neves, Professor of Leadership & Finance, ISEG

Office: Room 605, Building at Rua Miguel Lupi 20

Email: jcneves@iseg.ulisboa.pt

2. COURSE DESCRIPTION

This course presents the foundations of corporate investments and corporate finance with an emphasis on applications that are vital for corporate managers who are responsible for 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. Assessing the performance of the company
2. Evaluate a company's operating and financial risk.
3. Estimate the cost of capital of companies (both quoted and private) and investment projects;
4. Evaluate performance based on economic value added
5. Evaluate capital budget projects based on sound financial theory;
6. Decide the allocation of capital considering the existing of the portfolio investment opportunity;
7. Analyze, discuss and decide on the capital structure adequate to the strategy and risk appetite of the firm.
8. Define a dividend policy in the context of the corporate strategy

4. COURSE OUTLINE

1. Introduction
 - 1.1 The finance function and the CFO
 - 1.2 Corporate value, 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

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: Unilever, PLC

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 to use: WACC, APV or Equity Flow Approach?

- 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: The Yellow Snow Dilemma

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: Blaine Kitchenware Inc.

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: Whirlpool

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 one case study in syndicated group. One assessing the business performance of a company including the cost of capital

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

RECOMMENDED BOOK

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

Clayman, M. et al. (2012), *Corporate Finance: A Practical Approach*, Wiley, CFA Institute Investment Series

OTHER BOOKS IN CORPORATE FINANCE

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

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

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

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

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:

- Case study on Assessing Business Performance: 20%
- Short exercises during the class: 20%
- Final Exam in class (First sitting): 60%. If some students because of health restrictions the school limits the classes to on-line, the exam is substituted by an individual interview

The Final Exam (Normal Phase/First Sitting) is for those students in Continuous Evaluation System. It is a requirement to pass to get a minimum of 9.5 out of 20 in the final exam.

The Appeal Final Exam (Second Sitting) is for all students that are not in Continuous Evaluation System and for the students that fail the first sitting exam or want to improve the grade obtained in the first sitting exam.

Students with a higher grade than 16 (under any evaluation system) may be required to defend their grades in an oral exam.

FINAL EXAM DATES

First Sitting: 5 January 2021 at 09:00 a.m.

Rooms: To be defined

Second Sitting: 1 February 2021 at 09:00 a.m.

Room: To be defined

CLASSES:

- Group S12 Mondays from 10:00 to 13:00
 Room Anf 21 (1st Floor, Francesinhas Building 1)
- Group S42 Tuesdays from 10:00 to 13:00
 Room Anf 22 (1st Floor, Francesinhas Building 1)