Course Description And Objectives

Using the case method, Fin 653 brings financial management decisions from the business world to the classroom. The case method helps students develop decision-making skills in unstructured, uncertain, and complex (i.e., realistic) situations. The assigned cases cover a broad range if financial analysis with an emphasis on strategic valuations (mergers, acquisitions, and restructurings) and corporate financial strategy. The course is integrative in nature, with special attention to the integration of theory and managerial judgment.

Student Learning Outcomes

- Capital budgeting and resource allocation
- Management of the corporate capital structure
- Evaluate corporate projects using scenario, sensitivity, and simulation analysis
- Analysis of corporate acquisition; valuing enterprise, form of payment, and form of financing
- Application of option pricing theory in project valuation

Textbook And Materials

Robert Bruner (Darden School) and Harvard cases (selected packet available at university book store)

Lecture Notes (downloadable from my website)

Prerequisite

The specific prerequisite is BA 665 or equivalent. A single undergraduate introductory finance course, by itself, is not sufficient preparation for this course.
**Format**

Classes are divided between presentation and lecture/discussion sessions with emphasis on case presentations. The primary focus of presentation sessions is the analysis and discussion of a case. The focus of lecture/discussion sessions is to review, expand on, or introduce relevant topics.

**Administrative Notes**

**Grades.** Grade components are weighted as follows:

- 60% case presentations (20% x 3)
- 10% Attendance
- 20% Participation
- 10% Strategy Paper

Daily classroom work is evidenced primarily by participation in case discussions.

**Attendance.** Most of the learning from your case assignments takes place in the dynamic atmosphere of the case presentation and the ensuing discussion. Accordingly, attendance at case-presentation sessions is required.

**Peer Evaluation.** At the end of each presentation, I will ask you to fill out a form to evaluate the degree to which member of your group has contributed to the group’s efforts. No grades will be increased based on these evaluations. The teamwork portion of the grades of low contributors will be reduced.

**Consultation.** I will be glad to help you with any questions of a general nature that pertain to this course and to your cases. However, you should be aware that I will not address certain types of case-specific questions. I will not, for example, give advice on the best approach to a case, nor will I pre-approve any assumptions your group may be considering, not will I attempt to resolve any ambiguities in the cases.

**Risk analysis.** Risk analysis is an essential part of all financial analysis. You are expected to use risk-analysis techniques to test the robustness of your results to reasonable variations in key underlying assumptions. In the modern business world point estimates of important decision variable are seldom sufficient. A reasonable range of values is required. A particular requirement of this course is that simulation be one of the risk-analysis techniques used in every case solution.

**Strategy Papers.** Strategy papers are individual assignments. Each student on group assigned a strategy paper will write a two-page (single space) paper providing a methodology that could be followed to actually solve the case. The strategy paper is not an actual solution to the case – it should simply explain how one would go about solving the case, step by step. Thus, the strategy paper is procedural. The strategy paper should skip background details and deal only with recommended procedures. The level of detail that is appropriate in describing the procedures depends upon the objective of the particular case.
**Case Presentations**

We will analyze 12 cases in detail. You should form a group of 3 students. No later than 12 hours before class, the Presentation Group will provide the case solution to the Instructor via email attachment. All presentation and **supporting spreadsheet files** will be provided at this time.

The Presentation Group will come to class prepared to present the assigned case. At the beginning of class, the Presentation Group will provide a paper copy of all final **Power Point (2 slides per page)** and **Spreadsheets** to the instructor. The Presentation Group will assume the role of a team of outside consultants who have been hired by the Corporate Headquarters Group (class) to present independent recommendations and a solution to the problem at hand. All of the assumptions necessary to solve the case should be collected together and displayed on one or more sequential transparencies. The Presentation Group will have 40 minutes in which to make their formal presentation. With the exception of requires for clarification, the Group will be uninterrupted during its presentation. After the Presentation Group had finished, the Headquarters Group will become involved in an unrestricted question and answer session.

It is important to limit presentation time to 40 minutes to allow sufficient time for class discussion and my concluding comments. As a general guideline, we will allow 40 minutes for the presentation, 20-25 minutes for the question and answer session, and 5 minutes for my concluding comments.

I will generally limit my closing comments to one or more of the following areas.

- The Appropriateness; The approach to the case and the reasonableness of assumptions.
- Internal consistency; were the groups’ solution and conclusions generally consistent with their approach and their assumptions?
- Relevant generalizations or extensions.
- The historical outcome of the case (if available).

A typical request at the end of a case discussion is – “What is the answer?” Let me emphasize that the case method does not provide **THE ANSWER**. Unlike deterministic end-of-chapter problems, cases are complex statements of real-world situations and they will invariably have multiple variable answers. In spite of the apparent precision of our quantitative models, financial analysis is not an exact science. Different sets of assumptions will produce different answers, even if the same analytical models are used. Qualitative issues will often be important, and different interpretations of qualitative issues can reasonably be drawn and defended. In general, there is no single, **correct answer to complex business problems**. A good case begins the questioning process, not ends it. In the final analysis, what any one person would have done – or even what actually happened – are not very significant. What is important, is that you know what you would have done in a specific situation. Ultimately, in the case method, the question, not the answer, is the key to effective learning.

**QUESTIONS AND REFERENCES FOR ASSIGNED CASES**

A serious of questions for each case is provided below to direct your attention and guide your analysis. I want you to address these questions, but do not feel constrained by them. There may be important issues not addressed by these questions that need to be dealt with in your analysis.
1. **Teletech Corporation**
   1. How does Teletech currently use the hurdle rate?
   2. Please estimate segment WACCs for Teletech (see the worksheet in case Exhibit 1). As you do this, make careful note of points of judgment in the calculation.
   3. Interpret Rick Phillip’s graph (Figure 2 in the case). How does the choice of constant versus risk-adjusted hurdle rates affect the evaluation of Teletech’s two segments? What are the implications of this view? What are the arguments in favor? Opposed?
   4. Do you agree that “all money is green?” What are the implications of this view? What are the arguments in favor? Opposed?
   5. Is Helen Buono right that management would destroy value if all of the firm’s assets were redeployed into only the telecommunications business segment? Why or why not? Please prepare a numerical example to support your view.
   6. Has Products and systems destroyed value? What evidence or illustration can you give to support your opinion?
   7. What should Teletech say in response to Victor Yossarian?

2. **Coke vs Pepsi**
   1. What are the advantages and disadvantages of using EVA as a measure of company performance?
   2. Please examine the historical performance of Coke and Pepsi in terms of EVA.
   3. Calculate WACC for Coke and Pepsi. Assume tax rate of 35%.
   4. Calculate EVA for 2001 to 2003 using the forecasts given in the case and WACCs you have estimated.

3. **MCI Communication Corp: Capital Structure Theory**
   1. What message is MCI trying to send to financial markets?
   2. What will be the effects of issuing $2 billion of new debt and using the proceed to repurchase shares on:
      - MCI's shares outstanding,
      - MCI's book value of equity,
      - The price per share of MCI stock, and
      - Earning per share
   3. What is MCI's current (pre-repurchase) weighted average cost of capital (WACC)?
      What would you expect to happen to MCI's WACC if it issues $2 billion in debt and uses the proceeds to repurchase shares? Would you recommend that MCI increase its use of debt? If so, by how much?

4. **Rocky Mountain Advanced Genome Inc.**
   1. Please prepare to explain the implications of case Exhibit1 (Jan’s first task). Based on this exhibit, is terminal value a material component of firm value?
   2. Drawing on case Exhibit 4 and your own general knowledge, where would the various estimators be appropriate? (Jan’s second task).
   3. Regarding the cash-flow forecasts in case Exhibit 5, at what point in the future would you set the forecast horizon for the three investments? Why? More generally, what should determine when you stop forecasting annual cash flows and estimate a terminal value?
   4. Please estimate other terminal values based on alternative estimation approaches. What is the resulting present value of cash flows under Big Sur’s and RMAG’s outlook? How significant was terminal value in creating the difference between the two present-value estimates?

5. **Star River Electronics Ltd.**
   1. What is Star River’s WACC?
   2. Should Koh approve the packaging machine investment?
   3. How well has Star River done in the past? How healthy is it now?
   4. Can Star River repay the bank loan? How did you construct your financial forecast?
5. What are the key drivers of Star River’s forecasted financial need?

6. **General Mills Acquisition of Pillsbury**
   1. What are General Mill’s motives for this deal? Please estimate the present value of the expected cost savings.
   2. Why was the contingent payment included in this transaction? How does the “Claw-Back” affect the attractiveness of the deal from the standpoints of General Mills and Diageo?
   3. Draw the payoff diagram of the claw-back feature.
   4. What is the contingent payment worth in early December 2000?
   5. Is this deal economically attractive to General Mills’ shareholders? Would you recommend that shareholders approve or reject this deal?

7. **The Boeing 7E7**
   1. What is an appropriate required rate of return against which to evaluate the prospective IRRs from the Boeing 7E7?
      a. Please use the CAPM to estimate the cost of equity. At the date of the case, the 74-year equity market risk premium (EMRP) was estimated to be ____. Which beta and risk-free rate did you use? Why?
      b. Which capital-structure weights did you use and why?
   2. Judged against your WACC, how attractive is the Boeing 7E7 project?
      a. Under what circumstances is the project economically attractive?
      b. What does sensitivity analysis (your own and/or that shown in the case) reveal about the nature of Boeing’s gamble on the 7E7?
   3. Should the board approve the 7E7? Why or why not?

8. **JetBlue Airways IPO Valuation**
   1. What is an IPO and why is it such a big deal? Is this a good idea for JetBlue? Why?
   2. Calculate the value of JetBlue stock.
   3. What different approaches can be used to evaluate JetBlue stock.

9. **National Railroad Passenger Corporation**
   1. What is a financial lease? What advantages or disadvantages does it have over debt?
   2. What are the pros and cons of each of the three financing alternatives given in the case?
   4. Should the board approve the 7E7? Why or why not?

10. **Midland Energy Resources Inc**
    1. How are Mortensen’s estimates of Midland’s cost of capital used? How, if at all, should these anticipated used affect the calculations?
    2. Calculate Midland’s corporate WACC. Is Midland’s choice of EMRP appropriate? If not, what recommendations would you make why?
    3. Should Midland use a single corporate hurdle rate for evaluating investment opportunities in all of its divisions? Why or why not?
    4. Compute a separate cost of capital for the E&P and Marketing and Refining divisions. What causes them to differ from one another?
    5. How would you compute a cost of capital for the Petrochemical divisions?

11. **MW Petroleum Corporation (A)**
    1. Evaluate Amoco’s and Apache’s corporate objectives and strategies. Is it responsible to expect that the MW properties are more valuable to Apache than Amoco?
    2. Structure and execute a discounted cash flow valuation of all the MW reserves using APV. How much are the reserves worth? Is your estimate more likely to be biased high or low? What are the sources of biases?
3. How would you structure an analysis of MW as a portfolio of asset-in-place and options? Specifically, which parts of the business should be regarded as asset-in-place and which as options? What kinds of options are present? Should this approach yield a higher or lower value than the all-APV approach you employed above?

4. Execute the analysis you structured in question 3, beginning with the asset-in-place. How risky are the assets that underlie the options; i.e., how you estimate standard deviation for each? How much is the whole portfolio worth?

5. Assuming a sale goes through, how does Apache exercise each of the various options?

12. Petrolera Zuata, Petrozuata C.A.

1. How should PDVSA finance the development of the Orinco Basin? What are the costs and benefits of using project finance instead of traditional internal debt finance?

2. What are Petrozuata’s three or four most important operating risks? How does the deal structure address these risks? Who would bear these risks if the project were finance internally by PDVSA instead?

3. As currently envisioned, debt will comprise 60% of the funds needed for the project. Would you recommend a higher or lower leverage ratio? What happen to the minimum debt service coverage ratio and IRR as project leverage increases to 70% for project funds? Decreases to 50%?

4. Will project bonds receive an investment grade rating? What is the “weakest link” in the project?

5. As one of the sponsors, what are your expected returns? Please assume the asset beta for an integrated drilling, pipeline, and refining firm is 0.6.

6. What kind sensitivity analysis would you do to verify the project’s economics?

7. Would you invest project bonds? Would you invest equity capital as Conoco?
### Schedule for Presentation

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### Sequence of Lecture/Discussion Topics

Module 1: Valuation.

Module 2: Portfolio & CAPM.

Module 3: Capital Structure.
Module 4: Option

Module 5: Lease

Module 6: Project Finance