

**UNIVERSITY OF PENNSYLVANIA**  
**The Wharton School**

**FNCE 726: 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 who are interested in careers in corporate finance as members of the finance departments of an industrial corporation or the corporate finance group of an investment bank. The course extends the core theory introduced in Financial Analysis by emphasizing its practical applications to the strategic financial decision areas of a firm. Some students take this course as a capstone course. While it is also well-suited to students wishing to gain experience in applying the theory introduced in the Financial Analysis to real world case examples, this is not a remedial course in finance.

The theme of this course is value-based management. There has been remarkable progress in financial theory over the past twenty five years. As with all scientific disciplines, however, the theory often provides answers by stylized and simplified models of the real world. Financial techniques, although based on sound theoretical models, are not always perfect to deal with all the complexities of the real world. Value based management introduces coherence and consistency in dealing with complex real world problems despite the limitations of financial techniques. While our financial models may have errors in their predictions, they are still preferable to ad hoc financial decisions without any theoretical basis. The techniques surveyed in this course discipline managers by expressing key decisions in terms of their predictable impact on firm value.

The course consists of seven sections. The first four 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. Sections V and VI deal with dividend policy and security issuance. 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.

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 to tackle 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 value projects with highly levered capital structure 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 not only how to use them, but more importantly *when* to use them.

## Course Format

My sections of the course are taught entirely with cases except for a few review lectures on valuation theory and option pricing. The case method of instruction offers some distinct benefits. In preparing cases, you learn more than just the financial theory required to analyse 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 these 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 learning of all others.

The objective of the case method in finance is to use the logic of financial theory to arrive 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 and/or a paradigm that is proper for the problems encountered in a case.

To help manage your workload, you are encouraged to form groups of four students during the first week of class. Groups offer an invaluable opportunity to leverage your efforts with regard to calculation intensive study questions. They also enable you to try out ideas prior to class discussion. 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, 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:

R. Brealy and S. Myers, *Principles of Corporate Finance*, 7th Edition, Irwin, McGraw-Hill, 2003.

T. Copeland, T. Koller, and J. Murrin, *Valuation: Measuring and Managing the Value of Companies*, McKinsey & Company, Inc., John Wiley & Sons, Inc., 3<sup>rd</sup> Edition, 2000.

You most likely already own a copy of Brealy and Myer or a similar text from your previous finance courses. If you own a prior edition of this text, you should use it. If you own another corporate finance textbook that will suffice as well, though you have to figure out the relevant chapters.

Text by Copeland et. al. is a valuation book written from a practitioners' perspective. Several copies will be on reserve. You should purchase it only if you find it a useful addition to your library.

### Bulkpack

The course bulkpack from Wharton Reprographics contains all the cases and other recommended readings. In addition, students will be charged for class handouts that will be distributed regularly throughout the term

### webCafé

The course site at Wharton webCafé 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, such as office hours and rooms for teaching assistants, review sessions, exam, and guest speakers. webCafé is the information center for the course. Please check the course site regularly.

## 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 equally (25% each) on:

1. Class Participation
2. Written Case Reports by Groups
3. Midterm exam
4. Comprehensive Individual Case Report.

### 1. Class Participation

A goal of this course is to provide you with the opportunity to learn how best to contribute to discussions about complex financial issues. Corporate financial decisions are inevitably made in groups. In group setting, a well articulated expression of confusion is in some instances more valuable than an abruptly delivered “right” answer. Not having a background in finance, therefore, does not put you at a disadvantage with regard to class participation.

I will mark your class participation *daily* on a 0 to 4 point scale to maintain fairness and to minimize subjectivity in grading. *In determining your grades, I consider the degree to which your comments advance everyone’s learning.* 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 number of comments you make.

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 leaning 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. Case write-ups

There are eight written case assignments to be handed in as group reports throughout the semester. Four of those cases should be turned in before and the remaining three cases after the midterm exam. These reports will be graded on a scale from 1-5. Groups that provide a competent report will get a full credit, i.e., 3. Some exceptional reports will get bonus credit of 4 or 5. This will not exceed 10% of the teams for a grade of 4 and 5% for a grade of 5 on any case. Your case report should be in the form of an executive summary with a maximum of 4 pages. You may include your supporting computations and tables in an appendix.

Since you are preparing your reports in advance of class discussions, I will not grade your reports for “the correct” answer but on 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 Examination will be on **Wednesday, October 20, 2004 in class**. It is an “open book” and “open notes” exam. It will consist of problems similar to those in the cases. Course material prior to midterm reviews and extends most of the financial techniques that you learned in Financial Analysis course. Because of the need for fluency with these essential concepts and methods, you will be tested on them before we move to the second part of the course. The midterm exam is intended to be time-sensitive. Unless you meet regularly with your group and work through the cases analyses, you will be unable to complete the exam in two hours. No laptops are allowed in the midterm exam. You can use a financial calculator.

Copies of midterm exams with solutions from the last two years are available on webCafé.

Please note the scheduling of the midterm exam. You are responsible for ensuring that you are available and on campus to take the midterm exam. I will not allow anyone to take the exams at another time unless you are excused officially by the MBA office. If your travel plans conflict with the date of the exam, you should either change your travel plans now or enrol in a different section of the course.

### **4. Individual Case Report**

The final requirement of the course is a comprehensive individual case analysis. The case assignment will be either distributed in class or posted on webCafé on **Wednesday, December 1** and it is due in hard copy on **Monday, December 6**. It is not intended to be time-sensitive. The questions will be more open-ended than those in the midterm exam. To answer them, you will need to synthesize much of the material we cover throughout the course. Your work should demonstrate the mastery of knowledge you acquired in the course not only to me but also to yourself. We will devote the last week of classes to discussions of your results.

The individual report should be your own work. You cannot discuss the individual case assignment with anyone. You can use your class notes, but you can only use the information provided with the assignment.

All graded materials will be returned to your mail folders. Please indicate your section and date of graduation with your names on your written assignment and exams.

## **Attendance and Class Etiquette**

Students should attend the section of the class for which she is registered. In case of a conflict students can attend another of my section by permission. You can attend any of my sections during the dedicated interview week. 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 all times so that I get to know you and evaluate your class participations. 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.

## **Guest Speakers**

We will have occasional guest speakers during the term on current developments in financial markets. In order to accommodate the schedules of the guest speakers, we may have to reschedule one or two classes. I will notify you in advance for rescheduled classes.

## **Review Sessions and Office hours by Teaching Assistants**

We will offer periodic review sessions for those needing extra help with the prerequisite finance theory. Teaching assistants will also hold office hours to answer your questions for clarification on pending cases. Rooms and schedules of TA office hours will be posted on webCafé.

## Workload

The subject matter of this course is technical and difficult. Case preparations require substantial amount of time and dedication. Students in past years have indicated the work load for this course is *very heavy*.

## Academic Integrity and Code of Ethics:

Most case materials in this course are based on real events and companies. In preparing for class discussions or for your reports, you may use any publicly available past or current information about the companies dealt in cases. You are strongly encouraged to study cases with members of your group. Submitted assignments for grading should be your own or your group's joint work only. Each member of your group is expected to contribute equally to the group reports. Please do not allow specialization in your team. This is your opportunity to develop new skills.

Your ability to retain the knowledge gained from FNCE 726 will be a direct function of the amount of time you spend working through the cases. Inappropriate reliance on the work of others is self defeating. Grading system is designed so that all "good faith efforts" on the group reports will result in full credit.

There is limited number of good cases in finance and only a few new ones are produced each year. Thus, many cases remain on the course syllabus for few years. I distribute all materials used in class in hardcopy and post them on the webCafé. Any use of such previously distributed materials is, however, considered plagiarism, and it is not tolerated in any way.

***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 your written reports and class discussions. Violation of this rule will result in an automatic failing grade for the course and the violators will reported to the Wharton Graduate Division for further disciplinary action.***

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.

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### \* 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:

Simon Benninga, Marshall E. Blume, Richard Bower, Guido Cipelli, Desmond Conner, Ignacio de Orue, Steve DesJardines, Sonia Dula, Eugene F. Fama, Adam Frieman, William F. Fruhan, Hulya Eraslan, Ozer Ertuna, Benjamin C. Esty, Jr., Robert Gerry-Wade, Stuart C. Gilson, Robert R. Glauber, Mario Gobbo, Michael Goldstein, Mustafa Gultekin, Robert Hamada, Joel Hasbrouck, Gabriel Hawawini, Trent Hickman, Robert W. Holthausen, Mat Ide, Jeff Jaffe, Peter Jones, Donald Keim, Ronald Koenig, Maria C. Kosloski, Roger Leeds, Dennis E. Logue, Herwig Langohr, Inga Marie-Davis, Matthew McBrady, Morris Mendelson, Ian Murray, Ewa Morowska, Enrique Lavina, John Nellis, George Oldfield, John Percival, Thomas R. Piper, Lee Remmer, Richard J. Rogalski, Steven Ross, Mitch Scherzer, Jeremy Seddon, Arnold Shipp, Seymour Schmidt, Robert Stambaugh, Hans Stoll, Toshi Taga, Seha Tinic, Selim Topaloglu, Ed Travisani, Mete Tuncel, Derek Utter, Claude Viallet, Charles Vuylsteke, Richard West, Randolph Westerfield, Gavin Wilson, J. Peter Williamson, Oktay Yenal, Bilge Yilmaz, Unal Zenginobuz, and Joseph Zimmel.

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**

1. Lecture: Introduction and Course Overview

Readings: Brealy & Myers, Chapter 1  
Copland et al. Chapters 1

## **II. FINANCIAL ANALYSIS AND PLANNING**

2. Case: Clarkson Lumber Company  
Readings: Brealy & Myers, Chapters 29-32  
“Assessing the Financial Health of a Firm”

## **III. VALUATION THEORY AND CAPITAL STRUCTURE**

### **A. Identifying the Relevant Cash Flows for Capital Budgeting Projects**

3. Case: Empirical Chemicals A&B  
Readings: Brealy & Myers, Chapters 2-6 and 10-12

### **B. DCF Methods for Valuation**

4. Lecture: Capital Structure and Valuation Theory  
  
Readings: Brealy & Myers, Chapter 17-19  
Teaching Note: “Alternative Methods for Estimating Terminal Value”  
Teaching Note: “An Introduction to Cash Flow Valuation Methods”  
Teaching Note: “The Adjusted Present Value Method for Capital Assets”  
Teaching Note: “Valuing Equity Cash Flows”

5. Case: M&M Incorporated

### **C. Cost of Capital and Capital Structure**

6. Case: Marriott Corporation  
Readings: Brealy & Myers, Chapters 7-9, and 19  
Copeland, et al., Chapters 10 and 14  
“Best Practices” in Estimating the Cost of Capital: Survey and Synthesis” by R. Bruner  
“What Practitioners Should Know About Future Value” by M. Kritzman

### **D. Interaction between Investment and Financing Decisions**

7. Case: Galveston Fishing Company  
Readings: Copeland, et al., Chapters 8, 9 and 11-13  
  
8. Case: Southport Minerals  
9. Case: Kennecott Copper Corporation  
10. Case: American Chemical Company  
11. Case: MCI 1983  
12. Lecture: Review

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| 13. <b>OCTOBER 20 MIDTERM EXAM</b> <b>in class</b> |
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#### **IV. THE OPTIONS APPROACH TO CAPITAL INVESTMENT**

14. Lecture: Review of Black and Schole's Model for Option Valuation I
- Reading: Brealy & Myers, Chapters 20-23  
Copeland, et al., Chapter 20
15. Lecture: Review of Black and Schole's Model for Option Valuation II
16. Case: Chrysler's Warrants
17. Case: MW Petroleum Corporation
- Reading: "The Options Approach to Capital Investment" by Dixit and Pindyck  
"Capital Projects as Real Options: An Introduction"  
Copeland, et al., Chapter 20

#### **V. CORPORATE FINANCING DECISIONS**

- Readings: 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
18. Case: Corning Zero Coupon Convertible Debentures

#### **VI. DIVIDEND POLICY**

- Readings: Brealy and Myers, Chapter 16
19. Case: Avon Products

#### **VII. MERGERS AND ACQUISITIONS AND CORPORATE RESTRUCTURING**

- Reading: Brealy & Myers, Chapters 33 and 34  
Copeland, et al., Chapter 7 and 17-19
20. Case: Philip Morris
- Readings: "Valuation by Multiples" by Benninga and Sarig
21. Case: Conrail A & B
22. Case: Vodafone
23. Case: Privatization of SFM in Poland
24. Case: RJR Nabisco
25. Case: Individual case write-ups due
25. Lecture: Course Overview

**FNCE 726: ADVANCED CORPORATE FINANCE**  
**COURSE SCHEDULE FOR FALL 2004**  
(September 8, 2004)

Session #	Date	Topic	Assignment
1	Sept 8	Introduction	Group forming/no lecture
2	Sep 13	Clarkson Lumber Company	Case assignment
3	Sep 15	Empirical Chemicals A&B	Case assignment
4	Sep 20	Capital Structure Valuation Theory	Lecture
5	Sep 22	Capital Structure Valuation Theory and M&M Inc.	Lecture
6	Sep 27	Marriott Corporation	Case assignment
7	Sep 29	Galveston Fishing Company	Case assignment
8	Oct 4	Southport Minerals	Case assignment
9	Oct 6	Kennecott	Case assignment
10	Oct 11	American Chemical	Case assignment
11	Oct 13	MCI	Case assignment
12	Oct 18	Review	Lecture
13	Oct 20	<b>Midterm exam</b>	<b>In class</b>
14	Oct 27	Option Valuation Review	Lecture
15	Nov 1	Option Valuation Review & Real Options	Lecture
16	Nov 3	Chrysler's Warrants	Case assignment
17	Nov 8	MW Petroleum Corporation	Case assignment
18	Nov 10	Corning Zero Coupon Convertible Debentures	Case assignment
19	Nov 15	Avon	Case assignment
20	Nov 17	Philip Morris	Case assignment
21	Nov 22	Conrail A&B	Case assignment
22	Nov 24	Vodafone	Guest speaker
23	Nov 29	SFM Privatization	Guest speaker
24	Dec 1	RJR	Case assignment
25	Dec 6	Individual reports due	Case discussion
26	Dec 8	Overview	Lecture