

ADVANCED CORPORATE FINANCE**SUMMER 2024**

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REQUIRED COURSE MATERIAL

Required readings, cases and case questions will be available to you either on the course website or in the required textbook:

Required

Berk, Jonathan and Peter DeMarzo, 2020, *Corporate Finance (Fifth Edition)*, Pearson, New York, NY.

Recommended but not Required

McKinsey & Co., Tim Koller, Marc Goedhart and David Wessels, 2020, *Valuation: Measuring and Managing the Value of Companies (Seventh Edition)*, Wiley, New York, NY.

In addition, the course will have a dedicated website for other timely information and relevant downloadable material as it becomes available (including class notes). The course website can be accessed through Canvas.

REQUIRED PREREQUISITES AND CONNECTION TO THE CORE

Advanced Corporate Finance should be considered a capstone course. This is an advanced course in which students are expected to perform professional level work. The class is open to both 1st and 2nd year students who have completed or are concurrently taking B8306 Capital Markets and Investments, as some of the material covered in B8306 is necessary for this course. In particular, students should be familiar with notions of options pricing including valuation using the Black-Scholes formula. Students are also expected to be familiar with the key concepts introduced in core Corporate Finance.

COURSE DESCRIPTION

Advanced Corporate Finance builds directly upon the basic valuation tools developed in Corporate Finance and extends in the following directions: (1) The course introduces more advanced concepts into valuation (such as corporate securities beyond simple debt and equity) to equip students with the tools necessary to analyze more complex (and therefore, more realistic) capital structures and corporate transactions. (2) The course incorporates richer institutional detail into quantitative analysis, bringing students closer to real-world situations while maintaining a fundamentally analytical approach to financial decision-making. (3) The course explores new topics and recent developments in corporate finance theory and practice (especially post-financial crisis) as a means of exposing students to the ever-changing nature of the capital markets, both its terms and its practices. The more advanced tools and deeper understanding of the valuation process in this course serve the same goal stated in Corporate Finance: To improve corporate financial decision-making by executives and to provide value-creating tools of analysis for investors.

COURSE OBJECTIVES

The classes are structured to maximize the synergy between theory and practice, providing students portable, durable and marketable tools for their internships and careers.

This class is suitable for students looking to make executive strategic financial decisions, including investment bankers, consultants, CFOs and corporate treasurers, portfolio and investment managers, and students interested in private equity.

ASSIGNMENTS

All written assignments for each class (after the first class) will be discussed, completed and submitted by study groups (typically comprised of three students) prior to each class.

METHOD OF EVALUATION:

Participation	50%
Problem Sets	25%
Final Project	25%

CLASSROOM NORMS AND EXPECTATIONS

Each session will be comprised of an introductory lecture with class discussion of the session's reading assignment followed by time dedicated to the analysis of a case study which covers the concepts for that

session. The first (approx.) 90 minutes of each class will be dedicated to lecture and class discussion of the session's topics. The class discussion will be followed by an analysis of the session's case study for the remaining (approx.) 90 minutes. (A 15-minute intermission will divide the two segments.) **This course will rely heavily on class participation and requires substantial preparation for each session. It is essential that students complete all required reading and prepare for substantive class discussion with detailed notes on the assigned case study each session. To facilitate class discussion, please remember to bring name cards to every session.**

Assignment for First Class

Given the amount of material to cover in the course and the three-hour session format, much of the first day of class will be devoted to substantive class discussion on the readings and the session's case, *Fleetwood Enterprises, Inc., 1990*. **Students should be prepared to discuss the readings and the case in detail on the first day of class. Again, to facilitate class discussion, please remember to bring name cards to every session.** Please find questions which will be used to guide class discussion below:

- 1) Consider Fleetwood Enterprises' current capital structure. In what sense, if any, is this capital structure "optimal" or at least desirable?
- 2) What are some of the factors which should influence Mr. Bingham's decision on whether to undertake a share repurchase (i.e., recapitalize)? Consider:
 - a. corporate finance theory (e.g., Modigliani-Miller, the tradeoff theory of capital structure, etc.)?
 - b. the Company's business strategy and industry environment
 - c. the Company's chosen operating/organizational structure
 - d. any other relevant matters.
- 3) ***Considering solely the facts provided in the case, create your own financial projections for Fleetwood Enterprises and complete a discounted cash flow analysis of the Company. Provide a specific price per share as part of your answer.***
- 4) Assume Mr. Bingham has decided to repurchase shares. As Fleetwood's investment banker, consider and propose various alternative methods for returning capital to Fleetwood shareholders. Discuss the pros and cons of each alternative.
- 5) ***What amount should Mr. Bingham repurchase and what strategy should the Company employ to repurchase those shares? If you argue for no repurchase, discuss why you have concluded so. What specific considerations, quantitative or qualitative, influenced your decision?***

NOTE: For all of your work on this assignment and for the sake of simplicity, you can assume that the commercial paper outstanding is supporting the finance company receivables in a bankruptcy remote (completely standalone) subsidiary. Hence, such debt can be netted against the finance company receivables and ignored for your analysis. Assume all other cash and investments **NET OF INSURANCE RESERVES** is distributable to the parent.

*** * * Written responses to bold italicized questions are due prior to each class. * * ***

Session 1. Review of Capital Markets and Valuation

- A. Required Reading
 - 1. Berk and DeMarzo - Ch. 18: "Capital Budgeting and Valuation with Leverage"
 - 2. ["An Introduction to Cash Flow Valuation Methods" Case #9-295-155](#)
- B. Topics
 - 1. The cost of capital
 - 2. Review of cash flow valuation methods
 - 3. Review of Modigliani-Miller Propositions: Is capital structure irrelevant?
 - 4. A tradeoff theory of capital structure
 - 5. Leverage and implications on DCF analysis
- C. Case Study: ["Fleetwood Enterprises, Inc., 1990" Case #9-293-013](#)
- D. Additional Reading
 - 1. Berk and DeMarzo - Ch. 14: "Capital Structure in a Perfect Market"
 - 2. Berk and DeMarzo - Ch. 15: "Debt and Taxes"
 - 3. Miller (1977)

Session 2. Capital Budgeting and the Appropriate Cost of Capital

- A. Required Reading
 - 1. Berk and DeMarzo - Ch. 13: "Investor Behavior and Capital Market Efficiency"
 - 2. ["Note on Adjusted Present Value" Case #9-293-092](#)
- B. Topics
 - 1. Perfect and imperfect capital markets
 - 2. Efficient markets
 - 3. Complete and Incomplete Markets
 - 4. Earnings Multiples and the DCF Analysis
- C. Case Study: ["Globalizing the Cost of Capital and Capital Budgeting at AES" Case #9-204-109](#)
- D. Additional Reading
 - 1. Bagwell (1991)
 - 2. Black (1986)
 - 3. Fama and French (1992)

4. Fama and French (1996)

Session 3. Real Options

- A. Required Reading
 1. Berk and DeMarzo – Ch. 22 “Real Options”
 2. [“The Options Approach to Capital Investment” HBR Reprint #95303](#)
- B. Topics
 1. Review of basic option pricing theory
 2. Identifying real options
 3. Implications of real options on the traditional valuation of enterprises
 4. Potential approaches to valuation
 5. In Practice: Practical considerations when valuing real options
- C. Case Study: [“MW Petroleum Corporation \(A\)” Case #9-295-029](#)
- D. Additional Reading
 1. Berk and DeMarzo – Ch. 20 “Financial Options”
 2. Berk and DeMarzo – Ch. 21 “Option Valuation”
 3. Amram and Kulatilaka (1998)
 4. Black and Scholes (1973)
 5. Dixit and Pinkdyck (1994)

Session 4. Information Problems in Capital Markets

- A. Required Reading
 1. Berk and DeMarzo – Ch. 17: “Payout Policy”
 2. [Asquith, Paul and David W. Mullins, 1986, "Signaling with Dividends, Stock Repurchases, and Equity Issues," Financial Management Autumn: 27-44.](#)
- B. Topics
 1. Market for lemons and adverse selection
 2. Signaling
 3. Asymmetric information and implications for the capital markets

C. Case Study: [“Going to the Oracle: Goldman Sachs, September 2008” Case #9-309-069](#)

D. Additional Reading

1. Akerlof (1970)
2. Asquith and Mullins (1986)
3. Smith (1986)
4. Spence (1973)

Session 5. Information Problems in Capital Markets - Continued

A. Required Reading

1. Berk and DeMarzo – Ch. 16 “Financial Distress, Managerial Incentives, and Information”
2. [Smith, Jr., Clifford W., 1986, “Investment Banking and the Capital Acquisition Process,” Journal of Financial Economics 15: 3-29.](#)

B. Topics

1. Myers and Majluf (1984)
2. The pecking order theory of capital structure
3. In Practice: Due diligence

C. Case Study: [“Cash is King: Microsoft’s 2004 Cash Disbursement” Columbia CaseWorks ID#070302](#)

D. Additional Reading

1. Fazzari, Hubbard and Peterson (1988)
2. Lamont (1997)

Session 6. Agency Problems and Corporate Finance

A. Required Reading

1. [“Eclipse of the Public Corporation” HBR Reprint #89504](#)

B. Topics

1. Agency costs of equity and debt
2. An agency theory of capital structure
3. Large shareholders and monitoring

4. Debt as a bonding mechanism
5. The LBO considered
6. In Practice: Governance and incentives

C. Case Study: [“United Parcel Service’s IPO” Case #9-103-015](#)

D. Additional Reading

1. Demsetz (1983)
2. Jensen and Meckling (1976)
3. Jensen (1993)
4. Morck, Shleifer and Vishny (1988)

Session 7. Agency Problems and Corporate Finance - Continued

A. Required Reading

1. [Jensen, Michael C., and William H. Meckling, 1992, “Specific and General Knowledge, and Organizational Structure,” in Contract Economics edited by Lars Werin and Hans Wijkander, Blackwell Publishers, Cambridge, MA.](#) (Sections 1-5 required and Sections 6-8 optional)

B. Topics

1. Boundaries of the firm and optimal firm size: markets vs. hierarchies
2. The rise of the modern corporation
3. The entrepreneur’s role in the growth and development of an industry

C. Case Study: [“The Management of Berkshire Hathaway” Case #CG16-PDF-ENG](#)

D. Additional Reading

1. *The Visible Hand*, Chandler (1977)
2. *Morgan Stanley Roundtable*, Jensen et al. (2006)
3. Fama and Jensen (1983)
4. Klein, Crawford and Alchian (1978)
5. *Markets and Hierarchies*, Williamson (1975)

1.

Session 8. Debt Markets and Highly Leveraged Transactions

- A. Required Reading
 - 1. Berk and DeMarzo – Ch. 24 “Debt Financing”
 - 2. [“Valuing Late-Stage Companies and Leveraged Buyouts” Case #UVA7578](#)
 - 3. Sample bank term sheet
 - 4. Overview of public vs. private high yield terms
- B. Topics
 - 1. Banks vs. bonds
 - 2. Trends in syndication
 - 3. In Practice: Overview of provisions in a credit term sheet
- C. Case Study: [“DuPont Corporation: Sale of Performance Coatings” Case #UV6790](#)
- D. Additional Reading
 - 1. Kaplan (1989)
 - 2. Smith (1990)
 - 3. Shleifer and Vishny (1992)
 - 4. Smith and Warner (1979)
 - 5. Warner (1977)

Session 9. The Market for Corporate Control

- A. Required Reading
 - 1. Berk and DeMarzo – Ch. 28 “Mergers and Acquisitions”
 - 2. [Andrade, Gregor, Mark Mitchell and Erik Stafford, 2001, “New Evidence and Perspectives on Mergers,” Journal of Economic Perspectives, 15:103-120.](#)
- B. Topics
 - 1. Control premia in takeovers
 - 2. Value creation in M&A
 - 3. Division of gains

C. Case Study: [“Canadian Pacific’s Bid for Norfolk Southern” Case #9-216-057](#)

D. Additional Reading

1. Jensen and Ruback (1983)
2. Bradley, Desai and Kim (1988)

2.

Session 10. Initial Public Offerings

A. Required Reading

1. Berk and DeMarzo Ch. 23 “Raising Capital”
2. [“A Note on the Initial Public Offering Process” Case #9-200-018](#)

B. Topics

1. When is a company ready for an IPO?
2. In Practice: The IPO process
3. IPO-related anomalies

C. Case Study: [“Square, Inc. IPO” Case #9-817-054](#)

D. Additional Reading

1. Ritter (1991)
2. Loughran and Ritter (1995)

Session 11. The Board of Directors and the Fairness Opinion

A. Required Reading

1. Berk and DeMarzo - Ch. 29 “Corporate Governance”

B. Topics

1. Duties of a board of directors
2. The fairness opinion and related analysis
3. Recap of practical considerations in corporate finance

C. Case Study: [“American Cyanamid \(A\): Boardroom Response to a Hostile Takeover Offer” Case #9-897-048](#)

Session 12. Special Advanced Topic: Venture Capital and Private Equity

A. Required Reading

1. [Kaplan, Steven N., and Antoinette Schoar, 2005, "Private Equity Performance: Returns, Persistence, and Capital Flows," Journal of Finance 60: 1791-1823.](#)
2. [Hsu, David H., 2004, "What Do Entrepreneurs Pay for Venture Capital Affiliation?" Journal of Finance 59: 1805-1844](#)

B. Topics

1. Persistence in PE/VC returns
2. Application of advanced corporate finance topics to PE/VC

C. Case Study: ["Weston-Presidio Offshore Capital: Confronting the Fundraising Challenge" Case #9-296-055](#)

D. Additional Reading

1. Gompers and Lerner (1999)
2. Grossman and Stiglitz (1980)
3. Moon (2006)
4. Stafford (2021)

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