

ICEF, Higher School of Economics, Moscow
MSc in Financial Economics, 2nd year

Financial Economics II -- Corporate Finance
Fall 2019
Course Syllabus

Lectures: Sergey Stepanov (HSE)

Case studies: James Lewis (Canandaigua Management LLC)

Seminars: Anna Zolina

Prerequisites

Financial Economics I (Asset Pricing), Microeconomics

Course description and objective

The main objective of the course is to present the modern approach to the financial analysis of a company and to teach the principles and techniques of evaluating the most important corporate decisions. The core of the course is the analysis of investment (capital budgeting) and financing (capital structure) decisions of a firm. We will first discuss the principles and techniques of selecting investment projects. Secondly, we will examine the determinants of the capital structure choices by firms as well as the notion of the optimal capital structure. We will then discuss how to value a company, taking into account its capital structure. We will also analyze how firms decide on their payouts to shareholders and what the optimal payout policy should be. Finally, we will cover initial public offerings, mergers and acquisitions, and corporate governance.

Learning outcomes

- Understanding of factors/forces that affect firm value
- Ability to analyze and evaluate financial decisions of a firm
- Fundamental valuation skills
- Ability to bring finance theory into practice

Methods

The following methods and forms of study are used in the course

- Lectures (one or two lectures of 80 minutes per week, alternating from week to week).
- Seminars (one seminar of 80 minutes once every two weeks).
- Self-study
- Case studies (5-6 cases in total). Cases are to be solved in groups of max. 5 people. Each case will be discussed in a session of 80 minutes. You may be asked to present your solutions in class.
- Homework assignments (problem sets) to be solved individually

Course Material

Required reading: Jonathan Berk and Peter DeMarzo (BD), Corporate Finance, 2007, Pearson (or any later edition)

Additional readings:

- Welch, Ivo, Corporate Finance, 4th edition, 2017, available for free at <http://book.ivo-welch.info/read/>
- Hillier, David, Mark Grinblatt, and Sheridan Titman (HGT), Financial Markets and Corporate Strategy: 2nd European Edition, 2011, McGraw-Hill.
- Copeland, Thomas E., Weston, J. Fred, and Kuldeep Shastri (CWS), Financial Theory and Corporate Policy, 4th edition, 2005, Pearson.
- Tirole, Jean, The Theory of Corporate Finance, Princeton and Oxford: Princeton University Press, 2006.

Other materials and lecture slides will be available at icef-info.hse.ru

Evaluation

Home Assignments: 15%

Cases (including evaluation of presentations): 20%

Midterm test: 20%

Final test: 45%

The weights given above combine into your final grade for the course. That is, the final grade (out of 100) is $0.15 \times (\text{Home Assignments score}) + 0.2 \times (\text{Cases score}) + 0.2 \times (\text{Midterm test score}) + 0.45 \times (\text{Final test score})$.

All grades are given initially out of 100. The final grades are also transferred to 10- and 5-points grades in accordance with the ICEF Grading Regulations (par.3) available at https://icef-info.hse.ru/goto_icef_file_29837_download.html

You need to receive at least 35 points at the final test and 35 points in the aggregate in order to pass the course. If you have to skip the midterm test due to a valid documented reason, the final test will automatically carry 65% weight. If you skip the midterm test for no valid reason, you simply get 0 points for it.

Retakes are organized in accordance with the [HSE Interim and Ongoing Assessment Regulations](#) (incl. Annex 8 for ICEF). Grade determination after retakes is done in accordance with ICEF Grading Regulations (par. 5) available at https://icef-info.hse.ru/goto_icef_file_29837_download.html

Course Outline

1. Introduction. Notion of corporation, financial statements
Readings: BD, ch. 1, 2; Welch, ch. 1, 14
2. Fundamentals of capital budgeting
 - a. Refresher on time value of money and discounting, risk and return, CAPM
 - b. Basic investment decision rules (NPV, IRR, payback period, etc.)
 - c. Evaluating a project: forecasting earnings, determining cash flows, computing NPV, sensitivity and scenario analyses.Readings: BD, ch. 4-13; Welch, ch. 2-10; 13
3. Basics on financial options and real options

Readings: BD, ch. 20-22; Welch, ch. 13.6; CWS, ch. 9

4. Capital structure. Perfect world

Readings: BD, ch. 14, 23, 24; Welch, ch. 16, 17.

5. Capital structure. Effects of taxes and costs of financial distress

Readings: BD, ch. 15-16.4; Welch, ch. 18, 19

6. Business risk and bottom-up beta

Students learn two different sources of firm risk - business risk (i.e., unlevered CAPM beta) and financial risk - and how they interact to influence firm risk and cost of capital. We discuss the empirical methods to estimate the overall risk profile of a firm which operates in multiple lines of businesses. Particularly, students will learn how to choose comparables (pure plays) and to unlever/relever CAPM beta to assess a firm's risk profile. HBP case: "Marriott Corporation: The Cost of Capital (Abridged)" #9-289-047

Readings: BD, ch. 12, 19.4.

7. Discounted cash flows model (DCF) versus multiples valuation

Students learn various approaches to assess the value of a company. The course will put emphasis on two major approaches and their hybrid - discounted cash flows (DCF) model and multiples (i.e., relative) valuation. Students are expected to learn how to employ historical, financial data to create their valuation models. Students will discuss pros and cons of each of these approaches. In particular, the course will provide in-depth discussions on the validity of the underlying assumptions for each approach. Valuation will be done in various circumstances, for example, public equity, mergers and acquisitions (M&A), and leverage buyout (LBO).

HBP cases: "Teuer Furniture (A & B): Discounted Cash Flow Valuation" #KEL778, KEL788

Readings: BD, ch. 9, 18-19; Welch, ch. 13.1-13.3, 15, 16.6-18.3

8. Real options under uncertainty

Students will learn how to value enterprises under high uncertainty. Several types of real option models will be discussed – decision trees and Black-Scholes option pricing – to incorporate high uncertainty into valuation. We will discuss the validity and interpretation of real option models.

HBP case: "Pharmacyclics: Financing R&D" #9-201-056

Readings: BD, ch. 20-22; Welch, ch. 13.6; CWS, ch. 9

9. Mergers and acquisitions (M&As)

The course will provide the overview of M&A determinants, deal process, and outcomes.

- What is M&A?
- Why do firms do M&As? What determines the price of the deal?
- How do various stakeholders (shareholders, bondholders, employees, etc) respond to M&A?

Students will also gain understanding on a corporate governance perspective on M&A. Students are expected to gain understanding on sources of M&A synergies and how to incorporate into deal valuation. Based on deal valuation, students will discuss acquirer versus target managements' negotiation strategies.

HBP case: "American Chemical Corporation" #9-280-102

Readings: BD, ch. 28; Welch, ch. 13.6; CWS, ch. 9

10. Initial public offerings (IPOs)

Students will learn details of initial public offering (IPO) process. In particular, in-class discussions will focus on the followings:

- What is IPO? How do firms go public?
- Why do some firms go public while others do not?
- What determines the price of IPO shares?

Students will explore the aforementioned questions through a recent IPO case, Snap Inc. HBP case: "Snap Inc.'s IPO (A)" # 9-218-006

Readings: BD, ch. 23; Welch, ch. 21F-G (from companion to main textbook, <http://book.ivo-welch.info/companion/companion.pdf>)

11. Capital structure. Effects of agency problems + Case discussion

Readings: BD, ch. 16.5-16.7; HGT, ch. 16-18; Welch, ch. 18; Tirole, ch. 3-5 (more advanced level)

12. Capital structure. Effects of asymmetric information + Case discussion

Readings: BD, ch. 16.8-16.9; HGT, ch. 19; Welch, ch. 19; Tirole, ch. 6 (more advanced level)

13. Payout policy + Case discussion

Readings: BD, ch. 17; Welch, ch. 20

14. Corporate governance + Case discussion

Readings: BD, ch. 29; HGT, ch. 20; Tirole, ch. 11 (more advanced level); a few academic papers, to be provided

Distribution of hours for topics and types of work:

No	Topic title	Contact hours	
		Lectures	Classes
1.	Introduction. Notion of corporation, financial statements	4	2
2.	Fundamentals of capital budgeting	4	2
3.	Basics on financial options and real options	2	0
4.	Capital structure. Perfect world	2	1
5.	Capital structure. Effects of taxes and costs of financial distress	3	1
6.	Business risk and bottom-up beta	3	1
7.	Discounted cash flows model (DCF) versus multiples valuation	3	1
8.	Real options under uncertainty	3	1
9.	Mergers and acquisitions	3	1
10.	Initial public offerings	3	1

11.	Capital structure. Effects of agency problems + Case discussion	6	2
12.	Capital structure. Effects of asymmetric information + Case discussion	5	2
13.	Payout policy + Case discussion	2	2
14.	Corporate governance + Case discussion	2	2
	Total:	45	19