

BUSINESS ADMINISTRATION 452
Cases in Financial Management
Fall Semester 2004

INSTRUCTOR: Deborah N. Pittman
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OFFICE HOURS: 11:30 – 1:00 Tues Thurs
4:30 – 5:30 Tues Thurs
Other times by appointment
REQUIRED TEXTS: Cases from the Darden School of Business at the University of Virginia;
(These are to be purchased from department secretary)
Fundamentals of Corporate Finance, Ross, Westerfield, & Jordan

REQUIRED: Financial calculator
SUGGESTED: Popular business publications, especially the WSJ

COURSE OBJECTIVES:

1. To gain insight into how financial theory is relevant to actual business situations through practice. There is an orientation beyond mere description and analysis, toward normative thinking and decision making, as well as growth in judgment. The underlying focus throughout the course will be on valuation modeling and economic analysis as a foundation for corporate financial decision making.
2. To acquire proficiency in analytical techniques needed to make financial decisions. Cases explore the application of finance tools and concepts in an imperfect world where information is noisy, behavior is not always rational, and outcomes are unpredictable.
3. To sharpen written and oral presentation skills. Executives consistently state that these skills are critical to success in business.
4. To provide experience in collaborative effort. Much decision- making in business is accomplished in a group environment, and team members must sell ideas in a cooperative manner.
5. To gain an awareness and understanding of more recent financial trends and innovations.

COURSE STRUCTURE:

Cases: The second course in Corporate Finance utilizes case studies to accomplish the objectives stated above. Cases will be worked on in small groups. There will be a variety in delivery of the cases to enliven student participation and learning. Many cases will involve standard case discussions led by the professor, with students expressing their opinions and demonstrating their analysis done outside of class. However, in one case teams will negotiate with each other. Some cases will be number-crunching problems, and some will involve interpretation and the exercise of managerial judgment, and some will involve both. Some cases will be more difficult than others. Four cases will be formal, written cases prepared by each team, and presented orally by two teams. When you make an oral presentation, your overall grade for that case will take into consideration both the oral and written components.

Lectures: There will be lectures as well. The lectures will generally cover the areas that have not been covered in Corporate Finance, but we will spend some time reviewing certain material before going into more depth.

Teamwork: Students will form groups during the first week of the course. The groups are expected to meet regularly outside of class to prepare the upcoming cases. Students are provided in the syllabus a list of questions for each case which should be addressed as the teams meet. **Each student** should come prepared to discuss the group's answers in particular as well as other issues of the case which are brought up in class. Each team will also be required to make four formal written presentations and two oral presentations. The formal write-ups should never exceed four double-spaced typewritten pages plus exhibits. Formal written presentations will be graded primarily on completion, clarity of expression, knowledge of the facts of the case, and the ability to follow directions, i.e. **an emphasis on the analytical process and the ability to draw on correct theories.** Each team should come prepared to present their written results by sharing their spreadsheet.

Topics: We will cover the following topics: Evaluation of Corporate Performance, Forecasting, Cost of Capital, Capital Budgeting, Debt Management, Mergers, Corporate Financial Strategy and Valuation of the Firm.

Homework Assignments: Homework assignments will help the student prepare for the formal grading opportunities. Some are reading assignments and some require preparing spreadsheets or written answers. I will take them up and read in order to ascertain what areas need additional explanation and what effort is being made. There will be an overall grade given for these homework assignments to each group based on effort and completeness – not on correctness. Individual participation grades come from each student's daily participation in class discussions. Homework assignments will prepare you for the tests and for the formal case work.

Mid-term and Final: There will be two tests during the semester which will permit the student to demonstrate that the first two objectives of the course have been met. All work is to be the student's alone.

Grading:

Formal Case Presentations (4)
Group Homework Assignments
Participation
Mid Term Exam
Final Exam

Group Grade	40%
Group Grade	10%
Individual Grade	15%
Individual Grade	15%
Individual Grade	<u>20%</u>
	100%

Grading Scale:

94-100	A	74-76	C
90-93	A-	70 -73	C-
87-89	B+	67-69	D+
84-86	B	64-66	D
80-83	B-	60-63	D-
77-79	C+	Below 60	F

Honor Council Offenses:

1. It will be considered an Honor Council offense to use notes or other materials obtained from students who have taken this course in prior years.
2. When turning in homework and formal case write-ups, your pledge indicates the following:

“We pledge that each member signing below shared in the preparation of this case equally, we consulted with no student outside our group, and we used no information from previous semesters.”
3. If a team member is not contributing to the group product on case work, you will not be able to sign the pledge and therefore must notify instructor.

SYLLABUS

FINANCIAL PLANNING AND ANALYSIS

August 26	Introduction to Cases FOCUS: /Review of Discounted Cash Flow Model (Overview); Financial Statements; DuPont Analysis
August 31	FOCUS: Financial Statement Analysis Analyze Financial Statement of AutoZone in order to review financial concepts (<i>Homework</i> : Analyze and be prepared to discuss key ratios; reread Chapter 3) We will program AutoZone cash flow statement in class. Review how to program cash flow statement before coming to class.
September 2	FOCUS: Industry/Peer Analysis (<i>Homework</i> : The Financial Detective; follow instructions in case.
September 7	Oracle Systems Corporation (Formal Case Presentation #1) 1. What can the historical income statements (Exhibit 1) and balance sheets (case Exhibit 2) tell you about the health and current condition of Oracle Systems? 2. How can financial ratios extend your understanding of financial statements? What questions do the time series of ratios in case Exhibit 3 raise? What questions do the ratios on peer firms in case Exhibits 4 and 5 raise? 3. Is Oracle Systems Corporation financial healthy in September 1990? 4. In light of your answer to question 3, what might account for the firm's recent decline in share price?
September 9	FOCUS: Financial Forecasting (<i>Homework</i> : read Chapter 4; work 1-10 problems at the end of the chapter. You may check your answers against the Instructors Manual outside my door after completing your homework.) In class I will guide you through The Body Shop International PLC. We will follow instructions in the case; spreadsheet from each student will be turned in.
September 14	FOCUS: Financial Forecasting (<i>Homework</i> : Complete problems from chapter 4 not worked in class and check answers in instructors manual; STUDY file entitled IFFCF3.xls before class along with the file entitled "Sales-Based Forecast"). Bring all programming questions to class. We will continue to forecast financial statements, including how to program external funds needs or excess external funds and how to perform sensitivity analysis.
September 16	FOCUS: Financing Forecasting and Valuation Models (** <i>Participation</i> : At this point, each student should be able to program in class a pro forma spreadsheet, including external funds need and pro forma cash flow. All student will receive is historical balance sheet and income statement, and some assumptions; you will need to make the remaining assumptions. We will spend the first half of the class on this exercise. Each student will receive a participation grade on their spreadsheet; accuracy counts.
September 21	I will use IFFCF4 to illustrate how pro forma are used to value stock, both free cash flow approach and residual cash flow approach. Read the file "Valuation Methodology" before class.
September 23	FOCUS: Valuation Analysis (** <i>Homework</i> : Each team will prepare valuation of AutoZone's stock (free cash flow approach and residual cash flow approach) using assumptions I provide. We will review each in class and compare different scenarios. Bring your spreadsheet to class.

**heavier than normal weight on grade

*(Homework: Reading assignment in folder.
Video: Economic Value Added)*
Review of Porter Model

October 26

Astral Records / Mid-Term Case (Individual Effort)

Astral Instructions: To be turned in at the beginning of class.

1. Please assess the current financial health and recent financial performance of the company. What strengths and/or weaknesses would you highlight to Sarah Conner? Include a computation and analysis of the firm's sustainable growth rate using the most recent year.
2. Please forecast the financial statements of the firm for 1994 and 1995 using the base financial statements provided in your Excel file. Use the forecast assumptions below. What will be the external financing requirements of the firm in those years? If they do nothing different from the past, can the firm repay its loan within a reasonable period?
 - Sales growth of 15% annually, consistent with Conner's outlook given in the case.
 - Production costs of 60% of sales, also stated in the case. This compares to 56% for 1993, and generally reflects a rising trend over the past years, consistent with increasing price competition.
 - No new capital expenditures, consistent with the past three years. This may be inconsistent with 15% sales growth, and should be highlighted for Conner. But capital expansion is unlikely without the expectation of healthy returns on investment. Given the declining profit margins, such returns are debatable.
 - Constant annual depreciation expense, consistent with no new capital expenditures.
 - Interest expense was assumed to be 9%, consistent with the prior year.
 - Income taxes were assumed to be paid at a rate of 40% of pre-tax profit. This is roughly consistent with prior years.
 - Dividends were kept level at \$1 million, since that appears to be Astral's historical policy.
 - Cash was estimated at 6.5% of sales, which is an average over the past four years, and assumes that this cash is necessary to run the day-to-day operations of the business. In the most recent period, cash fell to 3.9%, an assumption that we will use.
 - Accounts receivable balances were assumed to be 120 days sales outstanding. This is a blending of the average of the past four years (115) and the most recent year (122).
 - Inventories and payables as a percent of cost of goods sold were assumed to be 155% and 24% respectively. Case Exhibit 3 shows that these assumptions are extrapolations of the results for 1993.
 - Short term debt is the plug figure. Long term debt is assumed not to be repaid over the forecast period.
3. Perform a sensitivity analysis of the following key drivers: sales growth, production costs as a percentage of sales, days' sales outstanding, and inventories as a percentage of cost of goods sold to determine their impact on external financing requirements. What are the managerial implications of these key drivers? That is, what aspects of the firm's activities should Conner especially focus on?
4. What is Astral's weighted average cost of capital (WACC)? What methods did you use to estimate the WACC? Assume that the market value of debt is equal to its book value since Astral's debt is 70% floating rate. Assume that Astral's equity is valued at a market/book multiple comparable to its peers.

5. What will be the free cash flows if Astral waits three years to purchase the machine? What will be the free cash flows if Astral purchases the new machine now? What is the incremental impact of buying now? What is the incremental impact of waiting? What should Astral do? Use 10% as WACC, ignoring your computed WACC.

MERGERS AND NEGOTIATIONS

- October 28 Valuation Issues and Methodology for Acquisitions
Video: Mergers
Read Chapter 25
- November 2 **The Battle for Value. Federal Express (Formal Case Presentation #3)**
1. Use the Porter model to describe the competition in the overnight package delivery industry and the strategies by which these two firms are meeting the competition. What are the factors facing the two firms as they pursue their goals? Do you think either firm can attain sustainable competitive advantage in this business? Which is the dominant firm and which is the innovator? Explain your answer.
2. Why did FedEx's stock price decline at J.C. Penney's announcement? Assuming a perfectly efficient stock market, how might one interpret this loss of \$85 million in FedEx's market value of equity?
3. . How have FedEx and UPS performed since the mid-1980s? Which firm is doing better? Discuss the insights you derived from the two firms' financial statements, financial ratios, stock price performance, and economic profit (or EVA). Be sure you understand how EVA is estimated, and its strengths and weaknesses as a measure of performance.
4. If you had to identify ONE of these companies as "excellent" which would you choose? On what basis?
- November 4 Preparation for ATT/McCaw Merger Negotiations/Briefing Sessions
(*Homework*: Read the case that applies to your team)
Note that your final exam case is a acquisition analysis case, so this exercise is important!
- November 9 ATT/McCaw Merger Negotiations/Negotiation Session (Participation Grades)
(**Homework*: Prepare your valuation and bids to turn in at beginning of class.)
- November 11 ATT/McCaw Merger Negotiations/Debriefing Session

CAPITAL STRUCTURE

- November 16 Introduction to Debt Policy and Value (in class)
(*Homework*: Chapter 17 review; handout)
- November 18 Optimal Capital Structure Discussion
Read Stewart Myer's article entitled, 'The Capital Puzzle'
Read Tonka case before coming to class.
- November 23 (*Homework*: Tonka Case: Answer the following questions:
1. How much business risk does Tonka face?
2. How much potential value, if any, can Tonka create for its shareholders at each of the proposed levels of debt? How would leveraging up affect the company's taxes?
3. How much financial risk would Tonka face at the proposed levels of debt shown in case Exhibit 12? How would the capital markets react to a decision by the company to increase the use of debt in its capital structure?
4. What capital structure would you recommend as appropriate for Tonka?

5. How might Tonka implement an aggressive capital-structure policy? What are the alternative tactics for leveraging up?
 6. What arguments would you advance to persuade Tonka's management to adopt your recommendation?
- Read Coleco case before coming to class.

November 30

Coleco Case (Formal Presentation #4)

1. Assess the product-market strategy and financial strategy Coleco pursued through 1987. Compare Coleco's strategy with that of Tonka in early 1987.
2. What went wrong? How did Coleco respond?
3. Assess various alternatives at this stage of Coleco's difficulties. What sort of refinancing plan would alleviate Coleco's financial difficulties?
4. What should Paul Meyer do now? Consider this question from the perspective of (a) Coleco's management, (b) its lenders, and (c) its shareholders.

December 2

Discussion of Corporate Governance Issues
Read: The Corporate Scandals of 2002: Causes and Effects

December 7

Review for Final Exam/ **Read Brown Forman Case before coming to class.**

Questions for final exam will not be provided until you arrive for the exam.

Exam dates:

You may select **any of the three times.**