



FINANCIAL STRATEGIES: INVESTMENT THEORY & ADVANCED TOPICS IN CORPORATE FINANCE

FIN 394.16 – 03990, 04000

H-MBA, FALL 2015

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Course Web Page	via Canvas

OBJECTIVES

- To examine the primary financial securities (stocks, bonds and derivatives) and methods for combining them into a portfolio.
- To offer an integrated view of the two key parts of Finance: Investment Theory and Corporate Finance. How investors value assets is essential to understand how managers should manage a firm's assets.
- To emphasize the links of Finance with other aspects of Corporate Strategy. To highlight the role of Finance in strategic decision making and to extend, integrate, and apply what you have learned in earlier Finance courses in the context of complex business cases.
- To discuss how a financial manager can identify and value real investment projects, in particular those that include *real options* that allow businesses to improve strategic decision making.
- To examine costs and benefits of various financing choices with emphasis on taxation, bondholder-equityholder conflicts, agency and informational problems.

METHODOLOGY

- This course will be a mix of traditional lecture material and case analysis. Approximately three quarters of the class will be devoted to lectures and one quarter to case discussions.
- For each case, you must hand-in a case write-up *at the beginning of the class when the case is due*. Case write-ups will be brief memos of at most four double-spaced pages (two/three pages is recommended). I will assign some specific questions to be addressed.
- In addition to case write-ups, I will post homework assignments. These assignments will consist of analytical and conceptual questions that will allow you to review and think about the main concepts that we will have discussed during the lectures.
- Both case write-ups and homework assignments are group assignments. Each group will be composed of a *maximum of five* students. You don't need to stay in the same group for all assignments. Please hand in *one printed assignment per group* and keep a copy for your records. Late assignments will not be accepted.

- There will be many opportunities for you to get involved in our class discussions. My teaching style is to rely on cold calling. This ensures that all students get a chance to participate and it helps you get used to thinking on your feet. Your *class participation* will be evaluated on my assessment of the following:
 1. Can you identify key issues?
 2. Can you clearly and convincingly articulate your viewpoint?
 3. Can you build on the arguments of others to contribute to a superior solution?
- Class attendance is mandatory and will affect your class participation grade. Please contact me by email in advanced if you cannot attend one of the sessions. If the absence is justified, remedial work may be assigned to make-up for the class absence.
- Homework assignments and class discussions constitute the best preparation for the exam.
- There will be a midterm and a final exam. We'll discuss in class the details relative to their implementation.

COURSE MATERIALS

- (Textbook) Grinblatt, M. and S. Titman, 2002, *Financial Markets and Corporate Strategy*, 2nd. Ed., Irwin/McGraw Hill. (GT thereafter).
- Course pack containing additional readings and cases.
- Class notes: Posted in Canvas in advance.

GRADING

Class assignments	40%
Class participation	10%
Midterm Exam	20%
Final Exam	30%

- The final exam will be cumulative. This allows me to implement “*the top 20% rule*”. According to this rule if you are in the top 20% of the class in the final exam (and you have fulfilled the rest of class requirements - i.e., midterm, assignments, participation and attendance- in a reasonably satisfactory way) you'll get an A in the class.

McCOMBS CLASSROOM PROFESSIONALISM POLICY

- The highest professional standards are expected of all members of the McCombs community. The collective class reputation and the value of the Texas MBA experience hinges on this.
- Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects. Please be on time, be prepared to actively contribute and avoid class disruptions.

ACADEMIC DISHONESTY

- I will be strict against academic dishonesty. We will follow the Honor System (please see the last pages of this syllabus for details).

STUDENTS WITH DISABILITIES

- The University of Texas at Austin provides upon request appropriate academic accommodations for qualified students with disabilities. For more information, contact the Office of the Dean of Students at 471-6259, 471-6441 TTY.

Articles

1. Alex Triantis and Adam Borison, “*Real Options: State of the Practice*,” Journal of Applied Corporate Finance 14-2, 2001.
2. John R. Graham and Campbell R. Harvey, “*Theory and Practice of Corporate Finance – Evidence from the Field*,” Journal of Financial Economics 61, 2001.
3. David S. Hawkins “*Bond Ratings*,” HBS 9-104-060, March-2005.
4. Morgan Stanley Roundtable, “*Managing Financial Trouble*” Journal of Applied Corporate Finance 2007.
5. Henri Servaes and Peter Tufano, “*The Theory and Practice of Corporate Debt Structure*” Deutsche Bank (2006).
6. Henri Servaes and Peter Tufano, “*The Theory and Practice of Corporate Liquidity Policy*” Deutsche Bank (2006).
7. Tim C. Opler, Michael Saron and Sheridan Titman, “*Designing Capital Structure to Create Shareholder Value*,” Journal of Applied Corporate Finance, 10-1, 1997.
8. Mayers, David, “*Convertible Bonds: Matching Financial and Real Options*,” Journal of Applied Corporate Finance, 2000.

Cases

1. Dixon Corporation: The Collinsville Plant (HBS 9-298-165)
2. Arundel Partners (HBS 9-292-140)
3. Massey Ferguson, 1980 (HBS 9-282-043)
4. MCI Communications Corp., 1983 (HBS 9-284-057)

CLASS SCHEDULE

To facilitate the organization of the class, I have divided the class periods in blocks of approximately two hours each. Each block corresponds to a lecture.

PART 1: SECURITY AND PROJECT VALUATION

Lecture 1 (Aug 11): Introduction. The risk-return trade-off.

Readings: Chapters (GT) 4 & 5.

Lecture 2 (Aug 11): Portfolio theory: Mean-variance analysis and CAPM.

Readings: Chapters (GT) 4 & 5.

Lecture 3 (Aug 12): NPV, Cost of capital & R-ADR method.

Readings: Chapters (GT) 9, 10 & 11.

Lecture 4 (Aug 12): Free-cash flow valuation: APV and WACC.

Readings: Chapters (GT) 9 & 13.

PART 2: FUTURES, OPTIONS AND REAL OPTION VALUATION

Lecture 5 (Aug 29): Intro to Options, Forwards & Futures. Fundamental vs. Derivative Valuation.

Readings: Chapters (GT) 7 & 8.

Lecture 6 (Aug 29): Option Pricing. Forward and Futures Pricing. Project Valuation Case.

Readings: Chapters (GT) 7 & 8. Dixon Corporation Case (due).

Lecture 7 (Sep 11/12): The Use of Forward Prices in Capital Budgeting. Introduction to Real Options.

Readings: Chapters (GT) 11 and 12.2-pp. 426-9. Article 1.

Lecture 8 (Sep 11/12): Real Option Valuation: Applications (I)

Readings: Chapter (GT) 12.

Lecture 9 (Sep 26): Real Option Valuation: Applications (II)

Readings: Chapter (GT) 12. Articles 2 (Part 1).

Lecture 10 (Sep 26): Real Option Valuation Case.

Readings: Arundel Partners Case (due).

PART 3: FIXED INCOME ANALYSIS & FIRM CAPITAL STRUCTURE

Lecture 11 (Oct 3): The Leverage Effect. Debt & Taxes.

Readings: Chapter (GT) 14 & 16. Article 3.

Lecture 12 (Oct 3): Limits on the Use of Debt: Bankruptcy Costs and Strategic Effects of Debt.

Readings: Chapter (GT) 16 & 17. Article 4.

Lecture 13 (Oct 31): Debt and Incentives. Leveraged Buy-Outs.

Readings: Chapter (GT) 18. Article 5.

Lecture 14 (Oct 31): Introduction to Fixed Income Analysis.

Readings: Chapter (GT) 2.

Lecture 15 (Nov 14): Managing Fixed Income. Duration and Convexity.

Readings: Chapter (GT) 23.

Lecture 16 (Nov 14): Capital Structure Analysis Case.

Readings: Massey Ferguson Case (due).

PART 4: ISSUING SECURITIES.

SECURITY DESIGN: THE CASE OF CONVERTIBLE BONDS

Lecture 17 (Nov 21): Raising Capital. The Information Conveyed by Financing Decisions.

Readings: Chapters (GT) 1 & 19. Articles 6 and 7.

Lecture 18 (Nov 21): Financing Growth. The Use of Convertible Bonds.

Readings: Articles 3 (Part 2) and 8.

Lecture 19 (Dec 5): Security issuance Case.

Readings: MCI Case (due).

Due dates:

1) Exams:

Midterm: Oct 24-25 (Takehome exam).

Final: Dec 11-12 (Takehome exam).

2) Cases:

Dixon: Aug 29.

Arundel: Sep 26.

Massey Ferguson: Nov 14.

MCI: Dec 5.

Homework due dates will be determined as class develops.

Honor Code Purpose

Academic honor, trust and integrity are fundamental to The University of Texas at Austin McCombs School of Business community. They contribute directly to the quality of your education and reach far beyond the campus to your overall standing within the business community. The University of Texas at Austin McCombs School of Business Honor System promotes academic honor, trust and integrity throughout the Graduate School of Business. The Honor System relies upon The University of Texas Student Standards of Conduct (Chapter 11 of the Institutional Rules on Student Service and Activities) for enforcement, but promotes ideals that are higher than merely enforceable standards. Every student is responsible for understanding and abiding by the provisions of the Honor System and the University of Texas Student Standards of Conduct. The University expects all students to obey the law, show respect for other members of the university community, perform contractual obligations, maintain absolute integrity and the highest standard of individual honor in scholastic work, and observe the highest standards of conduct. Ignorance of the Honor System or The University of Texas Student Standards of Conduct is not an acceptable excuse for violations under any circumstances.

The effectiveness of the Honor System results solely from the wholehearted and uncompromising support of each member of the Graduate School of Business community. Each member must abide by the Honor System and must be intolerant of any violations. The system is only as effective as you make it.

Faculty Involvement in the Honor System

The University of Texas at Austin McCombs School of Business Faculty's commitment to the Honor System is critical to its success. It is imperative that faculty make their expectations clear to all students. They must also respond to accusations of cheating or other misconduct by students in a timely, discrete and fair manner. We urge faculty members to promote awareness of the importance of integrity through in-class discussions and assignments throughout the semester.

Expectations Under the Honor System

Standards

If a student is uncertain about the standards of conduct in a particular setting, he or she should ask the relevant faculty member for clarification to ensure his or her conduct falls within the expected scope of honor, trust and integrity as promoted by the Honor System. This applies to all tests, papers and group and individual work. Questions about appropriate behavior during the job search should be addressed to a professional member of the Career Services Office. Below are some of the specific examples of violations of the Honor System.

Lying

Lying is any deliberate attempt to deceive another by stating an untruth, or by any direct form of communication to include the telling of a partial truth. Lying includes the use or omission of any information with the intent to deceive or mislead. Examples of lying include, but are not limited to, providing a false excuse for why a test was missed or presenting false information to a recruiter.

Stealing

Stealing is wrongfully taking, obtaining, withholding, defacing or destroying any person's money, personal property, article or service, under any circumstances. Examples of stealing include, but are not limited to, removing course material from the library or hiding it from others, removing material from another person's mail folder, securing for one's self unattended items such as calculators, books, book bags or other personal property. Another form of stealing is the duplication of copyrighted material beyond the reasonable bounds of "fair use." Defacing (e.g., "marking up" or highlighting) library books is also considered stealing, because, through a willful act, the value of another's property is decreased. (See the appendix for a detailed explanation of "fair use.")

Cheating

Cheating is wrongfully and unfairly acting out of self-interest for personal gain by seeking or accepting an unauthorized advantage over one's peers. Examples include, but are not limited to, obtaining questions or answers to tests or quizzes, and getting assistance on case write-ups or other projects beyond what is authorized by the assigning instructor. It is also cheating to accept the benefit(s) of another person's theft(s) even if not actively sought. For instance, if one continues to be attentive to an overhead conversation about a test or case write-up even if initial exposure to such information was accidental and beyond the control of the student in question, one is also cheating. If a student overhears a conversation or any information that any faculty member might reasonably wish to withhold from the student, the student should inform the faculty member(s) of the information and circumstance under which it was overheard.

Actions Required for Responding to Suspected and Known Violations

As stated, everyone must abide by the Honor System and be intolerant of violations. If you suspect a violation has occurred, you should first speak to the suspected violator in an attempt to determine if an infraction has taken place. If, after doing so, you still believe that a violation has occurred, you must tell the suspected violator that he or she must report himself or herself to the course professor or Associate Dean of the Graduate School of Business. If the individual fails to report himself or herself within 48 hours, it then becomes your obligation to report the infraction to the course professor or the Associate Dean of the Graduate School of Business. Remember that although you are not required by regulation to take any action, our Honor System is only as effective as you make it. If you remain silent when you suspect or know of a violation, you are approving of such dishonorable conduct as the community standard. You are thereby precipitating a repetition of such violations.

The Honor Pledge

The University of Texas at Austin McCombs School of Business requires each enrolled student to adopt the Honor System. The Honor Pledge best describes the conduct promoted by the Honor System. It is as follows:

"I affirm that I belong to the honorable community of The University of Texas at Austin Graduate School of Business. I will not lie, cheat or steal, nor will I tolerate those who do."

"I pledge my full support to the Honor System. I agree to be bound at all times by the Honor System and understand that any violation may result in my dismissal from the Graduate School of Business."