

UNIVERSITY OF NOTRE DAME
DEPARTMENT OF FINANCE
FIN 60400 Finance I
Fall (Module 2) 2007

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Text: Financial Management: An Introduction to Principles and Practice: Custom Edition,
Lewellen, Halloran, and Lanser, Thomson Learning Custom Publishing

FIN 60400 Course Notes and Cases, Thomson Learning Custom Publishing

Both of the above materials are available at the Hammes Bookstore

| <u>Grading:</u> | <u>Points</u> | <u>%</u> |
|-------------------------------------|---------------|-------------|
| Test #1 | 300 | 30 |
| Test #2 | 300 | 30 |
| Finance Cases: | | |
| Write-Up (1 assignment) | 100 | 10 |
| Presentation (1 assignment) | 100 | 10 |
| Responses (2 assignments) | 80 | 8 |
| Values Case Write-Up (1 assignment) | 40 | 4 |
| Problem Sets (10 assignments) | 50 | 5 |
| Attendance (10 of 12 classes) | 30 | 3 |
| | <u>1,000</u> | <u>100%</u> |

Tests:

Each test will cover approximately 50% of the course material. The tests will consist of true/false questions (30 points), multiple choice questions (60 points), problems (120 points), and essay questions (90 points). Each chapter covered on a test will receive about equal weight in the test questions and problems.

Problem Sets:

Homework assignments will be handed in at the start of class on the assigned dates. Each problem set will receive a grade of 5 points if it is satisfactory. Unsatisfactory problem sets will receive fewer than 5 points.

Attendance and Make-Up Policy:

The class roll will be taken daily. Each student will receive 3 points for each class attended up to a maximum of 10 classes. Students will be responsible for all the material assigned or covered in the text and in class.

No make-up tests will be given without official excuse subsequent to absence or instructor's approval prior to the test.

Cases (Team Grade):

Write-Ups

Two written case analyses will be completed on a team basis. Teams will consist of five individuals who will be pre-assigned by the MBA office. The specific questions to be answered in the case write-up are provided in this syllabus. The purpose of the write-up is to apply the concepts and analytical tools discussed in the text and in class to a realistic business scenario. Each team will submit one write-up for a finance case on the date that the case is assigned to that team. In addition, every team will submit a write-up for the Veridian values case on November 13. The following format should be followed on each write-up:

- 1) a cover page with the name of the case, the names of all team members, and the team number that will be assigned by the professor;
- 2) a two-page typed narrative that addresses the questions associated with the case;
- 3) an appendix that contains details of the qualitative analysis and shows all computations in separate exhibits.

Presentations

Each case team will also make an oral presentation in class of one case. The presentation will be based on the team's written analysis of one question associated with a case. The purpose of the presentation is to demonstrate your ability to analyze the issues raised in the questions associated with the cases. The case presentation will have two components:

- 1) Analysis of a specific case question (10 minutes)
- 2) Reply to questions and comments from one or more responding teams (5-15 minutes)

Response

Each case team will respond to the oral presentation of one team for two separate cases. The response will take the form of questions and comments for 5 minutes concerning the specific details of the analysis and recommendations of the oral presentation. The purpose of the response is to demonstrate your familiarity with the case and your ability to understand and evaluate the oral presentation of another team.

In addition to asking oral questions during class, each responding team will submit a typed list of four questions along with tentative answers to those questions. These questions and answers should deal with issues associated with the case questions assigned to a specific presenting team. Each answer should be three or four sentences in length.

Cases (Individual Grade):

Each team member will assign a percentage of team effort to each of the five team members. The instructor will average the percentage of team effort assigned to each team member. A student will lose points if his/her average percentage of team effort is less than 20%.

Example

| | |
|---|---|
| Team #1's total case grades | 292 points (out of 320 possible points) |
| Average % of team effort assigned to team member #1 | 17% |
| Team member #1's case grade (292 points x 17%/20%) | 248 points |

OVERALL COURSE GOALS

1. **Terminology** –basic facts and relationships of financial management
(Learning Objectives 1, 2, 3, 4, 5, 8, 9, 12, 13)
2. **Theory** –fundamental principles of valuation and the role of the risk-return tradeoff
_____ (Learning Objectives 5, 6, 7, 9, 11, 12, 13)
3. **Techniques** –analytical skills and methodologies employed by financial managers
(Learning Objectives 2, 3, 4, 5, 10, 11, 12, 13)_____

DETAILED COURSE LEARNING OBJECTIVES

By the end of the course, you should be able to:

1. Evaluate the role and responsibilities of a financial manager. (Ch. 1)
2. Construct and interpret a statement of cash flows. (Ch. 2)
3. Perform a financial ratio analysis of a firm. (Ch. 2)
4. Identify and distinguish the various types of financial markets and instruments. (Ch. 3)
5. Identify the determinants of interest rates. (Ch. 3)
6. Calculate and interpret the present value (PV) of a series of cash flows. (Ch. 5)
7. Describe the determinants of investment value. (Ch. 6)
8. Explain how an investment's required rate of return (RRR) is determined. (Ch. 6)
9. Calculate the value and yield on bonds and stocks. (Ch. 7)
10. Calculate and interpret the net present value (NPV) and internal rate of return (IRR) of a capital investment. (Ch. 9)
11. Accurately identify and estimate the cash flows that should be included in the NPV and IRR evaluation of a proposed investment. (Ch. 10)
12. Make the appropriate adjustments to account for the impact of inflation, unequal project lives, and capital rationing on the evaluation of a proposed investment. (Ch. 10)
13. Identify the real options associated with a proposed investment and calculate their impact on the investment's NPV. (Real Options notes)

Case Write-Up Information

Audience: Your superior who assigned you to analyze this case

Main Point: To demonstrate your ability to apply financial tools and concepts to the analysis of a real world firm. Each case is relevant to a number of the Course Objectives:

Oracle: This case requires teams to perform financial statement analysis through the use of financial ratios. (Course Objective # 2, 3, 7)

Veridian: This case requires evaluation of how the intangible aspects of value-based management can influence the traditional economic value of a firm. (Course Objectives # 1, 7)

Calaveras: This case requires the valuation of a firm through the use of several different valuation techniques, including the calculation of the PV of Free Cash Flows. (Course Objectives # 2, 6, 7, 8, 10)

Diamond: This case requires evaluation of a proposed capital investment through the use of NPV and IRR evaluation techniques. (Course Objectives # 5, 8, 10, 12)

Procedure: Discuss the following factors in answering the questions provided with the case:

1. the main problems or issues involved
2. proposed recommendations/solutions
3. rationale for your recommendations

Grading

Standards: The write-up will be graded on scale of 0 to 100 points based on the criteria shown on the Case Write-Up Evaluation form which will be discussed in class.

Note: The Veridian case will be graded on a scale of 0 to 40 points. All case teams will hand in a write-up for this case.

Case Presentation Information

- Audience:** Your superior who assigned you to analyze the case
- Main Point:** To demonstrate your ability to analyze the case issues and to effectively communicate the results of your analysis.
- Procedure:** The case presentation by the individual team members has two components:
1. Analysis of one case question (10 minutes)
2. Response to questions from the responding team(s) (5-15 minutes)
- Grading Standards:** The presentation will be graded on a scale of 0 to 100 points based on the criteria shown on the Case Presentation Evaluation form which will be discussed in class.

Case Response Information

- Audience:** Your subordinate to whom you have assigned the task of analyzing the case
- Main Point:** To demonstrate your ability to identify and address key financial issues raised by each case.
- Procedure:** After another team has presented its analysis of a specific case question, you will respond with questions and comments regarding the details of the team's analysis and recommendations. You will do this for two separate case presentations during the semester.
- Grading Standards:** A team's response will be graded on a scale of 0 to 40 points based on the criteria shown on the Case Response Evaluation form which will be discussed in class.

CASE QUESTIONS

Case #1: Oracle System Corp.

1. What do Oracle's historical financial statements (Exhibits 1 and 2) indicate about its performance and current financial position?
2. Calculate Oracle's annual statements of cash flows for the years 1986 through 1990 and the quarterly statement for the quarter ended August 31, 1990. What do these statements indicate about the firm's sources and uses of funds?
3. What questions about Oracle do the financial ratios in Exhibit 3 raise? What questions do the peer financial ratios in Exhibits 6 and 7 raise? (Note: ignore the financial data for Oracle in Exhibit 7. Exhibit 3 has the necessary data for Oracle.)
4. Was Oracle financially healthy in September 1990? What might account for the firm's decline in share price in late 1990?
5. What is the source of intrinsic investment value of Oracle? Is this source reflected in the firm's financial statements?
(Intrinsic value is the price that an investor should be willing to pay for the entire firm in an acquisition based on the firm's future cash flows. Intrinsic value can be distinguished from accounting book value as shown on the balance sheet and from the current market value as observed in financial markets.)

Case # 2: Veridian: Putting a Value on Values

1. How successful has David Langstaff's leadership been?
2. How should David Langstaff think about his responsibilities and duties in this situation?
3. What will Veridian look like after this merger? Should this even be a consideration to David Langstaff?
4. What should David Langstaff do about the \$28 per share offer? Is \$28 per share an appropriate price?

Case #3: Calaveras Vineyards

(Use Excel spreadsheet [Calaveras Vineyards.xls] for your calculations.)

1. Prepare a discounted free cash flow valuation of Calaveras. (Use a discount rate of 13% for the calculation of the PV of Calaveras' free cash flows.) How relevant is this information to Lynna Martinez and Peter Newsome? How relevant is this information to Anne Clemens?
2. Use other valuation techniques (accounting book value of assets, liquidation value of assets, P/E ratio multiple value, Market Value-to-Book Value ratio multiple) to value Calaveras. Which of the valuation techniques in questions 1 and 2 is most reliable? Why?
3. Perform a sensitivity analysis on assumptions that are "key value drivers." What does this analysis indicate about the reliability of your value estimate for Calaveras?
4. Would Calaveras be a creditworthy borrower? What are the principal risk factors in this credit? Can Calaveras service the proposed debt?
5. What should Anne Clemens do? Prepare a recommendation for action by Goldengate Capital. If you decline to participate on the proposed terms, prepare a counterproposal to NationsBank.

Case #4: Diamond Chemicals PLC

(Use Excel spreadsheet [Diamond Chemicals.xls] for your calculations.)

1. What changes should Lucy Morris ask Frank Greystock to make in his DCF analysis? What is the justification for each of these changes?
2. What should Morris be prepared to say to the Transport Division, the Director of Sales, her assistant plant manager, and the analyst from the Treasury staff?
3. How attractive is the Merseyside project? Based on which criteria? Which of Diamond Chemicals' investment criteria are most relevant for this proposed decision?
4. Should Morris continue to promote the project for funding? Perform a sensitivity analysis of key variables to indicate under what conditions Morris should delay the project or reject it altogether.

CASE ASSIGNMENTS

| <u>Case</u> | <u>Question #</u> | <u>Presenting Team</u> (10 Min./Team) | | <u>Responding Team</u> (5 Min./Team) | |
|-------------|-------------------|--|-------------------|---|-------------------|
| | | <u>Section 04</u> | <u>Section 02</u> | <u>Section 04</u> | <u>Section 02</u> |
| Oracle | 1 | Team # 1 | Team # 14 | Team # 6, 7 | Team # 19, 20 |
| | 2 | Team # 2 | Team # 15 | Team # 8, 9 | Team # 21, 22 |
| | 3 | Team # 3 | Team # 16 | Team # 10, 11 | Team # 23, 24 |
| | 4 | Team # 4 | Team # 17 | Team # 12 | Team # 25 |
| | 5 | Team # 5 | Team # 18 | Team # 13 | Team # 26 |
| Calaveras | 1 and 2 | Team # 6 | Team # 19 | Team # 1, 2, 3 | Team # 14, 15, 16 |
| | 3 | Team # 7 | Team # 20 | Team # 4, 5 | Team # 17, 18 |
| | 4 | Team # 8 | Team # 21 | Team # 10, 11 | Team # 23, 24 |
| | 5 | Team # 9 | Team # 22 | Team # 12, 13 | Team # 25, 26 |
| Diamond | 1 | Team # 10 | Team # 23 | Team # 1, 2, 3 | Team # 14, 15, 16 |
| | 2 | Team # 11 | Team # 24 | Team # 4, 5 | Team # 17, 18 |
| | 3 | Team # 12 | Team # 25 | Team # 6, 7 | Team # 19, 20 |
| | 4 | Team # 13 | Team # 26 | Team # 8, 9 | Team # 21, 22 |

Note: Case write-ups are to be completed only by the presenting teams for each case. The write-ups should include answers for all case questions. Responding teams will submit four questions and tentative answers that deal with the case question to be discussed by the presenting team. Each case team will make a presentation for one case and respond to another team's presentation for two cases. There will be no class presentation for the Veridian case.

PROBLEM ASSIGNMENTS

| | | |
|------|---------|----------------------------------|
| PS#1 | (Ch. 2) | Problem: 16, 17 |
| PS#2 | (Ch. 3) | Problem: 5, 7, 9, 16 |
| PS#3 | (Ch. 5) | Problem: 16, 20, 25, 26, 28, 36* |

*For Problem #36, part (c), assume that you own a \$50,000 Treasury note.

| | | |
|------|----------|-----------------------------|
| PS#4 | (Ch. 7) | Problem: 1, 2, 6, 7 |
| PS#5 | (Ch. 7) | Problem: 15, 16, 20, 21, 25 |
| PS#6 | (Ch. 9) | Problem: 3, 12, 13, 16 |
| PS#7 | (Ch. 9) | Problem: 18, 19, 20 |
| PS#8 | (Ch. 10) | Problem: 14*, 20* |

*In problems 14 and 20, all machinery is being depreciated to a zero book value.

* In problem 20, the old machine has 10 years left in both its depreciable life and its economic life.

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| PS#9 | (Ch. 10) | Problem: 25, 30, 31 |
| PS#10 | (Real Options Notes) | Problem: 4, 5, 6, 7, 8, 9 |

ASSIGNMENT SHEET

| <u>Class #</u> | <u>Date</u> | <u>Topic</u> | <u>Assignment</u> |
|----------------|------------------|---|--------------------------------------|
| 1 | 10/30 (Tues.) | Introduction Role of Financial Manager | None Chapter 1, pp. 2-15 |
| 2 | 11/1 | Financial Ratios Statement of Cash Flows | Chapter 2 PS #1 |
| 3 | 11/6 (Tues.) | Interest Rate Determination | Chapter 3, pp. 60-62, 70-80 PS #2 |
| 4 | 11/8 | Financial Statement Analysis | Case #1: Oracle |
| 5 | 11/13 (Tues.) | Values-Based Management PV Analysis | Case #2: Veridian Chapter 5 PS #3 |
| 6 | 11/15 | Investment Valuation Model Review Session | Chapter 6, pp. 164-182 |
| 7 | 11/20 (Tues.) | Test #1 Jordan Auditorium 10:30 a.m. - 12:30 p.m. | Chapters 1, 2, 3, 5, 6 |

| Class # | Date | Topic | Assignment |
|----------------|------------------|------------------------------|---------------------------------|
| 8 | 11/22 | Bond Valuation | Chapter 7, pp. 205-214 PS #4 |
| | | Stock Valuation | Chapter 7, pp. 215-229 PS #5 |
| 9 | 11/21 (Tues.) | Valuation | Case #3: Calaveras Vineyards |
| 10 | 12/4 (Tues.) | Capital Budgeting Criteria | Chapter 9, pp. 262-282 PS #6 |
| | | Capital Budgeting Criteria | Chapter 9, pp. 282-288 PS #7 |
| 11 | 12/6 | Capital Budgeting Cash Flows | Chapter 10, pp. 302-325 PS #8 |
| | | Capital Budgeting Cash Flows | Chapter 10, pp 325-333 PS #9 |
| 12 | 12/11 (Tues.) | Capital Budgeting | Case #4: Diamond Chemicals |
| 13 | 12/12 (Weds.) | Real Options | Real Option Notes PS #10 |
| | | Review Session | |
| | 12/18 (Tues.) | Test #2 | Chapters 7, 9, 10, Real Options |
| | | Jordan Auditorium | |