

**Kellogg School of Management
Northwestern University
Finance 440 'Turbo Finance'
Fall Quarter 2008**

Professor Janice Eberly

Course Description

Finance 440 combines the material of Finance 430 and Finance 441 into an intensive one-quarter course that provides an introduction to the major topics in the field of finance, with an emphasis on valuation and corporate finance principles.

Texts and Supplementary Materials

Required:

Richard Brealey, Stewart Myers, and Franklin Allen, Principles of Corporate Finance, McGraw-Hill, 9th Edition, 2008.

Case Packet (contains Course Notes, articles and old exams).

A copy of the overhead slides for each lecture will be handed out in class. Make sure you get a copy, as this will greatly reduce the need to take notes.

Supplementary readings and other topical material also will be posted on the course Web page on Blackboard. You should bring your nameplate to each class, and have it out throughout the quarter.

Recommended:

There is a handout in the case packet entitled *Using Financial Functions in Excel*, by Prof. Korajczyk. It is important to learn how to do these financial calculations on a spreadsheet, such as Excel. If you have a financial calculator and know how to use it, this can also be helpful, but it is not required.

For newcomers to finance, an introduction (such as Kenneth Morris and Alan Siegel, *The Wall Street Journal Guide to Understanding Money and Investing*, Fireside, 1999) may provide a helpful overview of financial markets and instruments.

Koller, Goedhart, and Wessels, *Valuation -- Measuring and Managing the Value of Companies*, Wiley, fourth edition, 2005. Brought to you by McKinsey and Company, this is an update of a classic book on capital budgeting. It integrates finance and accounting in a more practical way than you'll find in any textbook, while staying true to the principles of the theory of finance.

Office Hours

We will announce weekly office hours in class and on the web page when the term starts. If it is not possible for you to make this scheduled time, we can make an appointment. The best way to reach the faculty or TA is generally by email.

Review Sessions

The teaching assistant for this class is Jonathan Brogaard, who is a PhD student studying finance. Jonathan will run weekly review sessions on Wednesdays to go over the problem sets and cover additional questions. These are optional and you should attend as you need to. There will be a review session before the midterm and the final.

Grading

There are two exams; the midterm is worth 30% of your grade and the final is worth 40% of your grade. The midterm is a free option -- if it doesn't help your grade, 70% of the grade will be based on the final, which is cumulative. Requests for reconsideration of grading must be submitted in writing within 10 working days of when the material is returned. If a regrade is requested, the entire material will be re-evaluated. I cannot discuss any material for which a regrade will be requested, since the regrade (like the homework or exam) must be based entirely on your own work.

The Kellogg Honor Code strictly applies. Exams must be completed independently and within the allotted time. Only the specifically allowed materials may be used and nothing else. On the homework you can consult with any other class members and refer to class materials, except that answers to previous years' problems are off limits.

There are six graded homework assignments (problem sets and cases), some requiring the use of a PC and spreadsheet program; each is worth 5 points (5% of your grade). The assignments may be submitted by groups of up to five; working on the homework in groups is highly recommended. Your answers should be clear and explanatory (the solution and how you obtained it); a spreadsheet alone is not considered a sufficient solution.

Assignment due dates are given on the course outline and are non-negotiable – in the interest of fairness and as required by the honor code, all students should face the same set of deadlines. If you foresee a problem, let me know immediately. To summarize:

final score =

$$\text{HW \#1} + \text{HW \#2} + \text{HW \#3} + \text{HW \#4} + \text{HW \#5} + \text{HW \#6} + \max[\text{midterm} + \text{final}, \text{final} \times 1.75]$$

Comment on homework and practice problems: The main objective of the homework is to help you learn by preparing for the class and thinking about the material. The recommended problems from Brealey, Myers, and Allen are very helpful in absorbing the material and preparing for the exams (but they will not be graded). My advice is to do your best answering the homework and practice questions, but recognize that they are hard and meant to make you think. The best gauge is whether you understand the issues and the solutions that are handed out.

Course Outline and Assignments

This is the list of the topics that will be covered, readings, and recommended problems. This course moves very quickly. To keep up, it is essential that you complete the assigned readings prior to class, and that you work the practice problems along the way. Note that all the recommended problems refer to the "Practice Questions" section in Brealey, Myers, and Allen unless otherwise stated. Answers to these recommended problems are included on the web site. Copies of the instructor's manual (with answers to all problems) and study guide for Brealey, Myers, and Allen are on reserve in the library. ****denotes optional readings.**

Topic 1: Introduction to Present Value Concepts and Value Maximization

Week 1 *Reading:* BMA 1, 2, 3
 Course Notes #1
Practice Questions: Ch. 2: 9, 11, 12; Ch. 3: 12, 13, 14, 18-22, 27, 28, 33

Topic 2: Using Present Value for Capital Budgeting and Security Valuation

Week 1-2 *Reading:* BMA 4.1, 4.4, 5, 6, 7, 13.2
 Course Notes #2
 "AT&T Uses Shareholder Wealth as a Guide to Strategy" (*Planning Review*)
Case: Ocean Carriers
Practice Questions: Ch. 5: 26, 28; Ch. 6: 8, 10, 11, 12;
 Ch. 7: 19-22, 24, 26

Topic 3: Risk and Return I: Diversification and Portfolio Choice

Week 2-3 *Reading:* BMA 8, 9
 Course Notes #3
 "Great Expectations" (*The Economist*)
Practice Questions: Ch 8: 13,14, 17, 19; Quiz 4 & 7, plus Challenge Question #25
 Ch. 9: 8, 10, 15, 18

Topic 4: Risk and Return II: The CAPM and Valuation Under Uncertainty

Week 3-4 *Reading:* BMA 10
 Course Notes #4
 "How High a Hurdle?" (*The Economist*)
Optional Reading: BMA 11*, 12*
Case: Beta Management
Practice Questions: Ch. 10: 10, 15, 18, and Challenge Question #27

Topic 5: Market Efficiency

Week 4 *Reading:* BMA 14
 "Teaching Note on Market Efficiency"
 "Are Markets Efficient?" (*The Wall Street Journal*)
Optional Reading: "The Motives and Consequences of Debt-Equity Swaps and
 Defeasances: more evidence that it does not pay to manipulate earnings"
 (*Journal of Applied Corporate Finance*) *
Practice Questions: Ch. 14: 11, 13-16, and Challenge Question #20

Topic 6: Derivative Securities

Week 5 *Reading:* BMA 21, 22, 23
Course Notes #6
Teaching note on “Valuing Loan Guarantees”
Optional Reading: “The Options Approach to Capital Investment”* (*Harvard Business Review*)
Practice Questions: Ch. 21: 13, 20, 23, 27; Ch. 22: 10; Ch. 23: 9

Topic 7: Fixed Income Securities and the Yield Curve

Week 6 *Reading:* BMA 4.2-4.4, 24, 25.1, 27.1 - 27.3
Course Notes #7
“A Guide to Investing in U.S. Treasury STRIPS” (*AII Journal*)
Optional Reading: BMA 28.1 – 28.2*
Practice Questions: Ch.4: 21, 23-25, 27, Quiz #7; Ch. 27: 17-18;

Topic 8: Financing in Perfect Markets: Modigliani-Miller

Week 6 *Reading:* BMA 17 (focus on 17.5, perfect markets, for now), Ch. 18
Course Notes #8
Practice Questions: Ch. 17: 10, 12, 14; Ch. 18: 9, 13, 15, 19-20, Challenge Question #24

Topic 9: Capital Structure in Imperfect Markets I

Week 7 **Taxes and Financial Distress: Static Trade-off Theory**
Reading: BMA 19
Course Notes #9
“Debt and Taxes” (*The Journal of Finance*)
Case: Debt Policy at UST Inc.
Optional Reading: “The theory and practice of corporate finance: Evidence from the field,” (*Journal of Financial Economics*)*
Practice Questions: Ch. 19: 13, 21-22

Topic 10: Capital Structure in Imperfect Markets II

Week 8 **Valuation Techniques for Investment and Financing Decisions**
Reading: BMA 20
Course Notes #10
Case: Sampa Video, Inc.
Optional Reading: BMA 26*
Practice Questions: Ch. 20: 14, 16-18, 21

Topic 11: Dividends and Payout Policy

Week 9 *Reading:* BMA 17

Course Notes #11

Optional Reading: “Using Capital Structure to Communicate with Investors: The Case of CUC International” (*Journal of Applied Corporate Finance*) *

“Payout Policy in the 21st Century”, Brav, Graham, Harvey, & Michaely 2004*

“Effective Federal Tax Rates Under Current Law, 2001-2014,” CBO 2004*

Practice Questions: Ch. 17: 15, 18, 20

Topic 12: Raising Capital and Issuing Securities

Week 10 *Reading:* BMA 15

Course Notes #12

Optional Reading: BMA 16*, 25*