MGT 572
CORPORATE FINANCE

Spring 2010

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COURSE OBJECTIVE

Corporate Finance looks at two important, recurring challenges facing operating executives and financial managers: Managing the cash flowing through a business, and financing company operations. To address the first challenge the course will examine financial statement analysis, pro forma financial planning, cash budgeting and managing growth. Our study of financing company operations will consider the principal sources of capital to corporations and the ways in which companies can best utilize these sources to further operating goals, to avoid destroying shareholder value, and on occasion, to create shareholder value.

When you complete this course, you should be able to:

1. Analyze a company's financial statements and draw inferences about the firm's strengths and weaknesses.
2. Calculate and interpret a company's sustainable growth rate.
3. Appreciate the proper role of debt in financing operations.
4. Identify and analyze the many aspects of corporate financing policy, including the appropriate balance between debt and equity, the proper mix of internal and external sources of equity, the appropriate maturity profile and basis structure for liabilities, and the most advantageous markets in which to raise capital.
5. Appreciate the effect of company decisions to pay dividends or repurchase shares on firm value and know how to establish a practical residual payout policy.
6. Create financing policies that best support company operating strategies.

The course will be an active learning experience based primarily on the case method of instruction. The case method is the ideal way to study the topics addressed in this course because, although the topics are central to virtually all companies, existing theory has comparatively little of practical importance to say about several of them. The best way to learn the material, therefore, is to examine a sequence of practical problems to better understand the nature of those problems, and, more importantly, to master the logic by which alternative policies can be evaluated.
The philosophy of this course throughout will be that:

1. Skill in financial planning is vital to all operating executives, not just finance specialists.
2. Financing policy is much broader than simply the choice of an appropriate debt-equity mix, and creating a policy involves making choices over a wide range of issues.
3. Financing policy must be evaluated from multiple perspectives, including those of creditors, equity investors, competitors, and managers. All financial structures are loaded with incentives and disincentives for various parties, and we must understand these incentive effects before we can hope to assess the structure.
4. When creating financing policy, executives need to view capital markets from an entrepreneurial, or marketing, perspective. At root the task of creating financing policy is analogous to that of a marketing manager charged with designing, packaging and distributing a product. Here the manager is attempting to design and sell claims against the firm’s future income stream in a manner that provides capital on the most agreeable terms.

REQUIRED MATERIALS

2. Packet of cases and readings.

GRADING:
ABOUT THE INSTRUCTOR:

In 2005, Jack was named OGI’s Teacher of the Year, by vote of the student body and, in 2007, received the OGI School of Science and Engineering's Faculty Significant Achievement in Innovation Award.

Jack previously served as Vice-President and Chief Financial Officer of Planar Systems, Inc. and Smith’s Home Furnishings and as Corporate Controller of Tektronix. Earlier in his career, Jack held controllership positions with Fairchild Semiconductor, based in California, New Mexico, and Seoul, Korea.

Jack served as the American Electronics Association (now TechAmerica) Vice-Chair and Chair of both the Finance and the Emerging Business Committees. Jack was also a Board Member and President of the Portland Chapter of Financial Executives, International (FEI). During Jack’s FEI Presidency, the local chapter was runner-up for the Outstanding National Chapter of the Year award. Jack is also active with the Oregon Entrepreneurial Network (OEN), having served on the Entrepreneur of the Year Committee for two years. Jack is also a member of the Association for Corporate Growth.

In 2006, Jack was one of the judges for Ernst &Young's Entrepreneur of the Year award and in 2007 and 2008, was a judge for the Portland Business Journal's CFO of the Year award.

Jack also served as Chairman of the Technology Awards Banquet, with an attendance of over 600, in 2005.


Jack passed the CPA exam in 1979.

Jack is married and has three grown children. The oldest daughter is a nurse in Mammoth Lakes, California and her twin brother is a maintenance manager for Bishop’s in Portland. Jack’s youngest son is a CFO for a commercial real estate firm in Portland and was named to the Wilson High School and Portland Interscholastic League (PIL) Hall of Fame after a stellar high school and collegiate tennis career, including two state championships and captaining the University of Michigan tennis team.
WEEK 1: Interpreting Financial Statements - April 5-11, 2010


Lecture: Interpreting Financial Statements
Evaluating Financial Performance

Reading: Higgins, Chapters 1 & 2

Current Event Discussion: TBD

Article Discussion: The National Healthcare Crisis. Is eHealth a Solution? (HBSP Article BH 330)

Homework: Higgins, Chapter 1, Problem 4
Higgins, Chapter 1, Problem 8
Higgins, Chapter 2, Problem 8

Cases:

Prepare: Drivers of Financial Structure (HBSP Case Study 201039)
See how well you can identify the industries from the structure of the financial statements.

Prepare: Spencer Sporting Goods (Case To Be Distributed)

Working in teams, prepare answers to the following questions from the case:

What are Spencer’s main strengths and weaknesses at the present time? Why does the profitable company need money? In your estimation, how much money does Spencer need, and for how long, a few months or longer? As a banker, would you be willing to loan Spencer the needed amount, on what conditions?

Prepare: General Electric Healthcare, 2006 (HBSP Case Study 706478)
Was buying Amersham a good idea? Why or why not?

How does Amersham relate to the core idea behind the Global Product Company that was the essence of GE Medical Systems (the predecessor company to GE Healthcare)?

What kinds of actions did Immelt and Castell have to take in advance of the merger to ensure that any potential gains could be realized? What must Joe Hogan, in his new CEO role, now do to build on their earlier actions?

Video: Joe Hogan, President and CEO, GE Healthcare
WEEK 2: Financial Forecasting – April 12 -18, 2010

Topics Covered: Pro Forma Statements, Pro Forma Statements and Financial Planning, Computer-Based Forecasting, Coping with Uncertainty, Cash Flow Forecasts, Cash Budgets

Lecture: Financial Forecasting

Reading: Higgins, Chapters 3

Current Event Discussion: TBD

Article Discussions: Alterra Health Care’s Fast Track to Results (HBSP Article B0111D
Silo Busting: How to Execute on the Promise of Customer Service (HBR Article R0705F)

Homework: Higgins, Chapter 3, Problem 2
Higgins, Chapter 3, Problem 4
Higgins, Chapter 3, Problem 8

Cases:

Prepare: Sears Roebuck and Co. vs. Wal-Mart Stores, Inc. (HBSP Case Study 101011)

Working in teams, prepare answers to the following questions from the case:

What was Wal-Mart’s return on equity in 1997?
What was Sear’s return on equity that year?
Don Edwards was puzzled by these numbers because of Wal-Mart’s reputation as a premier retailer and Sear’s financial difficulties not long ago. What can we learn from looking at ROE?

What ratios are most important in evaluating the current performance of each of the two companies?
What are the determinants of ROE?

How useful are financial ratios in evaluating the performance of each of the two companies?

Prepare: Mangpu Central Hospital (A) (Crimson Press Coursepack)
Prepare a pro forma income statement and balance sheet for the coming year. Your “plug figure” for the line of credit should be ¥26,986.

What do these statements tell you about the operations of MCH?

Prepare: Mangpu Central Hospital (B) (Crimson Press Coursepack)
Prepare the cash flow worksheet contained in Exhibit 4. What does this tell you about the operations of MCH?
What is the cause of MCH’s cash flow problems? What solutions are available to Dr. Zhigang? What recommendations would you make to him?
WEEK 3: Managing Growth – April 24 (On-Campus)

**Topics Covered:** Sustainable Growth, Too Much Growth, What to Do When Actual Growth Exceeds Sustainable Growth, Too Little Growth, What to Do When Sustainable Growth Exceeds Actual Growth, Sustainable Growth and Pro Forma Forecasts, New Equity Financing

**Lecture:** Managing Growth

**Reading:** Higgins, Chapters 4

**Current Event Discussion:** TBD

**Article Discussion:** Sustaining Margin, Mission and Vision at St. Mary’s/Duluth Clinic (HBSP Article B0107C)

**Homework:** Higgins, Chapter 4, Problem 4
Higgins, Chapter 4, Problem 6

**Cases:**

**Prepare:** Calloway Laboratory: Pee for Profit (HBSP Case Study 807040)

Working in teams in class, prepare answers to the following questions:

- Why has Calloway been successful in the substance abuse screening business?
- Should Calloway enter the pain medication abuse market? If so, how?
- As a venture capitalist would you fund Calloway’s entry to the pain market and buy $5 million of shares directly from Arthur Levitan?

In addition to growing its substance abuse screening business, should Calloway pursue opportunity in the pain medication abuse market?

A. Yes, pursue the pain market.
B. No, only grow the substance abuse market.

As a venture capitalist would you be part of the $10-20 million financing round, of which $5 million would go directly to Arthur Levitan for some of his shares?

A. Yes would participate.
B. No, would not participate.

**Prepare:** Dividend Policy at FPL Group, Inc. (A) (HBSP Case Study 295059)

Working in teams in class, prepare answers to the following questions:

- Why do firms pay dividends? What, in general, are the advantages and disadvantages of paying cash dividends?
- What are the most important issues confronting the FPL group in May 1994?
From FPL’s perspective, is the current payout ratio appropriate? Would a higher payout ratio be more appropriate? a lower payout ratio?

From an investor’s perspective, is FPL’s payout ratio appropriate?

As Kate Stark, what would you recommend regarding investment in FPL’s stock: buy, sell or hold?

**WEEK 4: Financial Instruments and Markets - April 26-May 2, 2010**

**Topics Covered:** Financial Instruments, Financial Markets, Efficient Markets

**Lecture:** Financial Instruments and Markets

**Reading:** Higgins, Chapter 5

**Current Event Discussion:** TBD


**Homework:** Higgins, Chapter 5, Problem 2  
Higgins, Chapter 5, Problem 4  
Higgins, Chapter 5, Problem 8

**Cases:**

**Prepare:** Debt Policy At UST (HBSP 200069)

Working in teams, prepare answers to the following questions:

What are the primary business risks associated with UST Inc.? What are the primary attributes of UST Inc.? Evaluate from the viewpoint of a bondholder.

Why is UST Inc. considering such a dramatic change to their target capital structure after such a long history of conservative debt policy?

Calculate the marginal effect of the interest tax shield from the $1 billion in debt on UST’s value, assuming that:

1. the entire change in capital structure is implemented immediately (Jan. 1, 1999)
2. the tax rate is 38%
3. the $1 billion in new debt is constant and perpetual.

What will be the likely bond rating on the new debt? Why?
UST Inc. has paid uninterrupted dividends since 1912. Will the change in capital structure hamper future dividend payments?

Should UST implement the change in debt policy?

**Prepare:** Sealed Air Corporation’s Leveraged Recapitalization (A) (HBSP Case Study 294122)

- Why did Sealed Air undertake a leveraged recapitalization? Do you think that it was a good idea? For whom?

- Is pursuing a program of manufacturing excellence such as World Class Manufacturing (WCM) inconsistent with “levering up”?

- Why did Dermot Dunphy, the CEO, feel it was necessary to change the company’s priorities and incentive structure following the recap?

- Why did Sealed Air’s investor base turnover completely after the recap? Is this something managers should be concerned about?

- Was the constraint imposed on capital expenditures under the bank lending agreement good or bad for the company? Do you think managers will be able to successfully renegotiate this covenant?

- Would such an increase in leverage be good for all companies? Why or why not?

**WEEK 5: The Financing Decision - May 3-9, 2010**

**Topics Covered:** Financial Leverage, Measuring the Effects of Leverage on a Business, How Much to Borrow, Selecting a Maturity Structure

**Lecture:** The Financing Decision

**Reading:** Higgins, Chapters 6

**Is a Share Buyback Right Right for Your Company? (HBR Article R0104K)**

**Current Event Discussion:** TBD

**Article Discussion:** New Framework for Corporate Debt Policy (HBR Article 78504)

**Homework:** Higgins, Chapter 6, Problem 2
Higgins, Chapter 6, Problem 4
Higgins, Chapter 6, Problem 6
Higgins, Chapter 6, Problem 10
Case:

Prepare: Threshold Sports, LLC (UVA-F-1347)
What are management’s goals and strategy?

What creates the financing need in this company?

How do the three financing alternatives compare based on flexibility, risk, income (or valuation), control, timing, and any other considerations that you think may be important?

What course of action should Carl Frischkorn recommend? On what key bets does your proposal depend?

Prepare: Note on the Theory of Optimal Capital Structure (HBS Note 279069)

Working in teams, prepare answers the following questions:

Work through the data in Exhibit 1 to gain an understanding of how they are derived.

What factors are responsible for the optimal capital structure outlined in Exhibit 1? Why does the same optimal debt ratio simulataneously maximize the market value of the firm, maximize its stock price, and minimize its weighted average cost of capital?

What factors are responsible for the differences in optimal capital structure for firms of different industries and for firms in the same industry?

What approaches might a firm use to determine its capital structure? What problems might arise if the firm chooses a capital structure that is not optimal?

WEEK 6: Discounted Cash Flow Techniques - May 10-16, 2010

Topics Covered: Figures of Merit, Determining the Relevant Cash Flows

Lecture: Discounted Cash Flow Techniques

Reading: Higgins, Chapters 7
Introduction to Accumulated Value, Present Value and Internal Rate of Return (HBS Note 173003)

Pitfalls in Evaluating Risky Projects (HBR Article 85106)

Current Event Discussion: TBD

http://comp.uark.edu/~amalakho/teaching/finn5333/links/SharpePoint.pdf

**Homework:**  
Higgins, Chapter 7, Problem 2  
Higgins, Chapter 7, Problem 6  
Higgins, Chapter 7, Problem 12

**Cases:**

**Prepare:**  
Fonderia Di Torino S.P.A. (HBSP Case Study UV0092)

Assess the economic benefits of acquiring the Vulcan Mold-Maker machine. What is the initial outlay? What is an appropriate discount rate? What are the benefits over time? What is an appropriate discount rate? Does the net present value (NPV) warrant an investment in the machine?

What uncertainties or qualitative considerations might influence your recommendation? How, if at all, would an inflation rate of 3% (or higher) affect the attractiveness of the Vulcan Mold-Maker? Please estimate the impact on NPV from a change in any of those elements.

Should Francesca Cerini proceed with the project?

**Prepare:**  
Ginny’s Restaurant (HBSP Case Study (201099))

Working in teams, answer the assigned questions in the text.

**WEEK 7: Risk Analysis in Investment Decisions - May 17-23, 2010**

**Topics Covered:**  

**Lecture:**  
Risk Analysis in Investment Decisions

**Reading:**  
Higgins, Chapters 8  
Diversification, the Capital Asset Pricing Model, and the Cost of Equity Capital (HBS Note 276183)

Pitfalls in Evaluating Risky Projects (HBR Article 85106)

**Current Event Discussion:**  
TBD

**Article Discussion:**  
Innovation Killers: How Financial Tools Destroy Your Capacity to Do New Things (HBR Article 0801F)

**Homework:**  
Higgins, Chapter 8, Problem 2  
Higgins, Chapter 8, Problem 4

**Case:**
Prepare: Valmont Industries (UVA-F-1191)

Why do you think Valmont’s stock has “fallen out of favor” with Wall Street analysts? Using the financial data in Exhibit 5 and assuming 10% for the WACC and 35% as the tax rate, compute EVA for Valmont’s business segments for the years 1990-1993. What conclusions can you draw? For example, should Valmont expand or contract irrigation? Can you use EVA to help formulate the strategic direction of Valmont?

How do you interpret the EVAs for the corporate segment of the business? Does it appear that Valmont allocates corporate overhead expenses to its operating units? Should those costs be allocated for the purpose of computing EVA?

Should Terry McClain recommend that EVA be implemented at Valmont? If so, should he also recommend that managerial compensation be linked to EVA? Which employees in the company should be compensated based on EVA?

How would you design the incentive compensation formula for management? For example, would the formula use EVA or change EVA as the principal variable? How much of total compensation should be subject to EVA performance?

(Note: Please contact me to arrange for students to view the video associated with this case study)

WEEK 8: Business Valuation and Corporate Restructuring - May 24-30, 2010

Topics Covered: Valuing a Business, Discounted Cash Flow Valuation, Valuation Based on Comparable Trades, The Market for Control

Lecture: Business Valuation and Corporate Restructuring

Reading: Higgins, Chapters 9
What’s It Worth? A General Manager’s Guide to Valuation (HBR Article 97305)
Valuing Companies in Corporate Restructuring (HBS Note 201073)

Current Event Discussion: TBD

http://www.wrhambrecht.com/about/media/20050706wsj.pdf

Homework:
Higgins, Chapter 9, Problem 2
Higgins, Chapter 9, Problem 4
Higgins, Chapter 9, Problem 6
Higgins, Chapter 9, Problem 8
Case:

Prepare: Stonehill Family Practice (Crimson Press Coursepack)

Estimate the value of the practice using both the DCF and multiple approaches. DCF is based on projected values from 1998 to 2002.
Identify other approaches to estimate market value.
Identify other financial factors that potentially may influence the value of practice.
Develop a set of unresolved questions for Dr. Gill that will help assess how the practice operates.
What would you pay for this practice, given the DCF and multiple approaches and the strength and weaknesses of this practice.

WEEK 9: Mergers and Acquisitions - May 31-June 6, 2010

Readings: The Fine Art of Friendly Acquisition (HBR Article R00602)
Valuing a Business Acquisition Opportunity (HBS Note 289039)

Current Event Discussion: TBD


Case:

Prepare: Microsoft/Intuit (HBSP Case Study 295121)
If you were Bill Gates, what course of action would you take and why?
Pay $1.5 billion for a firm with total annual revenues of less than $200 million ( Exhibit 3)
Gear up to compete more aggressively and more effectively in these markets in an effort to repeat the kind of success that Microsoft had enjoyed in the word processing and spreadsheet market niches; or

Continue as a marginal player in the niches dominated by Intuit while focusing Microsoft’s efforts in other (perhaps more important) markets in the future.

WEEK 10: Corporate Finance Topics (On-Campus) – June 12, 2010

Research Topics:

Prepare: Each student to randomly select, research and analyze a pre-determined topic relating to corporate finance, and prepare a written summary documenting your findings. Also, prepare a 10-15 minute slide presentation to be delivered to the class during the Week 10 on-campus session.