

**Purdue University
School of Management**

MGMT 611
Financial Management II
Spring 2009

Professor John McConnell
Professor Mark Walker

Course Outline

This course is a continuation of your introduction to financial management. The objective of the two courses in combination (Financial Management I and Financial Management II) is to provide you with the conceptual framework necessary to appreciate and understand the problems facing a financial manager. Readings, class lectures, homework, and case discussions will focus on the basic tools used by financial analysts and financial decision-makers.

The two courses focus on the two basic problems that all firms face: on what should they spend their funds (investment decisions) and where should they get these funds (financing decisions)? In MGMT 611, we begin by exploring how the financial markets and investors view risk, and its implications for capital budgeting and corporate valuation. We will explore what securities the firm can issue to raise funds, how firms decide on the mix of securities with which they will finance their operations, and how to calculate the firm's resulting cost of capital. In the latter half of the course we will discuss corporate valuation, mergers and acquisitions, and initial public offerings (IPOs).

The textbook for the course is:

Stephen A. Ross, Randolph W. Westerfield, and Jeffrey F. Jaffe, *Corporate Finance*, Eighth Edition, McGraw-Hill/Irwin.

There is also a case packet for the course which you can pick up at the BoilerCopyMaker, Purdue Memorial Union, Room 157. A subscription to *The Wall Street Journal* or the *Financial Times* is a useful supplement to the course especially for students interested in selecting Finance as an option area.

The course grade will be based on a final exam, homework, and class participation. The weights for each of these are:

Final exam:	50%
Class participation:	35%
Homework:	15%

It is expected that the average course grade will be approximately 3.35 in keeping with the Krannert masters program guidelines. In the event of a major campus emergency, course requirements, deadlines and grading percentages are subject to changes that may be necessitated by a revised semester calendar or other circumstances. Here are ways to get information about changes in this course. Katalyst, email addresses: mcconnj@purdue.edu or mdwalker@purdue.edu, and office phone numbers: 494-5910 or 494-8616.

You will be allowed one “crib” sheet and a calculator for the final exam. The crib sheet can be no larger than a normal 8.5” × 11” paper. You may write or type on both sides. No cutting and pasting of photocopied materials; no stick-um notes; no multiple layers on one page; no laptops.

Offices and phone numbers are:

Professor John J. McConnell
KРАН 475
49-45910
mconnj@purdue.edu

Professor Mark D. Walker
KРАН 474
49-48616
mdwalker@purdue.edu

Office hours are:

Monday 4:30pm - 6:00pm
Wednesday 4:30pm - 6:00pm
or by appointment

Monday 1:30pm - 3:00pm
Wednesday 1:30pm - 3:00pm
or by appointment

You may also submit questions to either Professor McConnell or Professor Walker via e-mail.

Secretaries are:

Janet Yoakum (Professor McConnell)
KРАН 471
49-48503
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The following outline shows the topics to be covered and reading and case assignments for each day. The notation (CP) stands for course packet and (RWJ) stands for the textbook by Ross, Westerfield & Jaffe.

Class Participation Grades

The approach to attaching a grade to class participation this semester for MGMT 611 will be as follows:

At the end of each class period, the instructor will assign each student a score of 1, 2, or 3. The scores will be assigned taking into account both the quality and quantity of each student’s input for the day. We recognize that every student will not be able to participate every day, so we expect to have a lot of 1’s.

If a student is absent from class without consent, the student will be assigned a zero for the day. If a student is excused, the student will be assigned the average grade of his or her other daily grades, minus .5 for that day.

Each Friday, the weekly class participation scores for the week will be posted on Katalyst (<http://katalyst.mgmt.purdue.edu/>). At the end of the module, a total numerical score will be calculated by summing the daily scores.

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Daily Class Schedule

Monday, January 12

- Topic:** Risk and Return in Capital Markets
Lecture: Portfolios and Diversification of Risk
Reading: Pp. 256-273 and pp. 279-299 (RWJ)
Assignment: Problem Set 1 (CP)
This assignment is to be handed in for grading.
In your case packet you will find a reading titled “Notes on Risk Adjusted Discount Rates.” Please bring “Notes” to class.
Goal: To understand risk/return tradeoffs in capital markets.

Wednesday, January 14

- Topic:** Portfolio Theory and the Cost of Capital
Reading: Pp. 300-310 (RWJ)
Lecture: The CAPM and the Cost of Equity Capital
Assignment: Problem Set 2 (CP). Not to be handed in.
Please bring “Notes on Risk Adjusted Discount Rates” to class.
Goal: To develop a conceptual framework for measuring the cost of equity capital.

Monday, January 19

NO CLASS - MARTIN LUTHER KING, JR. DAY

Wednesday, January 21

- Topic:** Measuring the Cost of Equity Capital
Reading: Pp. 342-348 (RWJ)
Case: Bayou Petroleum, Inc. (CP)
Assignment: Please see the case for the assignment.
Goal: To become acquainted with estimating the cost of equity capital.

Monday, January 26

- Topic:** The Weighted Average Cost of Capital
- Reading:** Pp. 348-358 (RWJ)
How to Unlever Betas – and Why (CP)
- Case:** Marriott Corporation (CP)
- Assignment:**
1. How does Marriott use the estimate of its cost of capital? Is this appropriate?
 2. What is the weighted average cost of capital (WACC) for Marriott?
 3. What type of investments should be evaluated using Marriott's WAAC?
 4. What is the cost of capital for the lodging and restaurant divisions of Marriott?
 5. What is the cost of capital for Marriott's contract services division?
 6. If Marriott uses a single hurdle rate for evaluating investment opportunities in each of its lines of business, what is likely to happen to the company over time?
- Goal:** To understand the estimation and use of the weighted average cost of capital and the use of multiple discount rates within the same company.

Wednesday, January 28

- Topic:** Financial Market Efficiency and Corporate Financing Decisions: Part I
- Reading:** Pp. 368-397 and pp. 405-419 (RWJ)
- Lecture:** Corporate Debt Policy and Corporate Value
- Assignment:** Problem Set 3 (CP). To be handed in for grading.
Notes on Capital Structure Policy: The Debt Policy Puzzle (CP).
Please bring "Notes on Capital Structure: The Debt Policy Puzzle" to class.
- Goal:** To understand some fundamental concepts in corporate financing strategy.

Monday, February 2

- Topic:** Financial Market Efficiency and Corporate Financing Decisions: Part II
- Reading:** Pp. 423-448 and pp. 455-482 (RWJ)
- Lecture:** The Limits of Corporate Borrowing
- Assignment:** Problem Set 4 (CP). To be handed in for grading.
Please bring "Notes on Capital Structure: The Debt Policy Puzzle" to class.
- Goal:** To gain an understanding of the benefits and limitations of debt financing.

Wednesday, February 4

- Topic:** Managing Corporate Capital Structure in Practice: Part I
- Reading:** P. 397 and Chapter 16 (RWJ) (review)
- Case:** Heartland Electronics Corp. (CP)
- Assignment:**
1. Is Mr. Wilson working for shareholders' best interests in having such a rigid attitude toward debt financing?
 2. Would you be in favor of a share repurchase?
 3. What would be the valuation effects of a major share repurchase?
 4. Should the leverage ratio be determined by book values or market values?
 5. Would you recommend a debt issue? If so, how much?
- Goal:** To develop facility with managing corporate financing decisions.

Monday, February 9

Topic: Managing Corporate Capital Structure in Practice: Part II

Reading: P. 397 and Chapter 16 (RWJ) (review)

Case: Heartland Electronics Corp. -- continued

Assignment:

1. What would be the effect on stock price, and total equity value if Heartland were to buy back stock and issue debt?
2. What would the weighted average cost of capital be under the new capital structure? Assume HEC's $\beta_1 = 1.1$ to begin and the intermediate term government bond yield is 5.0%.

Goal: To appreciate the valuation consequences of financing decisions.

Wednesday, February 11

Topic: Corporate Valuation

Reading: Pp. 488-504 (RWJ)

Notes on Corporate Valuation (CP)

Lecture: Methods of Corporate Valuation

Please bring "Notes on Corporate Valuation" to class.

Goal: To become acquainted with methods of corporate valuation.

Monday, February 16

Topic: Valuation of an Acquisition Target

Reading: Pp. 812-839 (RWJ)

Case: Chances R, Inc. (CP)

Assignment:

1. What is the value of Chances R, Inc.? Consider both the value of the assets and the value of the equity.
2. How sensitive is your valuation to changes in key assumptions?
3. What price per share would you offer for the acquisition of Chances R's common stock?

Goal: To understand the use of valuation techniques in mergers and acquisitions.

Wednesday, February 18

Topic: Valuation in a Leveraged Buyout (LBO)

Reading: Pp. 488-504 plus especially pp. 508-509 (RWJ)

Hints for Analyzing Duck-In Stores, Inc. (CP)

Case: The Management Buyout of Duck-In Stores, Inc. (CP)

Assignment: Please see the case for the assignment.

Problem Set 5 (CP)

Goal: To understand the use of valuation techniques in LBOs.

Monday, February 23

Topic: Going Public: Issuing an IPO

Reading: Pp. 549-574 (RWJ)

Notes on Corporate Valuation: Using Multiples and Comparable Companies (CP)

Case: Wildfire Industries Corp. (CP)

Assignment: Please see the case for the assignment.

Goal: To become acquainted with managing the decision to “go public” with a stock issue.

Wednesday, February 25

Topic: Dividend Policy

Reading: Pp. 510-540 (RWJ)

Case: San Diego Gas & Electric Company (CP)

Assignment: Please see the case for the assignment.

Goal: To become acquainted with the factors that influence corporate dividend policy.

Monday-Friday, March 2 - March 6

Final Exam