This course is a continuation of your introduction to financial management. The objective of the two courses 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.

The required text for the course is:


There is also a case packet for the course which you can pick up at the Boilermaker Copy Center, Purdue Memorial Union, Room 157. A subscription to The Wall Street Journal or Financial Times is highly recommended.

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

- Final exam: 40%
- Class participation: 35%
- Homework: 25%

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” X 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:

<table>
<thead>
<tr>
<th>Office</th>
<th>Telephone</th>
<th>e-mail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professor John McConnell</td>
<td>KRAN 475</td>
<td>494-5910</td>
</tr>
<tr>
<td>Professor Raghavendra Rau</td>
<td>KRAN 472</td>
<td>494-4488</td>
</tr>
</tbody>
</table>

Office hours are:

- **Professor McConnell**
  - Monday: 4:30 p.m. – 6:00 p.m.
  - Wednesday: 10:30 a.m. – 12:30 p.m.

- **Professor Rau**
  - Monday: 11:30 a.m. – 1:00 p.m.
  - Wednesday: 11:30 a.m. – 1:00 p.m.

Professor McConnell’s and Professor Rau’s secretary is:

Janet Yoakum

<table>
<thead>
<tr>
<th>Office</th>
<th>Telephone</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>KRAN 471</td>
<td>494-8503</td>
<td></td>
</tr>
</tbody>
</table>

The following outline shows the topics to be covered and reading assignments for each day. The notation (CP) stands for course packet and (B&M) stands for the textbook by Brealey & Myers.
Our approach to attaching a grade to class participation this semester for MGMT 611 will be as follows:

At the end of each class period, we will assign each student a score of 1, 2, or 3. We will assess the scores after each class with the intent of 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 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 grades, minus .5 for that day.

On Fridays, we will post the weekly class participation scores for that week on Catalyst (http://catalyst.mgmt.purdue.edu/). At the end of the module a total numerical score will be calculated by summing the daily scores.
Daily Class Schedule

**Monday, January 10**

- **Topic:** Risk and Return in Capital Markets
- **Lecture:** Portfolios and Diversification of Risk
- **Reading:** Chapter 7 (B&M)
- **Assignment:** Problem Set 1 (CP)
  
  This assignment is to be handed in for grading.

  **Goal:** To understand risk/return tradeoffs in capital markets.

**Wednesday, January 12**

- **Topic:** Portfolio Theory and the Cost of Capital
- **Reading:** Pp. 187-203 (B&M)
- **Lecture:** The CAPM and the Cost of Equity Capital
- **Assignment:** Problem Set 2 (CP)
  
  Not to be handed in.

  **Goal:** To develop a conceptual framework for measuring the cost of equity capital.

**Monday, January 17**

NO CLASS - MARTIN LUTHER KING, JR. DAY

**Wednesday, January 19**

- **Topic:** Measuring the Cost of Equity Capital
- **Reading:** Chapter 7 and Pp. 187-203 (B&M) (review)
- **Case:** Patron Explorations, Inc. (CP)
- **Assignment:** Please see the case for the assignment.

  **Goal:** To become acquainted with estimating the cost of equity capital.

**Monday, January 24**

- **Topic:** The Weighted Average Cost of Capital
- **Reading:** Pp. 221-242 (B&M)
  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? How can you estimate its equity costs without publicly traded comparable companies?
  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 26

**Topic:** Financial Market Efficiency and Corporate Financing Decisions: Part I  
**Reading:** Pp. 343-370 and pp. 377-396 (B&M)  
**Lecture:** Corporate Debt Policy and Corporate Value  
**Assignment:** Problem Set 3 (CP)  
To be handed in for grading.  
**Goal:** To understand some fundamental concepts in corporate financing strategy.

Monday, January 31

**Topic:** Financial Market Efficiency and Corporate Financing Decisions: Part II  
**Reading:** Pp. 465-482 and pp. 489-516 (B&M)  
**Lecture:** The Limits of Corporate Borrowing  
**Assignment:** Problem Set 4 (CP)  
To be handed in for grading.  
**Goal:** To gain an understanding of the benefits and limitations of debt financing.

Wednesday, February 2

**Topic:** Managing the Corporate Capital Structure in Practice: Part I  
**Reading:** Chapters 17 & 18 (B&M) (review)  
**Case:** American Home Products (CP)  
**Assignment:**  
1. Is Mr. LaPorte 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? What difference does it make?  
5. Would you recommend a debt issue? If so, how much?  
**Goal:** To develop facility with managing corporate financing decisions.

Monday, February 7

**Topic:** Managing the Corporate Capital Structure in Practice: Part II  
**Reading:** Chapter 17 & 18 (B&M) (review)  
**Case:** American Home Products -- continued  
**Assignment:**  
1. What would the effect be on stock price, and total equity value if AHP were to buy back stock and issue debt?  
2. What would the weighted average cost of capital be under the new capital structure? Assume AHP’s $\beta_1 = 1.1$ to begin and the intermediate term government bond yield is 10.0%.  
**Goal:** To appreciate the valuation consequences of financing decisions.

Wednesday, February 9

**Topic:** Corporate Valuation  
**Reading:** Chapter 19 (B&M)  
**Lecture:** Methods of Corporate Valuation  
**Goal:** To become acquainted with methods of corporate valuation.
Monday, February 14
Topic: Valuation of an Acquisition Target
Reading: Chapter 33 (B&M)
Case: Hope Enterprises (CP)
Assignment: 1. What is the value of Hope? Consider both the value of the assets and the value of the equity. You may ignore the issue of warrants. You may also ignore the issuance of German DM denominated debt. Just assume that the company can issue 20-year bonds at 7.5%, as described in Exhibit 1.
2. How sensitive is your valuation to changes in key assumptions?
3. What price per share would you bid for the acquisition of Hope’s common stock?
4. Is Hope a good strategic fit for CHN?
Goal: To understand the use of valuation techniques in mergers and acquisitions.

Wednesday, February 16
Topic: Valuation in a Leveraged Buyout (LBO)
Reading: Chapter 25 (B&M)
Hints for Analyzing White Hen Pantry (CP)
Case: White Hen Pantry (CP)
Assignment: Please see the case for the assignment.
Goal: To understand the case for the assignment.

Monday, February 21
Topic: Going Public: Issuing an IPO
Reading: Chapter 15 (B&M) including Appendices and pp. 70-82 (B&M)
Case: Hubbard Enterprise, Inc. (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 23
Topic: Dividend Policy
Reading: Chapter 16 (B&M)
Case: San Diego Gas & Electric Company
Assignment: Case will be handed out in class.
Goal: To become acquainted with the factors that influence corporate dividend policy.

Monday - Friday, February 28 - March 4
Topic: Final Exam: Week of Feb. 28 – Mar. 4