This introductory course in Corporate Finance takes as its viewpoint the CFO of a firm. We assume that the CFO’s job is to maximize firm value and deal with three types of decisions: 1) which projects to invest in, 2) how to finance that investment, and 3) how to manage the cash flows of the firm. This is an applied course that will primarily use case studies to introduce financial tools needed to make value-enhancing business decisions.

A. Course Structure

The course consists of three main modules:

1) **Cash Flow Management:** The course starts with the tools of cash flow management. Cash flow management is necessary to forecast financing needs and to value assets. The tools we will discuss include ratio analysis, the sources and uses of funds statement, and pro forma statements.

2) **Capital Structure and Financing Needs:** The course continues with analyzing the factors that determine a company’s need for external financing. We then move on to a consideration of the optimal mix of debt and equity financing. We also discuss payout policy and convertible securities.

3) **Project and Company Valuation:** In the third module, we develop the tools needed for valuing investment projects. We use several different valuation methods including the determination of the relevant cash flows and the appropriate discount rate. We will then use these tools to select investment projects and value companies.

B. Administrative Structure

Prerequisites:

- Managerial Finance (15.401) and preferably some accounting (15.515 or 15.501/516).
- In particular, it is expected that students will be comfortable with the following topics from Managerial Finance: time value of money, risk-return trade-off, valuation of bonds and stocks, Capital Asset Pricing Model (CAPM).
Contact Information and Office Hours:

- Professor: David Thesmar
  - Email: thesmar@mit.edu
  - Phone: 617-225-9767
  - Office: E62-635
  - Office hours: Tuesdays 4.00-5.00 pm or by appointment.

- Teaching Assistants:
  - Section A: TBA
  - Section B: TBA

- Course Assistant:
  - Claudine Monique (cmonique@mit.edu, 617-324-7023, E62-631).
  - The course assistant will be helping you with administrative matters such as waiting lists, etc.

Schedule and Classroom:

- Section A: Mondays & Wednesdays 1:00-2:30 pm (E62-265).
- Section B: Mondays & Wednesdays 2:30-4:00 pm (E62-265).

Course Material:

- Course packet (required):
  - Contains the case studies, and some supplementary readings for the course.
  - You can purchase the course packet at http://www.study.net/mit.

- Course website:
  - Make sure you have access to Stellar (contact the course assistant if you are unable to access Stellar).
  - Check Stellar at least once a week. All course announcements will be posted on Stellar.

- Textbooks (optional):

- Additional material:
  - Handouts (slides) will be provided at the beginning of each class. Some of these slides contain gaps which we will fill out together in class.
  - I will post solutions of examples at the end of each class and a sample final exam in the second half of the semester.

Calculator and Name Tag:

Please bring your name tag and a calculator to class. There are no restrictions regarding the type of calculator you may use. Any calculator in which you can compute powers like $x^y$ will do the job.
C. Class Procedure

For each case, I will assign case questions and you will have to submit a two-page memorandum with your proposed answers to these questions. You are allowed and encouraged, but not required, to meet in groups outside of class to discuss and analyze the cases. If you choose to do so, the group cannot be larger than four students. I will accept one memorandum from the group and count it for all students in the group. Each group member must make a substantial contribution to each part of the assignment. It is not acceptable, e.g., to divide the assignments amongst the team members.

The rules for writing memoranda are as follows:

- Each memorandum should be typed and not exceed two pages.
- The two-page limit is for text only; you may attach as many numerical calculations as you wish.
- Write these as if you were writing a recommendation to a CEO (or other major decision maker).
- The memoranda are due at the beginning of the class (see grading criteria below).

Because of the nature of this course (and the grading criteria, see below), it is extremely important that you attend every class, arrive on time and be prepared to participate.

Starting from the second class on, I am asking you to sit in the same spot for the duration of the semester. You should bring your name tag to each class, to facilitate the discussion and receive appropriate credit for your remarks.

A mutually supportive learning environment depends on active attention and engagement. For this reason, the use of laptops, iPads, PDAs, phones and any other electronics with on/off switches is not allowed during classroom sessions. While some students like to use them for note-taking or other pursuits, the value of legitimate use of laptops and mobile devices is far outweighed by the distraction that they create for their classmates and the overall deleterious effect on the learning environment.

D. First Class

- No preparation is required for the first class.
- Bring your name tag and a calculator, make sure you have access to Stellar, and obtain the course packet from http://www.study.net/mit.

E. Requirements and Grading

- Case Write-ups: 25%.
  - Students should form teams of 1 to 4 max, and hand in a single write-up per team.
  - The team cannot change during the semester.
  - Follow the rules for writing write-ups (see above).
  - Write-ups are due at the beginning of class (make copies to refer to during the class).
  - Write-ups will not be accepted after the class has met.
  - Each team is required to hand in all write-ups.
  - Each write-up is graded on a three-grade basis (V+/V/V-).
  - Grading of homework will be on the basis of effort and internal consistency, not correctness. My view is that if students can do the homework perfectly before class there is little reason to attend. The purpose of homework is to ensure preparation before class.
• **Final Exam: 60%.**
  - In-class exam during exam week (May 22-26). The date will be announced as soon as it is set.
  - The exam is open book: you can bring the course handouts, textbooks, cases, personal notes, as well as a calculator.
  - The best way to prepare for the final exam is to prepare for the course every day, attend class, and actively participate.

• **Class Attendance and Participation: 15%.**
  - Because so much of the learning in this course occurs in the classroom, it is very important that you attend class and be prepared to discuss the cases.
  - Quality of your comments is more important than quantity.

### F. Course Policies

The course policies are designed to ensure fairness. By remaining enrolled in the course, you agree to abide by the policies detailed below:

• **The final exam cannot be rescheduled or made up.** Treat the exam date as you would an important meeting in the business world. In the unlikely event that you are faced with unforeseeable and unavoidable circumstances that will cause you to miss the exam, you must talk to me immediately. Travel is not an acceptable reason for exam rescheduling.

• **Re-grades.** The TAs and I will work hard to ensure that the same partial credit is allocated to the same partially correct answer on each exam. Occasionally, we will make mistakes in our grading, and we are eager to correct mistakes subject to the following limits. If you believe that there was a mistake in the grading of your exam, *within one week* following the return of the exam, submit the original exam and a separate written explanation of the points of contention to me. If the re-grade request is made after one week or without an accompanying written explanation, no re-grade will be given. All re-grade decisions are final. We reserve the right to correct all mistakes made grading an exam submitted for a re-grade.

• **Special Arrangements.** If you have a documented disability and anticipate the need for accommodations in this course, please make arrangements as soon as possible. Please contact the MIT Coordinator of Disabilities Services to request assistance in arranging appropriate accommodations with me.

• **Illness and emergency.** Documented evidence that you were seriously ill or had a serious emergency at the scheduled time of the final exam are the only valid excuses for missing an exam. In order to be excused from the exam, you must contact me *prior to the exam* and be ready to provide documentation after the exam.
G. **Course Outline (Summary)**

The course outline is subject to changes. Please follow the announcements in class and on Stellar.

<table>
<thead>
<tr>
<th>Class #</th>
<th>Day</th>
<th>Date</th>
<th>Topic</th>
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<td>Monday</td>
<td>6-Feb</td>
<td>Introduction</td>
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<td>Friday</td>
<td>8-Feb</td>
<td>Case Study: Cartwright Lumber (Part I)</td>
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<td>Monday</td>
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<td><em>Monday Class Schedule--- No Class</em></td>
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<td>Lecture: Capital Structure (Part I)</td>
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<td>Case Study: Marriott</td>
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<td><em>Sloan Innovation Period --- No Class</em></td>
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<td>Monday</td>
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<td>Lecture: WACC and APV</td>
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<td>Monday</td>
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<td><em>Patriots Day --- No Class</em></td>
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<td>Wednesday</td>
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<td>WACC and APV / Harris Seafoods</td>
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<td>Lecture: Valuing a Company</td>
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<td>24</td>
<td>Wednesday</td>
<td>17-May</td>
<td>Review for Final</td>
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H. Course Outline (Detailed)

Part I: Cash Flow Management

1 – Introduction
Lecture: Cash Flow Management
• Reading:
  - Asquith, Weiss, ch. 1: “Introduction”
  - Higgins, ch. 1: “Interpreting Financial Statements”
  - Brealey, Myers, Allen, ch. 14: “An Overview of Corporate Financing”

2 – Case Study: Cartwright Lumber Company (Part I)
• Reading:
  - Asquith, Weiss, ch. 2: “Determining a Firm’s Financial Health”
  - Brealey, Myers, Allen, ch. 28: “Financial Analysis”
  - Higgins, ch. 2: “Evaluating Financial Performance”

3 – Case Study: Cartwright Lumber Company (Part II)
• Reading:
  - Asquith, Weiss, ch. 3: “Pro Forma Forecasts”
  - Higgins, ch. 3: “Financial Forecasting”
  - Higgins, ch. 4: “Managing Growth”

4 – Case Study: Play Time Toy
• Reading:
  - Asquith, Weiss, ch. 4: “The Impact of Seasonality on a Firm’s Funding”

5 – Case Study: SureCut Shears

Part II: Financing

6 – Lecture: Capital Structure (Part I)
• Reading:
  - Asquith, Weiss, ch. 6: “An Introduction to Capital Structure Theory”
  - Brealey, Myers, Allen, ch. 17: “Does Debt Policy Matter?”
  - Brealey, Myers, Allen, ch. 18: “How Much Should a Corporation Borrow?”
  - Higgins, ch. 5: “Financial Instruments and Markets”
  - Higgins, ch. 6: “The Financing Decision”

7 – Case Study: Massey-Ferguson
• Reading:
  - Asquith, Weiss, ch. 5: “Why Financing Matters”
  - Myers: “The Search for Optimal Capital Structure”

8 – Lecture: Capital Structure (Part II)

9 – Case Study: Marriott
• Reading:
  - Asquith, Weiss, ch. 7: “Capital Structure Decisions”
10 – Lecture: Capital Structure: Asymmetric Information and Agency Costs
  • Reading:
    - Asquith, Weiss, ch. 12: “A Continuation of Capital Structure Theory”
    - Asquith, Mullins, “Signaling with Dividends, Stock Repurchases, and Equity Issues”

11 – Case Study: Intel
  • Reading:
    - Asquith, Weiss, ch. 11: “Dividend Policy”
    - Brealey, Myers, Allen, ch. 16: “Payout Policy”
    - Opler, Pinkowitz, Stulz, Williamson, “Corporate Cash Holdings”

12 – Case Study: MCI
  • Reading:
    - Brealey, Myers, Allen, ch. 15: “How Corporations Issue Securities”

Part III: Valuation

13 – Lecture: Valuation of Free Cash Flows
  • Reading:
    - Higgins, ch. 7: “Discounted Cash Flow Techniques”

14 – Case Study: Diamond Chemicals (A)

15 – Lecture: WACC and APV
  • Reading:
    - Brealey, Myers, Allen, ch. 19: “Financing and Valuation”
    - Higgins, ch. 8: “Risk Analysis in Investment Decisions”
    - Krüger, Landier, Thesmar, “The WACC fallacy: Real effects of using a single discount rate”,
      Journal of Finance 2015

16, 17 – Case Study: Harris Seafoods
  • Reading:
    - Asquith, Weiss, ch. 15: “Valuation”
    - Asquith, Weiss, ch. 16: “Valuation Nuances”
    - Brealey, Myers, Allen, ch. 10: “Project Analysis”

18 – Case Study: Dixon Corporation

19 – Case Study: Arundel Partners (Real Options)
  • Reading:
20 – Lecture: Valuing a Company
- Reading:
  - Higgins, ch. 9: “Business Valuation and Corporate Restructuring”
  - Brealey, Myers, Allen, ch. 31: “Mergers”

21 – Case Study: Monmouth
- Reading:
  - Asquith, Weiss, ch. 18: “Mergers and Acquisitions: Strategic Issues”

22 – Case Study: Southland Corporation
- Reading:
  - Asquith, Weiss, ch. 17: “Leveraged Buyouts and Private Equity”
  - Brealey, Myers, Allen, ch. 32: “Corporate Restructuring”

23 – Corporate Governance
- Reading:
  - Brealey, Myers, Allen, ch. 32: “Governance and Corporate Control around the World”

24 – Review for Final

Final Exam – during final exam week