"The academic approach helps analysts understand the system within which they are interacting. Understanding the why, where, and how is better than trying to follow a black box solution. The worst thing a practitioner can ask is: ‘Give me a rule of thumb I can follow without thinking.’ " David Nawrocki.

1. Introduction

This Corporate Finance course explores several issues related to companies, investors, and the interaction between them in capital markets. As an illustration of the questions we will raise (and hopefully answer) during the course, consider the following:

- What is the role that dividends play in the valuation of companies? What is a multiple such as the P/E ratio and how is it used in valuation. We will address related issues in Stock Pricing.
- What are credit ratings and how do they affect the return of a bond? Why is it that 30-year Treasury Bonds typically have higher yields than 1-year Treasury Bills? We will address related issues in Bond Pricing.
- Why do stocks produce higher returns than bonds? Why has the number of mutual funds been growing so rapidly? What does a Greek letter ($\beta$) have to do with a company’s required return on equity? We will address related issues in Risk, Return, Diversification, and the CAPM.
- How does a company estimate the rate at which to discount the expected cash flows of a project? How do companies separate ‘good’ projects from ‘bad’ projects? We will address related issues in The Cost of Capital and Project Evaluation.
- Why do Peter Lynch and Warren Buffet have such outstanding reputation as stock pickers? Why have index funds and ETFs been growing so rapidly? We will address related issues in Market Efficiency.
- Why do airlines usually have a large amount of debt in their balance sheets but Internet companies have very little? How does a company come up with the right mix of debt and equity? How does a company’s cost of capital change as the company’s debt-equity mix changes? We will address related issues in Capital Structure.
- Why do some companies like Amazon pay no dividends to their shareholders? Why do some other companies like GE typically pay high and increasing dividends? What is the relationship between a company’s dividend policy and its investment and debt policies? We will address related issues in Dividend Policy.
- Why has the issue of corporate value creation become linked to the letters EVA? How do synergies affect the valuation of a takeover target? Why do terminal values play such a critical role in valuation? We will address related issues in Corporate Value Creation and Valuation.
2. Learning Objectives

The ultimate goal of this course is to provide you with an analytical framework that will enable you to answer the questions posed above, many variations of them, and very different ones too. By the end of this course you should be able to value stocks and bonds; assess the risk and return of assets; properly diversify a portfolio; estimate a cost of capital; evaluate investment projects; find the mix of debt and equity a company should have in its balance sheet; implement a reasonable dividend policy; assess whether a company is creating or destroying shareholder value; and value a target company from the point of view of an acquirer.

3. Content

See a list of all the topics to be discussed during the course, and the required cases and readings for each session, on pages 3 and 4; and the date on which each topic will be discussed on page 5.

4. Methodology

The course consists of a combination of cases and discussions. Before each session, you should prepare the assigned case, or read the material indicated in the outline, and be ready to discuss it in class.

An excellent textbook that covers most of the topics to be discussed in the course is *Corporate Finance*, by Ross, Westerfield, and Jaffe (2008), referred to as "RWJ" in the outline. Chapters of the book sometimes will be complemented with technical notes, referred to as “TN” in the outline.

We will make extensive use of articles published in the *Wall Street Journal* (WSJ) and the *Financial Times* (FT), newspapers that you are strongly advised to read daily, and in other business magazines, such as *Fortune* or *Forbes*.

5. Evaluation

The credit for the course is split in the following way:

- Open-book, cumulative final exam: 40%
- Closed-book midterm exam: 35%
- Class participation: 25%
6. Outline

1- Introduction

1) Discussion  → Course overview
   → *Warren E. Buffett*, 1995 (Preparation sheet)

2- Stock Pricing

2) Case  → *Hilton Hotels, Corp.* (Preparation sheet I)
   → Readings  → RWJ, chapter 4 and chapter 5 (5.4-5.9)

3) Case  → *Hilton Hotels, Corp.* (Preparation sheet II)
   → Readings  → Same as in the previous session
   → TN, "The Essential Financial Toolkit – Tool 9" (*After class*)

3- Bond Pricing

4) Case  → *Atlas Investment Management* (Preparation sheet I)
   → Readings  → RWJ, chapter 5 (5.1-5.3), chapter 20, and chapter 25 (25.6)

5) Case  → *Atlas Investment Management* (Preparation sheet II)
   → Readings  → Same as in the previous session
   → TN, "The Essential Financial Toolkit – Tool 10" (*After class*)

4- Risk, Return, Diversification, and the CAPM

6) Discussion  → Risk, return, and diversification
   → Readings  → RWJ, chapter 9 and chapter 10 (10.1-10.6)
      → TN, "The Essential Financial Toolkit – Tool 3"
      → TN, "The Essential Financial Toolkit – Tool 4" (*After class*)

7) Discussion  → Diversification and the CAPM
   → Readings  → RWJ, chapter 10 (10.7-10.9) and chapter 12 (12.1-12.3)
      → TN, "The Essential Financial Toolkit – Tool 5" (*After class*)

5- The Cost of Capital and Project Evaluation

8) Case  → *The Boeing 777* (Preparation sheet I)
   → Readings  → RWJ, chapter 12 (12.4-12.6)
      → TN, "The CAPM, the Cost of Capital, and Project Evaluation"

9) Case  → *The Boeing 777* (Preparation sheet II)
   → Readings  → TN, "Beta, Leverage, and the Cost of Capital"
      → "Do You Know Your Cost Of Capital?" (*After class*)

10) Review  → What you hopefully learned so far

▪ Exam  → Closed-book midterm exam
6. Outline (Cont.)

11) Case → *The Boeing 777* (Preparation sheet III)  
→ RWJ, chapter 6 (6.1–6.6)

6- Market Efficiency

12) Discussion → Market efficiency and practical implications (Preparation sheet)  
→ Readings → RWJ, chapter 13  
→ "Monkey Business: Contest Ignores Risk"  
→ "The Titanic: The Untold Economic Story"

7- Capital Structure

13) Case → *Tonka Corporation* (Preparation sheet)  
→ Readings → RWJ, chapter 15  
→ TN, "The Modigliani-Miller Propositions: A Simple Example"

14) Case → *Polaroid Corporation, 1996* (Preparation sheet)  
→ Readings → RWJ, chapter 16

8- Dividend Policy

15) Case → *Consolidated Edison Company* (Preparation sheet)  
→ Readings → RWJ, chapter 18

16) Case → *Telefónica: The Dividend Decision* (Preparation sheet)  
→ Readings → Same as in the previous session

9- Corporate Value Creation and Valuation

17) Discussion → Corporate value creation and EVA  
→ Readings → "All About EVA"  
→ "America’s Best & Worst Wealth Creators"

18) Discussion → DCF Valuation  
→ Readings → RWJ, chapter 17 (17.1–17.6)

19) Case → *Hertz & Dollar Thrifty* (Preparation sheet)  
→ Readings → RWJ, chapter 29  
→ "Using APV: A Better Tool for Valuing Operations" (*After class*)

• Final Assessment

20) Review → *What you hopefully learned*

• Exam → *Open-book, cumulative final exam*
7. Schedule

• March

📅 March 31 → Course overview + Warren E. Buffett, 1995

• April

📅 April 1 → Hilton Hotels, Corp.
📅 April 3 → Hilton Hotels, Corp. (Cont.)
📅 April 7 → Atlas Investment Management
📅 April 8 → Atlas Investment Management (Cont.)
📅 April 28 → Risk, return, and diversification
📅 April 29 → Diversification and the CAPM
📅 April 30 → The Boeing 777

• May

📅 May 5 → The Boeing 777 (Cont.)
📅 May 6 → What you hopefully learned so far (Midterm exam review)
  ▪ May/7 → Closed-book midterm exam

📅 May 19 → The Boeing 777 (Cont.)
📅 May 23 → Market efficiency and practical implications
📅 May 26 → Tonka Corporation
📅 May 27 → Polaroid Corporation, 1996 (*) Note the double session this day (*)
📅 May 27 → Consolidated Edison Company (*) Note the double session this day (*)
📅 May 28 → Telefónica: The Dividend Decision

• June

📅 June 2 → Corporate value creation and EVA
📅 June 3 → DCF valuation
📅 June 4 → Hertz & Dollar Thrifty
📅 June 10 → What you hopefully learned (Final exam review)
  ▪ Jun/11 → Open-book, cumulative final exam
  ▪ Jun/13–15 → Go crazy, you have just survived your first year at IESE!
8. References

• Textbook


• Cases

- Warren E. Buffett, 1995 (Darden)
- Hilton Hotels, Corp. (IESE)
- Atlas Investment Management (IESE)
- The Boeing 777 (Darden)
- Tonka Corporation (Darden)
- Polaroid Corporation, 1996 (Darden)
- Consolidated Edison Company (Harvard)
- Telefónica: The Dividend Decision (IESE)
- Hertz & Dollar Thrifty (IESE)

• Technical Notes

- The Essential Financial toolkit – Tool 3 – Risk: Standard Deviation and Beta (IESE)
- The Essential Financial toolkit – Tool 4 – Diversification and Correlation (IESE)
- The Essential Financial toolkit – Tool 5 – Required Returns and the CAPM (IESE)
- The Essential Financial toolkit – Tool 9 – Multiples (IESE)
- The Essential Financial toolkit – Tool 10 – Bonds (IESE)
- The CAPM, the Cost of Capital, and Project Evaluation (IESE)
- Beta, Leverage, and the Cost of Capital (IESE)
- The Modigliani–Miller Propositions: A Simple Example (IESE)

• Articles

- “All About EVA.” Ben McClure, Investopedia.
9. Instructor's Bio

Javier Estrada is a Professor at the Finance Department of IESE Business School, in Barcelona, Spain. He holds a B.A. in Economics from the National University of La Plata (Buenos Aires, Argentina), and both an M.S. in Finance and a Ph.D. in Economics from the University of Illinois at Urbana-Champaign (USA). His areas of specialization are wealth management, portfolio management, investments, equity markets, emerging markets, and law & economics.

Javier held positions at both the Economics Department and the Business Department of the Carlos III University (Madrid, Spain). He is also a regular visiting professor at HANKEN (Helsinki, Finland), IPADE (Mexico City, Mexico), Torcuato Di Tella University (Buenos Aires, Argentina), and the University of Montevideo (Montevideo, Uruguay), and has lectured to executives, graduates, and undergraduates around the world.

Javier is the author of *Finance in a Nutshell* (FT Prentice Hall, 2005), originally written in English and subsequently translated into Spanish, Italian, and Chinese; a second edition of this book was published in 2011, is entitled *The FT Guide to Understanding Finance*, and was translated into Korean. He is also the author of *The Essential Financial Toolkit – Everything You Always Wanted To Know About Finance But Were Afraid To Ask* (Palgrave Macmillan, 2011).

Javier has done extensive research in the areas of portfolio management, investment strategies, and risk with a special focus on downside risk. He has also done research on emerging markets and insider trading. His articles have appeared in the Journal of Portfolio Management, the Journal of Wealth Management, the Journal of Asset Management, the Journal of Investing, and the Journal of Applied Corporate Finance, among other journals.

Javier is the founding editor of the Emerging Markets Review, the leading journal on emerging markets, was editor of the journal between inception in 2000 and the end of 2006, and currently remains an associate editor. He is also in the advisory board of several other academic journals.

Javier is Director of the SEP (Senior Executive Program) that takes place between New York and Miami, and the open-enrollment programs on 'Managing Your Own Portfolio' and 'Corporate Finance.'

Javier is a partner and financial advisor at Sports Global Consulting Investments, a company that specializes in providing wealth management advise to professional athletes; is a member of the CFA Institute’s Speaker Retainer Program; and was a tennis instructor.