



**[Business 200 – Foundations in Financial Accounting and Corporate Finance](#)**

**[Summer 2009 - May 18th to June 26th, 2009](#)**

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**Focus of Course:**

This course is suitable for students who have not had any prior exposure to Finance.

The course will prepare students for careers as treasurers, comptrollers and chief financial officers (CFO's) of mid-sized domestic organizations. More broadly, the course also prepares students for careers in international business, including global financial services such as banking and insurance. Much of the course deals with valuation concepts that are at the core of investment decisions (capital budgeting) for new equipment, the introduction of new products or the acquisition of other businesses and firms. Additionally, we focus closely on the funding/financing decisions that must be thoughtfully coordinated with the investment decision. Students will develop an understanding of financial accounting, planning and budgeting and a familiarity with financial spreadsheet analyses. Case studies and a valuation project will add depth to the text material.

The Summer 2009 course will also endeavor to tie basic Finance and Accounting concepts to the current financial crisis – especially where fundamental principles were compromised or ignored.

This is a foundations course, the first in a two-course sequence with International Financial Management – B 210. That course builds on the fundamentals developed here and incorporates them into the multi-currency context of the global economy. International Financial Management is, typically, offered in the spring semester.

**Class Meetings – 12 Sessions, including Final Exam:**

Monday and Wednesday 7:00 p.m. – 10:00 p.m.

The first class is Monday, May 18th from 7:00 p.m. – 10:00 p.m. – (Victoria Day – Canada, UK)

There is no class on Memorial Day - Monday, May 26th.

From June 1 to 26, we will follow a regular Monday and Wednesday schedule, with the final exam scheduled on Friday, June 26.

**Instructor's Office Hours:**

Monday and Wednesday 5:00 p.m. – 7:00 p.m. And by appointment at other times

**Required Texts:**

Please note that the major texts can be purchased in electronic formats. If you choose, the Brigham and Ehrhardt text may be bought on a chapter by chapter basis.

**Analysis for Financial Management, 8/e - Robert C. Higgins, University of Washington**

This is an easy to read book and will be used early in the course; very practical book.

**ISBN:** 0073041807

**Copyright year:** 2007

[http://highered.mcgraw-hill.com/sites/0073041807/information\\_center\\_view0/](http://highered.mcgraw-hill.com/sites/0073041807/information_center_view0/)

**Financial Management: Theory & Practice, 12th Edition  
includes Thomson ONE - Business School Edition 1-Year Printed Access Card -  
Eugene F. Brigham - University of Florida and Michael C. Ehrhardt - University  
of Tennessee**

This is the major text for the course. It is an excellent text and reference book.

ISBN-10: 0324422695 ISBN-13: 9780324422696

1104 Pages Casebound

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[http://academic.cengage.com/cengage/instructor.do?totalresults.do?page=null&keyf or=allsite&keyitem=all&keytype=null&resultfor=higheredu&resulttype=instructor&keyword\\_all=Brigham&pagefrom=search&disciplinenumber=414&product\\_isbn=9780324422696&contextelement=http://academic.cengage.com/cengage](http://academic.cengage.com/cengage/instructor.do?totalresults.do?page=null&keyf or=allsite&keyitem=all&keytype=null&resultfor=higheredu&resulttype=instructor&keyword_all=Brigham&pagefrom=search&disciplinenumber=414&product_isbn=9780324422696&contextelement=http://academic.cengage.com/cengage)

Course package of case studies - these materials will be available from the bookstore or HBS Publishing directly – cases are listed below.

**Supplementary Texts and Background References:**

Copeland, Koller and Mullin, Valuation: Measuring and Managing the Value of Companies; Wiley: 2000, 3<sup>rd</sup> edition.

Fraser, L.M. and A. Ormiston, Understanding Financial Statements; Prentice Hall: 2003, 7<sup>th</sup> edition.

Helfert, Erich A., Techniques of Financial Analysis; Irwin: 2002, 11<sup>th</sup> edition.

Hawawini, Gabriel and Claude Viallet, Finance for Executives and Managing for Value Creation, South-Western, 2001.

Shapiro, Alan C. and Sheldon D. Balbirer, Modern Corporate Finance; Prentice Hall, 2000.

Siegel, Jeremy; Stocks for the Long Run; McGraw Hill: 3<sup>rd</sup> Edition, 2003.

Stewart, G. Bennett III; The Quest for Value; Harper Business, New York, 1990.

Tracey, John A.; How to Read a Financial Report; Wiley: 2005, 6<sup>th</sup> edition.

**Additional Readings:**

Regular reading of newspapers such as the Financial Times of London, New York Times and Wall Street Journal, or magazines such as The Economist and Fortune will enhance your understanding of the material presented in this course by allowing you to apply what you learn to current domestic and international issues. Pertinent articles will be brought to your attention and distributed, as appropriate.

**Case Studies – tentative list:**

1. Clarkson Lumber Company - Working Capital Liabilities - HBS#N9 – 297 - 028
2. Toy World, Inc. - Working Capital Inventory Management - HBS#N9 – 295 - 073
3. Dynashears - Working Capital - Recession at time of Plant Expansion - HBS#N9 – 292 - 017
4. The Super Project - Capital Budgeting - HBS# 112 – 034
5. Carrefour S.A. - Business Expansion - HBS# 273 - 099
6. Bank of Montreal - Stock Valuation Analysis -Class Hand-Out
7. The University of Chicago Investment Office - Portfolio Analysis - HBS# 9 – 205 - 101
8. Boeing 7E7 - Weighted Average Cost of Capital - 9 – UV0 – 281 (case is available from hbs.edu)
9. Valuation Projects - to be determined

Students are requested to prepare all case studies for discussion in class, regardless of whether or not they are submitting a full length written report. The format for written reports will be discussed in class but, in general, the submissions should not exceed four pages plus two pages of calculations. Students are encouraged to work in groups of two and to exchange ideas and consider relevant issues with other students in the class.

**Grading:**

Case studies -	35%
Company valuation report, including presentation	15%
Completed as a group project – ( 3 or 4 students)	
Due in class – Wednesday, June 24, 2009	
Class Participation	15%
<b>Final Examination – Friday, June 26, 2009</b>	<b>35%</b>

**Attendance:**

This course has specifically been designed for the six-week summer program at Fletcher and has 12 three-hour classes, including the Final Examination on June 26, 2009. Given the amount of material that we will cover over the six-week period, and the sequential nature of the topics, students are requested to advise the instructor in advance if they expect to miss a lecture. In this way, suitable arrangements can be made concerning lecture notes, case discussions, meetings and other relevant matters.

**Problems Sets:**

Problem sets will be incorporated into the case study discussion to ensure that students gain practice and understanding of basic finance and accounting problems. We will also use problems from the texts. The problem sets serve to reinforce concepts discussed in class. Students are encouraged to work through the problems, in groups if this is helpful, and to seek the instructor's help when clarification and/or additional assistance are required. Solutions for all problem sets will be posted. In some cases, the instructor will provide access to Excel spreadsheets that will ease the mechanical aspects of the problems, thereby allowing students to focus on the conceptual material. Working

through the problem sets will also benefit students in preparing the three written case study reports and in the completion of the valuation project.

## Course Schedule, List of Topics, Assignments and Examinations

### Week 1 - Introduction to Cash Flows and Financial Statements

#### Module 1: Overview of Financial Management

- What is financial management all about
- Managing for value creation and measuring the value created by a business proposal
- Understanding the role played by financial markets in corporate finance
- What is risk

Chapter 1 - Brigham and Ehrhardt

Chapter 1 – Higgins

#### Module 2: Understanding Financial Statements

- Understanding the key concepts underlying financial statements
- Breaking the language barrier of financial accounting
- Understanding how financial statements are prepared and how they are interrelated

Chapter 3 – Brigham and Ehrhardt

### Week 2 – Analysis of Financial Statements and Working Capital Management

- There is no class on the Memorial Day Holiday on Monday, May 25.

#### Module 3: Assessing the Financial Health of the Firm

- Diagnosing the financial health of a firm through ratio analysis
- Gauging the drivers of a firm's profitability
- Understanding how business risk and financial leverage impact a firm's profitability

Chapter 13 – Brigham and Ehrhardt

Chapter 2 – Higgins

- **Case Study No. 1 – Clarkson Lumber Company – discussion only / class workshop**
- **Friday, May 29 - Preliminary Selection of Companies for Valuation Project – one page outline of target – to be submitted electronically by email**

### Week 3 – Financial Planning and Budgeting - Measuring Cash Flows - Additional Funds Needed

#### Module 4: Financial Planning and Budgeting

- Strategic planning and pro-forma financial statements
- Percent-of-sales forecasting methodology
- Estimating the external funding requirements (“the plug concept”)

Chapter 3 and 14 – Brigham and Ehrhardt

Chapter 3 and 4 – Higgins

- **Monday, June 1 - Case Study No. 2 – Toy World, Inc. Company – written report due**
- **Wednesday, June 3 - Case Study No. 3 – Dynashears – discussion only**

#### **Week 4 – Capital Budgeting and Evaluating Relevant Cash Flows**

##### Module 5: Measuring cash – flows

- Understanding the relationship between cash and cash-flows
- Understanding the relationship between profit and cash-flows
- How to use a firm's balance sheet and income statement to prepare its cash-flow statement

Chapters 22 - Brigham and Ehrhardt

##### Module 6: Capital Budgeting

- Understanding discounting and the time value of money
- How to calculate the net present value (NPV) of a project
- Comparing NPV with alternative decision rules to screen investment proposals
- Identifying and estimating a project cash-flow
- Identifying the major steps involved in capital budgeting decision

Chapters 2, 7, 10 and 11 – Brigham and Ehrhardt – readings restricted to support those materials covered in class.

Chapters 7 and 8 – Higgins

- **Monday, June 8 - Case Study No. 4 – The Super Project – written report due**
- **Wednesday, June 10 - Case Study No. 5 – Carrefour S.A. – discussion only**

#### **Week 5 – Valuation of Stocks and Bonds**

- **Monday, June 15 - Industry Analysis for Valuation Project due - tentative**

##### Module 7: Raising Capital and Valuing Securities

- How to estimate the amount of external funds a firm needs to finance its growth
- How the financial system works and what functions it performs
- Financial disintermediation, securitization and an introduction to derivatives
- Valuing the different sources of debt and equity capital issued by firms

Chapter 6 – Brigham and Ehrhardt – Bonds and Their Valuation

Chapter 21 – Brigham and Ehrhardt – Hybrid Financing: Preferred Stocks, Warrants and Convertibles

Chapter 5 – Higgins – Financial Instruments and Markets

- **Monday, June 15 - Case Study No. 6 – Bank of Montreal – discussion only**

##### Module 8: Measuring the Cost of Capital

- How to estimate the cost of debt
- How to estimate the cost of equity
- The weighted average cost of capital (“WACC”) and optimal capital structure
- The difference between the cost of capital for: a.) the firm as a whole, b.) one of its divisions and c.) a specific project

Chapters 9 and 16 – Brigham and Ehrhardt

- **Wednesday, June 16 – University of Chicago Investment Office**

**Week 6 – Capital Structure Decisions and Free Cash Flows**

Module 9: Business Valuation and Creating Value through Corporate Restructuring

- Alternative methods used to value businesses
- How to value a potential acquisition
- What is a leveraged-buy-out and how to structure the transaction; pitfalls of too much debt in an LBO transaction

Chapters 9 and 25 – Brigham and Ehrhardt – Corporate Valuation; Bankruptcy, Reorganization and Liquidation; and Mergers, LBOs, Divestitures, and Holding Companies – specific sections to be advised.

Chapter 9 – Higgins – section on “Business Valuation and Corporate Restructuring”

Review of major topics

- **Monday, June 22 - Case Study No. 7 – Boeing 7E7 – discussion only**
- **Wednesday, June 24 - Hand In Group Reports and Present Findings on Valuation Projects**
- **Friday, June 26 - Final Examination – 7:00 p.m. – 10:00 p.m.**

## **Study Questions for Cases**

### **1. Clarkson Lumber**

- a) Why does Mr. Clarkson have to borrow so much to support a profitable business?
- b) Do you agree with his estimate of loan requirements to finance the expansion of sales?
- c) As a banker, do you approve the loan request and, if so, what conditions – including collateral provisions would you impose?

### **2. Toy World, Inc.**

- a) What factors could Mr. McClintock consider in deciding whether or not to adopt the level production plan?
- b) What savings would be involved in adopting a level production plan?
- c) Estimate the amount of added funds required and the timing of the needs under level production. Prepare pro-forma income statements and balance sheets to make this estimate. Ignore interest expenses in making these estimates.
- d) Compare and graph the liabilities patterns feasible under the alternative production plans. What implications do their differences have for the risk assumed by various parties?

### **3. Dynashears**

- a) What assumptions did Mr. Sheehan make when he prepared the forecasts shown in case Exhibits 1 and 2? Are the assumptions reasonable?
- b) Why was Dynashears unable to repay its bank loan on March 31, 1991 as was originally forecast?
- c) Has Dynashears' financial condition worsened sufficiently to cause Mr. Winthrop any great concern?
- d) Compare the general nature of the financial problems faced by Dynashears, Play Time Toy Company and Butler Lumber.

### **4. The Super Project**

- a) What are the relevant cash flows for General Foods to use in evaluating the Super project? In particular, how should management deal with issues such as:
  - Test market expenses.
  - Overhead expenses.
  - Erosion of Jell-O contribution margin.
  - Allocation of charges for the use of excess agglomerator capacity.
- b) How attractive is the investment as measured by various capital budgeting techniques? How useful are each of the following measures of investment attractiveness: Payback period; Internal Rate of Return; New Present Value.
- c) How attractive is the Super Project in strategic and competitive terms? What potential risks and benefits does General Foods incur by either accepting or rejecting the project?
- d) Should General Foods proceed with the Super Project? Why or Why not?

### **5. Carrefour S.A.**

- a) What business is Carrefour in and who are its competitors – who would they be competing with today?
- b) How would you characterize Carrefour's approach to market?
- c) Using the concepts developed for Additional Funds Needed, discuss how Carrefour manages the different types of operations – own stores, franchise stores and partnerships?
- d) Comment, as best possible, on the cash conversion cycle and turnover ratios of the current assets and liabilities.

**6. Bank of Montreal**

- a) Use the no-growth, constant growth and multiple-growth rate dividend models to value the Bank of Montreal's intrinsic stock price.
- b) What are the advantages and disadvantages of the dividend models when compared with a Price/ Earnings multiple approach and Free Cash-Flow valuation approach?
- c) How do the recent increases in interest rates influence the profit performance of the Bank of Montreal – can you identify specific items in the income statement that are especially relevant?
- d) Why has the stock price of the Bank of Montreal increased so dramatically over the last two years? What do you expect will happen to the stock price over the next two years – why?

**7. Boeing 7E7**

- a) What business is Boeing in? Are the components of Boeing's financial strategy consistent with its growth objective?
- b) How does Boeing use its estimate of its cost of capital? Does this make sense?
- c) What is the weighted average cost of capital for Boeing Corporation?
- d) What risk-free rate and risk premium did you use to calculate the cost of equity?
- e) How did you measure Boeing's cost of debt?

## **Note on Case Reports:**

- Students are required to complete **two** written reports on an individual or joint basis with one or two other students.
- For all cases, written and discussion only, please feel free to discuss issues with other students – this exchange has a valuable learning component.
- Written reports should consist of the following:

### **1. Title page**

### **2. Executive Summary** – a summary of your report on one page only, ideally in bullet form.

- a. In real life, the reader may not proceed beyond the Executive Summary – be precise with your presentation so that it causes the reader to look at the entire report.
- b. This is the most important page of your report; it gets you to the next meeting.

### **3. Primary Text** – should not exceed four pages for most cases.

- a. Introduction and Problem Statement – What is the finance challenge in this case.
- b. Analysis of Internal Factors – discuss the issues faced by the firm itself.
- c. Analysis of External Factors – consider the broader operating environment faced by the firm, including relevant local, domestic and international factors.
- d. Alternatives – consider two to four possible alternatives and discuss the merits of each, including probability and economic consequences of each course of action or outcome.
- e. Implementation and Conclusions – what do you want to do, support your decision.

It may be prudent to include small tables and graphs in the primary text section. They save writing and highlight important information.

### **4. Calculations and Exhibits** – typically one or two pages of calculations that support the main text.

### **5. References** – Only if materials used go beyond the text books and cases – not required in most instances.

- Use the study questions for each case to guide your work
- Analysis of issues is the most important part of your report.
- State your assumptions clearly.
- Be creative – there is never just one way to solve a case.

## **Valuation Project**

The primary objective of the business valuation project is to develop a comprehensive recommendation on a company's stock. Is the stock one that investors should buy or sell?

To make a recommendation about the investment prospects of a stock, an analyst must have a thorough understanding of the following three areas:

1. Industry analysis.
2. Historical financial performance of the company.
3. Future financial prospects of the company.

### **Industry analysis:**

An investor must fundamentally decide whether the risks posed by a particular industry are acceptable given his or her other investments. This is the most basic question, "Do you like the industry?" Your report should carefully scope the industry risks faced by an investor. Where does the company rank within the industry and what are the prospects for the industry itself – is this a rust belt industry or a high technology biomedical firm. What is the state of local, domestic and international competition in your industry?

### **Historical Financial Performance:**

Using publicly available financial data, the annual reports – 10K and quarterly reports – 10Q, an analyst needs to offer insight to how the company is performing. An EVA and MVA framework is helpful but investors typically look for deeper understanding of performance drivers and management's ability to get the job done. Warren Buffett, the legendary investor, looks for businesses where consumers have to use the product every day and where profits are stable in strong and weak business cycles. For example, Gillette sells razor blades, a product that has consistent sales. Buffett also owns a paint company, the logic being that there is always something to paint.

### **Future Financial Prospects:**

A spreadsheet valuation must be undertaken to estimate how the company will perform in the future and how this impacts on the stock price. Over the term, we will develop the tools necessary to perform the valuation. Students will receive assistance with this exercise, as appropriate. A careful review of each line item on the income statement and how it is likely to change over the coming years is required. Clearly, the analyst provides a best estimate of performance and, over time, the market makes a judgment about the abilities of the analyst. The future prospects of the firm must consider whether the company can take its product to new markets. There must also be an assessment as to whether the firm will be an acquirer or potential target for another buyer in the event the industry is currently consolidating, or likely to face such pressures in the medium term.

In making your recommendation, there should be some comment on an appropriate investment holding period. For example, if the stock is currently selling at \$50, your one year target price may be \$75 and an investor might want to sell at that point. A prudent investor should always have an exit strategy, a function of price performance and time. Time horizons may be driven by a need for cash to make other investments, for example, a bigger house or vacation home, even education expenses. Liquidity is important.

### **Information and Data:**

A great deal of information is available on the websites of individual companies. The web is probably the best place to start. Fletcher students also have access to the Baker Library at Harvard Business School. This is an excellent resource and the staff is very helpful. The NYSE site at nyse.com is very good. Ask if you would like some help in choosing a company to study.

### **Report Requirements:**

This is a group effort, with each group having three or four students. The final report must include an Executive Summary clearly stating your recommendation. Additionally, Excel spreadsheets showing pertinent ratio analyses and a fully developed valuation model are to be included. The three major headings, as raised above must be incorporated in the report, including any graphs and charts that serve to illuminate your key points. The report should not be more than ten pages in total. Please ask if you have questions.

### **Due Dates:**

May 29 – One page proposal on the firm you wish to study – submission of this may be via email.

June 15 – Industry analysis due – Four pages maximum.

June 24 – In-class presentation and Final written report due.