CORPORATE FINANCE
WHAT IS IT?

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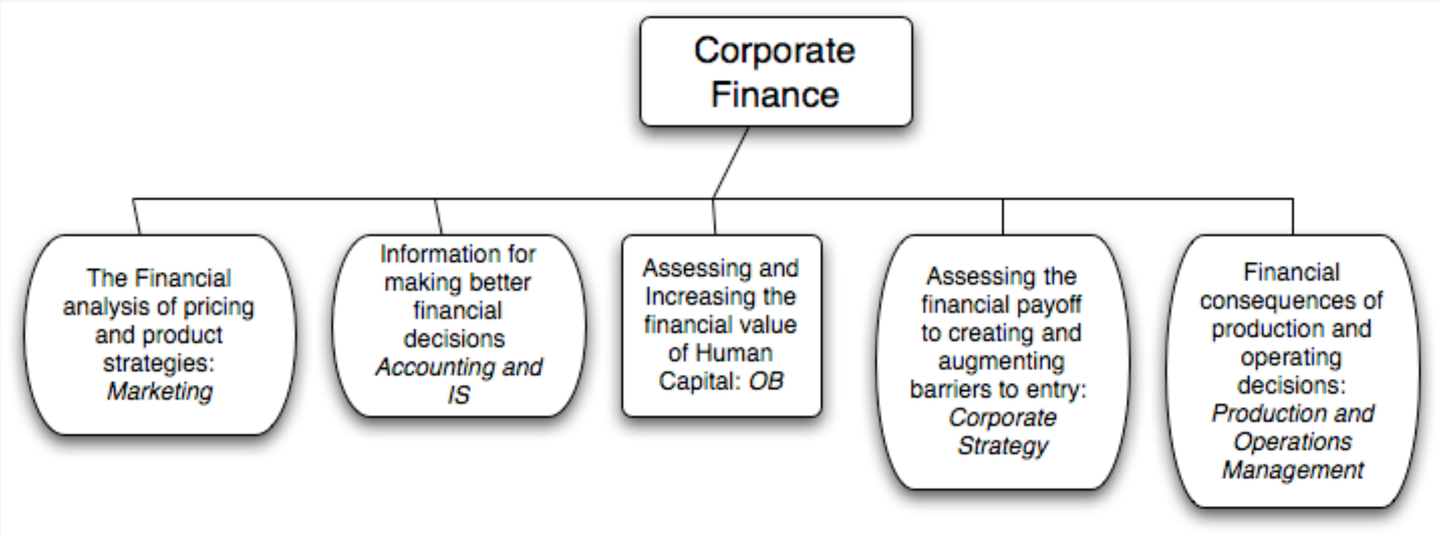
What is corporate finance?

- Every decision that a business makes has financial implications, and any decision which affects the finances of a business is a corporate finance decision.
- Defined broadly, everything that a business does fits under the rubric of corporate finance.



Objectives

- To give you the capacity to understand the theory and apply, in real world situations, the techniques that have been developed in corporate finance.
  - Motto for class: If it cannot be applied, who cares?.
- To give you the big picture of corporate finance so that you can understand how things fit together.
  - Motto for class: You can forget the details, but don't miss the storyline.
- To show you that corporate finance is fun.
  - Motto for class: Are we having fun yet?

The Traditional Accounting Balance Sheet

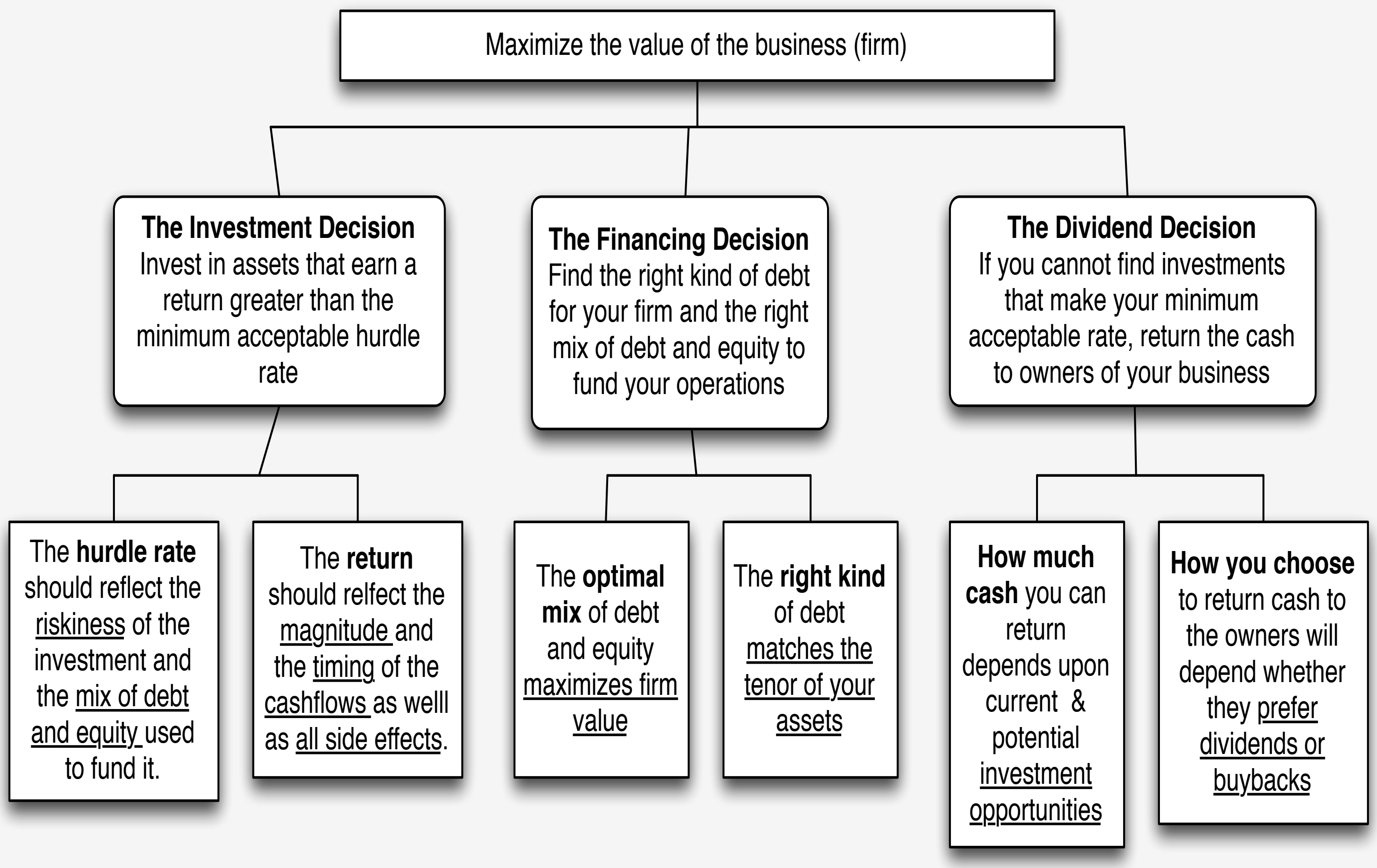
The Balance Sheet

Assets		Liabilities	
Long Lived Real Assets	Fixed Assets	Current Liabilties	Short-term liabilities of the firm
Short-lived Assets	Current Assets	Debt	Debt obligations of firm
Investments in securities & assets of other firms	Financial Investments	Other Liabilities	Other long-term obligations
Assets which are not physical, like patents & trademarks	Intangible Assets	Equity	Equity investment in firm

The Financial View of the Firm

Assets		Liabilities	
Existing Investments Generate cashflows today Includes long lived (fixed) and short-lived(working capital) assets	Assets in Place	Debt	Fixed Claim on cash flows Little or No role in management *Fixed Maturity* *Tax Deductible*
Expected Value that will be created by future investments	Growth Assets	Equity	Residual Claim on cash flows Significant Role in management *Perpetual Lives*

First Principles & The Big Picture



Theme 1: Corporate finance is "common sense"

- There is nothing earth shattering about any of the first principles that govern corporate finance. After all, arguing that taking investments that make 9% with funds that cost 10% to raise seems to be stating the obvious (the investment decision), as is noting that it is better to find a funding mix which costs 10% instead of 11% (the financing decision) or positing that if most of your investment opportunities generate returns less than your cost of funding, it is best to return the cash to the owners of the business and shrink the business.
- Shrewd business people, notwithstanding their lack of exposure to corporate finance theory, have always recognized these fundamentals and put them into practice.

Theme 2: Corporate finance is focused…

- It is the focus on maximizing the value of the business that gives corporate finance its focus. As a result of this singular objective, we can
  - Choose the "right" investment decision rule to use, given a menu of such rules.
  - Determine the "right" mix of debt and equity for a specific business
  - Examine the "right" amount of cash that should be returned to the owners of a business and the "right" amount to hold back as a cash balance.
- This certitude does come at a cost. To the extent that you accept the objective of maximizing firm value, everything in corporate finance makes complete sense. If you do not, nothing will.

Theme 3: The focus changes across the life cycle…

Con Ed's Financial Balance Sheet

Assets		Liabilities	
$ 15 billion	Investments already made	Debt	$ 7 billion
$ 3 billion	Investments yet to be made	Equity	$ 11 billion

Linkedin's Financial Balance Sheet

Assets		Liabilities	
$0.25 billion	Investments already made	Debt	$ 0.00 billion
13.35 billion	Investments yet to be made	Equity	$ 13.6 billion

Theme 4: Corporate finance is universal…

- Every business, small or large, public or private, US or emerging market, has to make investment, financing and dividend decisions.
- The objective in corporate finance for all of these businesses remains the same: maximizing value.
- While the constraints and challenges that firms face can vary dramatically across firms, the first principles do not change.
  - A publicly traded firm, with its greater access to capital markets and more diversified investor base, may have much lower costs of debt and equity than a private business, but they both should look for the financing mix that minimizes their costs of capital.
  - A firm in an emerging markets may face greater uncertainty, when assessing new investments, than a firm in a developed market, but both firms should invest only if they believe they can generate higher returns on their investments than they face as their respective (and very different) hurdle rates.

Theme 5: If you violate 1st principles, you will pay!

- There are some investors/analysts/managers who convince themselves that the first principles don't apply to them because of their superior education, standing or past successes, and then proceed to put into place strategies or schemes that violate first principles.
- Sooner or later, these strategies will blow up and create huge costs.
- Almost every corporate disaster or bubble has its origins in a violation of first principles.

And it will be applied…

Disney
Sector: Entertainment
Incorporated in: US
Operations: Multinational
Size: Large market cap

Bookscape
Sector: Book Retail
Incorporated in: US
Operations: New York
Other: Privately owned

Vale
Sector: Mining/Metals
Incorporated in: Brazil
Operations: Multinational
Size: Large market cap
Other: Government stake

Applied Corporate Finance

Deutsche Bank
Sector: Bank/ Investment Bank
Incorporated in: Germany
Operations: Multinational
Size: Large market cap
Other: Regulated

Tata Motors
Sector: Automotive
Incorporated in: India
Operations: Multinational
Size: Mid market cap
Other: Family Group

Baidu
Sector: Online Search
Incorporated in: Cayman Isl
Operations: China
Size: Mid market cap
Other: Shell company (VIE)

Set Up and Objective
1: What is corporate finance
2: The Objective: Utopia and Let Down
3: The Objective: Reality and Reaction

The Investment Decision
Invest in assets that earn a return greater than the minimum acceptable hurdle rate

Hurdle Rate
4. Define & Measure Risk
5. The Risk free Rate
6. Equity Risk Premiums
7. Country Risk Premiums
8. Regression Betas
9. Beta Fundamentals
10. Bottom-up Betas
11. The "Right" Beta
12. Debt: Measure & Cost
13. Financing Weights

Investment Return
14. Earnings and Cash flows
15. Time Weighting Cash flows
16. Loose Ends

The Financing Decision
Find the right kind of debt for your firm and the right mix of debt and equity to fund your operations

Financing Mix
17. The Trade off
18. Cost of Capital Approach
19. Cost of Capital: Follow up
20. Cost of Capital: Wrap up
21. Alternative Approaches
22. Moving to the optimal

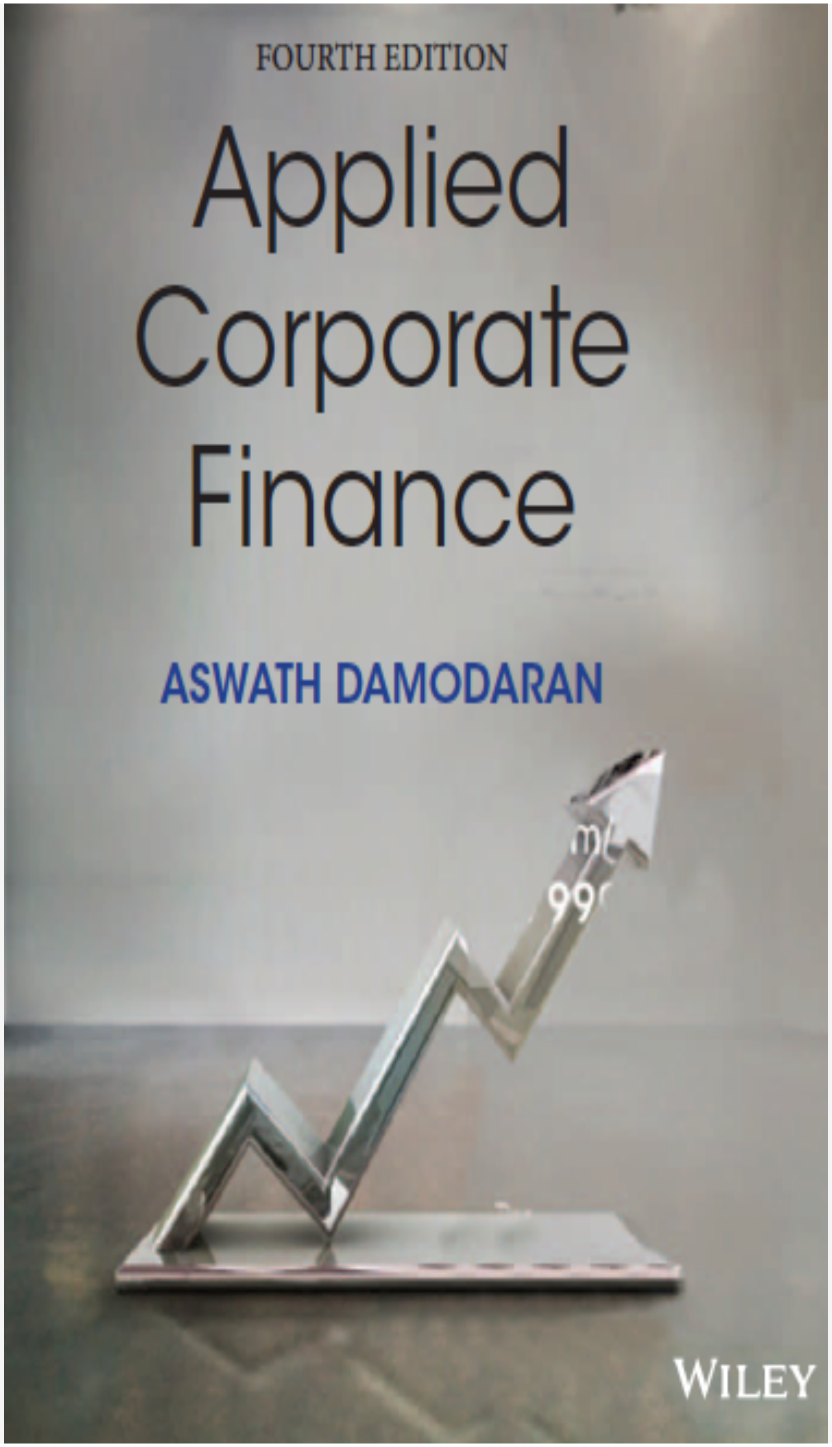
Financing Type
23. The Right Financing

The Dividend Decision
If you cannot find investments that make your minimum acceptable rate, return the cash to owners of your business

Dividend Policy
24. Trends & Measures
25. The trade off
26. Assessment
27. Action & Follow up
28. The End Game

Valuation
29. First steps
30. Cash flows
31. Growth
32. Terminal Value
33. To value per share
34. The value of control
35. Relative Valuation

36. Closing Thoughts


FOURTH EDITION
Applied Corporate Finance
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Chapter 1