

CORPORATE FINANCE

THE PROJECT

Aswath Damodaran

THE BIG PICTURE..

- You should find a group to work with between 4-8 people. You can make the judgment of optimal group size.
- If corporate finance is best learned through application and in real time, there is no better way to learn the subject than to try out everything we do in class on a real company in real time...
- You should consider this project a live lab experiment that you will be doing in class for the next 15 weeks. While I will try to apply the principles of corporate finance to the companies I have chosen, you will be applying the same principles to your company.

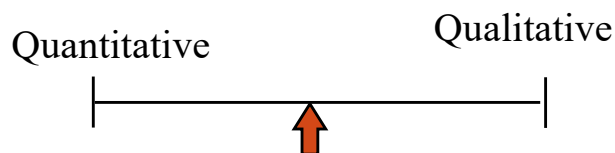
PICKING YOUR COMPANIES

- Each person picks a company. The company should be publicly traded and have at least one year of trading history and one set of annual financial statements. The company can be listed in any market.
- There should be a common theme in each group. The theme can be broadly defined. For instance, an entertainment group can include movie companies, television broadcasters and syndication companies. An automobile group can include auto companies, suppliers to auto companies and even an auto dealership. In putting together the group of companies, try to pick as diverse a mix of companies as possible (small and large, domestic and foreign, closely held and widely held....)
- Avoid the following
 - Financial service firms (banks, insurance companies & investment banks)
 - Money losing companies
 - Companies with large capital arms (GE and the auto companies)
 - Real estate investment trusts

II. STOCKHOLDER ANALYSIS

- What is the breakdown of stockholders in your firm - insiders, individuals and institutional?
- Who is the marginal investor in this stock?

Applies material from: Session 5

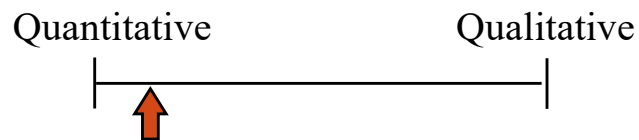


Spreadsheets:	-
Useful Data Sets:	Insider Holdings by Industry
	Institutional Holdings by Industry

III. RISK AND RETURN

- What is the risk profile of your company? How much overall risk is there in this firm? Where is this risk coming from (market, firm, industry or currency)? How is the risk profile changing?
- What return would you have earned investing in this company's stock? Would you have under or out-performed the market? How much of the performance can be attributed to management?
- How risky is this company's equity? What is its cost of equity?
- How risky is this company's debt? What is its cost of debt?
- What is this company's current cost of capital?

Applies material from: Sessions 6-11

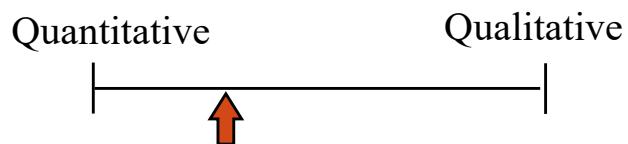


Spreadsheets:	Risk&Ret.xls (if needed)
Useful Data Sets:	Betas by Industry
	Jensen's Alpha by Industry
	Cost of Debt/Capital by Industry

IV. MEASURING INVESTMENT RETURNS

- Is there a typical project for this firm? If yes, what does it look like in terms of life (long term or short term), investment needs and cash flow patterns?
- How good are the projects that the company has on its books currently?
- Are the projects in the future likely to look like the projects in the past? Why or why not?

Applies material from: Sessions 12-16



Spreadsheets:	capbudg.xls
Useful Data Sets:	ROE and Equity EVA by Sector ROC and EVA by Sector

VI. OPTIMAL CAPITAL STRUCTURE

- Based upon the cost of capital approach, what is the optimal debt ratio for your firm?
- Bringing in reasonable constraints into the decision process, what would your recommended debt ratio be for this firm?
- Does your firm have too much or too little debt
 - relative to the sector?
 - relative to the market?

Applies material from: Sessions 18-19



Spreadsheets:	capstru.xls; capstruo.xls
Useful Data Sets:	Earnings Variance by Industry Market Debt ratio Regression

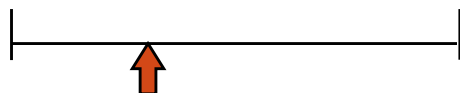
VII. MECHANICS OF MOVING TO THE OPTIMAL

- If your firm's actual debt ratio is different from its "recommended" debt ratio, how should they get from the actual to the optimal? In particular,
 - should they do it gradually over time or should they do it right now?
 - should they alter their existing mix (by buying back stock or retiring debt) or should they take new projects with debt or equity?
- What type of financing should this firm use? In particular,
 - should it be short term or long term?
 - what currency should it be in?
 - what special features should the financing have?

Applies material from: Sessions 20-21

Quantitative

Qualitative



Spreadsheets:

macrodur.xls

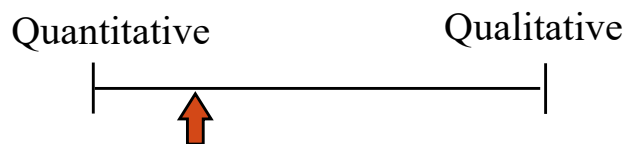
Useful Data Sets:

Firm Value Sensitivity by Industry

IX. A FRAMEWORK FOR ANALYZING DIVIDENDS

- How much cash could this firm have returned to its stockholders over the last few years? How much did it actually return?
- Given this dividend policy and the current cash balance of this firm, would you push the firm to change its dividend policy (return more or less cash to its owners)?
- How does this firm's dividend policy compare to those of its peer group and to the rest of the market?

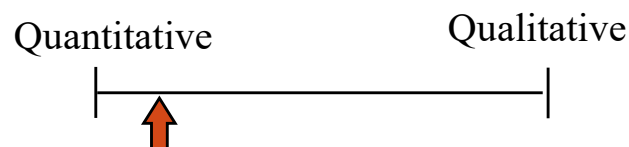
Applies material from: Sessions 23-24



Spreadsheets:	dividends.xls
Useful Data Sets:	Cap Ex Ratios by Industry
	Working Capital Ratios By Industry
	Debt Ratios by Industry

X. VALUATION

- What growth pattern (Stable, 2-stage, 3-stage) would you pick for this firm? How long will high growth last?
- What is your estimate of value of equity in this firm? How does this compare to the market value?
- What is the “key variable” (risk, growth, leverage, profit margins...) driving this value?
- If you were hired to enhance value at this firm, what would be the path you would choose?
 - Applies material from: Session 25



Spreadsheets:	Choice of valuation spreadsheets
Useful Data Sets:	Betas by Industry
	Growth Fundamentals by Industry
	Cap Ex and Wkg Cap by Industry

PROJECT TIME FRAME

- By this date You should be done with
- 1 (2/1) Find a group
- 2 (2/8) Pick your firm; Get data;
- 3 (2/15) Corporate Governance; Stockholder Analysis
- 5 (3/1) Risk and Return
- 6 (3/8) Measuring Investment Returns
- 8 (3/15) Capital Structure Choices
- 9 (3/29) Optimal Capital Structure
- 10 (4/5) Mechanics of Moving to the Optimal
- 12 (4/19) Assess Dividend policy
- 13 (4/26) A Framework for Analyzing Dividend Policy
- 13 (5/3) Valuation
- **5/5 Project Due by the end of the day (5 pm)**