

The University of Western Ontario
DAN Management and Organizational Studies

MOS 3311: Advanced Corporate Finance

GROUP PROJECT GUIDE

OVERVIEW

This document provides some guidelines for preparing your group project. The main goal of the project is to apply and synthesize course material, including the concepts, theories and models, and relate it to a real world example (a public firm) in the context of corporate finance and governance. You are likely to discover that the information that you would ideally like to have is not readily available and some compromise will have to be made. Your goal should be to do as much as you can on your own, given the available information and to use secondary data only once you have tried to calculate things on your own with primary data.

Your report should provide a narrative of the company, describing how the firm stands today, what it does well, what it does badly, as well as what needs to change. Keep in mind that this is a report of a finance course and should focus on the firm's financial perspective (and not, say, whether it has a popular product, a good marketing strategy, or even the accounting positions of the firm, for example). In particular, you will use what you have learned to:

- identify and evaluate the company's governance structure;
- assess and quantify the risk profile of a firm and estimate the firm's cost of capital;
- evaluate the company's capital budgeting practices;
- analyze and critically appraise the firm's capital structure, and dividend policy, and
- value the firm.

Note that these above questions are not meant to be comprehensive and you can definitely add on interesting questions that you come up with.

GENERAL RULES

DUE DATE: December 7th midnight.

This project is a group assignment, each group must have at most 5 members. Each group will receive one grade on the report plus an adjustment based on peer evaluation. Each group must submit only one copy of your report to me before the due date, uploaded to the Dropbox on OWL. Late assignments will NOT be accepted. Note that all reports will be subject to submission for textual similarity review to the commercial plagiarism detection software under license to the University for the detection of plagiarism.

Students should individually email me with a peer evaluation for the group work. The peer evaluation will be conducted near the end of the semester.

REQUIRED READINGS AND RESOURCES

- S.A. Ross, R.W. Westerfield, J.F. Jaffe, G.S. Roberts and H. Driss, 2022. Corporate Finance, Ninth Canadian Edition, McGraw-Hill Ryerson, ISBN: 978126088137
- Class notes and supplemented readings/materials posted on OWL.
- UWO Libraries has set up a resource page available at: <http://guides.lib.uwo.ca/mos3311>. There are links to sources for the relevant data you will need.
- Other data sources: Google (very convenient and useful without saying); Yahoo Finance (a convenient place to find the financial information and news).

FORMAT SPECIFICATIONS

The maximum length of the report is 20 pages, excluding exhibits, cover page and executive summary. The main text of your report should satisfy the following guidelines – Spacing: double; Margins: 1 inch; Font: Times New Roman, 12 point. Exhibits may be in a smaller font, but must always remain legible. Please note that your report does not have to be the full 20 pages; you should be brief and concise.

The report should contain:

- A cover page, which provides the title of the report, the date, all team members' name and student ID.
- An executive summary, which can stand alone and is no more than one page long and contains, in a summarized form, the essential elements of the report;
- The main body, which informs the reader of the specific topics and issues, and is clear, concise, and non-repetitious. It contains information, qualitative analyses, interpretation of quantitative analyses, and conclusions relevant to the topics and issues;
- A conclusion, which draws the document together and restates the main points of the document without the introduction of new topics or ideas;
- Any appendices, which contain supplementary information, such as data sources, etc., and should appear in the order they are presented in the main body;
- References, if applicable.

There is no set format for the main body of the report. You will be graded on the content of the report. Here are some general suggestions.

- One natural way to organize your report is according to the topics of the course. Each section could, thus, address each of the objectives listed before in "OVERVIEW". The topic questions found there are meant to help you think about the important issues. You need not discuss your answers to all the questions and you should also not be constrained by them. Highlight the information that is most relevant for your company.

- Write for a knowledgeable finance audience. You do not need to define or explain the basic concepts or tools that we have learned in the course.
- Clarity and brevity are essential elements in successful business reports. A business report is not an essay or a descriptive document and does not provide a large volume of background material. The text of the report should highlight critical elements with respect to the topic or issues, and supporting data should be included as appendices. All information contained in a business report should be essential to the reader's understanding of the topic or issues.
- The writing should satisfy the following: business language, a professional tone, and fact are used. Third person is an appropriate language for a business report. First person (I, we) and second person (you) are avoided. Grammar is correct, and there are no spelling or typographical errors. Sentences are properly constructed, using appropriate grammar, punctuation and range of vocabulary. Ideas are presented clearly and concisely. Acronyms, abbreviations and unusual terminology are clearly explained. The language used is appropriate for the audience.

COLLABORATION AND PLAGIARISM

You must use your own calculations and words. Copying from any source is an Academic Offense and will result in grade of zero on the relevant material. Researching ideas from published materials and sharing ideas with others is a legitimate approach to learning. However, each group must prepare its own original response that reflects independent thoughts (e.g., independent applications of ideas) and original writing. Students may not copy any part of their response from work done by another author.

In applying concepts from readings and other published sources, copied material and application of another author's original ideas must be appropriately referenced. You may use either endnotes or footnotes, as you desire. Violating these rules will be considered plagiarism. Western's Policy on "Scholastic Offences" including Plagiarism can be found on the web at <http://westerncalendar.uwo.ca>.

DATA SOURCES AND REQUIREMENTS

As we have seen, there are often several alternate ways to obtain estimates for relevant variables. I expect that you will at least attempt to come up with your own estimates using primary data. Of course, there will be times when you cannot obtain the required information, or your estimates differ wildly from those found in other, reliable sources. In these cases, you should identify your source and provide a brief justification for your choice to use it. This can be relegated to a (brief) data sources appendix, if you are constrained for space.

TOPIC SPECIFIC QUESTIONS 咨询微信ri sepaper

TOPIC 1&2 –Corporate governance related topics

BIG QUESTIONS: To understand the relationship between managers and stockholders, between stockholders and creditors, between the firm and financial markets, try answering the following questions (No need to follow the specific order of the following questions). Note that you may not have the information to answer every question, but try to keep your focus on the big questions.

- General introduction of the firm, e.g., what does the company do? What kind of assets has the company invested in?
- Who is the CEO of the company? How long has he or she been CEO?
- What is the management structure? Who are the key executives?
- Is the company a family firm? If so, is the CEO part of the family?
- What was the compensation for the CEO last year? Try to break down by salary, bonus and option components.
- How much stock and options in the company does the CEO own?
- Who is on the board of directors of the company? How long have they served as directors?
- How many of the directors are inside directors (a.k.a. insiders)?
- How many of the directors are CEOs of other companies?
- What percent of the stock is held by insiders in the company?
- Are there differences in voting rights across shares? If so, do incumbent managers own a disproportionate share of the voting shares?
- Who are the major stockholders and creditors? Individual investors or institutional shareholders?
- What percent of the stock is held by institutional investors?
- Have insiders been buying or selling stock in this company in the most recent year?
- Is this a company where there is a separation between management and ownership?
- Whether there is (are) institutional dual holder(s) in this firm? If so, what is the dualholder(s) stock holding and bond holding?
- Does the company also have listings in foreign markets (cross-listing)? (If you can, estimate the percent of the stock held by non-domestic investors).
- How has the company's stock performed recently?
- How much trading volume is there on the company's stock?
- Have there been any big news events related to the company recently? How has the stock price reacted to the news?

TOPIC 3 – RISK AND RETURN

BIG QUESTIONS: What is the risk profile of the company? Provide a qualitative and quantitative analysis of the company's risks and costs of capital.

Risk and Return Basics

- Obtain an estimate of the expected return and standard deviation for the company's stock. How would you characterize total risk for potential investors in the company's equity?
- What is the performance profile of an investment in this company? What return would you have earned investing in this company's stock? Would you have under or out-performed the market?
- Obtain an estimate of the risk-free rate and the expected return on the market portfolio.

Estimating the Cost of Equity

The CAPM - Regression Beta

Run a regression of returns on your firm's stock against returns on a market index, or alternately, if you have access to Bloomberg, go into the beta calculation page and obtain the relevant output (suggestion: in either case, use monthly data and 5 years of observations).

- What is the intercept of the regression? What does it tell you about the performance of this company's stock during the period of the regression?
- What is the slope of the regression? What does it tell you about the risk of the stock?
- How precise is this estimate of risk? (Provide a range for the estimate).
- Search for alternate estimates of beta for your company. How do they differ? How reliable are they?
- What portion of this firm's risk can be attributed to market factors? What portion to firm-specific factors? Why is this important?
- How much of the risk for this firm is due to business factors? How much of it is due to financial leverage?

The CAPM - Fundamental Beta

- Consider the firm's business components, and obtain an estimate of business beta for each component if the firm has stated business components.
- Attach weights to each component and estimate a levered and an unlevered beta for the business.

Cost of Equity

- Which of the beta estimates that you have obtained for the firm would you view as more reliable? Why?
- Using the beta that you have chosen, estimate the expected return on an equity investment in this company.
- How risky is this company's equity? Why? What is its cost of equity?
- As a manager in this firm, how would you use this expected return?

Alternatives to the CAPM

- Consider any alternate ways of calculating the cost of equity that you think are worthwhile.

Estimating Cost of Debt

- Does your company have the ability to service its existing debt load?
- If your company has bonds outstanding, what is the yield to maturity on a long term bond?
- If your company is rated: What is the most recent rating for the firm? What is the default spread and interest rate associated with this rating?
- If your company is not rated, does it have any recent borrowings? If yes, what interest rate did the company pay on these borrowing?
- Are there any alternative ways to estimate the cost of debt?
- How risky is this company's debt? What is its cost of debt?
- What is the company's marginal tax rate?

Estimating Cost of Capital

- Calculate the market value of equity. Calculate a market value for debt if possible. What are the weights of debt and equity?
- What is this company's cost of capital? Are there any reasons that it may have changed recently?
- 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?
- Are the projects in the future likely to look like the projects in the past? Why or why not? How will these projects affect the firm's risk?

TOPIC 4 – CAPITAL BUDGETING QQ2128789860

BIG QUESTIONS: How effective is the company at making capital budgeting decisions? What process is used to choose investments? How successful have previous investments been relative to expectations? What are the implications for future growth?

- What methods (NPV, IRR, Payback, Discounted payback, or other) does the firm use to make investment decisions?
- Is there a typical project for this firm? If yes, what would 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 those projects providing a tax shield?
- Have recent investment projects added value to the firm or destroyed value? If so, can you estimate how value was added or reduced?
- Are the projects in the future likely to look like the projects in the past? Why or why not? How will these projects affect the firm?
- Estimate the company's operating cash flows for the latest year for which you have data. How may these, and total cash flows, change going forward?
- Are there any real options in the firm? If so, what type?

TOPIC 5 – CAPITAL STRUCTURE

BIG QUESTIONS: What is the company's capital structure? How much debt should the company use in financing? Is there scope for increasing value by changing the capital structure? What is the company's dividend policy? Is there scope for increasing value by changing the policy?

General

- What are the different kinds of financing that this company has used to raise funds? Where do they fall in the continuum between debt and equity?
- Does management have a target capital structure? If so, how is justified? How is it maintained?
- Does the firm have too much or too little debt? Attempt to estimate the optimal debt ratio for the firm. You will need to make assumptions. You may consider using qualitative or quantitative analysis, or any combination.

Qualitative Analysis QQ2128789860

- How large, in qualitative or quantitative terms, are the advantages and disadvantages to this company from using debt? Consider for your firm: the potential benefits of additional debt (e.g. tax benefits); the potential for costs of financial distress; the potential for agency costs; the benefits of using debt as a disciplinary mechanism; and, the costs of information asymmetry.
- Would you expect your company to have a high or a low debt ratio? Does the company's current debt ratio match your expectations?

Cost of Capital Approach

- What is the current cost of capital for the firm?
- What happens to the cost of capital if the debt ratio is changed? (make assumptions)
- At what debt ratio is the cost of capital minimized and firm value maximized?

Relative Analysis

- Relative to the sector to which this firm belongs, does it have too much or too little in debt?
- Relative to the rest of the firms in the market, does it have too much or too little in debt?

Dividend Policy

- How much has this company paid in dividends over the last few years? How much stock has this company bought back over the last few years?

- How much cash available for equity holders has the firm generated over the past few years? How much has it actually returned to equity holders? How much cash does the firm currently have available?
- How well has management done at choosing investments? Does the firm appear to have good investments available?
- How does the firm's dividend policy compare to firms in its sector? Firms in the market?

TOPIC 6 – VALUATION

BIG QUESTIONS: What is the company worth in total? What is the equity claim worth? How does this relate to the company's actual (market) share price?

- What is the value of this firm, based upon a discounted cash flow model? How much of this value comes from the expected growth?
- In what aspect of corporate finance (capital budgeting, capital structure, or dividend policy) does this firm have room for improvement? If these problem areas were addressed, what would happen to the value of the equity in this firm?