

# Finance 5439: Capital Structure and Risk Management

Graduate School of Business Administration  
University of Florida

Professor Mark J. Flannery

Spring 2011

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Nearly all information about this course is contained in the course web page, which can be reached through the University's *Sakai* site:

<http://lss.at.ufl.edu>

*Sakai* requires you to log in using your GatorLink username and password. If you are new to Sakai, the site [https://lss.at.ufl.edu/help/Student\\_Faq](https://lss.at.ufl.edu/help/Student_Faq) provides information and FAQs

## *Course Goals*

This course continues and expands the material presented FIN 5437. We will cover:

- \* the connection between asset pricing and capital budgeting
- \* capital structure (leverage) and dividend policies
- \* options and firm risk management

FIN 5439 primarily presents a set of *concepts* for evaluating business decisions in a coherent fashion. Taken together, Fin5437 and FIN5439 present a core set of financial concepts and institutional facts, which should be known by all MBA students. In addition, these two courses provide background for students planning to take elective courses in finance, insurance, and real estate.

## **Assurance of Learning**

Each program at the Warrington College of Business Administration has developed goals and objectives that express the most valued skills and knowledge that students should be able to demonstrate upon completion of the total learning experiences in that program.

The **MBA** program goals and objectives that apply to this course are:

Learning Goal 5: Program graduates will be competent across business disciplines.

5A. Students will apply the essential elements of core business principles to analyze and solve problems in the business environment.

5B. Students will apply essential elements of core business principles to construct and implement decision making processes in the business environment.

**Laptop Restriction:** As a courtesy to those around you, please keep laptop computers, iPhones, etc. etc. off during class unless you are using your laptop as part of the class discussion (e.g. in case discussions). Class attendance is not required, except for quizzes and case discussions. So if you need to be somewhere else, feel free to be there. If you prefer to take notes on your laptop, please see me after the first class.

**Instructor Contact Information:**

The best way to get a quick answer or assessment is to catch me immediately before or after class, or during the break. If that doesn't work for you, please try to attend my regular office hours:

Office hours (tentative): 3:00 – 5:00 Monday, Wednesday  
(Will confirm office hours the first week of class, to be sure they are convenient for all students.)  
315C STZ  
Telephone: 392-3184  
Email: flannery@ufl.edu

If regular office hours are not convenient for you, we can arrange a specific appointment. My telephone has voicemail, and I read my email daily (even if I'm not in my office). Please do not call me at home – not even the night before the exam. (Thanks.)

**Cancelled Class and Makeup:** I need to be out of the country on Tuesday, March 15. That day's class will be presented on Friday, March 18 at two different times: Periods 5-6 and 7-8. Students are free to come to either presentation. In partial compensation for inconveniencing you, pizza and soda will be served at the first presentation; donuts and coffee at the second.

**Grading:**

Group Problem Sets (3):	12%
Group case write-ups (2):	22%
Quizzes in class (3 @ 12% each):	24% (your worst quiz is dropped)
Group assessment and class participation:	6%
Final exam:	36%

A short (7-week) module provides little opportunity to recover should you fall far behind. Keep current. If you encounter difficulties, take steps to resolve the problem ASAP(!).

**Forming Teams (Groups).** As in FIN5437, students should form groups of three for the Problem Sets and Case write-ups. Groups will remain together for the entire module. All team members receive the same score for each submission. I will record your group composition by reading the members' names on the first homework assignment.

**Class participation.** FIN 5439 involves considerable reading and lecture material. I want to spend as much class time as possible solving problems that illustrate the general points of analysis. Whenever possible, I will post the problems in advance on the class website. Learning finance is not a spectator sport. Please come on time prepared to discuss (or ask questions about) the day's material.

**Required readings:**

1. Brigham and Ehrhardt, *Financial Management, Theory and Practice*, 13<sup>th</sup> Edition, 2011. (This is the same text you have been using in Prof. Houston's FIN 5437.) Referenced below as "BE."

2. My "Topic Notes." A course packet at the Target Copy Center includes just the Topic Notes. Target is at 1412 NW University Avenue (376-3826) and at 3422 SW Arahcer Road (372-1171). You should probably call the store before you go over, to confirm that they have copies available for sale.

Alternatively, you may download and print the Topic Notes (as seven pdf files; about 200 pages) from the course web site, under "Topic Notes." Class slides are in the same place.
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**Quizzes:** The syllabus indicates the dates of three in-class quizzes with multiple choice answers. Be sure you have a calculator with you for all quizzes. The quiz will be the *last* activity in class on the scheduled day. Your lowest quiz score will be dropped when computing your final class grade.

*Recent years' quizzes and answers are posted under "Past Quizzes and Exams" under "Resources" at the course website in Sakai.*

**Problem Sets:** Each group should submit a single set of answers to each problem set. These answers will not be closely graded for content, but points will be deducted if the solutions are incomplete or carelessly done. No credit is given for late submissions. Solutions will be posted to the class Web page shortly after the submission deadline. Be sure you understand any differences between the posted solutions and your group's responses.

Some of the same problems were assigned last year, and written solutions were provided. You do yourselves no favor by simply replicating those solutions. The goal is to learn how to do the problems, not to practice your penmanship!

**Cases:** We will devote approximately one-half of a class session to discussing each of the (two) assigned cases. The class web site contains all the required case materials, including a set of questions around which you should organize your case analysis and discussion. Each team should prepare a case write-up, which is due at the start of class. All members of the team should come to class prepared to discuss *all* aspects of the case.

*Problem sets AND questions for the cases are posted under “Problem Set Assignments” under “Resources” at the course website.*

**Problem Sets and Case Write-ups** should be neatly typed. Case write-ups should take the form of a memo to your boss, or to the “head” person referenced in the case. For problem sets, you may hand-write the sections involving substantial numerical calculation, provided it is neat and professional-looking.

Submit cases and problem sets as a **hard copy** to me in class or to my mailbox in BUS 321.

In the event of an emergency, you may send an electronic copy -- in Word or Excel ONLY -- via email. But:

1. Be sure to paginate any Excel files, so I can print them *without editing*.
2. Name the file something that ties it to you. E.g. "Group\_1\_Case2.doc" is more likely to get you credit for the work than one of several files named "Homework.doc".
3. Don't use this form of submission except in an emergency.

For the *cases* ONLY, email me an electronic copy (e.g. a Word file) of the report *in addition to* submitting a printed copy in class.

**Re-grading Policy:** Believe it or not, professors sometimes make mistakes in grading an assignment. (Of course, this happens very rarely...) If you disagree with the way an assignment or examination has been graded, or you have remaining questions, write a short explanation (justification) of your concern. If you present me with the assignment or exam and your explanation during the seven calendar days following the day I return the material in class, I will re-read the *entire* submission, taking your comments into consideration. No re-grading will be considered outside this 7-day window.

**End-of-Chapter Problems:** The text includes numerous end-of-chapter questions and problems. Answers to the “Self-Test Problems” and to the “Problems” are provided in the book’s Appedices A and B respectively. The Instructor Manual provides answers to end-of-chapter “Questions” and I've posted the relevant chapters’ answers on the course Web page under “*Instructor’s Manual Answers to end-of-chapter questions*” under “*Resources*” at the course web site.

For each assigned chapter, I *strongly* encourage you to work at least some of the analytical problems. Ideally, you will be comfortable with them all by the end of the course.

**Past Exam and Quiz Questions:** The Web page contains a set of past exams, along with sample answers. You may find it helpful (or comforting) to look at these questions as part of your studying.

*Old quizzes, exams and sample answers are provided under “Past Quizzes and Exams” under “Resources” at the course website.*

**Exam/Quiz “crib sheet”:** Each student may use a one-page “crib sheet” during the quizzes and the exam. The content of this sheet may – should! – change as the course proceeds.

“One page” means one (single) side of one 8 ½ x 11 inch page.

There is no restriction of the size of the type or writing you employ on that page.

Students may cooperate in preparing crib sheets, but each student must have his/her own copy during the exam.

You may bring in a copy of someone else’s crib sheet, but it won’t do you much good. (The big value lies primarily in preparing the sheet.)

Bring your own working calculator to the exam. Calculators may not be shared.

**Final Exam:** Tuesday, April 26 from 7:15 - 10:15 pm

MBA students (Section 5077): HGS 140

Other students (Section 5284): HGS 150

No postponements or make-ups!

*Recent years’ final exam questions and sample answers are posted under “Past Quizzes and Exams” under “Resources” at the course web site.*

## Reading List

In the reading list, “BE” refers to the Brigham-Ehrhardt textbook, *Financial Management: Theory and Practice* (13<sup>th</sup> Edition).

“Topic Notes” can be

- downloaded from the course web site, or
- purchased at Target.

The relative importance of readings within each topic is indicated by their order in the list of required readings.

### 1) The CAPM and Capital Budgeting (1.5 sessions)

- Topic Note 1
- BE Chapter 9
- Review: BE Chapter 6, pages 231-246

### 2) The Cost of Capital and Firm Value (2.5 sessions)

- Topic Note 2
- BE Chapter 11
- Review: BE Chapter 3 material on net cash flow, taxes.
- Review: BE Chapter 7, pp. 287-294

For current bond pricing information, see [www.bondsonline.com](http://www.bondsonline.com).

**Problem Set # 1:** Due on Thursday, March 18, 5:00 pm.

**In-Class Quiz # 1:** Thursday, March 18 (30 minutes)

### 3) Choosing a Firm’s Capital Structure (Two sessions)

- Topic Note 3
- BE Chapter 15
- BE Chapter 26, pp. 1015-1019 (which may be confusing for now) and pp. 1019-1021 (which won’t be)
- Review: BE Chapter 9, pp. 357-367

**If you wish to review some important institutional features of capital markets, read some or all of:**

- BE Chapter 19, pp. 759-765, 770-777
- BE Chapter 20

(These two chapters are meant to buttress your institutional knowledge. If you can follow the lectures and the cases, you are probably OK in this dimension.)

**Case #1:** Southwest Airlines Winglets. This case will be discussed in class on Tuesday, March 29. Submit team write-ups at the start of class.

4. Option Concepts in Corporate Finance (2.5 sessions)

- Topic Note 4
- Review: BE Chapter 8, pp. 306-328 (Don't sweat over the details of pp. 319-325)
- BE Chapter 13, pp. 530-540
- Review: BE Chapter 26, pp. 1015-1019
- "The Trillion Dollar Bet": video (partial showing in class)

Many option value calculators are available on the Web. One is:

<http://www.intrepid.com/robertl/option-pricer1.html?q=~robertl/option-pricer1.html>

**In-Class Quiz # 2:** Thursday, March 31 (30 minutes)

**Problem Set # 2:** Due on Thursday, April 7, 5:00 pm.

5) Risk Management and Hedging (Two sessions)

- Topic Note 5
- BE Chapter 23 (This chapter is a very good complement to Topic Note 5.)

6) Valuing Options by Constructing Hedge Portfolios (Two sessions)

- Topic Note 6
- BE Chapter 25 (skip "Approach 4" on pages 985-986)

NOTE: be sure you can do the option pricing problems in Topic Note 6.

**In-Class Quiz # 3:** Thursday, April 14 (30 minutes)

**Case #2:** Southwest Airlines Jet Fuel Hedging. This case will be discussed in class on Tuesday, April 19. Submit team write-ups at the start of class.

7. Dividend Policy

- Topic Note 7
- BE Chapter 14

**Problem Set # 3:** Due on Thursday, April 21, 5:00 pm.

***Final Exam: Tuesday, April 26, from 7:15 - 10:15 PM. Each section is assigned to a specific Stuzin room.***

***MBA, Section 5077: HGS 140***

***MSM, Section 5284: HGS 150***

***No postponements or make-ups!***

## Summary Schedule, Finance 5439 (Spring 2011)

**This schedule is subject to minor changes, which will be announced in class.**

1	T, 3/1	Topic 1
2	Th, 3/3	Topic 1, Start Topic 2
		Spring Break (March 4 - March 12)
	Tu, 3/15	No Class
3	T, 3/17	Topic 2
4	Th, 3/18	Makeup Class: Topic 2 (conclude) <span style="float: right; color: magenta;">Problem Set #1</span> <span style="float: right; color: blue;">In-class Quiz #1</span>
5	T, 3/22	Topic 3
6	Th, 3/24	Topic 3
7	T, 3/29	Topic 4 (half of class) <span style="float: right; color: red;">Southwest Airlines Winglets Case</span>
8	Th, 3/31	Topic 4 <span style="float: right; color: magenta;">In-class Quiz #2</span>
9	T, 4/5	Topic 4
10	Th, 4/7	Topic 5 <span style="float: right; color: blue;">Problem Set #2</span>
11	T, 4/12	Topic 5
12	Th, 4/14	Topic 6 <span style="float: right; color: magenta;">In-class Quiz #3</span>
13	T, 4/19	Topic 6 (half of class) <span style="float: right; color: red;">Southwest Jet Fuel Hedging Case</span>
14	Th, 4/21	Topic 7 <span style="float: right; color: blue;">Problem Set #3</span>
		Review Session and extra office hours will be scheduled.
		Final Exam: Tuesday, April 26, 7:15 – 10:15 pm