

**Corporate Finance
LAW 719 (3 credits)**

Professor Michael Simkovic

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Classroom 1

Monday & Wednesday M/W 3:30 pm - 4:45 pm

Syllabus

Course Description

Welcome to Corporate Finance! I am delighted that you are taking the class and look forward to working with you. This course is a sequel to Business Associations. The purpose of this class is to allow you to work with accountants and investment bankers, not to make you an accountant or investment banker. The course is organized around four basic units: Valuing the Firm; Financing the Firm; Selling the Firm; and The Firm in Financial Distress. The course will involve some math, especially in the valuation unit, but nothing beyond algebra (the most complex math is exponents). A financial calculator is not necessary, but Excel is needed for this class.

Required Reading

The casebook is required for this course. You do not need to purchase a separate statutory supplement—the statutory supplement is in the form of a PDF that will be posted to the course website, and will be relevant starting around chapter 12. The book has been ordered by the bookstore.

- STEPHEN LUBBEN, CORPORATE FINANCE (Aspen / Wolters Kluwer) (2nd edition)
- Optional: (These are written at a somewhat more sophisticated and challenging level than the casebook)
 - Brealey Myers Allen, Fundamentals of Corporate Finance
 - McKinsey & Company, Tim Koller, Marc Goedhart, David Wessels, Valuation: Measuring and Managing the Value of Companies

Course Work & Grading

Your grade in the class will be based primarily on a 2.5 to 3 hour final examination which will include multiple choice and possibly short answer. You may use Excel during the exam. You may not communicate with anyone during the exam, nor may you retain copies of the exam questions—either will constitute a violation of the honor code. I may use class participation as a “tie breaker” when students’ exam scores place them on the border between two letter grades. I may also boost grades by one notch (i.e., from B+ to A-) for exceptionally good class participation (i.e., up to the top 10 percent of the class).

It is absolutely essential that you read casebook—including the mathematical formulas and statutes—and answer the problems in the text, as well as work any supplemental problems I may assign through the course website. **The questions and problems will help you learn the material.**

I encourage you to form study groups to work the questions and problems before class. I recommend forming a small study group (2-4 students) and meeting before class to discuss the problems, and at the end of each week to review.

Class Participation & Class Attendance

Class participation, attendance, and preparation are expected. I strongly recommend you attend class every day to avoid missing important material or falling behind. Class discussion will focus on the problems—case law will not be emphasized in this class, and in many situations we will not discuss cases that appear in the text.

During class, you may be connected to the Internet only for purposes related to class. This would include, for example, looking at a statutory provision or court opinion we are discussing or searching for other relevant information. This does not include, for example, reading the news, e-mailing classmates, or sending instant messages. I very much encourage the use of computers in the classroom (you will eventually need excel) and encourage you to be active learners. Like any technology, however, computers can be misused. Please do not let your computer become a distraction to you or your classmates.

Office Hours:

I will stay after class to answer any questions. If you cannot meet at the end of class, please email me to set up an appointment. Monday and Wednesday generally work best for me. I will also typically be available on Mondays or Wednesday afternoons if you wish to drop by my office. If it is inconvenient to meet in person, we can also schedule remote office hours by phone or through video conferencing, using Google Hangouts. We can also schedule group lunches or coffee if students are interested (2 to 4 students per lunch/coffee).

Syllabus Revisions

I may post revisions to the syllabus or announce changes in class. Please check the course website regularly!

Name Placards and Seating

Please bring a name placard to class and place it in front of you. If you have lost your name placard, you may obtain a free replacement from Margaret Miller or Shirly Kennedy. Please keep the back row empty for guests and visitors.

Guest Lectures

There may be guest lectures from USC alumni or others in business law or finance. Students should attend these guest lectures, the same as any other class, and the material may be tested.

Course Outline

The syllabus below lists the broad outline of the course. On average, I expect that we will cover about 1 chapter for every hour and half to three hours of class (i.e., roughly 1 to 2 modules per week), although we may move faster or slower through some chapters. The material is challenging and my goal is to pace the class to maximize learning and comprehension. At the end of each class, I will explain how far into the next assignment I think we will get.

Please complete all problems in each chapter unless I indicate otherwise in the syllabus, on the course website, or during class.

I anticipate that we will cover roughly the first 15 to 20 chapters of the book. We may skip some materials, in particular chapter 18. We will need to cover the fundamentals in the early portion of the book. Coverage of advanced materials will vary depending on the pace I think works best for the class. I will try to save time for a review session on the last day of class.

Part 1: Valuing the Firm

Module 1: Understanding the Firm's Business (reading and understanding a 10-K; introduction to accounting; EBITA and other measures of firm health)

- Lubben Introduction and Chapter 1
- Dynegy Annual Report:
 - On course website
 - Assume a law firm partner has asked you to "get smart" on the client's business so you can participate in a meeting in one hour. Read accordingly.

Module 2: The Time Value of Money (time value of money; one period present values; multiple period present values; perpetuities and annuities)

- Lubben Chapter 2

Module 3: Discount Rates; The Net Present Value Rule and Some Competitors (NPV; internal rate of return; payback rule and hurdle rates; choosing among projects with unequal cash flows)

- Lubben Chapters 3 and 4¹

Module 4: Valuing Debt (price/yield relationship; term structure; bond cash flows; zero coupon bonds; valuation of bonds as annuities; yield to maturity)

- Lubben Chapter 5

Module 5: Risk and Return (systematic vs. firm-specific risk; beta; diversification; expected return; arbitrage and the law of one price; short selling and its limits)

- Lubben Chapter 6²

Module 6: The Capital Asset Pricing Model (efficient capital markets hypothesis; CAPM and its flaws)

- Lubben Chapter 7³
- [FT.com: Wanted: a New Model for Markets](#)

Module 7: Capital Structure as Economic Dream (the debt-equity choice in the abstract; Modigliani-Miller I and II)

- Lubben Chapter 8
- Please also start to read Chapter 9, which we will start if there is time.

Module 8: Some Real World Considerations (the tax benefits of debt; the costs and benefits of leverage, dividends and dividend smoothing; share repurchases; taxation of dividends; risk adversity and cash retention; conglomerates and spinoffs)

- Lubben Chapter 9 & 10

Module 9: Valuation with Debt (WACC; integration of CAPM and WACC in discounted cash flow valuation; other models)

- Lubben Chapter 11

Part 2: Financing the Firm

Module 10: Introduction (brief review of Business Associations; common stock; the stock market; separation of ownership and control; dividend payments as perpetuities)

- Lubben Chapter 12⁴

Module 11: Preferred Shares (key types of preferred shares; certificates of designation; rights of preferred shareholders)

- Lubben Chapter 13

Module 12: Bonds and Notes I (Trust Indenture Act; negative pledge and other key clauses; call provisions; subordinated debt; defeasance)

- Lubben Chapter 14

Module 13: Bonds and Notes II (caselaw)

- Lubben Chapter 15

Module 14: Loan Agreements (loan agreements and their terms (e.g., what is a “yank a bank” provision?); revolving, term, and swing line pieces of loans; role of loans in company’s cash management system; secondary markets for loans; relations among the lenders; second lien and mezzanine debt)

- Lubben Chapter 16

Module 15: Options, Warrants, and Convertibles (the basic instruments; anti-dilution provisions; option pricing – theory and reality; “death spiral” convertibles)

- Lubben Chapter 17

Module 16: Derivatives (forwards and futures; interest rate, currency, total return and credit default swaps; hedging and speculative uses of derivatives; ISDA’s role and documents; collateral requirements; regulation under Dodd-Frank – end user exemption, etc.; special bankruptcy “safe harbors” for derivatives)

- Lubben Chapter 18
- ISDA Equity Definitions (skim)

Module 17: Asset Securitization (deal structures; regulatory and cost of capital motivations; CDOs; synthetic securitization; conduits; transactional problems with MBS)

- Lubben Chapter 19

Module 18: Hedge Funds, Private Equity, and Venture Capital (legal structure and regulation; investment strategies; prime broker relationships; manager compensation; post Dodd-Frank role in financial system)

- Lubben Chapters 20 & 21
- [Dealbook, Dropbox \\$8 billion valuation, \\$250 million fundraising round](#)
- [Dealbook, Hedge Funds and Carried Interest](#)

Part 3: Selling the Firm

(NOTE: If you are using the 1st edition of the casebook, in the second edition, the order of chapter 22 and 23 has been reversed)

Module 19: Tender offers (Federal Williams Act regulations; friendly and hostile deals; poison pills; two-step transactions)

- Lubben Chapter 22 (chapter 23 in 1st edition of casebook)
- Williams Act (1934 Act sections 13 & 14) and rules thereunder

Module 20: Mergers (merger agreements and key clauses (reps and warranties, MAC clauses, etc.); deal structures; taxes; deal protections)

- Lubben Chapter 23 (chapter 22 in 1st edition of casebook)
- Del. § 251

Module 21: Asset sales and successor liability (asset purchase agreements; successor liability; deal structures)

- Lubben Chapter 24
- Del. § 271

Module 22: Leveraged buyouts and distressed acquisitions (motivations; LBO financing; fraudulent transfer, lender default and other deal risks; WARN Act and other hurdles to the private equity model)

- Lubben Chapter 25
- Delaware UFTA

Part 4: The Firm in Financial Distress

Module 23: Exchange Offers, Workouts, Prepacks (distressed exchange offers under the Trust Indenture Act and other securities laws (registered vs. unregistered exchange offers); standstill agreements with creditors; the CDS problem; the general problem of distressed debt trading during

negotiations; tax issues regarding NOLs; securities law and pre-bankruptcy solicitation; refiling problems)

- Lubben Chapters 26 & 27
- 1933 Act §§ 3(a)(9); 4(2), 11 U.S.C. § 1126(b) (11 U.S.C. ____ refers to the Bankruptcy Code)
- 11 U.S.C. §§ 1125(g); 1126

Module 24: Introduction to Chapter 11 (overview of key concepts like estate, automatic stay, and debtor in possession; DIP financing and “first day” motions; international corporate groups; the controversy over “forum shopping” in large cases)

- Lubben Chapter 28
- 11 U.S.C. §§ 101, 109, 362-65, 1101-03, 1106-08

Module 25: Chapter 11 Plans and Sales (negotiation of the plan; buying the “fulcrum security” and claims trading; voting and cramdown; the balance of power among stakeholders; 363 sales; 363(f) as solution to successor liability problems; credit bidding; lender control of chapter 11 process)

- Lubben Chapters 29 & 30
- 11 U.S.C. §§ 363, 503, 506, 507, 510, 1121, 1123, 1126, 1129, 1141, 1145

Class recordings

Class recordings will be available during the semester to students who miss class because of illness, death of a family member or other serious family emergencies, or a job interview that could not be scheduled to avoid missing class. If one of these situations arises, to request the recording please email me and David Dinh in IT (ddinh@law.usc.edu) with the name of the class, the room number, day and times, and the reason for the absence. Class recordings will be made available to all students during the last week of class to be used for exam review purposes.

Thank you very much. I look forward to a great semester together!

Notes for those using the 1st edition of the casebook

¹ Note on Chapter 4 for those using the 1st edition: Clarification and errors (fixed in 2nd edition):

- Some students find the hypothetical that begins on page 53-54 ambiguous as to whether there should be 10 or 11 cash flows in the “own” option. The numbers are worked using 10 cash flows, but the text could lead them to believe there should be 11.
- Second, note that there are two errata in the chapter in the 1st edition.
 - At the bottom of page 51 it should be a 7% discount rate if the text is to tie with the numbers on the next page.
 - On page 56, the IRR example should read \$100,000 (vs. \$200,000) on the far right if the example is to connect with the numbers used in the prior problem set, and the answer provided in the text on page 56 (and in the spreadsheet).

² Note on Chapter 6 for those using the 1st edition: On page 78, the example really shows squared difference from the mean, rather than variance. The number 50 should be divided by 3, to get a variance of 16.67, and a standard deviation of 4.08.

³ Note on chapter 7 for those using the 1st edition,

- Problem 7.2.3 on page 98 should read as follows:

Sam Spade is considering buying some shares in Bogartco, which trades at \$50 per share. He concludes that the expected rate of return on this investment is 10% per year. If the risk-free rate is 3% and the market return is 7% and the stock’s beta is 1.5%, is this a good buy or not? What if the risk premium changes to 5%? What are the limitations of this analysis?

- Skip problem 7.2.2 on page 98

⁴ Chapter 12 was extensively revised in the 2nd edition.

USC Statement on Academic Conduct and Support Systems

Plagiarism – presenting someone else’s ideas as your own, either verbatim or recast in your own words – is a serious academic offense with serious consequences. Please familiarize yourself with the discussion of plagiarism in *SCampus* in Part B, Section 11, “Behavior Violating University Standards” <https://policy.usc.edu/scampus-part-b/>. Other forms of academic dishonesty are equally unacceptable. See additional information in *SCampus* and university policies on scientific misconduct, <http://policy.usc.edu/scientific-misconduct>.

Support Systems:

Student Counseling Services (SCS) - (213) 740-7711 – 24/7 on call

Free and confidential mental health treatment for students, including short-term psychotherapy, group counseling, stress fitness workshops, and crisis intervention. <https://engemannshc.usc.edu/counseling/>

National Suicide Prevention Lifeline - 1-800-273-8255

Provides free and confidential emotional support to people in suicidal crisis or emotional distress 24 hours a day, 7 days a week. <http://www.suicidepreventionlifeline.org>

Relationship & Sexual Violence Prevention Services (RSVP) - (213) 740-4900 - 24/7 on call

Free and confidential therapy services, workshops, and training for situations related to gender-based harm. <https://engemannshc.usc.edu/rsvp/>

Sexual Assault Resource Center

For more information about how to get help or help a survivor, rights, reporting options, and additional resources, visit the website: <http://sarc.usc.edu/>

Office of Equity and Diversity (OED)/Title IX compliance – (213) 740-5086

Works with faculty, staff, visitors, applicants, and students around issues of protected class.
<https://equity.usc.edu/>

Bias Assessment Response and Support

Incidents of bias, hate crimes and microaggressions need to be reported allowing for appropriate investigation and response. <https://studentaffairs.usc.edu/bias-assessment-response-support/>

Student Support & Advocacy – (213) 821-4710

Assists students and families in resolving complex issues adversely affecting their success as a student
EX: personal, financial, and academic. <https://studentaffairs.usc.edu/ssa/>

Diversity at USC – <https://diversity.usc.edu/> Tabs for Events, Programs and Training, Task Force (including representatives for each school), Chronology, Participate, Resources for Students