Project Outline

What is this project?

This project provides an opportunity to get some hands-on experience applying corporate finance theory and models to real firms. In the process, you will get a chance to:
(a) evaluate the risk profile of a firm, and examine the sources of risk.
(b) analyze its capital structure, and decide whether the firm is under or over leveraged.
(c) examine its dividend policy, and decide whether more or less should be paid in dividends
(d) value the firm
(e) restructure the firm, and revalue it.

How is the project structured?

1. This is a group project. Each group must from two to four individuals in it.
2. The group will pick a company to analyze. 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.
3. Each person will be responsible for doing the entire analysis for the company that he or she has chosen.
4. At the end of the process, the group will write one report for the firm in the group.

How will the project be graded?

1. Each group will receive one grade and every group member will receive the same grade.
2. No attempt will be made to allow for intra-group differences in effort.

Who polices the group?

1. You do.
2. In exceptional circumstances, I will step in and act as divorce or marriage counselor as the case may be.

Project Description

This project covers everything we will be doing in class and some additional topics as well . I have listed some of the key questions that you will be answering. Note that these questions are not meant to be comprehensive and you can add on interesting questions that you come up with. You do not need to answer all of the questions. As a group you need to decide which ones you will be answering and how you are approaching this paper. I would suggest you use "Skype" or similar to discuss your work if you cannot arrange a common location to meet.

Topics and Key Questions

I. Corporate Governance Analysis

Is this a company where there is a separation between management and ownership? If so, how responsive is management to stockholders?

How does this firm interact with financial markets? How do markets get information on the firm?

How does this firm view its social obligations and manage its image in society?

II. Stockholder Analysis

Who is the average investor in this stock? (Individual or pension fund, taxable or tax-exempt, small or large, domestic or foreign)

Who is the marginal investor in this stock?

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 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? How much of the performance can be attributed to management?

How risky is this company's equity? Why? 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?

IV. Measuring Investment Returns

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 the projects in the future likely to look like the projects in the past? Why or why not?

V. Capital Structure Choices

What are the different kinds or types of financing that this company has used to raise funds? Where do they fall in the continuum between debt and equity?

How large, in qualitative or quantitative terms, are the advantages to this company from using debt?

How large, in qualitative or quantitative terms, are the disadvantages to this company from using debt?

From the qualitative trade off, does this firm look like it has too much or too little debt?

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?

Does your firm have too much or too little debt relative to the market?

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?

VIII. Dividend Policy

How has this company returned cash to its owners? Has it paid dividends, bought back stock or spun off assets?

Given this firm's characteristics today, how would you recommend that they return cash to stockholders (assuming that they have excess cash)?

IX. A Framework for Analyzing Dividends

How much 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?

X. Valuation

What type of cash flow (dividends, FCFE or FCFF) would you choose to discount for this firm?

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?

Useful spreadsheet that you can use for this project can be found here:

http://raj.rajaditi.com/finance/corp/pages.stern.nyu.edu/_adamodar/New_Home_Page/spreadsh.html

Project Idea Borrowed from:

Aswath Damodaran, Professor of Corporate Finance and Valuation at the Stern School of Business at New York University.