KARACHI UNIVERSITY BUSINESS SCHOOL
UNIVERSITY OF KARACHI

BS (BBA) – VII

Course Title	**:**	**FINANCIAL MANAGEMENT**
Course Number	**:**	**BA(BS) – 601**
Credit Hours	**:**	**03**

Course Contents:

1. Cost Of Capital

1.1. Calculate and interpret the weighted average cost of capital (WACC) of a company;
1.2. Describe how taxes affect the cost of capital from different capital sources;
1.3. Describe the use of target capital structure in estimating WACC and how target Capital structure weights may be determined;
1.4. Explain how the marginal cost of capital and the investment opportunity schedule are used to determine the optimal capital budget;
1.5. Explain the marginal cost of capital's role in determining the net present value of a project;
1.6. Calculate and interpret the cost of debt capital using the yield–to–maturity approach and the debt–rating approach;
1.7. Calculate and interpret the cost of non–callable, nonconvertible preferred stock;
1.8. Calculate and interpret the cost of equity capital using the capital asset pricing
1.9. Model approach, the dividend discount model approach, and the bond–yield plus risk–premium approach;
1.10. Calculate and interpret the beta and cost of capital for a project;
1.11. Describe uses of country risk premiums in estimating the cost of equity;
1.12. Describe the marginal cost of capital schedule, explain why it may be upward sloping with respect to additional capital, and calculate and interpret its break–points;
1.13. Explain and demonstrate the correct treatment of flotation costs.

Contents

Cost of Capital
Costs of different sources of capital
Topics in the cost of capital estimations

2. Portfolio Risk And Return: Basics

2.1. Calculate and interpret major return measures and describe their appropriate uses;
2.2. Describe characteristics of the major asset classes that investors consider in forming portfolios;

2.3. Calculate and interpret the mean, variance, and covariance (or correlation) of asset returns based on historical data;
2.4. Explain risk aversion and its implications for portfolio selection;
2.5. Calculate and interpret portfolio standard deviation;
2.6. Describe the effect on a portfolio's risk of investing in assets that are less than perfectly correlated;
2.7. Describe and interpret the minimum–variance and efficient frontiers of risky Assets and the global minimum–variance portfolio;
2.8. Discuss the selection of an optimal portfolio, given an investor's utility (or risk aversion) and the capital allocation line.

Contents

Introduction to portfolio management
Some background assumptions
Markowitz Portfolio theory

3. Portfolio Risk And Return: Extensions

3.1. Describe the implications of combining a risk–free asset with a portfolio of risky assets;
3.2. Explain the capital allocation line (CAL) and the capital market line (CML);
3.3. Explain systematic and nonsystematic risk, including why an investor should not expect to receive additional return for bearing nonsystematic risk;
3.4. Explain return generating models (including the market model) and their uses;
3.5. Calculate and interpret beta;
3.6. Explain the capital asset pricing model (CAPM), including its assumptions, and the security market line (SML);
3.7. Calculate and interpret the expected return of an asset using the CAPM;
3.8. Describe and demonstrate applications of the CAPM and the SML.

Contents

Capital Market Theory: An Overview
The capital asset pricing model: Expected return and risk
Relaxing the assumptions
Empirical test of CAPM
Relationship between systematic risk and return
Market portfolio theory versus practice

4. Overview of Equity Securities

4.1. Describe characteristics of types of equity securities;
4.2. Describe differences in voting rights and other ownership characteristics among different equity classes;
4.3. Distinguish between public and private equity securities;
4.4. Describe methods for investing in non–domestic equity securities;
4.5. Compare the risk and return characteristics of different types of equity securities;
4.6. Explain the role of equity securities in the financing of a company's assets;
4.7. Distinguish between the market value and book value of equity securities;
4.8. Compare a company's cost of equity, its (accounting) return on equity, and investors' required rates of return.

Contents

Overview of the valuation process
Three step valuations process
Theory of Valuation
Valuation of Alternative investments
Relative Valuations Techniques
Estimating the inputs: the required rate of return and the expected growth rate of the valuation variables

5. Equity Valuation: Concepts and Basic Tools

5.1. Evaluate whether a security, given its current market price and a value estimate, is overvalued, fairly valued, or undervalued by the market;
5.2. Describe major categories of equity valuation models;
5.3. Explain the rationale for using present value models to value equity and describe the dividend discount and free–cash–flow–to–equity models;
5.4. Explain the rationale for using present value models to value equity and describe the dividend discount and free–cash–flow–to–equity models;
5.5. Calculate the intrinsic value of a non–callable, non–convertible preferred stock;
5.6. Calculate and interpret the intrinsic value of an equity security based on the Gordon (constant) growth dividend discount model or a two–stage dividend discount model, as appropriate;
5.7. Identify companies for which the constant growth or a multistage dividend discount model is appropriate;
5.8. Explain the rationale for using price multiples to value equity and distinguish between multiples based on comparable versus multiples based on fundamentals;
5.9. Calculate and interpret the following multiples: price to earnings, price to an estimate of operating cash flow, price to sales, and price to book value;
5.10. Describe enterprise value multiples and their use in estimating equity value;
5.11. Describe asset–based valuation models and their use in estimating equity value;
5.12. Explain advantages and disadvantages of each category of valuation model.

Contents

Equity Valuation Models and their rationale
Common and preferred stock valuation
Multi stage models
Price Multiple model

6. Fixed–Income Securities: Defining Elements

6.1. Describe the basic features of a fixed–income security;
6.2. Describe functions of a bond indenture;
6.3. Compare affective and negative covenants and identify examples of each;
6.4. Describe how legal, regulatory, and tax considerations affect the issuance and trading of fixed–income securities;
6.5. Describe how cash flows of fixed–income securities are structured;
6.6. Describe contingency provisions affecting the timing and/or nature of cash flows of fixed–income securities and identify whether such provisions benefit the borrower or the lender.

Contents

Basic Features
Covenants and indentures
Timing and nature of cash flow

7. Fixed–Income Markets: Issuance, Trading, and Funding

7.1. Describe classifications of global fixed–income markets;
7.2. Describe the use of interbank offered rates as reference rates in floating–rate debt;
7.3. Describe mechanisms available for issuing bonds in primary markets;
7.4. Describe secondary markets for bonds;
7.5. Describe securities issued by sovereign governments, non–sovereign governments, government agencies, and supranational entities;
7.6. Describe types of debt issued by corporations;
7.7. Describe short–term funding alternatives available to banks;
7.8. Describe repurchase agreements (repos) and their importance to investors who borrow short term.

Contents

Indentures and Covenants
Maturity
Par Value
Coupon rate
Bond Provisions
Conversion Privilege
Put provisions
Currency denominations
Embedded Options
Borrowing funds to purchase bonds

8. Measures of Leverage

8.1. Define and explain leverage, business risk, sales risk, operating risk, and financial risk, and classify a risk;
8.2. Calculate and interpret the degree of operating leverage, the degree of financial leverage, and the degree of total leverage;
8.3. Analyze the effect of financial leverage on a company's net income and return on equity;
8.4. Calculate the breakeven quantity of sales and determine the company's net income at various sales levels;
8.5. Calculate and interpret the operating breakeven quantity of sales.

Contents

Operating Leverage
Financial Leverage
Breakeven

9. Capital Structure

9.1. Explain the Modigliani–Miller propositions regarding capital structure, including the effects of leverage, taxes, financial distress, agency costs, and asymmetric information on a company's cost of equity, cost of capital, and optimal capital structure;
9.2. Describe target capital structure and explain why a company's actual capital structure may fluctuate around its target;
9.3. Describe the role of debt ratings in capital structure policy;
9.4. Explain factors an analyst should consider in evaluating the effect of capital structure policy on valuation;
9.5. Describe international differences in the use of financial leverage, factors that explain these differences, and implications of these differences for investment analysis.

Contents

Capital Structure Decisions
Practical Issues in capital structure policy

10. Dividends and Share Repurchases: Basics

10.1. Describe regular cash dividends, extra dividends, liquidating dividends, stock dividends, stock splits, and reverse stock splits, including their expected effect on shareholders' wealth and a company's financial ratios;
10.2. Describe dividend payment chronology, including the significance of declaration, holder–of–record, ex–dividend, and payment dates;
10.3. Compare share repurchase methods;
10.4. Calculate and compare the effect of a share repurchase on earnings per share when
10.5. The repurchase is financed with the company's excess cash and
10.6. The Company uses debt to finance the repurchase;
10.7. Calculate the effect of a share repurchase on book value per share;
10.8. Explain why a cash dividend and a share repurchase of the same amount are equivalent in terms of the effect on shareholders' wealth, all else being equal.

Contents

Dividends Concepts
Dividend payment procedures
Cash dividend and Share repurchase

11. Dividends and Share Repurchases: Analysis

11.1. Compare theories of dividend policy, and explain implications of each for share value given a description of a corporate dividend action;
11.2. Describe types of information (signals) that dividend initiations, increases, decreases, and omissions may convey;
11.3. Explain how clientele effects and agency issues may affect a company's payout policy;
11.4. Explain factors that affect dividend policy;
11.5. calculate and interpret the effective tax rate on a given currency unit of corporate earnings under double taxation, dividend imputation, and split–rate tax systems;

11.6. Compare stable dividend, constant dividend payout ratio, and residual dividend payout policies, and calculate the dividend under each policy;
11.7. Explain the choice between paying cash dividends and repurchasing shares;
11.8. Describe broad trends in corporate dividend policies;
11.9. Calculate and interpret dividend coverage ratios based on
11.10. Net income and
11.11. Free cash flow;
11.12. Identify characteristics of companies that may not be able to sustain their cash dividend.

Contents

Dividend policy and company Value: Theory
Factor Affecting Dividend policy
Payout policies
Analysis of Dividend Safety

12. Working Capital Management

12.1. Describe primary and secondary sources of liquidity and factors that influence a company's liquidity position;
12.2. Compare a company's liquidity measures with those of peer companies;
12.3. Evaluate working capital effectiveness of a company based on its operating and cash conversion cycles, and compare the company's effectiveness with that of peer companies;
12.4. Describe how different types of cash flows affect a company's net daily cash position;
12.5. Calculate and interpret comparable yields on various securities, compare portfolio returns against a standard benchmark, and evaluate a company's short–term investment policy guidelines;
12.6. Evaluate a company's management of accounts receivable, inventory, and accounts payable over time and compared to peer companies;

Contents

Managing and measuring liquidity
Managing cash positions
Investment short term funds
Managing accounts receivables
Managing Inventories
Managing Accounts payables
Managing Short term financing

Recommended Books:

1. Brigham, & Houston, (2004). *Financial Management.* Edinburgh: The Dryden Press.
2. Lawrence J. Gitman, Chad J. Zutter, (2011). *Principles of Managerial Finance*, 13th Edition, Prentice Hall.
3. Houston, & Brigham, (2004). *Financial Management, Theory and Practice*. New Jersey: Harcourt Brace College Publishers.
4. Hampton, J. J. (1989). *Financial Decision Making, Concepts, Problems and Cases.* Singapore: Prentice Hall.
5. Rao, R. K. S. (1989). *Fundamentals of Financial Management.* Oxford: Maxwell McMillan.
6. Brealey, R. A. & Marcus, A. J. (2007). *Fundamentals of Corporate Finance.* New Jersey: McGraw–Hill/Irwin.
7. Besley, S. & Brigham, E. F. (2007). *Essential of Managerial Finance.* Dallas: Thomson South–Western.
8. CFA Curriculum