249 – Introduction to Finance of Businesses (Spring 2012)

Time: Thursdays 8:00 – 9:50

Location: 240

Instructor: David Mendel

Office hours: Thursdays 10:00 – 12:00

Location: 227A

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**Course Overview**

The course will begin with a review of financial documents. We will use reports from Apple, IBM, and Amazon among others to obtain a working knowledge of the financial document landscape and a basic understanding of accounting (the language of finance). As with most of the course the study materials will be drawn from my bSpace, the internet and the databases available through the library. You should budget $15 for books and materials. There is no textbook.

We will use the skills acquired in phase one above to analyze transactions. We will study in detail the recent initial public offering (IPO) of Groupon. A merger and a study of bankruptcy are also on the syllabus.

As there are considerable differences between the financing needs of different businesses (e.g., a utility company and a grocery store) we will then use the skills acquired to investigate how various companies manage their finances. In particular we will look at a number of financial companies (banks, insurance companies, investment banks, hedge funds) to follow the money through these businesses and to gain some insight into how the greater financial system works.

Throughout the course you will learn how to go about the research of businesses, valuation techniques, and some basic business skills. We will use current events for class discussions. Sprinkled liberally throughout the course will be discussions about the personalities and the culture of the financial markets.

This is not a read the text, teach the text, test the text course. In fact there is no assigned textbook. The material for this course is taken from the internet (often ripped from the headlines), the school’s databases, my bSpace, one business school case you will purchase and a book by Michael Lewis. To get the benefit of this course you will need to do the homework, attend the class, and participate in the discussion.

## Syllabus

1/12/12 Class 1

**No Numbers Class**

We will use documents from IBM’s investor relations website to get an overview of [financial documents](http://www.ibm.com/investor/help/guide/statement-basics.wss).

Using the footnotes to the Apple Inc. annual report we will begin the process of exploring the contents and the interpretation of financial documents. In particular we will look at the effect of an accounting change on the [company’s reported earnings and cashflow](https://bspace.berkeley.edu/portal/site/acf29446-27d3-4c68-9fd5-a1e9b28b1c58).

You will learn how to get financial documents from the internet starting with this class.

The detailed homework assignment for this class is currently posted on my bSpace.

1/19/12 Class 2

**Balance Sheets and Income Statements**

Our “text’” for income statements and balance sheets is the Merrill Lynch Guide to [Understanding Financial Reports](http://www.ml.com/media/14069.pdf). It is free.

JP McGivney Inc. was Bernie Madoff writ small. We will use the 1985 annual report of Mr. McGivney’s company to gain familiarity with financial reports and to learn how to spot red flags.

From my bSpace read [Wealth Unlimited hits limit](https://bspace.berkeley.edu/portal/site/acf29446-27d3-4c68-9fd5-a1e9b28b1c58/page/8eca6e57-4c1d-4bfb-89e5-012d06a6d261).

There will also be a short tutorial on Excel for those not familiar the program.

Detailed homework for this class will be posted later.

1/26/12 Class 3

**Cash flow**

Cash and cashflow are the lifeblood of all businesses. We will study the difference between earnings and cash and examine the way cash cycles through different businesses.

Read this article from the Charles Schwab website [cash flow vs. earnings](http://www.schwab.com/public/schwab/resource_center/expert_insight/investing_strategies/stocks/cash_flow_vs_earnings_which_is_more_meaningful.html)

We will compare and contrast the finances of [Amazon](http://phx.corporate-ir.net/phoenix.zhtml?p=irol-irhome&c=97664) vs. [Barnes and Noble](http://www.barnesandnobleinc.com/for_investors/for_investors.html).

Detailed homework for this class will be posted later.

2/2/12 Class 4

**Ratio Analysis**

You will purchase and download a business school case on ratio analysis. Budget $3.85 for this purchase. A business school case is not the same as law school casework).

You will do a simple investing exercise using Excel to learn the [power of compounding](http://www.smartmoney.com/investing/basics/the-power-of-compounding-17625/?hpadref=1).

Detailed homework for this class will be posted later.

2/9/12 Class 5

**Bonds and Bankruptcy**

We will learn the language and mechanics of bonds.

We will take a look inside [the bond rating business](http://www.moodys.com/cust/default.asp).

Use [Altman z-scores](http://www.grahaminvestor.com/articles/quantitative-tools/the-altman-z-score/) to predict which retailers may file for bankruptcy.

Finally you will read and we will discuss a short primer on investing in bankruptcy.

Detailed homework for this class will be posted later.

2/16/12 Class 6

**Initial Public Offerings (IPOs)**

Ignore the fifteen second ad preceding this [video clip](http://www.cnbc.com/id/45066957/Cramer_s_Groupon_IPO_Strategy) of Jim Cramer’s rant from the CNBC show Mad Money about the Groupon IPO. Also ignore everything after 6 minutes and thirty seconds of the clip. A hard copy of the [prospectus for the Groupon IPO](http://www.sec.gov/Archives/edgar/data/1490281/000104746911005613/a2203913zs-1.htm) will be handed out in class 5. You will learn how to read one of these documents and how one might think about public offerings in general and Groupon in particular.

Detailed homework for this class will be posted later.

2/23/12 Class 7

**Mergers**

You will read background material to get an overview and some of the legal aspects of mergers. Then we will take an in-depth look at the [Berkshire Hathaway merger with Burlington Northern](http://www.cnbc.com/id/33602516).

Detailed homework for this class will be posted later.

3/1/12 Class 8

**Start-ups**

You and a partner will build an income statement and balance sheet for [International Widget](http://www.financialcrisiscards.com). Determine how much capital will be needed to start this business. Estimate how many units you will need to sell to break even. Detailed information about International Widgets will be available later on my bSpace.

Angeline’s Louisiana Kitchen is a restaurant on Shattuck Avenue in Berkeley. We will get an inside look at the restaurant business and details on the start-up of [Angeline’s Louisiana Kitchen](http://www.angelineskitchen.com/)

Detailed homework for this class will be posted later.

3/8/12 Class 9

**Real Estate**

[Mission West Properties](http://www.missionwest.com/index.html) is a Real Estate Investment Trust (REIT) that owns 108 commercial properties in the south bay, including the campuses of both Microsoft and Apple.We will get an inside look at [commercial real estate in the south bay](http://seekingalpha.com/article/30635-mission-west-properties-ceo-speaks-about-his-company) and the opportunity to discuss it with the management of Mission West.

Detailed homework for this class will be posted later.

3/15 /12 Class 10

**Banking, the Carry Trade, and the Federal Reserve Bank**

Commercial banking is principally about two things (1) [the spread between the cost of deposits and the return one can earn on that money](http://www.ft.com/intl/cms/s/0/f3aec6c2-b99e-11de-a747-00144feab49a.html#axzz1ha1bt7io) and (2) the amount of leverage a bank can employ in earning that spread. When it is done well it is a good business. When it is done poorly it can create a Lehman Brothers or MF Global debacle.

We will look at the [cost of funds](https://www.wellsfargo.com/savings_cds/cds) and the [return on investment](https://www.wellsfargo.com/credit_cards/) for Wells Fargo Bank.

We will get an overview of the role of the [Federal Reserve Bank](http://www.frbsf.org/publications/federalreserve/fedinbrief/roles.html) and examine the income statement and balance sheet of the central bank.

Detailed homework for this class will be posted later.

3/22/12 Class 11

**Manufacturing**

We will be studying [Rogers Corporation](http://www.rogerscorp.com/), a manufacturer of specialty materials that goes into products like cell phones and ipads.

We will look in detail at the company’s decision to move operations to [China](http://findarticles.com/p/articles/mi_m0EIN/is_2007_June_13/ai_n27273543/)

Detailed homework for this class will be posted later.

3/29/12 no class

**Spring recess**

4/5/12 Class 12

**Insurance**

The principle business of the Berkshire Hathaway Corporation is insurance. Legendary investor Warren Buffett is the chairman of the board of the company. We will use the [chairman's letter](http://www.berkshirehathaway.com/2002ar/2002ar.pdf) from the 2002 Berkshire Hathaway annual report as our source document for our study of the insurance business.

Detailed homework for this class will be posted later.

4/12/12 Class 13

**Valuation**

The issue of valuation will be discussed throughout the course. The subject of valuation is complex and could be the subject of an entire course. This class is devoted to an overview of some of the formal methods of valuation.Three methods of valuing assets will be covered: [discounted cash flow](http://www.investopedia.com/terms/d/dcf.asp), [comparables](http://www.zillow.com/wikipages/All-About-Comps/) and [options](http://www.hoadley.net/options/calculators.htm).

Detailed homework for this class will be posted later.

4/19/12 Class 14

**Investment Banking**

We will use a book written by Michael Lewis about his experiences as a Wall Street salesman in the late 1980s to get an insight into the operations and culture of Wall Street.

You will need to purchase a copy of [Liar’s Poker](http://books.wwnorton.com/books/detail.aspx?id=4925). Budget $10 for purchase this book.

We will also discuss recent efforts to [regulate Wall Street](http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf) and other [recent street events](http://www.bloomberg.com/apps/news?pid=20601103&sid=aj5CUuYxfE2Q).

Detailed homework for this class will be posted later.

4/26 Review session

**Grades**

I will be teaching a method of thinking as well as a body of knowledge. The easiest and best way to demonstrate your understanding will be through class participation. You can distinguish yourself by the quality of the questions you ask as much as by the answers to the questions I may ask. Show up to class prepared to participate and your grade will probably take care of itself. There may be a very small amount of homework to hand in. The final will be a take-home exam and will be comprehensive as you will need to employ skills accumulated during the semester.