

UNIVERSITY OF PENNSYLVANIA
The Wharton School

Corporate Valuation
FNCE207 & FNCE728

Robert W. Holthausen
Autumn, 2010

DETAILED COURSE OUTLINE

Office: Steinberg-Dietrich Hall 1332

Telephone Number: 215 898-7781

Office Hours: Monday: 3:30 pm - 4:50 pm (except 10/12 – Fall Break)
Wednesday: 2:30 pm - 3:50 pm (11/24 –Thanksgiving Break)

Additional Hours by appointment.

The TAs and their office hours for this course will be announced in the next week.

EMAIL: holthausen@wharton.upenn.edu

I will answer email that can be answered with a simple reply (for example, "yes" or "no" or a few sentences). I will not answer emails that require long explanations. In those cases, I will ask you to call me or see me in my office. I generally answer emails at least once per day.

1. Course Objectives.

The objective of this course is to learn firm, debt and equity valuation methods from both a conceptual and practical framework. The approach combines both accounting and finance into a practical framework for valuing firms, debt and equity. While there is some new finance theory introduced in this course, the emphasis is on the practical application and integration of finance and accounting concepts to valuing companies. We will discuss standalone valuation, valuation in an M&A setting, LBOs and multinational valuation. We do not specifically discuss valuation of financial institutions.

Students with weak accounting and finance backgrounds will be at a disadvantage in this course. Working knowledge of EXCEL is also important. ***Students who hoped to never see a financial statement again should not take this course.***

The course utilizes extensive and detailed readings, chapter exercises, multiple valuation cases (some use sanitized data and others use real data), a midterm exam and a final exam. Prior students indicate that the workload for this course is demanding, as such, it is only recommended for those students who are interested in learning valuation techniques in depth. Students interested in broader topical coverage and a less detailed examination of valuation techniques should consider the Advanced Corporate Finance (the corporate finance case course).

This course is designed for students with little or no practical work experience in valuing companies. I do not believe that the "value added" from this course for students who have previous job related valuation experience is as high as for those with no relevant prior experience, but former students with prior work experience disagree with me on this issue.

My goal in this course is to give you a through grounding in the theory and practice of valuation. From time-to-time I will discuss common errors that practitioners make and I will discuss some issues that practitioners often ignore. My view is that you need to fully understand the potential consequences of potential shortcuts you might make in valuing a company. In some cases, those shortcuts are justified because they will have little to no impact on the valuation and would not be worth the time required. In other cases, taking those shortcuts could lead to more serious errors. I will also discuss areas where there is uncertainty about how best to do certain tasks in a valuation. In these situations, I will indicate what is typically done or what is typically ignored and discuss relevant research in the area, so you at least have an appreciation of the issue and the alternative views on the matter.

2. Minimal Prerequisites.

- A. Introductory Financial Accounting
- B. Introductory Corporate Finance.
- C. Introductory Statistics or Econometrics.
- D. A basic knowledge of EXCEL.

Note, some prior students have indicated that they thought intermediate accounting (ACCTG 201 and/or ACCTG 202 OR ACCTG 742) was the real prerequisite. However, many students have succeeded in this course without accounting training beyond introductory financial accounting. Stronger accounting skills will, of course, make some of the material easier to understand.

3. Course Texts.

A. Required Texts.

Richard Brealey, Stewart Myers and Franklin Allen, Principles of Corporate Finance, Tenth Edition, McGraw Hill, 2010. This is a text virtually all of you should own having taken Corporate Finance. **If you own a prior edition of this text, I would not bother purchasing the tenth edition.** If you own another corporate finance textbook (such as Corporate Finance by Ross, Westerfield and Jaffe), that will suffice as well, though you will have to figure out the relevant chapters for reading. *This text is just background reading for concepts you should already know.*

B. Bulkpack

The bulkpack is currently available from Wharton Reprographics in two bound volumes at a total cost of approximately \$112. The bulkpack material comprises all of the required reading for the class. The bulkpack is material that Mark Zmijewski at the University of Chicago and I are developing for a textbook called *Corporate Valuation: Theory, Practice and Evidence*. *NOTE: This bulkpack is not available from Study.Net.* The book is under contract and the publisher does not want it released through Study.Net. The book is revised relative to last year so students should not try to use last year's bulkpack. **Students should read the relevant material before class.** Unless otherwise specified, students will be held responsible for all material in the bulkpack, whether covered in class or not.

In addition, students may be billed for class handouts. I anticipate approximately 200 pages of additional handouts, though there may be more depending on the material developed during the semester and whether material is handed out in class or is distributed electronically. Extra handouts will be on file in the filing cabinet outside my office door (Steinberg-Dietrich Hall 1332) if you miss class. Once those extra copies are gone, students will be responsible for borrowing the relevant material from another student in order to make a copy. Your bursar bill will reflect the actual cost of the handouts at the end of the semester at Wharton Reprographics standard per page rate.

C. Web Café

Material for the cases will be made available for student access via Web Café. The available material for the cases is the underlying data and the case write-ups.

In addition, there will be copies of the PowerPoint slides I will use during lectures available via Web Café as well. These will not be distributed in hard copy as they generally follow the notes in the bulkpack, but students wishing to have them prior to class, can print them out. The final version of these will be available by at least 8:00AM on the day of class. There will generally be three copies of the PowerPoint slides (2, 4 and 6 slides per page). In some cases I may create slides that are just one per page because of small print in tables and graphs. If you are registered for the class, you can gain access to the web Café room for this course via mySPIKE (<http://myspike.wharton.upenn.edu>) or on the Web Café home page (<http://webcafe.wharton.upenn.edu>). Both MBA students and undergraduates have access to mySPIKE.

Mark Zmijewski and I would appreciate it if you would report typos, errors and comments. Thus, there will be a place on Web Café where you can report typos, errors and passages that confused you. This area will be organized by chapter number and will be visible to everyone so you can see whether a typo has already been noted and whether I responded to some issue of clarification. I will comment on any item that requires clarification. Your feedback will help us rewrite our new material as we get closer to publication.

D. Other Interesting but not Required Texts and Material.

Lawrence Revsine, Daniel Collins, W. Bruce Johnson and H. Fred Mittelstaedt, Financial Reporting and Analysis Fourth Edition, Prentice-Hall, 2009. This is a useful book to aid in understanding how accounting records various transactions, understanding the cash flow statement and how to analyze accounting statements. The course does not rely explicitly on this text so you should only purchase it if the book is a useful addition to your library. It is a good reference book which you might want to own if your intended career will require you to read and comprehend financial statements (e.g., equity analyst, valuation work, etc), or if you need help with the accounting aspects of the course. If you already own another book with the same topical coverage, it is not worth buying this one. Other accounting texts that you may already own may help you with the accounting aspects of the course as well.

McKinsey & Co., Tim Koller, Marc Goedhart and David Wessels, Valuation: Measuring and Managing the Value of Companies, Fifth Edition, John Wiley & Sons, 2010. This is a valuation book written largely from a practitioner's perspective.

For those who would like to learn useful Excel shortcuts and how to build standard investment banking models, you might want to purchase Knowledge Base Level I or Knowledge Base Level II from DealMaven, Inc. (which is now owned by FactSet). Knowledge Base Level I teaches Excel shortcuts and how to build a standard IBANK model. Knowledge Base Level II discusses LBO and M&A transactions and how to build an LBO model and an accretion/dilution analysis for an M&A deal. To purchase or learn more about either of these products, go to

<http://store02.prostores.com/servlet/factsetdealmavenorders/StoreFront>

There is student pricing available, but they aren't giving it away.

4. Grading.

Grading in the course will be based on the following criteria:

Darden Corporation – Cash Flow and Free Cash Flow Analysis	10%	
Judson Green	10%	
Darden Corporation – Forecasting Model	15%	1
Xerox – ACS Merger	10%	
Midterm Examination I	25%	
Midterm Examination II	30%	
Total	100%	

I anticipate giving an overall GPA of 3.25 for all MBA students in Corporate Valuation. If class performance is exceptional, the combined GPA can be as high as 3.33 (the maximum allowable in the grading system), and if I feel class performance is lacking the MBA GPA can be set at less than 3.25. Undergraduate grades will then be determined relative to the cutoffs established for various grades for the MBA students. When that procedure is followed, there is no guarantee that the GPA for the MBAs and undergraduates will be the same.

UNDERGRADUATES PLEASE NOTE: The deadline for dropping from a finance course is Monday, September 20th. If an undergraduate student drops after that date, a “W” will appear on his or her transcript.

A. Class and Participation and Attendance

Some classes require you to be prepared for class discussion (discussion of assigned cases or problems), while other classes will be lecture format. During lectures, I encourage you to ask questions. Voluntary class participation is expected, however, I will cold call on individuals in class from time to time. Participation will affect student's grades who wind up near a grade boundary.

The education experience for everyone suffers if participation or attendance for the class becomes a problem. If attendance or participation lags, I reserve the right to change the grading criteria in the middle of the semester to weigh class participation and attendance in the grading scheme (retroactively).

B. Name Cards/Seating Charts

In order to get to know your names, I would like students to display name cards in class at all times. Please write your name in large, dark letters on the name card.

C. Examinations.

The midterm examination will be administered on **Monday, October 25, 2010** from **6:00 pm - 8:00 pm** (rooms to be announced). The midterm exam will be "open book". You may bring the H&Z book, class notes, one accounting book, and the Brealey, Myers and Allen textbook to the exam. **No other material is allowed.** The midterm exam covers Chapters 1-10 and Appendix A. Class will not meet at its regularly scheduled time on Monday, October 25 because of the midterm exam that evening.

The final examination will be administered **Friday, December 17, 2010**, from **6:00 pm - 8:00 pm**. This exam will also be "open book". You may bring the H&Z book, class notes, one accounting book and the Brealey, Myers and Allen textbook to the exam. **No other material is allowed.** The final examination is cumulative and covers all material covered in the course.

Copies of exams and suggested solutions from the last two years will be made available on webCafé.

Please note the scheduling of the two exams. You are responsible for ensuring that you are available and on campus to take the exams. I will not FAX exams to remote locations. I will not permit anyone to take the exams at another time unless you are gravely ill, face a significant emergency or have an exam or class conflict. If your travel plans conflict with the date of an exam, you should change your travel plans now, or drop the course.

You must ensure that you are available for both examinations, October 25 and December 17. Please advise potential employers that you cannot schedule interviews that conflict with your exam schedule.

You are responsible for letting me know by September 21 of any exam or class conflict you have with either exam in the course.

D. Chapter Exercises and Valuation Cases

Students will hand in the Judson Green Case, the Darden Corporation Cash Flow and Free Cash Flow Case, the Darden Forecasting and Financial Model Case and the Xerox-ACS Merger Case. Late assignments will not be accepted. Students must turn in their assignments prior to the start of class. You should bring an extra copy of each valuation case with you since we will be discussing those cases in class on the day they are due. Some cases require electronic submission and the case assignments will alert you to that requirement.

Note that the chapter exercises and valuation cases are marked on the outline as either D or D & S. If marked D, it means you must be prepared to discuss the chapter exercise though it will not be submitted. If marked D & S, you must be prepared to discuss the case and you must submit it at the beginning of the class.

You may work individually or in teams of up to **four individuals** on the valuation cases that are submitted. If you work as a team, all members of the team will receive the same grade on submitted work. No team can have more than four members (more on teams later).

The first page of a submitted valuation case should indicate the case name, the names of the individuals participating in the grade and the section number of each student.

Answers should be clearly marked and final answers should be highlighted in some manner. Work must be legibly and accurately portrayed to receive credit.

Using solutions to exercises and cases handed out in prior years or using the work of prior or current students who are not members of your group on submitted work is considered a violation of the codes of academic honesty. Moreover, it is likely your exam performance will suffer as these valuation cases are intended to help you prepare for exams.

5. Attendance and Class Etiquette

Students should attend the section of the class for which they are registered. Students are expected to attend class throughout the semester. In the case of a **rare conflict**, students can attend another of my sections. I teach the same class at 9:00, 10:30 and noon in JMHH 260 on Mondays and Wednesdays. If you attend a different section of the class, do not take a seat from a student registered for that class. You should notify me by 8:00 AM by email if you are planning to attend a different section and you should come up to me prior to the start of the class you will attend.

Students are expected to arrive on time for class. Once in class, students should remain until the class is completed. Arrivals and departures during class time interfere with the educational process and are not fair to the other students or myself. If you choose to schedule an interview on-campus during class, do not come to class for part of the period, come to another section and notify me in advance.

6. Workload

The subject matter of this course is quite technical and difficult. Students in past years have indicated that the workload for this course is very heavy. Because of the technical nature of this course, the course does not appeal to all students. I believe in communicating the complexity of the issues one faces in valuation. I will rarely gloss over something even if it is difficult.

7. Relation to Advanced Corporate Finance (the corporate finance case course)

The Corporate Valuation course concentrates on valuation issues only and looks at valuation issues in detail. This means we will discuss topics like how to analyze a company's historical data, estimating free cash flows, building a financial model, estimating the cost of capital, leveraging and unlevering, market multiples, LBOs and valuation for M&A transactions. The Corporate Finance Case course generally examines a variety of issues such as working capital management, optimal capital structure, dividend signaling, capital budgeting and valuation. Thus, while the corporate finance case course deals with valuation issues, it does not look at them in as much detail and generally uses cases whose data has been sanitized. However, the corporate finance case course has a much broader topical coverage.

8. Academic Integrity

Students are expected to follow the rules of academic honesty in this class. This means that examinations are to be the work of the individual student using only the material permitted during the examination. Regarding submitted valuation cases, the work should be the work of *only the team members* reported on the front of the case. Students should not in any way rely on solutions to cases distributed in prior years or on the work of prior students or current students that are not members of their team. This prohibition extends to prior homework, cases or projects that are directly relevant to the assignment being completed. When a valuation case requires you to produce a forecasting or valuation model, the use of a forecasting or valuation model not created exclusively by the student team for this course is a violation of the codes of academic integrity. In other words, for all submitted cases, you must start with an excel spreadsheet which is at most populated with some raw data. **If you have questions concerning this policy, please see me for a clarification before you use any questionable material.**

Please note that if you violate this policy, failing the class will constitute the minimum penalty, regardless of the degree of your violation.

9. Teams

The valuation cases can be worked on individually or in teams of up to four students. Teams of five or more are not allowed (no exceptions). MBAs and undergraduates may not be on the same team. MBAs may form teams across sections. I encourage you to work in teams to maximize the learning experience. I will not become involved in any group problems. Teams may change composition during the course of the semester. If a set of teammates decides they can no longer work together, they are free to separate. If any member of the team cannot find another suitable team to join, he or she will have no choice but to hand in the rest of the valuation cases individually. In choosing teammates, consider the skills your team will want to possess: accounting, finance and excel modeling expertise. Also make sure that your teammates' expectations for their performance in this course are consistent with your expectations for yourself.

Please sign up for a team no later than Wednesday, September 29. To sign up for a team – please perform the following steps.

1. In the **webCafé** room for the Corporate Valuation course, click on the **Team Registration and Assignment Submission** folder for your course (FNCE 207 for undergraduate students, FNCE 728 for MBA students).
2. Read the onscreen description there, and then click on **Team Registration (Sign Up Here)**
3. Read the onscreen instructions above the list of teams. These instructions describe how to sign up for a team, which is also covered in the next step. *As described there, each student has to sign up individually for a team.* Since all assignments use teams of four, one student will register for the first available empty team, and then other teammates will need to register separately to join the teammate who first registered.
4. When you are ready to sign up for any of the available teams of four, check off the checkbox for your desired team and then click the **join or change teams** button. (If you need to switch teams or leave a team you already chose, you may click the **join or change teams** button without first selecting a checkbox.

10. Lunches

In an effort to get to know more of you personally, I am happy to take as few as three students and as many as six students to lunch at a nearby restaurant (usually Pod). Because I teach at noon on Mondays and Wednesdays and have other lunchtime commitments on Thursday and Friday, I am generally available only on Tuesdays at noon. In total, I am available for nine lunches this semester. There will be a sign-up function for lunches in the Course Web Café site with the Tuesday dates when I am available during the semester. If you discover that you cannot go to a lunch that you had previously signed up for, please go to the Web Café site and remove yourself from the list as soon as you know you cannot attend so that another student can sign up. I apologize that I cannot accommodate more students over the course of the semester. The first lunch will be September 21 and I will try to have the lunch sign-up activated on Web café on Tuesday, September 14.

**COURSE CALENDAR
CORPORATE VALUATION
FNCE207 & FNCE728**

**R. HOLTHAUSEN
AUTUMN, 2010**

NOTE: ASSIGNMENTS AND DATES ARE SUBJECT TO CHANGE

Class			Brealey, Myers & Allen		Assignment
			H & Z		
1	September 8, 2010	Introduction to Course and Valuation	1 & App. A		
2	September 13, 2010	Creating and Measuring Value & Analyzing Financial Statements	2 Skim 3&4	2-6 29	
3	September 15, 2010	Free Cash Flow Basics and the SCF	5		D - Problem 5.4
4	September 20, 2010	Creating a Financial Model.	6		
5	September 22, 2010	Additional Forecasting and Free Cash Flow Measurement Issues	7		D - Problem 7.5
6	September 27, 2010	Additional Forecasting and Free Cash Flow Measurement Issues	7		D - Supplementary Problems 1 and 2 on Web Café
7	September 29, 2010	The APV and WACC DCF Valuation Methods	8		D - Problem 8.5
8	October 4, 2010	Free Cash Flow Analysis			D&S - The Darden Company - CF & FCF Case
9	October 6, 2010	Excess Earnings Valuation Models	10		D - Problem 10.5
	October 11, 2010	NO CLASS - Fall Break			
10	October 13, 2010	Measuring Continuing Value	9		D - Problem 9.8
11	October 18, 2010	COMPREHENSIVE CASE -- Judson Green			D & S -- Judson Green Case
12	October 20, 2010	Cost of Equity Capital	11	7-9	
13	October 25, 2010	MIDTERM EXAM -- CHAPTERS 1-10 & App. A From 6:00 to 8:00 PM (No Class during Regular Class Hours)			
14	October 27, 2010	Cost of Equity Capital	11 & 12		
15	November 1, 2010	Cost of Debt	13	24-25	
16	November 3, 2010	Cost of Debt	13	24-25	
17	November 8, 2010	Levering and Unlevering	14	14, 24 17-19	
18	November 10, 2010	Levering and Unlevering	14		D -- Probs. 14.6, 14.13 (A&B), 14.14 (A&B)
19	November 15, 2010	Financial Modeling			D&S -- Darden Forecasting and Modeling Case
20	November 17, 2010	WACC and Special Issues	15	19	
21	November 22, 2010	Market Multiples	16		
22	November 24, 2010	Market Multiples	16 & 17		
	THANKSGIVING BREAK				
23	November 29, 2010	Leveraged Buyouts and LBO Models	18	32, 33	
24	December 1, 2010	Multinational Valuation	No Reading		
25	December 6, 2010	To Be Announced	No Reading		
26	December 8, 2010	Mergers and Acquisitions			Xerox & ACS Merger Case
27	December 17, 2010	FINAL EXAM -- CUMULATIVE from 6:00 to 8:00 PM			