

Tentative Syllabus
Finance 728 – Corporate Valuation
Fall 2011
Prof. Michael R. Roberts

Description and Format

This is a course on corporate valuation. The emphasis will be on valuation problems in the context of the firm (e.g., capital budgeting, acquisitions, firm valuation, equity valuation). We will not be valuing derivative securities or fixed income products. The finance department offers classes focused exclusively on these topics.

My teaching philosophy is learning by doing. As such, the lectures and assessments will all be based on doing valuations in various settings and employing various techniques. We will introduce and illustrate the underlying theory through numerous examples.

The class format consists of lectures on each topic, typically followed by a case focusing on that topic. For each lecture, I encourage you to come to class prepared by bringing the lecture slides and having completed the pre-readings. Doing so will enable you to get more out of the lectures and allow us to cover more ground. The goal with lectures is to introduce and reinforce valuation techniques.

For the cases, students should work in groups of three to four to solve the case. Case solutions consist of a 3-5 page write-up and an appendix containing any analysis, figures, and tables. For each case, one group of students will be responsible for presenting their findings in a PowerPoint (or any other software) presentation. Presentations should be approximately 50 minutes in length. After the presentation, the case will be further reviewed. The goal with cases is to apply the valuation techniques and do so in a setting mimicking reality. An important lesson of this course is the ability to ask appropriate questions of valuation exercises.

This course is dynamic, hence, the tentative nature of this syllabus. We will explore different topics more or less deeply as we see fit. I encourage the discussion of workplace related questions, subject to relevance and time constraints. Likewise, I encourage the discussion of current events, again subject to relevance and time constraints.

This is a challenging course, but one that is, hopefully, equally rewarding.

Pre-Requisite Knowledge

I will assume that you have a working knowledge of finance (i.e., Finance 601) and accounting (Accounting 620). This knowledge is essential because there is not enough time in the course to review this material.

Materials

I rely on a variety of materials to construct this course. I also offer a large number of suggested readings, as listed here and below in the discussion of course topics. You are not expected to

read everything suggested on this syllabus. Doing so would be inefficient as many readings are redundant. I suggest that you peruse the readings to determine what works best for you.

- 1) Cases: Cases are listed below and are available on Study.net
- 2) Slides: Lecture Slides will be made available in advance of each class via WebCafe. I recommend printing them out and bringing them to class to ease note taking.
- 3) Articles and Exercises: Various articles and exercises for each topic are also listed below and will be made available via Study.net or WebCafe, depending on copyright issues.
- 4) Texts: There are a number of excellent texts that could be used for this course. I rely primarily on Berk and DeMarzo (BD), *Corporate Finance*, 2nd ed. Alternative texts include:
 - a. *Principles of Corporate Finance* 10th ed., Brealey, Myers, and Allen (BMA). Alternative text to BD with similar coverage.
 - b. *Corporate Valuation: Theory, Evidence, and Practice* Vols. 1 and 2, Holthausen and Zmijewski. A detailed two volume text on valuation containing more accounting aspects.
 - c. *Valuation: Measuring and Managing the Value of Companies* 4th ed., Koller, Goedhart, and Wessels. A more strategic oriented introduction to valuation.
 - d. *Valuation: The Art and Science of Corporate Investment Decisions* 2nd ed., Titman and Martin. Introductory valuation text.

Assessment

Grades will be based on the following criteria

- 1) 15%, Class participation: To get the most out of the class you must not only attend but actively participate in the class discussion. This will require advance preparation including reviewing lecture slides, completing the background reading, and preparing case solutions. Also factored into this component are the case presentations-board discussions.
- 2) 50%, Case Solutions: For each case, you will work in groups of 3-4 to prepare a case solution. Case solutions consist of a 3-5 page write-up and an appendix containing any analysis, figures, and tables.
- 3) 35% Final Project. The final project will be an integrated case that brings together many, if not all, of the concepts covered in the course. It will be a take-home project for which you will have one week to complete ***by yourself. You may not engage anyone to help you with this final project.*** Your solution should mimic that of the case assignments – a 3-5 page write-up accompanied by an Appendix containing any relevant analysis, figures, and tables.

Course Outline

- 1) Course Introduction
 - a. Lecture Topics
 - i. Course Overview and Administration
 - b. Readings
 - i. *What's It Worth? A General Manager's Guide to Valuation*, Luehrman, Harvard Business Review, 1997, Reprint 97305.
- 2) Decision Criteria
 - a. Lecture Topics
 - i. Investment Decision Rules (NPV, IRR, Payback Rule, Project Selection with Resource Constraints)
 - b. Readings
 - i. Chapter 6, Berk and DeMarzo
 - ii. Chapters 5 and 6, Brealey, Myers, and Allen
- 3) Free Cash Flow
 - a. Lecture Topics
 - i. Fundamentals of Capital Budgeting (Forecasting Earnings, Determining Free Cash Flow & NPV)
 - b. Readings
 - i. Chapter 7, Berk and DeMarzo
 - ii. Chapters 2 and 5, Brealey, Myers, and Allen
 - iii. *Net Present Value and Internal Rate of Return: Accounting for Time*, Excerpted from "Manager's Toolkit: The 13 Skills Managers Need to Succeed," 5245BC
 - c. Problem Set
 - i. Valuing Capital Investment Projects, Kester, (9-298-092)
 - d. Case:
 - i. Ocean Carriers, Stafford, Luchs, and Chao, 9-202-027
- 4) Cost of Capital
 - a. Lecture Topics
 - i. CAPM
 - ii. Equity Cost of Capital
 - iii. Debt Cost of Capital
 - iv. Project Cost of Capital
 - v. Other Securities' Costs of Capital
 - vi. Alternative Asset Pricing Approaches
 - b. Readings
 - i. Chapter 12, Berk and DeMarzo
 - ii. Chapter 9, Brealey, Myers, and Allen
 - iii. *Business Valuation and the Cost of Capital*, Luehrman (9-201-037)
 - iv. *Stock Prices, Beta, and Strategic Planning*, Harrington, Harvard Business Review, May-June 1983, Reprint 83306
 - c. Case
 - i. Cost of Capital at Ameritrade, Mitchell and Stafford, (9-201-046)
- 5) Multiples
 - a. Lecture Topics

- i. Multiples and Comparables
 - b. Readings
 - i. Chapter 9.4 (Multiples Valuation), Berk and DeMarzo
 - ii. Page 77 (Multiples Valuation), Brealey, Myers, and Allen
 - iii. *Corporate Valuation and Market Multiples*, Luehrman, (9-206-039)
- 6) WACC Method
 - a. Lecture Topics
 - i. Valuation with WACC
 - b. Readings
 - i. Chapter 18.1 and 18.2, Berk and DeMarzo
 - ii. Chapter 19.1 – 19.3, Brealey, Myers, and Allen
 - c. Case
 - i. Radio One, Inc., Ruback and Fischer, (9-201-025)
- 7) Flow-to-Equity Method (FTE)
 - a. Lecture Topics
 - i. Free Cash Flow to Equity (FCFE)
 - ii. Valuing Equity Cash Flows
 - b. Readings
 - i. Chapter 18.4, Berk and DeMarzo
 - ii. Chapter 19.2, Brealey, Myers, and Allen
- 8) Adjusted Present Value (APV)
 - a. Lecture Topics
 - i. Unlevered value of a project
 - ii. Valuing the Interest Tax Shield
 - iii. APV with alternative capital structure strategies
 - iv. Alternative costs and benefits associated with financing
 - b. Readings
 - i. Chapter 18.3, 18.6 – 18.8, Berk and DeMarzo
 - ii. Chapter 19.4, Brealey, Myers, and Allen
 - iii. *Using APV: A Better Tool for Valuation Operations*, Luehrman, Harvard Business Review, May-June 1997, Reprint 97306
 - iv. *The Adjusted Present Value Method for Capital Assets*, Fenster and Gilson, (9-294-047).
 - c. Case
 - i. Sampa Video Inc., Andrade, (9-201-094)
- 9) Real Options
 - a. Lecture Topics
 - i. Real vs. Financial Options
 - ii. Decision Trees
 - iii. Option to Delay
 - iv. Growth and Abandonment Options
 - b. Pre-Readings
 - i. Chapters 20-21 (Background material on options), adjusted Chapter 22 (Real Options), Berk and DeMarzo
 - ii. Chapters 20-21 (Background material on options), Chapter 22 (Real Options), Brealey, Myers, and Allen

- iii. *Investment Opportunities as Real Options: Getting Started on the Numbers*, Luehrman, Harvard Business Review, July-August 1998, Reprint 98404.
- iv. *Strategy as a Portfolio of Real Options*, Luehrman, Harvard Business Review, September-October 1998, Reprint 98506.
- v. *Making Real Options Really Work*, van Putten and MacMillan, Harvard Business Review, December 2004, Reprint R0412K
- vi. *The Options Approach to Capital Investment*, Dixit and Pindyck, Harvard Business Review, May-June 1995, Reprint 95303.
- vii. *A Real-World Way to Manage Real Options*, Copeland, Harvard Business Review, Reprint R0403G
- c. Cases
 - i. Arundel Partners
 - ii. (Optional) Real Options Exercises, Luehrman, (9-208-045)

Course Schedule

The class will meet every Tuesday and Thursday during the Fall semester. Section 003 will meet from 12:00 to 1:20 in SHDH 215. Section 004 will meet from 1:30 to 2:50 in SHDH 215. A tentative outline of each class is provided in the table below.

Class	Day	Date	Topic
1	Th	Sep 9	Introduction
2	T	Sep 13	Lecture: <i>Decision Criteria</i>
3	Th	Sep 15	Lecture: <i>Decision Criteria</i>
4	T	Sep 20	Lecture: <i>Free Cash Flow</i>
5	Th	Sep 22	Lecture: <i>Free Cash Flow</i>
6	T	Sep 27	Lecture: <i>Cost of Capital</i>
7	Th	Sep 29	Case: <i>Ocean Carriers</i>
8	T	Oct 4	Lecture: <i>Cost of Capital</i>
9	Th	Oct 6	Lecture: <i>Cost of Capital</i>
--	T	Oct 11	Fall Term Break
10	Th	Oct 13	Lecture: <i>Multiples</i>
11	T	Oct 18	Case: <i>Cost of Capital at Ameritrade</i>
12	Th	Oct 20	Lecture: <i>WACC Method</i>
13	T	Oct 25	Lecture: <i>WACC Method</i>
14	Th	Oct 27	Lecture: <i>Flow to Equity Method</i>
15	T	Nov 1	Case: <i>Radio One, Inc.</i>
16	Th	Nov 3	Lecture: <i>APV Method</i>
17	T	Nov 8	Lecture: <i>APV Method</i>
18	Th	Nov 10	Lecture: <i>Real Options</i>
19	T	Nov 15	Case: <i>Sampira Video</i>
20	Th	Nov 17	Lecture: <i>Real Options</i>
--	T	Nov 22	Thanksgiving
--	Th	Nov 24	Thanksgiving
21	T	Nov 29	Case: <i>Arundel Partners</i>
22	Th	Dec 1	Review & Final Project Assigned
23	T	Dec 6	Review & Final Project
24	Th	Dec 8	Final Project Presentations