FNCE 207 & 728: CORPORATE VALUATION

Professor Vincent Glode, CFA   **Wharton School**
Spring 2016   **University of Pennsylvania**

Office:	Steinberg-Dietrich Hall 2330
Telephone Number:	215-898-9023
Email address:	vglode@wharton.upenn.edu

I will only answer emails containing simple questions about administrative issues. I will not answer emails that require long explanations about the course content. In those cases, I ask you to attend office hours, talk to me in class, or schedule an appointment.

Office Hours:	For convenience, my office hours are by appointment. Simply send me an email to schedule a meeting. See course website for details about TAs' office hours.
Class Times:	Section 207-001: Monday/Wednesday, 12:00 -- 1:20 PM in JMHH F70
	Section 728-001: Monday/Wednesday, 1:30 -- 2:50 PM in JMHH F70
	Section 728-002: Monday/Wednesday, 3:00 -- 4:20 PM in JMHH F70

1. *Course Objectives.*

The objective of this course is to learn firm, debt, and equity valuation methods from a conceptual and practical framework. 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 real companies.

The subject matter of this course is relatively technical and difficult. Students who took this course in the past have indicated that the **workload is extremely heavy** compared to other courses**.** Because of the technical nature of this course, it does not appeal to all students and is only recommended for those students who are interested in learning valuation techniques in depth. I believe in communicating the complexity of the issues one faces when valuing companies. I will rarely gloss over something, even if it is difficult. Students interested in broader topical coverage and a less detailed examination of valuation techniques should consider the Advanced Corporate Finance course instead. **Students who hope to never see a financial statement again should not take this course. In fact, students with weak accounting and finance backgrounds will feel at a disadvantage in this course. Working knowledge of Microsoft Excel is also important.**

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 is as high for students who had previous job-related valuation experience or those who went through the CFA program as it is for those with no relevant prior experience. However, several former students with prior work experience or a CFA training still found this course valuable to take. From time-to-time I will discuss common errors that practitioners make or issues that they often ignore. My view is that you need to fully understand the meaning and the consequences of any shortcut you might take when valuing a company. In some cases, those shortcuts are justified because they will have little to no impact on the valuation and more complex methods would not be worth the time required. In other cases, the same shortcuts will lead to serious errors. I will also discuss areas where there is uncertainty about how best to perform certain tasks and 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.   Basic knowledge of Microsoft Excel or some other spreadsheet package.

Note that knowledge of intermediate accounting is preferable for this course, although it is not required. Stronger accounting skills will, of course, make some of the material easier to understand.

3.   *Textbooks.*

      A.   Course Textbook

The required text is <u>Corporate Valuation: Theory, Evidence and Practice</u> by Robert Holthausen and Mark Zmijewski, published by Cambridge Business Publishers. The book is a substantially revised version of the softbound pre-publication versions used in prior years and students should not use those older versions. The book is available through the bookstore or at this link:

https://store.collegiatelearning.com/product/corporate-valuation-1st-ed/

      B.   Course Website

Material for the projects and additional readings will be posted for student access on Canvas. There will be copies of the PowerPoint slides I use in my lectures on the website as well. These will not be distributed in hard copy as they generally follow the notes in the textbook, but students wishing to have them prior to class, can print them out in the morning of each lecture. You can gain access to the Canvas room at:

https://canvas.upenn.edu/

      C.   Other References

<u>Principles of Corporate Finance</u> by Brealey, Myers, and Allen. This is a text virtually all of you should own having taken Introductory Corporate Finance. If you own another edition of that book or any other corporate finance textbook (such as <u>Corporate Finance</u> by Berk and Demarzo), that will suffice as well. *This text is just background reading for concepts you should already know.*

<u>Financial Accounting</u> by Libby, Libby, and Short. This is a text virtually all of you should own having taken Introductory Financial Accounting. If you own another edition of that book or any other financial accounting textbook (such as <u>Intermediate Accounting</u> by Kieso, Weygandt, and Warfield), that will suffice as well. *This text is just background reading for concepts you should already know.*

<u>Damodaran on Valuation</u>, by Damodaran. This valuation textbook is quite popular and covers many of the concepts covered in this class, but with less depth than the course textbook.

<u>The Dark Side of Valuation</u>, by Damodaran. This valuation textbook covers advanced concepts linked to the valuation of young, distressed, and complex businesses.

<u>The Signal and the Noise</u>, by Silver. A great, yet light, introduction to the process of forecasting under uncertainty: we are not trying to forecast everything perfectly, we are simply trying to do the best we can with the information we have!

Reading the Financial Times (http://www.ft.com), the Wall Street Journal (http://www.wsj.com), or any close substitute (http://www.thestreet.com) is highly recommended. Following financial news will be essential for valuing your company.

4.   *Grading.*

Grading will be based on the following weights:

Class Participation (e.g., attendance, in-class exercises)	10%
Valuation of a Company (divided in 3 stages)	30%
Midterm Exam	30%
Final Exam	30%

PLEASE NOTE: The Finance Department's Drop Deadline is January 25 and is different than the University's deadline. Should you decide to drop a Finance course, you must do so prior to the Finance Department's drop deadline. **If you drop a Finance course that is full after the department deadline <u>you will receive a "W" on your transcript</u>.**

A.   Class and Participation and Attendance

Class participation counts for 10% of your grade. Some classes require you to be prepared for discussion, while other classes will strictly follow a lecture format. During lectures, I encourage you to ask questions. Voluntary class participation is expected, but I will also cold call on individuals in class from time to time. The education experience for everyone suffers if participation or attendance becomes a problem.

B.   Seating

I will bring a class roster with photos for every class. But in order for me to get to know all names quickly, I ask students to sit in the same area of the classroom for every lecture.

C.   Exams

The best way to prepare for the two exams is by going through examples from the lecture notes and exercises at the end of each chapter in the textbook <u>after each lecture</u> and working through past exams. The first exam will be administered **in class** on **February 24** and covers Chapters 1-7. The final exam will be administered **during the final exam period** and covers all material mentioned in the course (i.e., it is cumulative). **As of now, the University has set a tentative date for May 9, but it is subject to change**. **You are responsible for ensuring that you are available and on campus to take both 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, or face a significant emergency (which needs to be documented). **If your travel plans or interview plans conflict with the course, you must change your plans now or drop the course.**

D.   Projects and In-Class Exercises

Students will have to submit three separate reports for each stage of the valuation project during the semester. Late submission will incur a penalty of 10% per calendar day, counting the day of submission itself. Students must turn in these projects before noon. Students who rely on team members to do all their valuation projects will fail to learn the material necessary to pass the exams.

Note that the in-class exercises to prepare and the project submission deadlines are marked on the outline as either D or S. If marked S, you must submit the assignment before noon on that day. If marked D, it means you must be prepared to discuss the exercise in class, though it does not need to be submitted.

Using solutions handed out in prior years for discussed exercises or 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, your exam performance will suffer as these assignments and projects are intended to help you prepare for exams.

You may work individually or in teams of up to **four individuals** on the valuation project. If you work as a team, all members of the team will receive the same grade on submitted work (more on teams later).

As part of the course requirements, you will value a company of your own choosing. There are several criteria that you must satisfy when choosing 3 candidates for the company you will value:

1.   This has to be a company that you and your teammates **have not done any valuation work** on in a prior course or in a job or internship or in any other capacity. In other words, you may not value a company where some of the valuation work has already been completed by you or any of your teammates.

2.   The company you pick should be publicly traded in the U.S. and there should be at least three years of historical data available for this company. **Check this before submitting company names.**

3.   There should be at least three U.S. publicly traded competitors in the same line of business with at least three years of historical data. It is best if these are "pure-plays" (i.e., only in the business of the firm being valued). **Check this before submitting company names.**

4.   On one hand, you should pick a company for which you believe you can create reasonable forecasts. In other words, picking a technology company where the technology is unproven and the demand for the technology is highly uncertain is going to create special challenges when forecasting. On the other hand, you should value a **company that interests you and will keep you motivated for the whole semester (and that might mean picking a company that is a little bit more challenging to value).**

Complete instructions for this project are available on the course website. It would be wise to target a few companies and select your team members as soon as possible. **Team composition and the names of the 3 candidates of companies you would like to value are due on January 27, which is right after the official drop deadline for finance courses.**

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 may attend another one of my sections. I teach the same class at 12:00, 1:30, and 3:00 PM the same room on Mondays and Wednesdays. However, you need to notify me by 10:00 AM on the day of the lecture if you plan to attend a different section.

Students are expected to arrive on time for class. Once in class, students should remain there 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, instead come to another section and notify me in advance.

6.   *Academic Integrity.*

Students are expected to follow the rules of academic honesty in this class. Examinations are to be the work of the individual student using only the material permitted during the examination. Regarding submitted assignments and projects, the work should be the work of **only the team members** listed on the front of the document. **Students should not in any way rely 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 project requires you to produce a forecasting or valuation model, the use of a forecasting or valuation model not created exclusively by the student team is a violation of the codes of academic integrity. In other words, **for all submitted assignments, you must start with an Excel spreadsheet which is at most populated with some raw data**. Moreover, as indicated previously, the company you value must be one that none of your team members has valued previously. 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.

7.   *Teams.*

Assignments and valuation projects can be worked on individually or in teams of up to four students (no exceptions). MBAs and undergraduates may not be on a same team but teams can include students from different sections. I encourage you to work in teams to maximize the learning experience. **I will not become involved in group problems**. In choosing teammates, consider the main skills each team needs to possess: accounting, finance, and Excel modeling. Also make sure that your teammates' expectations for their performance in this course are consistent with yours. **The composition of your team needs to be decided by the time you submit the names of the potential companies you would like to value.**

8.   *Lunches.*

In an effort to get to know more of you personally, I am happy to take between 3 and 6 students to lunch at a nearby restaurant at a regular frequency throughout the semester. Because I teach on Mondays and Wednesdays and have other lunchtime commitments on Tuesday and Friday, I generally schedule these lunches on Thursdays. There will be a sign-up function on the course website where I will post, throughout the semester, the dates for which I am available. If a group of students cannot meet for lunch on Thursday at noon and wish to schedule an alternative time, please email me and I will do my best to accommodate you.

Date	Topic	H & Z Chapter	Assignment (D=Discussion & S=Submission)
13-Jan	Introduction to Course and Valuation	1	
20-Jan	Creating Economic Value	1	
25-Jan	Measuring Economic Value	2	
27-Jan	Computing Free Cash Flows	3	**S - Names of 3 Companies to Value**
1-Feb	Creating a Financial Model	4	D - Interpreting Financial Ratios: P2.1, P2.3
3-Feb	Creating a Financial Model	4	D - Computing Free Cash Flows: P3.1
8-Feb	Various Forecasting and Measurement Issues		
10-Feb	DCF Valuation Methods	5	D - Computing Interest Tax Shields: P3.9
15-Feb	Excess Earnings Valuation	7	
17-Feb	Measuring Continuing Value	6	**D & S - Valuation Project: Stage 1**
22-Feb	Catch-Up and Review		D - Using DCF Method: P5.6
24-Feb	**MIDTERM EXAM (IN CLASS)**		
29-Feb	Cost of Equity Capital	8	
2-Mar	Cost of Equity Capital	8	
7-Mar	NO CLASS - Spring Break		
9-Mar	NO CLASS - Spring Break		
14-Mar	Cost of Debt	9	
16-Mar	Levering and Unlevering	10	
21-Mar	Levering and Unlevering	10	
23-Mar	WACC and Special Issues	11, 12	**D & S - Valuation Project: Stages 1+ 2**
28-Mar	Market Multiples	13	D - Computing Cost of Capital: P10.7
30-Mar	Market Multiples	14	
4-Apr	Advanced Topic: LBOs	15	
6-Apr	Advanced Topic: Financial Institutions	See Canvas	
11-Apr	Advanced Topic: Insider Trading	See Canvas	
13-Apr	TBA		
18-Apr	Student Presentations		**D & S - Valuation Project: Stages 1+ 2+ 3**
20-Apr	Student Presentations		
25-Apr	Student Presentations		
27-Apr	Catch-Up and Review		

FINAL EXAM (DURING FINAL EXAM PERIOD)