

FNCE 207 & 728: VALUATION

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Wharton School
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Emails should only be used for administrative issues. See section 6 below for information about the pedagogical support offered for the course.

Class Times: Section 207-001: Mon./Wed., 12:00-1:20pm **on Canvas (Zoom)**
Section 207-002: Mon./Wed., 1:30-2:50pm **on Canvas (Zoom)**
Section 728-001: Mon./Wed., 3:00-4:20pm **on Canvas (Zoom)**

1. *Course Objectives.*

The objective of this course is to learn firm, debt, and equity valuation methods in a framework that is **both conceptually rigorous and relevant for practice**. While new concepts are introduced in the course, the emphasis is on properly applying finance and accounting concepts already covered in other courses to value real companies.

The subject matter of this course is relatively technical and challenging. Students who took this course in the past have indicated that the **workload is extremely heavy** compared to other courses. Because of its technical nature, this course does not appeal to all students and is only recommended for students motivated to learn valuation techniques in great depth. I believe in communicating the complexity of the tradeoffs one faces when valuing companies. **We will not gloss over important issues, even if they are difficult to understand. Students who hope to never see financial statements again should not take this course. Working knowledge of Microsoft Excel is also essential.** Students interested in broader topical coverage and a less detailed examination of valuation techniques should consider the Advanced Corporate Finance course instead.

The course is designed for students with little or no practical work experience in valuing companies. However, several former students who had relevant work experience and/or a CFA training still found this course valuable to take. From time-to-time we will discuss common errors that practitioners make or issues that they tend to ignore. It is important to fully understand the meaning and consequences of each shortcut we might consider using when valuing a company. In some cases, a few shortcuts are justified because they will have little to no impact on the valuation outcome and more complex solutions would not be warranted. In other cases, the same shortcuts will lead to serious errors in the valuation outcome and must be avoided. We will discuss areas where there is uncertainty

about how best to perform certain tasks and what is typically done or ignored. We will then discuss the relevant academic research on the topic, so that students have an appreciation of the issues and the alternative views on the matter.

2. ***Non-Negotiable Pre-Requisites.***

- A. Introductory Corporate Finance course.
- B. Introductory Financial Accounting course.
- C. Working knowledge of regression analysis.
- D. Working knowledge of Microsoft Excel.

Students coming in with a weak understanding of the accounting and finance concepts covered in the pre-requisite courses will feel at a disadvantage in this course. In fact, although not required, knowledge of intermediate accounting is preferable. It goes without saying that stronger accounting, finance, and Excel modeling skills will make the material easier to understand and the assignments easier to complete.

3. ***Course Material.***

- A. Course Textbook

The required text is Corporate Valuation: Theory, Evidence and Practice (2nd Edition) by Robert Holthausen and Mark Zmijewski, published by Cambridge Business Publishers. Make sure to purchase the **2nd edition**, as it contains essential updates about the U.S. tax code. The book is available through the bookstore or at this link:

<https://cambridgepub.com/book/corpval2e>

- B. Course Website

Material for the valuation projects and additional readings will be posted for student access on Canvas. I will also upload **abridged** versions of the PowerPoint slides prior to class to help students follow the lectures. You can gain access to the Canvas website at:

<https://canvas.upenn.edu/>

- C. Other Useful References

Corporate Finance by Berk and DeMarzo. This is a text all students should own having taken Introductory Corporate Finance. If you own an alternative corporate finance textbook (such as Principles of Corporate Finance by Brealey, Myers, and Allen), that will suffice as well. This text is just background reading for finance concepts you should already know.

Financial Accounting by Libby, Libby, and Short. This is a text all students should own having taken Introductory Financial Accounting. If you own an alternative financial accounting textbook (such as Intermediate Accounting by Kieso, Weygandt, and Warfield), that will suffice as well. This text is just background reading for accounting concepts you

should already know.

Damodaran on Valuation by Damodaran. This valuation textbook is quite popular and covers many of the concepts covered in this class, but with less depth than our main textbook.

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

The Signal and the Noise by Silver and Superforecasting by Tetlock and Gardner. Entertaining introductions to the process of forecasting under uncertainty: **we are not trying to forecast everything perfectly, we are simply trying to be as precise as possible given 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.**

Students will be graded using the following weights:

| | |
|--|-----|
| Class Participation | 10% |
| Valuation of a Company (divided in 3 stages) | 30% |
| Exam I | 30% |
| Exam II | 30% |

A. Class Participation and Classroom Etiquette

Students can improve their participation grade by (i) attending my synchronous lectures **fully prepared, with their camera on, and participating to the discussion**, as well as by (ii) making **positive contributions to the discussion board**.

- Regarding (i), former students have told me that an important benefit of taking this course is to be able to **interact** with smart, hard-working students who are motivated to learn how to value companies and willing to have their misconceptions challenged. Thus, students should **turn on their Zoom video (bandwidth permitting), participate to the discussion, and ask questions**. Voluntary class participation is expected, but I might cold call on individuals from time to time if needed. Students will be expected to **have read the assigned chapters prior to attending my lectures and have worked on the end-of-chapter exercises assigned for in-class discussion**. Everyone's educational experience suffers if participation or attendance becomes a problem.
- Regarding (ii), this option is especially **valuable to students located in far-away time zones**, for which regularly attending my lectures synchronously might be a challenge. Making positive contributions to the discussion board (e.g., by answering your classmates' questions and sharing interesting articles) gives you a chance to make up for a lack of in-class participation. **(I still advise all students, even those far**

away, to do their best to attend lectures synchronously as it optimizes their learning experience.)

Students can worsen their participation grade by **violating my course policies, the Wharton Learning Agreement, or any basic norm of classroom etiquette and professionalism.**

Note also that all registered students are expected to attend the first lecture if it occurs at a reasonable time in their time zone or watch it within 24 hours otherwise. The first lecture is used to set clear expectations about the course's objectives and its workload. Students should then acquire the necessary information to make a quick decision about whether they want to stay enrolled for the course and form a team for the valuation project or leave their spots to students who were relegated to the waitlist.

B. Projects and In-Class Exercises

As part of the course, students will be asked to value a company of their own choosing in a team of up to four students (more on teams below). Each team will have to submit three separate reports, one for each stage of the valuation project. Late submission will incur a penalty of 10% per calendar day, counting the day of submission. Complete instructions for this project are available on the course website. It would be wise to form teams and start thinking about potential companies to value as soon as possible. **Team composition and company names are due on February 1st.**

Note that exercise and project deadlines are marked on the calendar below as either S or D. If marked as S, students must submit their assignment **before noon** on that day. If marked as D, students must be **prepared to discuss the exercise during 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 any submission is considered a **violation of the code of student conduct**. If caught, the penalty will be severe. Moreover, your exam performance (assuming you did not get caught) will suffer as these assignments and projects are intended to help you learn the material.

C. Exams

The first exam will be administered **during class** on **March 3rd** and will cover Chapters 1-7. The second exam will be administered **during class** on **April 21st** and will cover all material covered in the course (with a strong emphasis on material covered after the first exam). You are responsible for ensuring that you are available to take both exams on those days. **If your travel or interview plans conflict with the schedule of the course, you must change your plans or drop the course now.**

The best way to prepare for the two exams is by going through the examples from the lecture notes and the end-of-chapter exercises in the textbook after each lecture and working through past exams prior to taking the actual exams.

5. *Teams.*

Assignments and valuation projects can be worked on individually or in teams of up to four students (MBAs and undergraduates may not be on the same team). For the valuation project, I encourage all students to work in teams to maximize the learning experience. In choosing teammates, students should keep in mind the broad skillset that each team needs to possess: accounting, finance, and Excel modeling. **They should also make sure that all team members target the same performance/grade for the course. I will not become involved in team problems.** Team composition needs to be set by the time teams submit their suggestions of companies they would like to value.

6. *Pedagogical Support.*

This course is extremely challenging, but students have access to a wide portfolio of supporting tools. First, my five excellent teaching assistants will hold office hours on Zoom every weekday throughout the semester (see Canvas for schedule). Second, several of our class meetings will be reserved for students to ask me questions about the valuation project and/or in preparation for the exams. Third, the course website will feature a vibrant discussion board monitored daily by myself and the teaching assistants where students can ask questions and find answers to all the questions their classmates previously asked. **Questions pertaining to the content of the class should all be asked on the discussion board rather than by email, thereby ensuring that all students have access to the same information and reducing the duplication of our answers.** Finally, I will promptly schedule appointments with students who have challenging questions that couldn't be answered through the three channels described above or sensitive questions that shouldn't be shared with the rest of the class. (For convenience, my office hours are by appointment.)

7. *Academic Integrity.*

Students are expected to follow the university codes of academic integrity. Examinations are to be the work of the individual student using only the material permitted during the examination. Submitted assignments should be the work of **only the team members** listed on the title page of the document. **Students should not in any way rely on the work of prior students or current students who are not on 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/valuation model, the use of a model not created exclusively by the students on the team for the purposes of this class is a violation of the code of academic integrity.** For all submitted assignments, students must start with an Excel spreadsheet which is at most populated with raw data. Moreover, as previously indicated, the company being valued must be one that none of the team members has valued before. If you have questions concerning this policy, please see me for a clarification before using any questionable material. **If you violate this policy, failing the class will constitute the minimum penalty, regardless of the degree of your violation.**

COURSE CALENDAR**SPRING 2021**

NOTE: TOPICS COVERED, ASSIGNMENTS, AND DATES ARE SUBJECT TO CHANGE

| Date | Topic | H & Z Chapter | Assignment (D=Discussion & S=Submission) |
|--------|--|---------------|--|
| 20-Jan | Introduction to Course and Valuation Process | 1 | |
| 25-Jan | Creation of Economic Value | 1 | |
| 27-Jan | Measurement of Economic Value | 2 | |
| 1-Feb | Free Cash Flow Computation | 3 | S - Names of 3 Companies to Value |
| 3-Feb | Financial Modeling | 4 | D - Interpreting Financial Ratios: P2.1, P2.3 |
| 8-Feb | Financial Modeling | 4 | |
| 10-Feb | Forecasting and Measurement Issues | | |
| 15-Feb | DCF Valuation Methods | 5 | D - Computing Free Cash Flows: P3.1 |
| 17-Feb | Excess Earnings Valuation Methods | 7 | |
| 22-Feb | Q & A about Project | | D - Computing Interest Tax Shields: P3.12 |
| 24-Feb | Continuing Value | 6 | D & S - Valuation Project: Stage 1 |
| 1-Mar | Catch-Up and Review | | D - Using DCF Method: P5.6 |
| 3-Mar | EXAM I | | |
| 8-Mar | Cost of Equity | 8 | |
| 10-Mar | <i>SPRING-SEMESTER BREAK</i> | | |
| 15-Mar | Cost of Equity | 8 | |
| 17-Mar | Cost of Debt | 9 | |
| 22-Mar | Levering and Unlevering | 10 | |
| 24-Mar | Levering and Unlevering | 10 | |
| 29-Mar | Q & A about Project | | |
| 31-Mar | WACC and Special Issues | 11, 12 | D & S - Valuation Project: Stages 1 + 2 |
| 5-Apr | Market Multiples | 13 | D - Computing Cost of Capital: P10.7 |
| 7-Apr | Market Multiples | 14 | |
| 12-Apr | <i>SPRING-SEMESTER BREAK</i> | | |
| 14-Apr | Insider Trading Regulations | See Canvas | |
| 19-Apr | Catch-Up and Review | | |
| 21-Apr | EXAM II | | |
| 26-Apr | Q & A about Project | | |
| 28-Apr | Recap and Final Words | | D & S - Valuation Project: Stages 1 + 2 + 3 |