Enterprise Valuation, 2015

Professor Niso Abuaf

Course Summary

In principle, we can think of valuation as consisting of three parts: (1) discounted cash flow valuation (DCF); (2) comparables analysis; and (3) other considerations such as capital structure and corporate governance that may affect valuation. As such, the course will cover topics such as the hard (mathematical) vs. soft (human/behavioral) aspects of valuation; financial statement analysis; arbitrage and the law of one price; discounted cash flow valuation (DCF); estimating discount rates; measuring and forecasting cash flows including cash flow dynamics; valuation of various classes of securities such as bonds and stocks using both DCF and comparables analysis; other drivers of valuation including capital structure, taxes, financial distress, corporate payout policies, economic value added, cash, cross holdings and other assets, employee equity options and compensation, principal-agent problems, intangibles, control, liquidity, synergy, transparency, strategic and project optionalities, corporate governance, and M&A policy. Though the course will focus on the valuation of various financial instruments within the framework of Modern Finance Theory, we will also bring in the perspective of the Capital Markets.

Course Content

1. Overview of and introduction; hard and soft aspects of valuation (science vs. art)
    a. The corporation (BDMCh1, TMCh1, ADCh1))
    b. Financial statements and valuation (BDMCh2, TMCh6&7)
    c. The law of one price and valuation ((BDMCh3)
2. Discounted cash flow valuation
    a. Time, money, and interest rates
        i. The time value of money (BDMCh4)
        ii. Interest rates (BDMCh5)
    b. Valuing bonds and loans (BDMCh6)
    c. Valuing projects; investment decision rules (BDMCh7, TMCH2&3)
    d. Capital budgeting and forecasting cash flows (BDMCh8, TMCh6&7, ADCh3&4)
    e. Cost of capital; estimating discount rates (BDMCh10-14, TMCh4&5, ADCh2)
        i. Risk and return
        ii. Firm and project cost of capital
3. DCF and beyond – Relative valuation (comparables analysis)
    a. Stock and enterprise valuation (BDMCh9, ADCh5&6)
        i. Using DCF (BDMCh9,)
        ii. First principles (TMCh8, ADCh7)
        iii. Equity multiples (ADCh8)
        iv. Enterprise value multiples (TMCh10, ADCh9)
4. Other value drivers
    a. Capital structure (BDMCh14)
        i. Debt and taxes (BDMCh15)
        ii. Financial distress, managerial incentives, and information (BDMCh16)
        iii. Payout policy (BDMCh17)

       b. Is the firm earning its cost of capital (Economic Value Added)
       c. Cash, cross holdings, and other assets (ADCh10)
       d. Employee equity options and compensation (ADCh11)
       e. The value of intangibles (ADCh12)
       f. The value of control (ADCh13)
       g. The value of liquidity (ADCh14)
       h. The value of synergy (ADCh15)
       i. The value of transparency (ADCh16)
       j. The Cost of distress (ADCh17)
       k. Corporate governance
       l. Activist investors
       m. Valuation and M&A policy (BDMCh28)
    5. The bottom line (ADCh18)

Course Philosophy

The course will consist of professor's lectures, student case and project presentations, homeworks, and active class participation. I will encourage lively discussions of current events.

The objective of the course is to help students synthesize the theory, the empirical evidence, market color and various other constraints in making pragmatic corporate finance management recommendations and valuation decisions– that is, the pragmatic application of theory. I encourage class participation and cross learning.

Current Events

Follow the current financial and economic events in the media. Get engaged with what is going on in the political, economic, and financial world around you. Try to read the Wall Street Journal, the New York Times, the Financial Times, Business Week, the Economist, Barron's, and other financial and economic publications. Try to watch Bloomberg TV, or CNBC. Try to listen to Bloomberg radio. Bring your observations and thoughts to class, discuss them with your classmates and your professor.

Grading

Will be based on Midterm (30%), Homeworks (30%), Project (30%), and class participation (10%). For absences exceeding 15% of class time, I maintain the right to fail you in the course. The project grade will be based on originality, literature survey, use of analytical methods, and presentation quality. Please upload your projects onto the BB.

Case Presentations

Case presentations will count towards the class participation grade. The cases include Arcadian Biotech Startup, JetBlue IPO, Rosetta Stone IPO, Ben and Jerry, Fedex vs. UPS, Genzyme, and new cases.

Assignments

The best way to understand the material and prepare for the exams is to do problems. I will give homework problems and later discuss them in class and post written solutions on the Blackboard. You

should try to solve the problems in advance, on your own. These assignments will be graded. Please note that the problems are very useful in your preparation for the exams.

Textbooks

Main textbook is Jonathan Berk and Peter DeMarzo, **Corporate Finance (BDM),** *most recent edition*, Pearson Prentice Hall. Please note that *myfinancelab* associated with textbook BDM is a mandatory requirement for the course. The course id for myfinancelab and Instructions on how to register for myfinancelab are listed in a separate document on the BB.

A supplemental textbook is Sheridan Titman and John D. Martin, **Valuation: The Art and Science of Corporate Investment Decisions (TM)**, *most recent edition*, Pearson 2016, **ISBN 978-0-13-347952-2**.

Another supplemental textbook is Aswath Damodaran, **Damodaran on Valuation (AD)**, most recent edition, Wiley.

Please note that this is an exhaustive list, and I do not expect the students to read every single assignment. I have listed these references more for future research, as opposed to compulsory reading.

Computation requirements (EXCEL)

You can use any financial calculator. I personally prefer and highly recommend the HP-12C. Purchasing the HP-12C, or downloading it on your smartphone will make your life considerably easier. It is mandatory that you bring your calculator to class each time. I also strongly encourage you to use **EXCEL** when doing your homework problems and in your projects. Moreover, fluency in EXCEL is virtually becoming mandatory in the workplace. If you are facile with EXCEL, you may not need a calculator at all.

Blackboard (BB)

All course announcements and related materials will be posted on the class website on *Blackboard:* http://blackboard.pace.edu. Students are required to periodically check the class announcements and course documents on *the Blackboard*. Also, all housekeeping information regarding course management, including textbook ISBNs, myeconlab course id, class meeting places and times, exam dates, etc., advice on how to do well in the course, accommodations for students with disabilities will be posted on the BB.

Other resources

I recommend that you familiarize yourself with **Bloomberg**, particularly the equity and relative valuation (RV) pages.

I also recommend other websites such as Damodaran, Schiller, Yahoo finance, Google finance, Nasdaq, the street, seeking alpha, and various other broker-dealer websites.

General Responsibilities

It is your responsibility to read, understand and abide by all of the course information and policies listed herein. Failure to do so may result in your failing this course or being withdrawn from the course by your professor.

You are responsible for knowledge of any administrative announcements (test information, schedule changes, etc.) that are made at any time during scheduled class periods and on the BB.

Additional Housekeeping

I will post additional housekeeping announcements in separate documents on the BB, see BB paragraph.