

FIN 286

TTH 8:00 a.m. – 10:00 a.m. (03595)

TTH 10:00 a.m. – 12:00 a.m. (03580)

TTH 2:00 p.m. – 4:00 p.m. (03585)

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Fall 2012

GSB 3.104

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Office hours:

TTH 12:30 p.m. – 1:30 p.m.

and by appointment

## Valuation

### Course Objectives

This course builds on the financial theories, intuitions, and tools developed in BA 285T. It introduces valuation concepts related to the valuation of projects and business enterprises and to the claims on the cash flows that they generate. Topics covered include forecasting cash flows, discount rate estimation, the interaction between capital structure and value, as well as cost, market, income, and option-based valuation methods. Students are introduced to the relevant theories and tools, and are taught how to apply these theories and tools in realistic settings.

The prerequisite for this course is BA 285T.

### Readings

The assigned readings for this course come from two sources:

- 1) A course packet which is available at the University COOP.
- 2) The BA 285T textbook: Berk, Jonathan and Peter DeMarzo, 2011, Corporate Finance (2<sup>nd</sup> ed.), Pearson/Addison-Wesley, Boston, MA.

Students may also find the following books to be useful references at various times during the course.

Koller, Tim, Marc Goedhart, and David Wessels, 2010, McKinsey Valuation (5<sup>th</sup> ed.), John Wiley & Sons, Inc., Hoboken, NJ.

Titman, Sheridan and John D. Martin, 2011, Valuation: The Art and Science Of Corporate Investment Decisions (2<sup>nd</sup> ed.), Prentice Hall, Boston, MA.

**Course-related information, including the syllabus and handouts, will be posted on Blackboard.**

## Course Requirements and Grading

Final grades will be determined as follows:	<u>Weight</u>
<b>Homework Assignments</b>	45%
There will be three homework assignments, each of which will count 15% of the final grade.	
<b>Final Exam</b>	55%
The final exam will be given during the final exam period at a time and place to be announced (The university scheduling office will announce this during the first week in November.).	

Plus/minus grading will be used for final course grades.

### McCombs Classroom Professionalism Policy

The highest professional standards are expected of all members of the McCombs community. The collective class reputation and the value of the Texas MBA experience hinges on this. Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects.

The Texas MBA classroom experience is enhanced when:

- **Students arrive on time.** On time arrival ensures that classes are able to start and finish at the scheduled time. On time arrival shows respect for both fellow students and faculty and it enhances learning by reducing avoidable distractions.
- **Students display their name cards.** This permits fellow students and faculty to learn names, enhancing opportunities for community building and evaluation of in-class contributions.
- **Students minimize unscheduled personal breaks.** The learning environment improves when disruptions are limited.
- **Students are fully prepared for each class.** Much of the learning in the Texas MBA program takes place during classroom discussions. When students are not prepared they cannot contribute to the overall learning process. This affects not only the individual, but their peers who count on them, as well.
- **Students attend the class section to which they are registered.** Learning is enhanced when class sizes are optimized. Limits are set to ensure a quality experience. When section hopping takes place some classes become too large and it becomes difficult to contribute. When they are too small, the breadth of experience and opinion suffers.
- **Students respect the views and opinions of their colleagues.** Disagreement and debate are encouraged. Intolerance for the views of others is unacceptable.

- **Laptops are closed and put away.** When students are surfing the web, responding to e-mail, instant messaging each other, and otherwise not devoting their full attention to the topic at hand they are doing themselves and their peers a major disservice. Those around them face additional distraction. Fellow students cannot benefit from the insights of the students who are not engaged. Faculty office hours are spent going over class material with students who chose not to pay attention, rather than truly adding value by helping students who want a better understanding of the material or want to explore the issues in more depth. Students with real needs may not be able to obtain adequate help if faculty time is spent repeating what was said in class. There are often cases where learning is enhanced by the use of laptops in class. Faculty will let you know when it is appropriate to use them. In such cases, professional behavior is exhibited when misuse does not take place.
- **Phones and wireless devices are turned off.** We've all heard the annoying ringing in the middle of a meeting. Not only is it not professional, it cuts off the flow of discussion when the search for the offender begins. When a true need to communicate with someone outside of class exists (e.g., for some medical need) please inform the professor prior to class. Remember, you are competing for the best faculty McCombs has to offer. Your professionalism and activity in class contributes to your success in attracting the best faculty to this program.

### **Academic Dishonesty**

I have no tolerance for acts of academic dishonesty. Such acts damage the reputation of the school and the degree and demean the honest efforts of the majority of students. The minimum penalty for an act of academic dishonesty will be a zero for that assignment or exam.

The responsibilities for both students and faculty with regard to the Honor System are described on <http://mba.mcombs.utexas.edu/students/academics/honor/index.asp>. As the instructor for this course, I agree to observe all the faculty responsibilities described therein. During Orientation, you signed the Honor Code Pledge. In doing so, you agreed to observe all of the student responsibilities of the Honor Code.

If the application of the Honor System to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification.

### **Students with Disabilities**

Upon request, the University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. Services for Students with Disabilities (SSD) is housed in the Office of the Dean of Students, located on the fourth floor of the Student Services Building. Information on how to register, downloadable forms, including guidelines for documentation, accommodation request letters, and releases of information are available online at <http://deanofstudents.utexas.edu/ssd/index.php>. Please do not hesitate to contact SSD at (512) 471-6259, VP: (512) 232-2937 or via e-mail if you have any questions.

### Class Schedule/Readings

- Oct. 18 Course overview, Capital budgeting  
 Readings: Review your BA285T notes on capital budgeting.  
 Parrino R. et al., Fundamentals of Corporate Finance, scan Chapter 11.
- 23 Cost of capital, Financing decisions and value  
 Readings: Parrino R. et al., Fundamentals of Corporate Finance, Chapter 13.
- 25 Financing decisions and value  
 Readings: Parrino R. et al., Fundamentals of Corporate Finance, Chapter 16.  
 Graham, J. and C. Harvey, How Do CFOs Make Capital Budgeting and Capital Structure Decisions, *Journal of Applied Corporate Finance* 15, Spring 2002, pp. 8-23 only.  
 Barclay, M. J., and C. W. Smith, The Capital Structure Puzzle: The Evidence Revisited, *Journal of Applied Corporate Finance* 17, Winter 2005, pp. 8-17 only.  
*Optional:* Berk J., and P. Demarzo, Corporate Finance, Chapters 14 - 16 discuss related concepts if you want more detail.
- 30 Marriott Corporation: Cost of Capital (Abridged) case  
 Readings: Case only  
**Homework #1 due at the beginning of class**
- Nov. 1 Introduction to business valuation  
 Reading: Parrino, R., Choosing the Right Valuation Approach, 2005 CFA Institute Conference Proceedings, pp. 15-24.  
 Parrino R. et al., Corporate Finance, Chapter 18, pp. 580 – 594.
- 6 The Free Cash Flow from the Firm (FCFF), Free Cash Flow to Equity (FCFE), Adjusted Present Value (APV), and Capital Cash Flow (CCF) approaches to valuation.  
 Readings: Berk J., and P. Demarzo, Corporate Finance, Chapter 18.  
 Ruback, R. S., Capital Cash Flows: A Simple Approach to Valuing Risky Cash Flows, *Financial Management* (Summer 2002), pp. 85-103.
- 8 The cost and market approaches to valuation  
 Reading: Pratt, S. P., R. F. Reilly, and R. P. Schweih, Valuing a Business: The Analysis and Appraisal of Closely Held Companies, Chapter 11.

- 13 Berg Electronics case  
Readings: Case only
- 15 Additional valuation topics: Premiums and discounts, valuing leveraged buyouts, and valuation concepts specific to mergers and acquisitions  
Readings: Pratt, S. P., *Business Valuation: Discounts and Premiums*, scan Chapters 1, 2, 5, 9, and 13.  
**Homework #2 due at the beginning of class**
- 20 IBP Valuation  
Readings: Dillon, Nancy, *DLJ Knows Where the Beef Is*, *New York Daily News* (October 3, 2000).  
Mehring, Jaine I., *Analyst Report on IBP, Inc.*, SalomonSmithBarney, October 2, 2000, pp. 1– 4.  
McMillin, John. M. and Jeffrey G. Kanter, *Analyst Report on IBP, Inc.*, Prudential Securities, October 3, 2000, pp. 1– 5.  
Mehring, Jaine I., *Analyst Report on IBP, Inc.*, SalomonSmithBarney, October 4, 2000, pp. 1– 9.
- 27 Sensitivity Analysis, Scenario Analysis, and Simulation Analysis  
Readings: Monte Carlo Simulation, Section 10.2 in Chapter 10 of *Principles of Corporate Finance* (6th ed.) by Richard A. Brealey, Stewart C. Myers, and Franklin Allen, New York, NY, McGraw Hill/Irwin, 2000, pp. 268 – 275.  
Ruback, R., *Downsides and DCF: Valuing Biased Cash Flow Forecasts*, *Journal of Applied Corporate Finance* 23, Spring 2011, pp. 8-17.
- 29 Financial Options  
Readings: Parrino et al., *Fundamentals of Corporate Finance*, Chapter 20.  
*Optional*: Berk J., and P. Demarzo, *Corporate Finance*, Chapters 20-22.  
**Homework #3 due at the beginning of class**
- Dec. 4 Financial Options and the Valuation of Corporate Securities  
Readings: None
- 6 Course Wrap-Up and Final Exam Review  
Readings: Review your course notes.