



FIN 286 - VALUATION FALL 2014

| | |
|------------------------|--|
| Professor | Matthias Kahl |
| Office | CBA 6.248 |
| Office Hours | MW 3:15 p.m. to 5:15 p.m. and by appointment |
| Phone | (512) 232-9375 |
| E-Mail | matthias.kahl@mcombs.utexas.edu |
| Course Times | Section 03875: MW 8:00 a.m. to 10:00 a.m., GSB 3.138 Section 03880: MW 10:00 a.m. to 12:00 p.m., GSB 3.138 Section 03885: MW 1:00 p.m. to 3:00 p.m., GSB 3.138 |
| Course Web Page | via Canvas |

Course Objectives

The objective of this course is to learn how to value projects, firms, and other assets. We will cover the relevant financial theory underlying each valuation approach and then focus on how to use these tools and techniques to actually perform valuations in practice. Learning by doing will be important. At the end of the course, you should be able to perform most types of valuations you are likely to encounter in practice.

We start with the WACC approach and analyze the relationship between capital structure (the mix of debt and equity) and firm value. Then we discuss relative valuation, which uses multiples (such as the price-earnings ratio) to value firms. Our next approach is Adjusted Present Value (APV), which is especially useful for valuing firms undergoing dramatic changes in leverage, such as in a leveraged buy-out. We also consider how mergers and acquisitions (M&A) can increase firm value and study valuation in the M&A context. In the last part of the course, we cover financial options and briefly discuss how to value them. The course offers a mixture of lectures and detailed discussions of case studies, which will allow us to practice our valuation skills in realistic settings. Both lectures and case discussions are vital parts of the course.

Leadership and this Course

The Texas MBA program is designed to develop influential business leaders. The MBA Program has identified four fundamental and broad pillars of leadership: knowledge and understanding, communication and collaboration, responsibility and integrity, and a worldview of business and society.

In this course, you will enhance your knowledge and understanding of valuation. Through class discussion, informal study groups, and formal group projects you will enhance your communication and collaboration skills. You will learn how managers should perform valuations effectively and with integrity. Finally, we will discuss several cases and examples involving international companies, giving you a global perspective on valuation.

Prerequisites

The prerequisite for this course is the Core MBA Finance course (BA 285T).

Course Conduct and Work Load

Learning by doing is crucial for this course. The course requires a large amount of work and effort.

Course Materials

Required: Instead of a textbook, there is a required course packet available in the McCombs Copy Center (GSB 3.136) with the required readings and the cases.

Optional: There is an optional course packet available in the McCombs Copy Center (GSB 3.136) with optional readings.

Course Requirements and Grading

The course grade is based on the total score each student obtains in the course. The total score is determined by the score on the following assignments, with the following weights:

| | |
|-------------------------|-----|
| Class Participation | 15% |
| Individual Problem Set | 15% |
| Final Examination | 35% |
| Case Write-Ups (groups) | 35% |

Class participation takes into account the quality and the quantity of your contributions to the class discussions, both for the lectures and the cases. The individual problem set will be distributed on October 29. It is due on November 5. The final examination will be held on December 8 from 9:00 a.m. to 12:00 p.m. (the room will be announced later). It is cumulative and covers all the material taught in the course. I will distribute review questions throughout the course for which you do not have to turn in your answers to me. However, you should work on these ques-

tions, compare your solutions to mine, which I will distribute in class, and clarify any questions you have concerning the solutions.

For the case write-ups, you will form groups of three persons. Each group is responsible for a case write-up for each case. Your three highest case grades will count for the grading; I will drop your lowest score. I will supply you with questions that will guide your write-up. The write-ups should not be longer than three pages (excluding exhibits). If you include exhibits, please refer to them in the text and make it clear why they are included. Each case write-up must be the group's own product. You are not allowed to look at previously prepared solutions to the case.

Each student is expected to work hard on each case. Each student should be prepared to participate in the case discussion. To ensure that each student works hard on each case, I will ask each group member to evaluate the contribution and performance of the other group members.

The MBA Programs Committee approved the following target grade distribution for all Core and Flex Core courses: A (4.0) 25%, A- (3.67) 20%, B+ (3.33) 15%, B (3.0) 35%, B- (2.67) or below 5%. This course (aggregated over the three sections I teach this semester) uses that target distribution as a guideline for establishing final 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.

You should treat the Texas MBA classroom as you would a corporate boardroom.

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 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 respect the views and opinions of their colleagues.** Disagreement and debate are encouraged. Intolerance for the views of others is unacceptable.
- **Students minimize unscheduled personal breaks.** The learning environment improves when disruptions are limited.

- **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.
- **Technology is used to enhance the class experience.** 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 technology in class. Faculty will let you know when it is appropriate.
- **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.

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 the final pages of this syllabus. As the instructor for this course, I agree to observe all the faculty responsibilities described therein. As a Texas MBA student, you agree 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.

Course Schedule

The following class schedule is tentative. We will sometimes take a little bit more and sometimes a little bit less time for a topic than planned. I will announce any adjustments in class. All required readings and the cases are in the required course packet. All optional readings are in the optional course packet.

1.) Session 1 (October 13):

Topics: Introduction. Overview and Free Cash Flow.

2.) Session 2 (October 15):

Topics: Calculating WACC.

Reading:

Mandatory: Bradford Cornell, “The Cost of Capital”, Chapter 7 in Bradford Cornell, “Corporate Valuation. Tools for Effective Appraisal and Decision Making”, Irwin, The McGraw-Hill Companies, Inc., Chicago/ London/ Singapore, 1993.

3.) Session 3 (October 22):

Topics: Calculating WACC. Continuation Value.

Reading:

Mandatory: Tim Koller, Marc Goedhart, and David Wessels, “Estimating Continuing Value”, Chapter 10 in Tim Koller, Marc Goedhart, and David Wessels, “Valuation: Measuring and Managing the Value of Companies”, 5th edition, John Wiley & Sons, Inc., Hoboken, New Jersey, 2010.

4.) Session 4 (October 27):

Topics: Continuation Value. Capital Structure and Firm Value. WACC with Changing Leverage.

Readings:

Mandatory: Richard A. Brealey, Stewart C. Myers, and Franklin Allen, “Does Debt Policy Matter?”, Chapter 17 in Richard A. Brealey, Stewart C. Myers, and Franklin Allen, “Principles of Corporate Finance”, 11th edition, McGraw-Hill/Irwin, New York, 2014 (in the following called “Brealey, Myers, and Allen”).

Optional: Brealey, Myers, and Allen, Chapter 18, “How Much Should a Corporation Borrow?”

5.) Session 5 (October 29):

Topics: Tottenham Hotspur plc case. WACC with Changing Leverage.

Assignments: Tottenham Hotspur plc case write-up due. Distribution of Problem Set.

6.) Session 6 (November 3):

Topics: WACC with Changing Leverage. Multiples.

Reading:

Mandatory: Aswath Damodaran, “Fundamental Principles of Relative Valuation”, Chapter 17 in Aswath Damodaran, “Investment Valuation. Tools and Techniques for Determining the Value of Any Asset”, third edition, John Wiley & Sons, Inc., Hoboken, New Jersey, 2012 (in the following called Damodaran).

7.) Session 7 (November 5):

Topics: Multiples. Highly Leveraged Transactions and Adjusted Present Value.

Reading:

Optional: Damodaran, Chapter 18, “Earnings Multiples”.

Assignment: Problem Set due.

8.) Session 8 (November 10):

Topics: Highly Leveraged Transactions and Adjusted Present Value. Simulation.

9.) Session 9 (November 12):

Topics: USG Corporation case.

Assignment: USG Corporation case write-up due.

10.) Session 10 (November 17):

Topics: Mergers and Valuation.

Reading:

Optional: Robert F. Bruner, “Does M&A Pay?”, Chapter 3 in Robert F. Bruner, “Applied Mergers & Acquisitions”, John Wiley & Sons, Hoboken, New Jersey, 2004.

11.) Session 11 (November 19):

Topics: Options.

Reading:

Mandatory: Brealey, Myers, and Allen, Chapter 20, “Understanding Options”.

12.) Session 12 (November 24):

Topics: Big Beer: Inbev vs. Anheuser-Busch case. Options.

Assignments: Big Beer: Inbev vs. Anheuser-Busch case write-up due.

13.) Session 13 (December 1):

Options. Conclusion and Review.

14.) Session 14 (December 3):

Topics: Fleetwood Enterprises, Inc., 1990 case. Conclusion and Review.

Assignment: Fleetwood Enterprises, Inc., 1990 case write-up due.

Honor Code Purpose

Academic honor, trust and integrity are fundamental to The University of Texas at Austin McCombs School of Business community. They contribute directly to the quality of your education and reach far beyond the campus to your overall standing within the business community. The University of Texas at Austin McCombs School of Business Honor System promotes academic honor, trust and integrity throughout the Graduate School of Business. The Honor System relies upon The University of Texas Student Standards of Conduct (Chapter 11 of the Institutional Rules on Student Service and Activities) for enforcement, but promotes ideals that are higher than merely enforceable standards. Every student is responsible for understanding and abiding by the provisions of the Honor System and the University of Texas Student Standards of Conduct. The University expects all students to obey the law, show respect for other members of the university community, perform contractual obligations, maintain absolute integrity and the highest standard of individual honor in scholastic work, and observe the highest standards of conduct. Ignorance of the Honor System or The University of Texas Student Standards of Conduct is not an acceptable excuse for violations under any circumstances.

The effectiveness of the Honor System results solely from the wholehearted and uncompromising support of each member of the McCombs School of Business community. Each member must abide by the Honor System and must be intolerant of any violations. The system is only as effective as you make it.

Faculty Involvement in the Honor System

The University of Texas at Austin McCombs School of Business Faculty's commitment to the Honor System is critical to its success. It is imperative that faculty make their expectations clear to all students. They must also respond to accusations of cheating or other misconduct by students in a timely, discrete and fair manner. We urge faculty members to promote awareness of the importance of integrity through in-class discussions and assignments throughout the semester.

Expectations Under the Honor System

Standards

If a student is uncertain about the standards of conduct in a particular setting, he or she should ask the relevant faculty member for clarification to ensure his or her conduct falls within the expected scope of honor, trust and integrity as promoted by the Honor System. This applies to all tests, papers and group and individual work. Questions about appropriate behavior during the job search should be addressed to a professional member of the Career Management Office. Below are some of the specific examples of violations of the Honor System.

Lying

Lying is any deliberate attempt to deceive another by stating an untruth, or by any direct form of communication to include the telling of a partial truth. Lying includes the use or omission of any

information with the intent to deceive or mislead. Examples of lying include, but are not limited to, providing a false excuse for why a test was missed or presenting false information to a recruiter.

Stealing

Stealing is wrongfully taking, obtaining, withholding, defacing or destroying any person's money, personal property, article or service, under any circumstances. Examples of stealing include, but are not limited to, removing course material from the library or hiding it from others, removing material from another person's mail folder, securing for one's self unattended items such as calculators, books, book bags or other personal property. Another form of stealing is the duplication of copyrighted material beyond the reasonable bounds of "fair use." Defacing (e.g., "marking up" or highlighting) library books is also considered stealing, because, through a willful act, the value of another's property is decreased. (See the appendix for a detailed explanation of "fair use.")

Cheating

Cheating is wrongfully and unfairly acting out of self-interest for personal gain by seeking or accepting an unauthorized advantage over one's peers. Examples include, but are not limited to, obtaining questions or answers to tests or quizzes, and getting assistance on case write-ups or other projects beyond what is authorized by the assigning instructor. It is also cheating to accept the benefit(s) of another person's theft(s) even if not actively sought. For instance, if one continues to be attentive to an overheard conversation about a test or case write-up even if initial exposure to such information was accidental and beyond the control of the student in question, one is also cheating. If a student overhears a conversation or any information that any faculty member might reasonably wish to withhold from the student, the student should inform the faculty member(s) of the information and circumstance under which it was overheard.

Actions Required for Responding to Suspected and Known Violations

As stated, everyone must abide by the Honor System and be intolerant of violations. If you suspect a violation has occurred, you should first speak to the suspected violator in an attempt to determine if an infraction has taken place. If, after doing so, you still believe that a violation has occurred, you must tell the suspected violator that he or she must report himself or herself to the course professor or Associate Dean of the McCombs School of Business. If the individual fails to report himself or herself within 48 hours, it then becomes your obligation to report the infraction to the course professor or the Associate Dean of the McCombs School of Business. Remember that although you are not required by regulation to take any action, our Honor System is only as effective as you make it. If you remain silent when you suspect or know of a violation, you are approving of such dishonorable conduct as the community standard. You are thereby precipitating a repetition of such violations.

The Honor Pledge

The University of Texas at Austin McCombs School of Business requires each enrolled student to adopt the Honor System. The Honor Pledge best describes the conduct promoted by the Honor System. It is as follows:

"I affirm that I belong to the honorable community of The University of Texas at Austin Graduate School of Business. I will not lie, cheat or steal, nor will I tolerate those who do."

"I pledge my full support to the Honor System. I agree to be bound at all times by the Honor System and understand that any violation may result in my dismissal from the McCombs School of Business."