

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
- 2) The BA 285T textbook: Berk, Jonathan and Peter DeMarzo, 2014, Corporate Finance (3rd 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 (5th ed.), John Wiley & Sons, Inc., Hoboken, NJ.

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

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

Course Requirements and Grading

Final grades will be determined as follows:	<u>Weight</u>
Homework Assignments (2 at 12.5% each)	25%
Valuation/Negotiation Exercise	15%
Peer Evaluation of Class Participation	5%
Instructor Evaluation of Class Participation	15%
Final Exam	40%

Plus/minus grading will be used for final course grades. The grading policy for the class will follow the resolution of the MBA Policy Committee recommending that mean instructor GPA grades for MBA classes in Dallas and Houston fall within +/- 0.1 of 3.4.

McCombs Classroom Professionalism Policy

The highest professional standards are expected of all members of the McCombs community. The value of the Texas MBA degree 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 experiences are 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.
- **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 distractions and fellow students cannot benefit from the insights of the students who are not engaged. Furthermore, faculty office hours are more likely to be 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.

There are often cases where learning is enhanced by the use of laptops in class. I will let you know when it is appropriate to use them.

- **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 me 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.

Accommodations for Religious Holidays

By UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious holy day. If you must miss a class, an examination, a work assignment, or a project in order to observe a religious holy day, you will be given an opportunity to complete the missed work within a reasonable time after the absence.

Students with Disabilities

Upon request, the University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. The Services for Students with Disabilities (SSD) office 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 at ssd@austin.utexas.edu if you have any questions.

Academic Dishonesty and the Honor Code

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 Graduate 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.

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. By taking this course, you agree to observe all of the student responsibilities of the Honor Code.

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 Services 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 overhead 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 Graduate 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 Graduate 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 Graduate School of Business."

Class Schedule/Readings

Jan. 10 **Class 1:** Course overview, capital budgeting

Readings: Review your BA285T notes on capital budgeting.

Parrino R. et al., Fundamentals of Corporate Finance, scan Chapter 11.

Class 2: Cost of capital, financing decisions and value

Readings: Parrino R. et al., Fundamentals of Corporate Finance, Chapter 13.

Berk J., and P. Demarzo, Corporate Finance, Chapter 14.

Jan. 11 **Class 1:** Financing decisions and value

Readings: Parrino R. et al., Fundamentals of Corporate Finance, Chapter 16.

Berk J., and P. Demarzo, Corporate Finance, Chapter 15.

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.

Class 2: Payout policy, Midland Energy Resources, Inc.: Cost of Capital case

Readings: Parrino R. et al., Fundamentals of Corporate Finance, Chapter 17.

Midland Energy Resources case.

Jan. 23/24 **Class 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. 583 – 597.

Homework #1 due at the beginning of class on January 23

Class 2: 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.

Jan. 30/31 **Class 1:** The cost and market approaches to valuation

Reading: Pratt, S. P., R. F. Reilly, and R. P. Schweihs, Valuing a Business: The Analysis and Appraisal of Closely Held Companies, Chapter 11.

Homework #2 due at the beginning of class on January 30**Class 2:** Additional valuation topics: Premiums, discounts, 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.

Asynchronous Delivery: Valuation/negotiation case: In groups, value the company in the case, negotiate its purchase or sale, and prepare a 5 minute presentation summarizing your valuation and negotiations.

Feb. 13/14 **Class 1:** Berg Electronics Case.

Reading: Berg Electronics case only

Class 2: IBP valuation, financial options

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.

Parrino et al., Fundamentals of Corporate Finance, Chapter 20.

Optional Readings: Berk J., and P. Demarzo, Corporate Finance, Chapters 20, 21, and 22.

Feb. 27/28 **Class 1:** Financial options, options in corporate finance

Readings: Parrino et al., Fundamentals of Corporate Finance, Chapter 20.

Optional Readings: Berk J., and P. Demarzo, Corporate Finance, Chapters 20, 21, and 22.

Class 2: Valuation/negotiation case (**Valuation case presentations and discussion**)

Readings: None

Final Exam will be distributed on February 28.