

FINA 7A10: Intermediate Corporate Finance – Valuation

Fall 2018, 2nd half-semester (October 15 to December 7)

Prof. Vijay Yerramilli

Class Time/ Venue: Wednesday 6:00–9:00pm, CEMO101

Office: 240D Melcher Hall

Office Hours: Wednesday 4:00–5:00pm, or by appointment

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Course description and objectives

The objective of this course is to provide you an in-depth understanding of *valuation* techniques. We will develop standard valuation tools based on the discounted cash flow (DCF) framework, which is widely used in practice to value firms, assets, and projects. Please see Appendix A for a complete list of topics covered.

The course is intended to be a “hands on” applied course on valuation. Accordingly, I will emphasize rigorous and detailed applications of basic valuation principles to solve real-life problems. Needless to say, the course is quantitative in nature, and will involve complex spreadsheet modeling in Excel. However, valuation is not just about crunching numbers in a spreadsheet; a successful financial analyst must also know how to communicate his/her findings. The case studies will help you develop all these crucial skills. In terms of pedagogic goals, by the end of this course, you should be able to:

- Evaluate corporate projects and make decisions based on financial data.
- Value firms using their financial statements and forecasts of future revenues and costs.
- Understand how changes in capital structure (i.e., debt-equity composition) affect the firm’s cost of capital and value.

Who should take this course?

A thorough understanding of valuation is essential for anyone planning a career in business, and especially for those specializing in finance. The topics in this course have applications in corporate finance, mergers and acquisitions, investment banking, commercial banking, security analysis, and consulting. Therefore, they are most likely to come up in job interviews. Moreover, FINA 7A10 is a prerequisite for many other advanced electives in finance.

Prerequisites

FINA 6A35 (“*Managerial Finance*”) is a necessary prerequisite. I expect that you have a clear understanding of time value of money concepts and the risk-return relationship at the level of the CAPM. I have prepared a PowerPoint presentation titled “Review of Basic Valuation Concepts” that provides a quick review of these important concepts. It is your responsibility to go through these lecture slides and brush up on these concepts *before* the first lecture, because I’ll not be presenting this material in class.

You must have a clear understanding of financial statements. You may want to use the two *Merrill Lynch* brochures available on the course webpage to brush up on the organization of financial statements.

You must also be comfortable with *Microsoft Excel* because the case studies require you to build and analyze complex spreadsheets.

Course Material

I will post all my lecture slides, Excel files, and copies of articles on the course page on Blackboard (<http://www.uh.edu/blackboard>). All important announcements will also be made on Blackboard. So please make sure to check this page regularly.

The cases studies can be downloaded directly from Harvard Business School Publishing (*HBSP*: <http://hbsp.harvard.edu>). I have prepared a case packet, which is available at <https://hbsp.harvard.edu/import/574098>. Once you log in to HBSP, click on “*My Courses*” and select the course name “*Valuation (Fall 2018)*”. (**Note:** You may have to login with your UH email id for HBSP to recognize you as a UH student.)

There is no required textbook for this class. However, I recommend that all finance students acquire a copy of “*Valuation: Measuring and Managing the Value of Companies,*” *Sixth Edition (Wiley Finance)*, by *McKinsey & Company’s Tim Koller, Marc Goedhart and David Wessels (ISBN: 978-1118873700)*. This is not a standard textbook but it offers a detailed and practical guide to valuation, that should be useful beyond this course. It is definitely a worthwhile investment for students specializing in finance.

Grading

Your final letter grade for this class will depend on your performance on the case studies, the quizzes, and the final exam. The weightages of these components are as follows: **final exam (45%), case studies (30%), and quizzes (25%)**.

There are no fixed cutoffs for determining the letter grades because I grade on a curve. Class participation is encouraged and will be rewarded at the margin. On the other hand, free-riding on case studies will be penalized: I could downgrade your grade by several notches if you receive poor grades on your peer evaluation (more on this below). There is no pre-specified grade distribution for this course. I am prepared to assign a high proportion of ‘A’ grades if performance is excellent, and will not hesitate to assign lower grades if performance is not up to the mark. Below is a detailed description of the individual components in the grading schedule.

Final Exam

A comprehensive final exam will be held from 5:00-8:00pm on **Wednesday, December 12**. This will be a closed-book and closed-notes exam. However, you are allowed to bring a “cheat-sheet” with notes written on one side of one sheet (8.5”x11”), to help you recall essential formulas and procedures. I will assign homework assignments periodically to prepare you for the exam (moreover, the case studies will also offer you the opportunity to further hone your valuation skills). These assignments do not have to be turned in, and will not be graded.

You should also bring a calculator (and some spare batteries!) because I do not allow use of computers during the exam. Make sure you know how to operate the calculator. The best way to prepare for the final exam is to solve the homework problems with the aid of the cheat-sheet and the calculator.

Case Reports

You will be required to submit written case reports for the **three** cases below whose names are listed in bold font. I will also discuss the fourth case – “Midland Energy Resources, Inc.: Cost of Capital” – when we study cost of capital, but you will not be required to submit a report for this case.

1. **Ocean Carriers**
2. Midland Energy Resources, Inc.: Cost of Capital
3. **Sampa Video, Inc.**
4. **JetBlue Airways IPO Valuation**

You will work on case studies in teams (of up to 4 students). Given the importance of teamwork in this class, it is imperative that you form teams by the end of the first week

of classes. Once you form a team, you should designate one team member to send me an email containing the names of all team members. *The deadline for sending me this email is 5:00pm on Friday, October 19.* If you are unable to find teammates by this date, please let me know so that I can assist you in forming/ joining a team.

All case reports are equally weighted. The specific questions pertaining to each case will be provided to you well in advance of the due date. Detailed guidelines for preparing case reports are in Appendix B. Case reports must be submitted electronically on BlackBoard before the submission deadline. Do retain a hard copy of the report with you because you may need it for the in-class discussion. You will receive the team score on your case report within a week of submission. *I do not allow any resubmissions after the case has been discussed in class.*

Your individual score on case reports will depend on your team score and a confidential peer evaluation submitted by your teammates at the end of the course. The integrity of the peer-evaluation is essential to avoid free-riding within teams. *Peer evaluations are mandatory and must be turned in by the day of the final exam.* I will post the peer evaluation form on Blackboard closer to the due date. I reiterate that these evaluations are confidential. I will not share individual evaluations with your teammates under any circumstances.

Quizzes

I will hold three quizzes to assess your understanding of the topics covered in class, and to provide you timely feedback regarding your individual performance. These will be online quizzes administered through Blackboard so that you may take them at your convenience within a stipulated time frame. To assist in your preparation for the final exam, I recommend that you treat the online quizzes also as closed-book, closed-notes tests, and rely only on the cheat-sheet (described above) and a calculator.

You will need to download and install the “**Respondus LockDown Browser**” for the University of Houston on your computer in order to take the online quizzes through Blackboard. This is a secure browser for taking exams in Blackboard, and prevents you from printing, copying, going to another URL, or accessing other applications during an assessment. *Please note that the quizzes will not be accessible with a standard web browser.* Visit <http://www.uh.edu/fdis/technology/respondus-lockdown/getting-started-lockdown> for more information on how to download and install this browser. A student guide is available at http://www.uh.edu/blackboard/downloads/Learn_LockdownBrowser_student_guide.pdf. I will provide a “mock” quiz on Blackboard so that you can test this tool on your computer before taking the actual quizzes.

Appendix A: (Tentative) Course Schedule

The course schedule is only tentative, and may change depending on the progress that we make.

Week 1 (October 17)	Overview of the DCF Methodology DCF Technique I: WACC Method
Week 2 (October 24)	DCF Technique I: WACC Method Application to Project Valuation
Week 3 (October 31)	Weighted Average Cost of Capital (WACC) WACC and Capital Structure: “De-levering” and “Re-levering” Methods. Illustration using the “ <i>Midland Energy Resources, Inc.: Cost of Capital</i> ” case study.

CASE REPORT for “*Ocean Carriers*” due by 6:00pm on November 5 (Monday)

Week 4 (November 7)	In-class discussion of “ <i>Ocean Carriers</i> ” DCF Technique II: Adjusted Present Value (APV) Method
Week 5 (November 14)	DCF Technique II: Adjusted Present Value (APV) Method WACC Method vs. APV Method

NO CLASS on November 21 (Thanksgiving Break)

CASE REPORT for “*Sampa Video, Inc.*” due by 6:00pm on November 26 (Monday)

Week 6 (November 28)	In-class discussion of “ <i>Sampa Video, Inc.</i> ” Multiples Valuation
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CASE REPORT for “*JetBlue Airways IPO Valuation*” due by 6:00pm on December 5 (Wed)

Week 7 (December 5)	In-class discussion of “ <i>JetBlue Airways IPO Valuation</i> ” Discussion of the final exam
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FINAL EXAM on December 12 (Wednesday), from 5:00–8:00pm

Appendix B: Guidelines for Preparing Case Reports

- I will provide you with a list of questions for each case, to help guide and focus your analysis of the case. *Your case report must be structured in the form of answers to these questions.*
- *Your analysis must be based ONLY on the information provided to you in the case* (plus, a few additional assumptions if necessary). Do not make up your own forecasts/numbers.
- Read the case thoroughly to identify the main issues and problems. Critically evaluate the information provided to you. As in real life, you will never have all the information you require to make a decision. You will, therefore, have to make reasonable assumptions regarding the missing data/links. Describe these assumptions in the case report, and provide a short justification.
- The case report **must contain all the exhibits** (tables, figures, etc.) that are necessary to support your written analysis, so that the reader can understand your analysis without having to go through your Excel spreadsheet. For example, (at a minimum) provide a table presenting your forecasts of future earnings and free cash flow, so that the reader can figure out how you arrived at your value estimate.
- **Be brief.** Your report should include a write up not exceeding 4 pages in length, plus supporting tables, graphs or figures. Do not waste space rehashing the facts of the case. Use font size of 11 or higher. Make sure that the tables are readable.

Please designate a team member *to submit your report (in PDF format) electronically on Blackboard* before the deadline for submission. DO NOT email the report/ spreadsheet to me. You DO NOT NEED TO submit the Excel spreadsheet unless I ask for it.

Appendix C: Miscellaneous Information

Accessibility Statement

The C. T. Bauer College of Business would like to help students who have disabilities achieve their highest potential. To this end, in order to receive academic accommodations, students must register with the Center for Students with Disabilities (CSD), and present approved accommodation documentation to their instructors in a timely manner.

Academic Misconduct

The University of Houston's Academic Honesty Policy is strictly enforced by the Bauer College and by this professor. A discussion of the policy is included in the UH Student Handbook, <http://www.uh.edu/dos/studenthandbook>. It is your responsibility to fully understand and comply with all principles contained within this Handbook. Please make sure you understand this policy and in particular, you understand the meaning of plagiarism.