Applied Corporate Finance and Investment Banking

This course builds off the concepts studied in the introductory corporate finance course and applies them to the fundamental investment banking activities of financing and valuing companies and of analyzing corporate transactions. Stress is on bridging the gap between theory and practice, a gap that can be alarmingly high. Following the late Fischer Black, the course is designed around a serious of questions. I have found that I remember questions better than answers and I feel your experience will be similar, at least in the long run. Readings for each week will be the primary source of the questions. For each session, some of the key questions are enumerated below, but the lists are not comprehensive.

I have also found that to understand an issue a student must to explain it. Consequently, the entire grade for this course is based on participation. Instead of lecturing, I will call on specific students to answer a series of questions. It will be a bit like a scientific version of a Harvard law school class. Don’t panic if you don’t know answer to some of the questions because I suspect that will be common. However, if it becomes a habit, your grade will suffer. For those of you who do go into business related fields, there is a side benefit of this approach. Because corporate events are fast moving, business ideas are usually evaluated in Q&A sessions similar to those in this course.

Prerequisites: BEM 103.

Time: Wed 7-10 pm in Baxter 125

Office hours: Wed 6-7 pm and by appointment in Baxter 325

TA: TBA

Materials: All reading materials for course are available electronically in the course readings database.
Reading Assignments and Course Schedule

**Week 1: What is a firm? What is it supposed to do? Where can I get data about firms?**

What is a firm? What is the relation of the firm to its various stakeholders? Why are managers and shareholders unique stakeholders?

What is the theoretical objective of the firm? How is that objective to be carried out? What does it mean, operationally, to maximize value? How do firms create value in the first place? What redress do shareholders have if a firm fails to maximize shareholder value?

What determines the scope of the firm? That is why are some activities carried out within a firm and others between firms (in the market)?

Where can I get data about a firm and its financing?

**The readings**

- Milgrom and Roberts, Chapter 2
- Lazard report on Time Warner (general background for course, just look over document for now)

**Week 2: What is the cost of capital and how do I estimate it?**

What is the cost of capital? What affects the cost of capital? What can a firm do to lower its cost of capital?

For bonds, what is the difference between expected and promised returns? Which is associated with the cost of debt? How do I calculate or estimate both?

For equity, why use a model rather than past average of excess returns? How do the models work? Is there an analogue to the yield on a bond that does not require a model? What are practical issues that arise when operationalizing the competing approaches? What are the statistical issues? What are the data problems?

**The readings**

- Review BEM 105 material on the cost of capital
- Cornell Chapter 7
- Damodaran Chapter 4
Week 3: Applied Valuation: How do I estimate what a firm is worth?

What is the basic concept behind DCF? What are the first, second and third order considerations? Where do I get data? Precisely how does the DCF valuation work? Are the competing variants of DCF analysis ultimately consistent? How does debt create value? How is that value captured in the different variants?

What assumptions must be made to do valuation by direct comparison? What are common multiples? To what observable variables are they applied?

The readings
Ruback Capital Cash Flows
Cornell Chapter 4
Damodaran Chapter 12
Merrill Lynch Comparable Analytics

Week 4: Tools related to valuation with an application - Valuing Google

What are security analysts? Who do they work for? What time of information do they provide? What recent controversy have they been involved in?

What is an event study? How does it work? Why is the form of the model usually not critical?

What approach does Damodaran use to value Google? What is the valuation date? What are the key value drivers? How do employee stock options affect valuation?

The readings
Asquith on Analysts Reports
Kothari on Event Studies
Example of an actual Event Study
Damodaran Valuation of Google

Week 5: Issues related to mergers, acquisitions and financial restructuring (1)

What do we mean by “liquidity”? Why does liquidity have value? How great is the value of liquidity? How can a firm increase liquidity?

Does control have value? When and how much? Why is a premium often paid for control? What are synergies? Where do they come from? How are they measured?

The readings
Damodaran on the Value of Liquidity
Weston: Chapters 1, 6, 8 (these apply to next two sessions).

Week 6: Issues related to mergers, acquisitions and financial restructuring (2)

The menu of transactions – what is the difference between mergers, acquisitions, LBOs and spin-offs? How do you measure whether a transaction is a success? How do ex-ante measures differ from ex-post measures? What are reasons for transactions other than maximizing shareholder wealth? How can you tell if transaction occurred for one of those reasons?

The readings
Weston: Chapters 11, 13.

**Week 7:** A break: Session with Marty Willhite of Munger, Tolles on legal aspects of business transactions and evaluating contractual terms.

This will also be an interactive session, but a bit less intense than the normal classes. One key issue – identifying optionality in contracts and transactions.

**The readings**

Judicial decision: Amazon v. Toys R Us

**Week 8: Two issues: The value of good governance and assessing real options**

What is the fundamental problem of social coordination (remember the pin factory)? How do investors protect themselves from corruption (self-dealing) in situations where official protection is limited? How does that affect corporate valuation? In this regard, what is Tobin’s q and how is it used? How does Shleifer design his empirical tests? What are his main conclusions?

What is a real option? How do real options differ from options on traded securities? What is the distinction between the DCF approach and valuation using real options? How reliable are real option valuations likely to be in practical situations?

**The readings**

Shleifer and La Porta on Investor Protection
Damodaran on real options

**Week 9: Case studies: Paramount takeover and Iridium start-up (only do valuation part of Iridium)**

All the questions will flow from case descriptions of two deals: the valuation of the satellite phone company, Iridium, at its inception and analysis of the takeover battle for Paramount between Viacom and QVC. The focus of my questions in the Paramount transaction will also be on valuation.

**The readings**

Case materials on Paramount and Iridium

**Week 10: Venture capital and the evaluation of start-up businesses – particularly technology businesses (with participation from a venture capitalist)**

**The readings**

TBA