Applied Corporate Finance and Investment Banking

This is the BEM “lab” course. Stress is on bridging the gap between theory and practice, a gap that can be alarmingly high. Throughout the course we will use current financial data and attempt to integrate it with the theories you learned in BEM 103 and the accounting you learned in BEM 101. This requires a detailed understanding of the limitations of the data in relation to the assumptions of financial theories. The organizing theme of the course is valuation because all financial decision making can be reduced to an appropriate comparison of estimated values.

I have found that to understand an issue a student must to explain it. Consequently, the entire grade for this course is based on participation. In addition to 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. To perform well, it is critical that you do the reading prior to each class session. For those of you who do go into business related fields, there is a side benefit to the participatory 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, BEM 101 or equivalent knowledge of accounting.

Time: Wednesday 6-8:50 pm in Baxter 25.

Office hours: By appointment in Baxter 211, bcornell@hss.caltech.edu

TA: Yifei Huang, Yifei@caltech.edu


Related Books on Valuation

Cornell: Corporate Valuation.
Damodaran: Damodaran on Valuation.
Koller, Goedhart and Wessels: Valuation.
Pratt: Valuing a Business.

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

*Note: Reading should be done prior to the week under which it is listed.*

**Week 1 (4/3): Introduction to the course. What is a firm? What is it supposed to do from a financial point of view? Why is valuation at the heart of financial decision making?**

To prepare for the class spend some time working with the Yahoo and Google finance sites. Be able to download and analyze corporate financial statement data.

**Reading.** Penman Chapter 2.

**Week 2 (4/10): The DCF and Residual Earnings Approach to Valuation (1).**

These are the two core valuation models in practice. The key is understanding corporate financial data, and its limitations, well enough to apply the models in practice. What seems simple in theory can become complicated in practice.

**Reading.** Penman Chapter 3 p. 91-97, Chapters 4 and 5.

**Class presentation: Project 1**

**Week 3 (4/17): The DCF and Residual Earnings Approach to Valuation (2).**

Continuation of the previous topic.

**Reading.** Penman Chapter 7, Chapter 14 p. 437-442, 450-461.

**Class presentation: Project 2**

**Week 4 (4/24): Session at CompassLexecon on current state of the art with respect to financial data. Begin analysis of the cost of capital.**

What is the “cost of capital?” What are its components? What are its determinants? What is a practical approach for estimating it? Why is the cost of capital used as the discount rate in valuation?

**Reading.** Cornell Chapter 4, 7. Penman Chapter 14 p. 445-450.

**Week 5 (5/1): Analysis of the cost of capital. Valuation complications.**

Both the discounted cash flow and residual earnings models are a bit bare bones. They hide details that can have a significant effect on value. Here we examine some important complications in greater detail including dirty surplus accounting, employed stock options, core versus temporary earnings, liquidity discounts and control premiums.

**Reading.** Penman Chapter 9 and 13, 392-407.

**Class presentations: Project 3 and Project 4**

In practice valuation by multiples is the most popular approach. Be prepared to discuss how multiple valuations are constructed and what are their strengths and weaknesses. We also explore the role of security analysts and how they use valuation models.


Class presentations: Project 5 and Project 6


Class presentations: Project 7

Reading. Arnott, Hsu and Moore: Fundamental Indexation.


This will also be an interactive session led by Mr. Walker. It will focus on the identification, evaluation and nurturing of an actual start-up business at IdeaLab.

Reading. Materials provided by Steve Walker. Damodaran: Valuing Intangible Assets

Class presentations: Project 8


Event studies are among the most commonly used tools in applied finance. You should be prepared to discuss exactly how they are constructed and what they are designed to measure.


Class presentations: Projects 9, 10