NTERNATIONAL MANAGEMENT INSTITUTE, BHUBANESWAR
Post Graduate Diploma in Management (PGDM)
Financial Statement Analysis and Business Valuation (FN630)
CREDIT: Full (three credits)
SESSION DURATION: 90 Minutes

TERM: VI
YEAR: 2015-2017
BATCH: II

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Consulting hours: Mutual Availability

Course Overview

Valuation plays a key role in many areas of finance -- in corporate finance, in mergers and acquisitions and in portfolio management. This course gives detailed insights about the valuation process. The premise of this course is that we can make reasonable estimates of value for most assets, and that the same fundamental principles determine the values of all types of assets, real as well as financial. Some assets are easier to value than others, the details of valuation vary from asset to asset, and the uncertainty associated with value estimates is different for different assets, but the core principles remain the same. The course is also geared towards enabling students to determine the factors which drive corporate value and to develop strategies to enhance company's value.

The course examines the three basic valuation approaches that can be used to value an asset. The first, discounted cash flow valuation, relates the value of an asset to the present value of expected future cash flows on that asset. The basis of this approach is that we buy most assets because we expect them to generate cash flows for us in the future. There are three inputs that are required to value any asset in this approach – the *expected cash flow*, the *timing* of the cash flow and the *discount rate* that is appropriate given the riskiness of these cash flows. The second, relative valuation, estimates the value of an asset by looking at the pricing of 'comparable' assets relative to a common variable like earnings, cash flows, book value or sales. The basis of this approach is that we essentially put our trust in markets getting the values right, at least on average. The third, contingent claim valuation, uses option pricing models to measure the value of assets that share option characteristics. A contingent claim or option is an asset which pays off only under certain contingencies - if the value of the underlying asset exceeds a pre-specified value for a call option, or is less than a pre-specified value for a put option. The basis of this approach is that discounted cash flow models understate the value of assets with option characteristics. The understatement occurs because DCF models value assets based upon a set of expected cash flows and do not fully consider the possibility that firms can learn from real time developments and respond to that learning. For example, an oil company can observe what the oil price is each year and adjust its development of new reserves and production in existing reserves accordingly rather than be locked into a fixed production schedule.

While they can yield different estimates of value, one of the objectives of this course is to explain the reasons for such differences, and to help in picking the right model to use for a specific task. The models discussed under various approaches provide a range of tools that analysts/valuers will find of use, but the cautionary note is - valuation is not an objective exercise, and any preconceptions and biases that an analyst brings to the process will find their way into the value.

Learning Outcomes

After undergoing this course, the participants will be able to:

LO1. Explain the role and need for valuation.
LO2. Describe various approaches to valuation.
LO3. Compute the value of a company.
LO4. Differentiate between various approaches of valuation in different context, examination of quality of earnings and other balance sheet related items.
LO5. Determine the value drivers for a company.
LO6. Criticize the valuation of other analysts.

Evaluation Criteria

Component	Description	Weight(%)
End term	It will be based on entire syllabus.	30
Quiz	There shall be TWO quizzes before the mid term and end term examinations of 10 marks each	20
Mid Term		30
Project	It will be on group (group of 2-3 students) basis. Project will involve ascertainment of earnings quality and its implications for corporate value.	20

References Books:

- Palepu, Healy, Bernard, Business Analysis & Valuation, CENGAGE Learning, Indian 3rd Edition, 2010 (PAL)
- Damodaran on Valuation – A. Damodaran, *Wiley India* (DAM)
- Financial Statement Analysis & Security Valuation – Penman, *TMH* (PEN)
- Business Valuation – Mohanty, *Taxmann* (MOH)

Session Wise Schedule

Session	Topic	LOs	Reading/Cases
1	Analysing Taxes • Importance of Taxes in Valuation • Understanding Marginal & Effective Tax Rates • Analysis of Deferred Tax Assets and Liabilities	LO1	Classroom discussions
2-5	Analysing Profitability & Growth • Return on Equity and its decomposition • Drivers of Profitability • Permanent and Transitory Earnings • Analysing Core Income • PE ratios and growth • Analyzing Quality of Earnings and Profits	LO4, LO5	PEN Chapter 11, 12
6-7	Valuation Framework • Reorganising Balance Sheet, Income Statement and Cash Flow Statements • Concept of FCFs	LO2, LO3	Classroom discussions
8-9	Estimating a Firm's Cost of Capital • Cost of Equity Capital ✓ Estimating risk free rate ✓ Estimating market premium ✓ Estimating beta • Cost of Debt Capital • WACC	LO3, LO5	MOH Chapter 3
10-16	Valuation Techniques • Forecating of Cash Flows • DCF Valuation • EBO Model • Relative Valuation (PE, PEG, PB, Value to Sales, Price to Sales, Value to EBITDA)	LO2, LO3, LO4, LO5,	Classroom discussions, MOH Chapter 5 DAM Chapter 4 **CASE:** 1. Apollo Tyres 2. Talbros Automotive Components
17-19	Valuation of Mergers and Acquisition • Valuing Synergies • Tax Benefits	LO2, LO3, LO4, LO5.	MOH Chapter 2, 8 DAM Chapter 6, 7
20	**PROJECT PRESENTATION**	LO6	