

## FINA 399J Equity Valuation

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### Course Objectives

The course is designed for students with career interests in financial analysts and investment banking.

A solid understanding of accounting rules is important in valuation, and you can get the necessary information in many accounting courses. This course, however, is not a course in Financial Statement Analysis, so detailed discussion of accounting rules will not be carried out unless those accounting rules are directly relevant to equity valuation.

Different from FINA321, which is from a firm's point of view to evaluate investment projects, the current course is from investors' point of view to evaluate a firm's equity.

There are three basic valuation approaches: (1) discounted cash flow valuation (DCF); (2) valuation by multiples using comparables; and (3) contingent claims (real option) approach of valuation. We will cover all three approaches and do one case for each approach. Besides, we will also introduce some popular trading strategies used by the fund industry.

### Prerequisites FINA221

**Course Website** <http://webct.ust.hk>

**Recommended textbooks** There is no required textbook. The following books are used as references:

*Valuation, Measuring and Managing the Value of Companies* by Tim Koller, Marc Goedhart and David Wessels, Fourth Edition, University Edition, McKinsey & Company

*Investment Valuation: Tools and Techniques for Determining the Value of Any asset* by Aswath Damodaran, University Edition, Wiley

*Business Analysis & Valuation: Using Financial Statements (Text & Cases)* by Palepu, Healy and Bernard, South-Western College Publishing, Thomson Learning.

### Student groups

Students should form their own groups of no more than 6 at the beginning of the semester. These groups will be responsible for preparing case analyses and valuation project reports and give a presentation for the valuation project. Please hand in the names of group members by September 11 to Ms Kao.

## Grading

The course grade will be determined on the basis of

1. Three (group) case reports	30% (10% each)
2. Mid-term Exam	30%
3. Final Exam	40%
4. Valuation Project (group)	40%
a. Report	30%
b. Presentation	10%
Total	140%

In the case report and valuation project, all group members will receive the same basic grade to begin with. The basic grade will then be adjusted according to a peer evaluation. The peer evaluation will be confidential and will be done at the time of the final exam.

In the peer evaluation, each member of your group will be asked to rank every other member on a scale of 1 to 5 (for a 6 members group) indicating his/her evaluation of each member's relative contribution to the group's effects (excluding himself/herself). A rank of 5 is the best possible, and 1 is the lowest possible. The average rank of each group member will then be computed. Suppose this average rank for an individual is  $x$  (a number between 1 and 5), that individual's eventual grade in the group case and project is:

$$\text{Grade} = \text{Basic grade} \times [90\% + 10\% \times (x-3)/2]$$

If the group size is less than 6, the formula will be adjusted accordingly as following:

$$\text{5 members group: Grade} = \text{Basic grade} \times [90\% + 10\% \times (x-2.5)/1.5]$$

$$\text{4 members group: Grade} = \text{Basic grade} \times [90\% + 10\% \times (x-2)/1]$$

$$\text{3 members group: Grade} = \text{Basic grade} \times [90\% + 10\% \times (x-1.5)/0.5]$$

If you are brave enough to do the projects by yourself or with another student, there will be no adjustment on the basic grade.

Note you are not allowed to give the same rank to any two people in your group. If you do or you do not rank someone in your group, those individuals will be assigned a median rank from you (for example, 3 for a group of size 6). As a penalty, your average rank will be lowered to 1.

The valuation project will be handed out at the first day of class. Each group is required to turn in a one page progress report at the middle of the semester. The report will not be

graded, but you may get some feedback based on it. Besides a valuation report, each group will need to prepare a 10 to 15 minutes presentation. There will be two parts of the presentations, which part your group belongs to will be determined by lottery on September 12<sup>th</sup>.

**The midterm exam will be on Thursday, October 19<sup>th</sup> (6:30pm - 8:30pm)** in Lecture Theater B. The final exam will be schedule by the Registrar during the published final exam period. Plan to be available for the midterm and final exams on the scheduled dates.

### Course Outline

The class schedule is provided below. Keep in mind that this is only a rough schedule and that I may speed-up or slow down depending on the progress of the class.

Week of	Topic	Assignment
5-Sep	Introduction	Hand out the valuation project
7-Sep	Discount Dividend Model	
12-Sep	Discounted Free Cash Flow	Hand out DCF case
14-Sep	Discounted Free Cash Flow	
19-Sep	Forecast	
21-Sep	Forecast	
26-Sep	Discuss DCF case	DCF case due on Sept 25 noon
28-Sep	Forecast	
3-Oct	Forecast	
5-Oct	Valuation using multiples	
10-Oct	Valuation using multiples	Hand out the valuation using multiple case
12-Oct	Valuation using multiples	
17-Oct	Midterm review	
19-Oct	<b>Midterm exam</b>	Lecture Theater B 6:30pm-8:30pm
24-Oct	Estimate cost of capital	Turn in a one page report for the valuation project
26-Oct	Go over midterm	
31-Oct	Estimate cost of capital	
2-Nov	Discuss valuation using multiple case	Valuation using multiple case due on Nov 1 noon
7-Nov	Estimate cast of capital	
9-Nov	Valuation using real options	Hand out the real option case
14-Nov	Valuation using real options	
16-Nov	Trading strategies	
21-Nov	Trading strategies	
23-Nov	Discuss valuation using real option case	Real option case due on Nov 22 noon
28-Nov	Valuation project presentation	Valuation project due on Nov 27 noon
30-Nov	Valuation project presentation	
5-Dec	Guest Speaker	
7-Dec	<b>Final review</b>	