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B.Com Honours

Semester V

Calicut University

FUNDAMENTALS OF INVESTMENT BANKING

Course Code: COM5EJ315 • Module 2 Notes

Module II: Investment Banking and Business Valuation

Covers corporate value drivers, valuation approaches (Market, Income, Asset), Comparable Companies Analysis (CCA), Discounted Cash Flow (DCF), Asset Book Value, and arriving at Fair Value.

Unit 8: Corporate Value vs Investment Value & Value Creation

Corporate Value (Enterprise Value): Total value of firm's core operations ($\text{EV} = \text{Equity Value} + \text{Net Debt}$). Value Drivers: ROIC vs WACC spread, Free Cash Flow (FCF) growth rate, & capital efficiency.

Unit 9: Business Valuation Models Overview

Three Primary Valuation Approaches: Market Approach (CCA & PTA), Income Approach (DCF & LBO), & Asset Approach (Book Value & Liquidation Value).

Unit 10: Market Approach (CCA & PTA)

- 1. Comparable Companies Analysis (CCA):** Valuing firm using trading multiples (EV/EBITDA, P/E, EV/Sales) of peer public companies.
- 2. Precedent Transactions Analysis (PTA):** Valuing firm using multiples paid in historical M&A acquisitions (includes control premium).

Unit 11: Income Approach (DCF & LBO Analysis)

Discounted Cash Flow (DCF): Present value of projected Free Cash Flows to Firm (FCFF) discounted at Weighted Average Cost of Capital (WACC).

Terminal Value (TV) calculated via Gordon Growth Model: $\text{TV} = \frac{\text{FCFF}_{n+1}}{\text{WACC} - g}$.

Unit 12: Asset Approach to Valuation (Book & Liquidation Value)

Book Value Method: Net Asset Value ($\text{NAV} = \text{Total Assets} - \text{Total Liabilities}$).

Liquidation Value: Net proceeds realized if assets are sold rapidly in distressed forced sale.

Unit 13: Special Cases & Arriving at Fair Value

Adjustments to Valuation: Control Premium (+20-30% for M&A control), Discount for Lack of Marketability (DLOM -15-20% for private firms), & Football Field Chart synthesis.

Practical Solved Problem 1 (DCF Enterprise Value Calculation): Projected FCFF for 3 years: Year 1 = ₹100 Cr, Year 2 = ₹120 Cr, Year 3 = ₹140 Cr. WACC = 10%, Terminal Growth Rate (g) = 3%. Calculate Enterprise Value (EV).

$$\text{EV} = \text{PV of FCFF (Y1-Y3)} + \text{PV of Terminal Value [FCFF}_3 \times (1+g) / (\text{WACC} - g)]$$

Step-by-step Solution:

1. PV of FCFF:

$$\text{\text{\$ PV}(Y1)} = \frac{100}{1.10^1} = 90.91 \text{ \text{ Cr} \$}$$

$$\text{\text{\$ PV}(Y2)} = \frac{120}{1.10^2} = 99.17 \text{ \text{ Cr} \$}$$

$$\text{\text{\$ PV}(Y3)} = \frac{140}{1.10^3} = 105.18 \text{ \text{ Cr} \$}$$

Sum of 3-Year Cash Flow PV = **₹295.26 Cr.**

2. Terminal Value at Year 3:

$$\text{\text{\$ TV}}_3 = \frac{140 \times 1.03}{0.10 - 0.03} = \frac{144.20}{0.07} = 2,060 \text{ \text{ Cr} \$}$$

$$\text{PV of Terminal Value: } \text{\text{\$ PV}(\text{TV})} = \frac{2,060}{1.10^3} = \text{\text{\$1,547.71 \text{ Cr}}} \$$$

$$\text{4. Total Enterprise Value (EV)} = \$ 295.26 + 1,547.71 = \text{\text{\$1,842.97 \text{ Cr}}} \$$$

Practical Solved Problem 2 (Comparable Companies Analysis - CCA Multiple): Target Firm EBITDA = ₹50 Cr.
Peer Average EV/EBITDA Multiple = 12.0x. Net Debt = ₹100 Cr. Calculate Target Equity Value.

$$\text{Enterprise Value} = \text{EBITDA} \times \text{Peer EV/EBITDA Multiple}; \text{Equity Value} = \text{EV} - \text{Net Debt}$$

Calculation:

$$\text{1. Implied Enterprise Value} = \$ 50 \text{ \text{ Cr} } \times 12.0 = \text{\text{\$600 \text{ Cr}}} \$$$

$$\text{2. Implied Equity Value} = \$ 600 \text{ \text{ Cr} } - 100 \text{ \text{ Cr} } = \text{\text{\$500 \text{ Cr}}} \$$$

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