# Contents

## CHAPTER 1
**Introduction to Valuation** 1  
A Philosophical Basis for Valuation 1  
Generalities about Valuation 2  
The Role of Valuation 6  
Conclusion 9  
Questions and Short Problems 9

## CHAPTER 2
**Approaches to Valuation** 11  
Discounted Cash Flow Valuation 11  
Relative Valuation 19  
Contingent Claim Valuation 23  
Conclusion 25  
Questions and Short Problems 25

## CHAPTER 3
**Understanding Financial Statements** 27  
The Basic Accounting Statements 27  
Asset Measurement and Valuation 29  
Measuring Financing Mix 36  
Measuring Earnings and Profitability 42  
Measuring Risk 47  
Other Issues in Analyzing Financial Statements 53  
Conclusion 55  
Questions and Short Problems 55

## CHAPTER 4
**The Basics of Risk** 58  
What is Risk? 58  
Equity Risk and Expected Return 59  
Alternative Models for Equity Risk 71  
A Comparative Analysis of Equity Risk Models 76  
Models of Default Risk 77  
Conclusion 81  
Questions and Short Problems 82

## CHAPTER 5
**Option Pricing Theory and Models** 87  
Basics of Option Pricing 87  
Determinants of Option Value 89
### CHAPTER 6
**Market Efficiency—Definition, Tests, and Evidence**

- Market Efficiency and Investment Valuation 111
- What Is an Efficient Market? 112
- Implications of Market Efficiency 112
- Necessary Conditions for Market Efficiency 114
- Propositions about Market Efficiency 114
- Testing Market Efficiency 116
- Cardinal Sins in Testing Market Efficiency 120
- Some Lesser Sins That Can Be a Problem 121
- Evidence on Market Efficiency 122
- Time Series Properties of Price Changes 122
- Market Reaction to Information Events 130
- Market Anomalies 134
- Evidence on Insiders and Investment Professionals 142
- Conclusion 149
- Questions and Short Problems 150

### CHAPTER 7
**Riskless Rates and Risk Premiums**

- The Risk-Free Rate 154
- Equity Risk Premium 159
- Default Spreads on Bonds 177
- Conclusion 180
- Questions and Short Problems 180

### CHAPTER 8
**Estimating Risk Parameters and Costs of Financing**

- The Cost of Equity and Capital 182
- Cost of Equity 183
- From Cost of Equity to Cost of Capital 210
- Best Practices at Firms 221
- Conclusion 222
- Questions and Short Problems 223

### CHAPTER 9
**Measuring Earnings**

- Accounting versus Financial Balance Sheets 229
- Adjusting Earnings 230
- Conclusion 247
- Questions and Short Problems 249
| CONTENTS |
|-------------------|-------|
| Firm Valuation: The Adjusted Present Value Approach  | 398  |
| Effect of Leverage on Firm Value  | 402  |
| Adjusted Present Value and Financial Leverage  | 415  |
| Conclusion  | 419  |
| Questions and Short Problems  | 419  |

**CHAPTER 16**

**Estimating Equity Value per Share**  | 423  |
---|---|
Value of Nonoperating Assets  | 423  |
Firm Value and Equity Value  | 440  |
Management and Employee Options  | 442  |
Value per Share When Voting Rights Vary  | 448  |
Conclusion  | 450  |
Questions and Short Problems  | 451  |

**CHAPTER 17**

**Fundamental Principles of Relative Valuation**  | 453  |
---|---|
Use of Relative Valuation  | 453  |
Standardized Values and Multiples  | 454  |
Four Basic Steps to Using Multiples  | 456  |
Reconciling Relative and Discounted Cash Flow Valuations  | 466  |
Conclusion  | 467  |
Questions and Short Problems  | 467  |

**CHAPTER 18**

**Earnings Multiples**  | 468  |
---|---|
Price-Earnings Ratio  | 468  |
The PEG Ratio  | 487  |
Other Variants on the PE Ratio  | 497  |
Enterprise Value to EBITDA Multiple  | 500  |
Conclusion  | 508  |
Questions and Short Problems  | 508  |

**CHAPTER 19**

**Book Value Multiples**  | 511  |
---|---|
Price-to-Book Equity  | 511  |
Applications of Price–Book Value Ratios  | 521  |
Use in Investment Strategies  | 530  |
Value-to-Book Ratios  | 532  |
Tobin’s Q: Market Value/Replacement Cost  | 537  |
Conclusion  | 539  |
Questions and Short Problems  | 539  |

**CHAPTER 20**

**Revenue Multiples and Sector-Specific Multiples**  | 542  |
---|---|
Revenue Multiples  | 542  |
Sector-Specific Multiples  | 571  |
CHAPTER 25
Aquisitions and Takeovers 702
  Background on Acquisitions 702
  Empirical Evidence on the Value Effects of Takeovers 705
  Steps in an Acquisition 705
  Takeover Valuation: Biases and Common Errors 724
  Structuring the Acquisition 725
  Analyzing Management and Leveraged Buyouts 730
  Conclusion 734
  Questions and Short Problems 735

CHAPTER 26
Valuing Real Estate 739
  Real versus Financial Assets 739
  Discounted Cash Flow Valuation 740
  Comparable/Relative Valuation 759
  Valuing Real Estate Businesses 761
  Conclusion 763
  Questions and Short Problems 763

CHAPTER 27
Valuing Other Assets 766
  Cash-Flow-Producing Assets 766
  Non-Cash-Flow-Producing Assets 775
  Assets with Option Characteristics 777
  Conclusion 778
  Questions and Short Problems 779

CHAPTER 28
The Option to Delay and Valuation Implications 781
  The Option to Delay a Project 781
  Valuing a Patent 789
  Natural Resource Options 796
  Other Applications 802
  Conclusion 802
  Questions and Short Problems 803

CHAPTER 29
The Options to Expand and to Abandon: Valuation Implications 805
  The Option to Expand 805
  When Are Expansion Options Valuable? 812
  Valuing a Firm with the Option to Expand 815
  Value of Financial Flexibility 817
  The Option to Abandon 820
  Reconciling Net Present Value and Real Option Valuations 823
  Conclusion 823
  Questions and Short Problems 824
## Contents

### CHAPTER 30
**Valuing Equity in Distressed Firms**
- Equity in Highly Levered Distressed Firms 826
- Implications of Viewing Equity as an Option 828
- Estimating the Value of Equity as an Option 831
- Consequences for Decision Making 836
- Conclusion 839
- Questions and Short Problems 839

### CHAPTER 31
**Value Enhancement: A Discounted Cash Flow Valuation Framework**
- Value-Creating and Value-Neutral Actions 841
- Ways of Increasing Value 842
- Value Enhancement Chain 859
- Closing Thoughts on Value Enhancement 864
- Conclusion 865
- Questions and Short Problems 865

### CHAPTER 32
**Value Enhancement: Economic Value Added, Cash Flow Return on Investment, and Other Tools**
- Economic Value Added 869
- Cash Flow Return on Investment 884
- A Postscript on Value Enhancement 890
- Conclusion 891
- Questions and Short Problems 891

### CHAPTER 33
**Probabilistic Approaches in Valuation: Scenario Analysis, Decision Trees, and Simulations**
- Scenario Analysis 894
- Decision Trees 899
- Simulations 908
- An Overall Assessment of Probabilistic Risk-Assessment Approaches 919
- Conclusion 921
- Questions and Short Problems 921

### CHAPTER 34
**Overview and Conclusion**
- Choices in Valuation Models 925
- Which Approach Should You Use? 926
- Choosing the Right Discounted Cash Flow Model 929
- Choosing the Right Relative Valuation Model 933
- When Should You Use the Option Pricing Models? 937
- Conclusion 938

### References 939

### Index 954