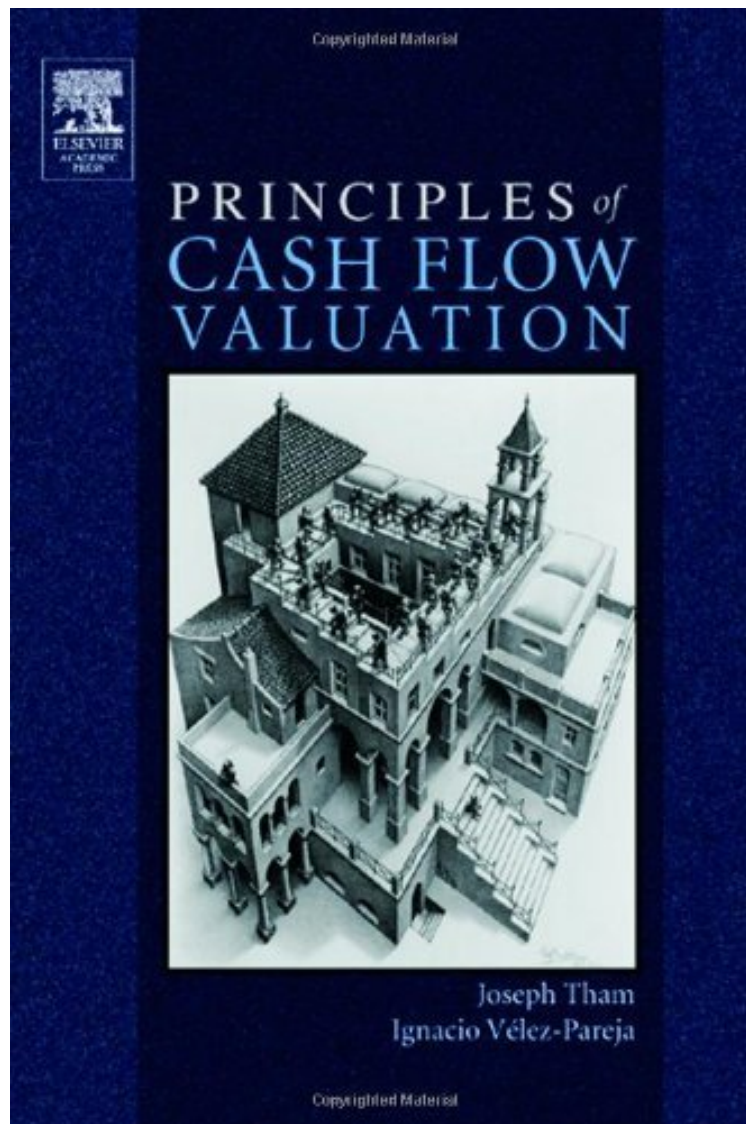


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Principles of Cash Flow Valuation: An Integrated Market-Based Approach (Graphics Series)

Joseph Tham, Ignacio Velez-Pareja
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Tools for constructing integrated and consistent business valuation models
By JUAN C. GUTIERREZ B. In the modern business environment, one of the most important tasks for CEOs and CFOs is related to the development of integrated and consistent business valuation models. Tham V?lez Pareja`s book is a well-oriented proposal in that sense and could be judged for what it has to offer: an organized and specific approach for structuring and valuating the firm cash flows with a special treatment in Non-Traded firms, and from that point of view a useful tool for fundamental valuation in emerging markets. The authors begin with a definition of basic concepts in market-based cash flow valuation and a brief review of financial statements and accounting concepts, before explaining in full detail the integrated approach for the construction of four interrelated proforma financial statements: the Balance Sheet, the Income Statement, the Cash Flow Statement, and the annual Cash Budget Statement. These four financial statements form the basic building blocks for the valuation exercise. Additionally, Tham V?lez Pareja have exposed several methods for deriving the firm cash flows. Special emphasis is given to the five advantages of deriving the Free Cash Flow from the Cash Budget Statement: simplicity, usefulness as a managerial tool, consistency, representation of reality and flexibility for purposes of sensitivity and scenario analysis. Next, the authors have examined some critical issues related to the calculation of the Terminal Value and have exposed the need to guarantee the amount of reinvestment for growth in the Free Cash Flow, showing the importance of specifying the ROMVIC (Return on Market Value of Invested Capital). The last part of the book is very useful from a practitioner?s point of view, because the case study enables the application of the main topics in the book. This is not a book about sophisticated tools for valuing real options. It?s a book about how to construct integrated and consistent corporate valuation models, a simple but usually ignored necessity of good corporate financial models. I would recommend the book to those who clearly understand the main topics of business valuation and its role in corporate finance, and are open-minded to new proposals in a well known field.

JUAN CARLOS GUTI?RREZ B. FINANCE PROFESSOR EAFIT University Medell?n, Colombia
1 of 1 people found the following review helpful.

Cash flow and cost of capital in one theoretical system.
By G. L. Dumrauf
If you need to understand the basic fundamentals of valuation, Principles of cash flow valuation, an integrated market-based approach, is the book you need. The book thoroughly describes valuation techniques, explaining the theory and giving comprehensive examples. Techniques for translating the financial statements into free cash flows and variations of the discounted cash flow approach are well described in a pedagogical way. Few books put the topics (Modigliani-Miller propositions, CAPM, tax shield, investment, cost of capital) in one theoretical system. Plus, Professors V?lez Pareja and Tham maintains a free website where you can find valuation and cost of capital models. Principles of cash flow valuation is a rigorous, detailed textbook on topics in valuation for Master finance courses.

Principles of Cash Flow Valuation is the only book available that focuses exclusively on cash flow valuation. This text provides a comprehensive and practical, market-based framework for the valuation of finite cash flows derived from a set of integrated financial statements, namely, the income statement, balance sheet, and cash budget. The authors have distilled the essence of years of gathering academic wisdom in the study of cash flow analysis and the cost of capital. Their work should go a long way toward bridging the gap between the application of cost benefit analysis and the theory of capital budgeting. This book covers the basic concepts in market-based cash flow valuation. Topics include the time value of money (TVM) and an introduction to cost of capital; basic review of financial statements and accounting concepts; construction of integrated pro-forma financial statements; derivation of free cash flows; use of the WACC in theory and in practice; estimating the WACC for non traded firms; calculating the terminal value beyond the planning period. It also revisits the theory for cost of capital and explains how cash flows are valued in reality. The ideas are illustrated using examples and a case study. The presentation is appropriate for a range of technical backgrounds. This text will be of interest to finance professionals as well as MBA and other graduate students in finance.

- * Provides the only exclusive treatment of cash flow valuation*
- * Authors use examples and a case study to illustrate ideas*
- * Presentation appropriate for a range of technical backgrounds: ideas are presented clearly, full exposition is also provided*
- * Named among the Top 10 financial engineering titles by Financial Engineering News

"The book goes a long way towards bridging the gap between the application of cost benefit analysis and the theory of capital budgeting. The authors have distilled the essence of years of gathering academic wisdom in the study of cash flow analysis and the cost of capital and presented it in a manner that is of immediate benefit both to the student and the practitioner in the field."--Savvakis C. Savvides, Cyprus Development Bank.

"The book by Tham and Velez-Pareja is a very modern approach to valuation theory. The author's focus is not the pure theory of valuation but rather they present a book full of useful hints and tips that will please the practitioner. Tham and Velez-Pareja in particular stress the importance of financial statements and their use in valuation. Many detailed examples make it easy not only to

understand but also to apply valuation theory."-- Professor Dr. Dr. Andreas Löffler, Lehrstuhl für Banken und Finanzierung, Universität Hannover "This is an elegant and insightful exposition of the principles and techniques involved in valuation of cash flows. The issues related to construction of cash flows and estimation of cost of capital under different scenarios that are vital to the valuation of firms and investments, are dealt with in a careful and straightforward fashion. The arguments are made in a clear and animated fashion and the presentation style is an interesting blend of rigorous analysis and simple illustrations. An essential reading for any one interested in understanding the issues associated with cash flow valuation and it should prove equally valuable to both scholars and practitioners."-- Gangadhar P Shukla, Professor of Public Policy, Duke University One of the Top Ten financial engineering titles published in 2003-2004 - Richard Norgate, Ph.D., Financial Engineering News From the Back Cover "This is an elegant and insightful exposition of the principles and techniques involved in valuation of cash flows...essential reading for anyone interested in understanding the issues." ?Gangadhar P. Shukla, Professor of Public Policy, Duke University "The book goes a long way toward bridging the gap between the application of cost benefit analysis and the theory of capital budgeting. The authors have distilled the essence of years of gathering academic wisdom in the study of cash flow analysis and the cost of capital." ?Savvakis C. Savvides, Cyprus Development Bank "[The authors] present a book full of useful hints and tips that will please the practitioner. Tham and Velez-Pareja in particular stress the importance of financial statements and their use in valuation." ?Andreas Löffler, Professor, Lehrstuhl für Banken und Finanzierung, Universität Hannover Principles of Cash Flow Valuation: An Integrated Market Approach provides a comprehensive and practical, market-based framework for the valuation of finite cash flows that are derived from a set of integrated financial statements, namely, the income statement, balance sheet, and cash budget. In addition to the standard cash flows such as the Free Cash Flow (FCF) and the Cash Flow to Equity (CFE), the book discusses the novel Capital Cash Flow (CCF) approach to valuation. A detailed numerical example illustrates the construction of the pro-forma financial statements. A separate chapter is devoted to calculations on the terminal value. Cost of capital theory is presented in a progressive fashion?from the simple and intuitive to the complex?with mathematic clarity and various numerical examples to facilitate understanding and learning. Assuming perfect capitals, the authors derive the appropriate expressions for the Weighted Average Cost of Capital (WACC) and carefully explain the subtleties that underlie the different formulations of the WACC. In addition, the authors show that the Discount Cash Flow (DCF) methods are fully consistent with the Residual Income Model (RIM) and the Economic Value Added (EVA) approach. About the Authors Joseph Tham (thamjx@duke.edu) is visiting assistant professor at the Duke Center for International Development (DCID), Terry Sanford Institute of Public Policy at Duke University and a research associate at the Center for International Health and Development (CIHD) at Boston University School of Public Health (BUSPH). Ignacio Velez-Pareja (ivelez@poligran.edu.co) is Dean of the School of Industrial Engineering at Politecnico Gran Colombiano in Bogota, Colombia. About the Author By Joseph Tham and Dr. Ignacio Velez-Pareja