



Financial Statement Analysis and Valuation B7009-001 – Spring 2023

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Course description and objectives

The purpose of this course is to learn about fundamental drivers of value and risk by analyzing financial statements of businesses in different industries. Every public company provides a lot of financial and operational information in its filings. How can this information be used to evaluate its prospects and its risks?

The course is organized around two themes (1) how to identify relevant information in the financial information reported by firms, and (2) how to draw inferences using sound analytical methodology. To this end, we will review techniques for valuation and risk analysis used by banks and asset management firms. The valuation models you will study in this course are all fundamental models – models that use financial information and review the fundamental operating characteristics of the company. We will learn to build simple financial models, perform risk analysis and fine tune value drivers. Much of the data comes from the financial statements – but it requires a careful study of arcane footnotes to unearth the information provided by the companies. This is an advanced course that goes into the details of footnote analysis, accounting rules, and financial presentations. This course builds on what you learned in *Financial Accounting* and *Corporate Finance*. It is assumed that you have already taken these courses. If you have not taken these courses you should first talk with me before you register. This course will build significantly on your knowledge from those courses. If your basics are solid and you are interested in learning to read financial statements; if you wish to learn to apply financial analysis; this course is for you. We will use excel to build some of the models – but this is not a course in excel. But, it is highly recommended that you have a good working knowledge of how to build formulas in excel **before** you come to this class.

By the end of the course, you should be able to perform a thorough, credible investment or credit analysis that meets a high standard. Students should have the ability to estimate fundamental values, and pull apart the information in the financial statements to get relevant information. This course should be of interest to those contemplating careers in investment banking, security analysis, private equity, hedge funds, and corporate finance.

Course materials

I will be teaching this course entirely from my own notes that draw heavily from my personal experiences in financial markets. There is no required text book. Since there is no required book, if you

miss my class, you will not be able to make up by reading a book. It is highly advised that you do not miss any of the classes. If it is unavoidable, you should watch the video of the class to make up what you miss. All the teaching will be from my notes. Your assignment questions, cases and projects will all be based on what I teach in class. If you find it helpful to get a book, I recommend that you get Professor Penman's book on Financial Statement Analysis and Valuation, but it is not required.

Course notes for each session will be available in advance (on Canvas). A tentative course schedule is provided at the end of this syllabus. I will assume that when you show up for class, you have already skimmed through the assigned material and worked on the assignment for the day, if any.

Sharing of course material (both receiving and giving) with someone who is not enrolled in the course or someone who is not in your section is not allowed. It would be considered a violation of the honor code (and potentially of copyrights).

Pedagogy

A significant portion of the work will be done in the form of in-class exercises or cases. Some exercises/cases will require advance preparation while some will require work in groups in class.

The purpose of this course is to teach you to make judgments about value and risks associated with investments (in firms and industries) through an analysis of their financial statements. You will therefore be required to work on two projects during the course. One of the projects is an individual project while the other is a group project.

For the individual project, you will be asked to select a firm for study. This should be a firm that you are curious about. You will be asked to choose a firm from a selection of companies given by me. In some cases, I will allow you to choose your own company. The individual project will be done in three phases. For this purpose, you will prepare and submit three reports on the firm you choose. With each report it is expected that you will apply what you learn in this course to arrive at your conclusions. You will prepare your first report sometime before Session 6, your second report sometime before Session 10, and your final report before Session 12.

For the group project, you will be assigned to a team. For this purpose, the entire class will be divided into teams of four or five. Each team will study one industry. At any time, the entire class will study at least three (or four) industries during the course. Sometimes, more than one team may be assigned to the same industry. Each group will do two assignments on its assigned industry. The first assignment is due sometime after Session 3. The second assignment, which requires you to do credit analysis on firms in your industry and is due sometime before Session 8.

All submission become due at 11:59 p.m. on the day specified.

We may have guest speakers coming to speak to the class during the course. Since it is difficult to get a time commitment from some of the speakers in advance, I will announce their visits as and when the information becomes available. I will require all of you to be present in class and on time whenever we have a guest speaker presentation.

Grading

Your grade will be decided based on a combination of the following:

Individual assignment	50
Group assignment	40
Class Participation	10
Total	100

Individual Project

There is a three-part individual project to be submitted during the course. On the first day of class, each of you will be asked to select a company. Just prior to your Session 6 you will submit your first report. For this report you will perform a detailed fundamental analysis of the company and present a report on your findings. Just prior to Session 10 you will submit your second report. For this report, you will model the firm's operating income. Modeling the operating income requires analysis of revenues and operating costs. The primary focus of this report is to reinforce your understanding of the firm's revenue and cost model. Just prior to Session 12 you will submit your final report. In this report you will present a one-year ahead three statement financial model of the firm stating clearly all the assumptions. You will present a forecast estimate of the firm's earnings per share (EPS). You will present your estimate of the value of the firm value, and its forecast share price.

This is a Type C assignment.

Team Projects

For the team project, you will present two reports. For your first project each group will perform a common size financial statement analysis of companies in an assigned industry. You should submit your report prior to Session 4. For your second project (which will be due just prior to Session 8) each team will do a credit analysis of firms in your assigned industry.

This is a Type A assignment.

I may require you to make presentations of your team projects. I will require you to set up a call with me before any such presentation where I will review your presentation and approve it. I have found this to be very helpful to the teams and to the class.

Class Participation

The class participation grade will depend on class attendance, on-time arrival and professional behavior during class including but not limited to, not leaving while the class is in session, no private conversations, no use of unauthorized electronics like computers, tablets and phones, preparedness, responses to questions asked during class (cold calls or voluntary), questions, comments, and sharing your professional experience and similar demonstrations of positive engagement. If you cannot attend a class or need to come in late or leave early, I will expect you to inform me in advance and take my permission as a common courtesy.

There is no midterm or final exam for this course.

Honor Code Individual and Group Work Guidelines

Type	Designation	Discussion of Concept	Preparation of Submission	Grade
A	Group/Group	Permitted with designated group	By the group	Same grade for each member of the group
B	Group/Individual	Permitted	Individually (No sharing of any portion of the submission)	Individual
C	Individual/Individual	None of any kind	Individual	Individual

<i>Session</i>	<i>Topics, Assignments</i>
Session 1	Introduction to valuation with multiples. Why fundamental analysis? In class examples. In class exercises.
Session 2	How to read a 10K. Fundamental factors that affect business performance. Return Analysis with ROA, ROE. Finer points of DuPont Decomposition. In class examples. In class exercises.
Session 3	Standardizing company reports. Common size analysis. Comparative analysis with common sized statements. In class Case.
	Group Assignment 1 Due: Analysis of Common Size financial statements
Session 4	Finer details of fundamental analysis – RNOA, PEG, Time value of money, Adjustment to PE multiples. In Class exercises.
Session 5	Multi-period analysis for valuation – DDM, DCF and Residual income Models. Recasting the cash flow statement for valuation and financial management. Common errors and how to fix them. DCF-RI models comparisons. Terminal Value Analysis. In class Exercises.
	Individual Assignment 1 Due: Basic fundamental Analysis
Session 6.	Introduction to credit analysis. In class exercise
Session 7	Guest Speaker (Topic: Business Drivers)
	Group Assignment 2 Due: Credit Metrics and Assessment for select firms/industries
Session 8	Introduction to fundamental analysis and model building. Basics of income statement analysis. Analysis of revenues and costs. In class exercise.
Session 9	Introduction to fundamental analysis and model building. Basics of income statement analysis. Footnote analysis. In class exercise.
	Individual Assignment 2 Due: Operating Income Model
Session 10	Introduction to fundamental analysis and model building. Basics of balance sheet modeling and cash flow analysis. Footnote analysis. In class exercise.
Session 11.	Introduction to fundamental analysis and model building. In class exercise/ cases.
Session 12	Valuations / Final Review
	Individual assignment 3 Due – Three Statement model and valuation.