Financial Statement Analysis and Corporate Valuation

Course Overview

Financial statement analysis consists of using reported accounting data for the purpose of deriving measurements that aid in decision making. This course is designed to provide a foundation consistent with this function. Throughout the course we will center on developing an understanding of screening, forecasting, and valuation tools that help one analyze information in corporate financial statements. The course includes but is not limited to topics related to the use of ratio analysis, the development of earnings-based valuation models and how those models relate to conventional cash flow models, and the assessment of accounting assumptions and their impact on firm value.

The course can be considered as encompassing three integrated modules. The first focuses on strengthening understanding of the accounting framework. Emphasis is place on using detailed ratio analysis for a variety of purposes, including using accounting data to provide a historical perspective on firm activities, assessing current profitability, and predicting financial distress. The second part of the course uses this foundation with an explicit focus on common valuation techniques. This will include applied model building using discounted cash flow, multiples, and earnings based valuation methods. The conventions used in forecasting a complete set of financial statements will be emphasized. The final part of the course builds on this developed framework. While the first two parts encompass general methods applicable to most any firm, the focus in the last is on the identification of critical accounting factors that may be unique to a given firm under evaluation. These topics will include consideration of and adjustments for off-balance sheet assets, understated liabilities, and detecting earnings management.

The course is expected to help solidify and integrate core concepts from other finance and accounting courses, particularly the first-year accounting course and the corporate valuation modules in the second year Valuation in Financial Markets course. It should benefit students planning careers in security analysis, investment banking, financial management or corporate finance. The course should also be beneficial to those interested in developing their own framework for using accounting data in their investment decisions.
Materials


A course pack containing supplemental readings is required. A list of the supplemental readings is provided on the following pages.

Course Website

All class assignments will be posted to the class website approximately one week in advance of their discussion. These will include problems, technical notes, and cases. Some course materials are included in the course pack, some will be individually gathered from on-line sources, and some will be distributed during class.

Grading

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<td>Participation</td>
<td>40 %</td>
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<td>Final Exam</td>
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<td>Group Case</td>
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Group Case

A case assignment is due before the start of class on February 14. The case is to be completed in groups of 2 or 3. The case will be designed to reinforce concepts from the first two modules of the course, and will serve as the basis for the class discussion on February 14. You may select your groups on your own, or you may request I place you in a group of my choosing.

Instructor: Paul Simko, FOB 292B, 924-1391
simkop@darden.virginia.edu
Course Topics

I. Accounting Relationships, Ratio Analysis and Earnings Quality

1. Introduction to Financial Statement Analysis
   SBW Chapter 1: pp. 2-41
   Moehrle, Moehrle and Tomlinson (2002)

2. Assessing Earnings Quality
   SBW Chapter 6: pp. 363-366

3. Ratio Analysis using the Dupont Framework
   SBW Chapter 4: pp. 198-211, 214-225, 229-234

4. Data Gathering and Detailed Profitability and Risk Analysis
   SBW Chapter 5: pp. 285-305
   Teach (2007)

5. Financial Leverage and Predicting Financial Distress
   SBW Chapter 5: pp. 305-317
   Altman (2003)

II. Account Forecasting and Valuation

6. Forecasting Financial Statements
   Review as needed SBW Chapter 10: pp. 720-767
   Myers (2007)

7. Cash Flow Based Valuation
   SBW Chapter 10: pp. 767-772
   Review as needed SBW Chapter 11: pp. 812-828
   Review as needed SBW Chapter 12: pp. 855-882

8. Accounting-Based Residual Earnings Valuation
   SBW Chapter 13: pp. 932-952
   Lee (1996)

9. Multiples Analysis; Catch up and Review
   SBW Chapter 14: pp. 968-997

10. Group Case Discussion
### III. Special Topics in Accounting Based Valuation

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| 11 | Evaluation of Earnings Management and Off-balance Sheet Transactions  
SBW Chapter 5: pp. 317-322  
SBW Chapter 8: pp. 543-545  
Review as needed SBW Chapter 8: pp. 535-542  
Beneish (1999)  
Tunick (2004)  
| 12 | Implications of Off-Balance Sheet Transactions  
SBW Chapter 8: 561-575 |   |   |
| 13 | Implications of Off-Balance Sheet Transactions (cont’d)  
Miller and Bahnson (2007) |   |   |
| 14 | Using Income Tax Information in Financial Analysis  
SBW Chapter 8: pp. 575-587 |   |   |
| 15 | Stock Options and Assessing Firm Value; Wrap-up  
SBW Chapter 9: pp. 667-671 |   |   |

Listed immediately below each topic are relevant background readings that will aid in the preparation of assigned cases and problems. SBW refers to the Stickney, Brown and Wahlen (2007) text. The remaining supplemental readings are listed on the following page. Most cases, technical notes, and problems will be posted to the course website approximately one week in advance of their discussion.
**Supplemental Readings***

4. Myers, R. 2007. The cash trap: Cash may be a comfort in an uncertain economy, but it can also be a drag on shareholder value. *CFO Magazine*. (November 1).

*Included with course pack. Other readings may be linked on course website.*