

Financial Statement Analysis (ACCT-UB.0003) Spring 2014

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Office Hours:* Tuesdays 1pm-2pm and Thursdays 1pm-2pm, unless noted otherwise in NYU Classes

TA Office Hours:* Mondays 5pm-6pm & Wednesdays 5pm-6pm

***Note:** If you plan to attend office hours (with the TAs or the professor), please reserve a time slot in advance. You will find a link to reserve an appointment within each office hour posted in the schedule on NYU classes.

Course Objective:

The objective of this course is to understand how to read, interpret, and analyze financial statements. Throughout the course, we will use the financial statements of several real companies to illustrate concepts. Specifically, we will:

- Study the interrelationships between financial statement line items
- Use ratio analysis to understand and compare firms
- Understand accounting disclosures
- Use accounting disclosures to adjust financial statements
- Forecast future earnings using accounting disclosures
- Value a firm using forecasts

Prerequisites:

The course assumes you have a solid grasp of general accounting concepts and principles

Course Materials:

- The required textbook for the course is “Financial Statement Analysis & Valuation,” by Easton, McAnally, Sommers, and Zhang. If you can find an earlier version of the textbook cheaper online, feel free to use it. You will generally not need to bring the book to class, but my lectures will assume you have read the assigned pages.
- I suggest you buy a 3-ring notebook for class notes. At the beginning of each class, I will hand out the lecture slides as well as select pages from financial statements for illustrative purposes.
- You will need access to Microsoft Excel for the second half of the course and to complete the course project.
- While not strictly necessary, you will find a financial calculator useful in this course. If you plan to go into accounting or finance, this is a worthwhile investment. The Texas Instruments BA II Plus Financial Calculator sells for \$25 on Amazon.

Grading:

Your grade in the course will be determined according to this tentative point distribution:

Analyst Report – Part 1	10%
Conference Call Summary	5%
Analyst Report – Part 2	10%
Group Presentation	10%
Exam I	25%
Exam II	30%
Professionalism	10%

The class will be divided into groups of 5 (you will select your own group).* Each group will be responsible for analyzing and comparing a pair of companies within the same industry. At the end of the semester, each group will present recommendations (buy / hold / sell) for their pair of companies. Deliverables related to these companies comprise 35% of your grade:

Analyst Report - Part 1: Comparative Analysis (10%)

The objective of Part 1 is to assess your ability to gather, analyze and consolidate a firm's historical information into a clear and concise report. The purpose of the report is to use financial accounting information to assess profitability and creditworthiness.

Conference Call Summary (5%)

A Conference Call Summary is a one-page, single-spaced synopsis of the most recent earnings conference call for each of your companies. You will also come up with a question you would have liked to ask on the call.

Analyst Report - Part 2: Forecasts, Valuation and Recommendation (10%)

The objective of Part 2 is to assess your ability to incorporate historical financial information, footnotes, and other disclosures into forecasts of financial statements and value a firm's common equity.

Group Presentation (10%)

The objective of the group presentation is to assess your ability to articulate a logical argument, synthesize information, and incorporate what you have learned into a broader framework.

*A note on group work: You will be working in groups for most of your professional career, so I view the ability to thrive within a team a necessary skill to develop. I will assume each team member contributes equally to each deliverable and the group presentation - and therefore each member of the team will receive the same grade. I will, however, ask each member of the team to evaluate the overall participation level of the other four members of the team at the end of the semester. An exceptionally low participation level by any team member will result in a reduction of that team member's grade.

Exams (55%)

There are two exams that are aimed at assessing your grasp of the learning objectives for each section. You are required to bring writing equipment, a calculator, and 1 page of hand-written notes. The class meeting prior to each exam will be a review session.

Professionalism (10%)

I expect you to treat this class as you would treat any professional responsibility. For example, I expect you to arrive on time and keep your cell phone off for the duration of the class. I also expect you to be prepared to discuss all materials relevant to the topic of the day. I strongly believe that learning is an active process. Hence, your participation is evaluated on a daily basis and figures prominently in your professionalism score. You will be asked in the final class to provide a self-assessment of your class participation. I use your self-evaluation along with my own notes and the following guidelines.

	More than 14 times (i.e., once per week)	Full credit
If you participate in class:	1 - 14 times	-20%
	Zero times	-50%

Additional Information:

Electronic Devices:

Laptop computers, iPads, and iPhones are distracting and are therefore not permitted during class unless specifically instructed otherwise.

Policy on Class Attendance:

I do not take attendance. However, if you miss class, you cannot participate, which detracts from your ability to actively participate in your education and reduces your class participation score. I understand that over the course of 28 sessions, conflicts come up and you may need to miss a class. Therefore, if you cannot attend your registered class, you may attend the other class section (so if you can't make the 9:30, attend the 11:00, and vice versa). Please let me know you are doing this in advance and allow registered students to have the seats if the section is full. If you miss class for any reason, I will make the course material available to you upon request for the day(s) you miss because I want you to have the opportunity to make up the material you missed on your own. Please note interviews should be scheduled around your class schedule and do not count as excused absences.

Re-Grade Policy:

Grading mistakes happen occasionally. Therefore, you are permitted to submit re-grade requests on the exams and group projects *within one calendar week* of the posting of the grades. To have the exam or project re-graded, you must submit a *written* 1-page description of your argument that explains the grading mistake and why you believe you deserve additional credit. Upon receipt of your written description, I will review the *entire* project or exam for grading accuracy; therefore your grade may go up or down as a result of the re-grade request. For group work, every member of the group must agree to the re-grade request.

Stern Honor Code:

You are expected to abide by the Stern honor code.

Course Framework:

Specific content and dates are subject to change. The general progression of the course is divided into five sections, as follows:

1. Using Ratio Analysis to Understand and Compare Firms

The computation of various financial ratios is often associated with financial statement analysis. In this section, you will learn:

- The value of common-size financial statements in understanding the nature of a firm's business
- How ratios can be used to identify trends within a company over time and across firms within an industry
- How to use financial ratios to assess a firm's profitability and risk
- How to interpret financial statement ratios
- How operating and financing activities affect inferences of financial statement ratios

Date	Topic	Readings 3e (2e)	Assignment Due
January 28	Introduction & Overview of the course		"Getting to know you" survey
January 30	Review of financial statements	Skim Mod. 2 to 2-20 Target MD&A	
February 4	Common-size financial statement analysis	Appendix 3B	
February 6	Profitability analysis	Mod. 3	
February 11	Risk analysis	Mod. 4	Group Formation
February 13	Risk analysis	7-22 to 7-27	

2. Pro-Forma Financial Statements

Many accounting choices firms make will need to be adjusted (or "backed-out") to make the financial statements useful for forecasting future earnings. In this section, you will learn:

- How to adjust the financial statements to allow for cross-sectional comparison
- The discretion management has in classifying revenues, expenses, gains, and losses on the income statement and the implications of this discretion.
- How to recast financial statements once red flags are identified and/or to undo distortions
- The difference between temporary and permanent income

Date	Topic	Readings 3e (2e)	Assignment Due
February 18	Adjusting the Financial Statements	2-13	
February 20	Adjusting the Financial Statements	5-2 to 5-5 & 5-28 to 5-34 (5-2 to 5-5 & 5-26 to 5-30)	

3. Accounting Analysis & Understanding accounting disclosures

Accounting analysis is the cornerstone to sound financial statement analysis. Without a solid understanding of a company's accounting policies, an analyst will be unable to determine whether cross-sectional and time-series variation in financial ratios is due to substantive differences in economic performance or superficial differences in accounting policies. In this section, you will learn:

- How to identify and evaluate critical accounting policies contained in the footnotes to the financial statements
- The effects of these choices on the historical and future financial statements
- How to adjust the financial statements to allow for cross-sectional comparison
- How changes in the asset and liability valuations on the balance sheet impact the measurement of net income on the income statement

Date	Topic	Readings 3e (2e)	Assignment Due
February 25	Revenue Recognition	5-5 to 5-12 (5-5 to 5-11)	Analyst Report - Part I
February 27	Accounts Receivable	6-1 to 6-13	
March 4	Inventory	6-13 to 6-25	
March 6	PP&E	6-26 to 6-35 (6-27 to 6-36)	
March 11	Midterm Review		
March 13	Midterm		
March 25	Leases	10-3 to 10-11	
March 27	Taxes	5-19 to 5-25 (5-18 to 5-25)	
April 1	Inter-corporate entities	9-2 to 9-28	
April 3	Stock Options / Catch-up		

4. Forecasting

Forecasting future financial statements is the ultimate goal of financial statement analysis. Theoretically, equity valuation is derived from future cash distributions to equity holders (expected future dividends). Practically, equity valuation is derived from estimates of future net income. In this section, you will learn:

- How the various financial statement ratios combine to provide a structured framework from which you can forecast future performance and calibrate its reasonableness
- The importance of sales to forecasting future financial statements
- How to identify the critical forecasting assumptions
- The difference between income flows and cash flows

Date	Topic	Readings 3e (2e)	Assignment Due
April 8	Forecasting the Income Statement	Mod. 11	
April 10	Forecasting the Balance Sheet & Cash flows	Mod. 11	
April 15	Assessing the Reasonableness of Forecasts	Mod. 11	Earnings Call Summary

5. Valuation

The final element of the course uses forecasts to construct valuation estimates. In this section, you will learn:

- Equity value is a simple summation of the discounted expected future net distributions of cash to equity holders
- The assumptions of the discounted cash flow (DCF) valuation method
- The principles behind estimating a terminal value and choosing a discount rate
- Valuation heuristics, or shortcuts, to estimate a company's value or to compare it to a peer (e.g., Price-Earnings ratio, Market-to-Book ratio, and PEG ratio)
- The assumptions behind some common valuation heuristics and how to leverage these heuristics when performing macro-level analysis of firms
- How to convert analyst forecasts into a simple valuation heuristic
- The intuition supporting the use of the P/E ratio
- How to “anchor” valuation on current earnings

Date	Topic	Readings 3e (2e)	Assignment Due
April 17	Present Value & Cost of Capital	12-6 to 12-16 (12-5 to 12-14)	
April 22	Dividend Discount Model	12-17 to 12-21 (12-14 to 12-19)	
April 24	Discounted Cash Flow Model	13-2 to 13-10 & Appendix 13C (13-4 to 13-9 & Appendix 13C)	
April 29	Market-Based Valuation	15-3 to 15-12 (15-3 to 15-11)	
May 1	Group Presentations		Analyst Report Part II
May 6	Group Presentations		
May 8	Final Review		
May 15	Final Exam (8:00 & 10:00)		