

Financial Statement Analysis MBA Spring 2020

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Office Hours: by appointment

Introduction:

Financial statements are the most comprehensive source of information used to evaluate an organization's past performance and future prospects. This course provides students with a set of tools to effectively analyze an organization's financial statements. Specifically, this course is designed to develop students' ability to (1) identify business strategies and associated risks; (2) assess reporting and disclosure choices given the economic environment in which the organization operates; and (3) use ratios and other analytical methods to evaluate and forecast performance. This course should be of interest to anyone who uses financial statements for decision making, including lenders, equity analysts, investment bankers, management and boards of directors, and others charged with monitoring or advising financial performance.

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

Prerequisites:

The course assumes you have a solid grasp of general accounting concepts and principles such as the material covered in Financial Accounting and Reporting (COR1-GB.1306) or equivalent.

Course Materials:

- The required textbook for the course is "Financial Statement Analysis & Valuation," by Easton, McAnally, Sommers, and Zhang, fifth edition. You are not to use an earlier version. You will not need to bring the book to class, but I shall assume you have read the assigned pages. You will also need the textbook to complete the optional practice problems, which you will find helpful in assimilating the material.
- Throughout the course, you will receive course packets and/or electronic access to material containing lecture slides, in-class exercises, and financial statements for illustrative purposes.
- You will need access to Microsoft Excel. It would be very helpful to bring your laptops to class.
- You will also find a financial calculator very helpful.

Grading:

Your course grade will be computed tentatively as follows:

Assignments	30%
Exams (best 1 out of 2)	35%
Group Project	<u>35%</u>
	100%

Exams (35%)

There are 2 exams that are aimed at assessing your grasp of the learning objectives for each section. Please bring writing equipment, a calculator, and 1 page of formulas and notes. If necessary, part or all of the class meeting prior to each exam will be a review session. You are expected to take all exams at the scheduled times. There will be no make-up exams given. I will use the best one out of two exam grades to compute your course grade.

Assignments (35%)

There are 2 assignments throughout the course that are aimed at solidifying your understanding of the concepts covered in class by applying them to the financial statements of the Starbucks Corporation. Because we have 26 sessions and the extent of material we cover each weekend will depend on how fast we can progress in light of possible diversity in your exposure to accounting, the assignments will be composed at the end of the 3/3-5 (probably related to DuPont and penman profitability analysis) and the 4/2-7 (Accounting analysis) weekends, to be submitted at the beginning of the following class. You can work on these assignments individually or in groups of up to 3 people (you may hand in one copy per group). In order to receive credit for the assignments, they need to be submitted in hard-copy before class begins. If you cannot attend class on an assignment due date, you may submit the assignment before the specified due date. The solution is posted at 5pm on the due date of the assignment, therefore I cannot accept late submissions.

Note: The TA will be available upon request before the assignment is due.

Re-Grade Policy:

You are permitted to submit regrade requests on assignments *within one calendar week* of the posting of the grades. To have an exam regraded, 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* exam for grading accuracy; therefore your grade may go up or down as a result of the regrade request.

Group Project (35%)

The purpose of the group project is to synthesize the various analytical skills discussed in class by applying those skills to analyze the current financial statements of a publicly traded company. Groups of no more than 3 students that you will self-select will choose one company in the retail, manufacturing, or service industry (avoid financial institutions and regulated utilities). The deliverable will include a 3-5 page written report plus the presentation slides. You will be provided with sample projects submitted by students from past classes.

Additional Information:

Electronic Devices:

It will be useful for you to bring laptop computers to class so as to access financial statements online. However, iPads, and iPhones are distracting and I prefer that you not use them during class.

Policy on Class Attendance:

Past Courses have shown a strong correlation between class attendance and overall course performance. The material we cover in class supplements the material in the book. Therefore, reading the book is a complement (not a substitute) to attending class. I understand that personal and religious conflicts come up and you may need to miss a class. If you miss a class for any reason, I will make the video available to you upon request for the day(s) you miss.

Stern Honor Code:

You are expected to abide by the Stern honor code.

Questions:

I shall be happy to entertain questions that seek clarification of material being discussed. However, questions unrelated to the immediate discussion would be distracting and would disrupt the sequence and flow of the topics. That said, I shall be very happy to respond to these other questions separately outside the class and/or via email or other electronic means of communication.

Course Framework:

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

1. In this section of the course, you will develop the tools to understand and compare firms. We will:

- Review basic financial accounting concepts
- Learn about the business competitive environment and company strategies
- Become familiar with the information available to investors and analysts
- Learn where to find information in real 10-Ks
- Learn how to compute various financial ratios
- Understand the value of common-size financial statements in understanding the nature of a firm’s business
- Learn how ratios can be used to identify trends within a company over time and across firms within an industry
- Learn how to use financial ratios to assess a firm’s profitability and risk
- Learn how to interpret financial statement ratios
- Learn how to adjust the financial statements to allow for cross-sectional and time series comparison
- Understand the discretion management has in classifying revenues, expenses, gains, and losses on the income statement and the implications of this discretion
- Learn how to recast financial statements to undo distortions
- Learn the difference between temporary and permanent income

Date	Topic	Before Class Readings 5e	After Class Practice Problems 5e
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2/4	Introduction	1-12 to 1-19	
2/6	Accounting Refresh	Skim 2-1 to 2-20, Starbuck MD&A	E1-34, M2-23, 28
2/11	Intro to Financial Statements		E2-38, M2-28, P2-45
2/13	Intro to Financial Statements		
2/18	Common-size Analysis	Pepsi & Coke MD&A	E2-40, 41, 42
2/20	Common-size Analysis		
2/25	Profitability Analysis	1-24 to 1-27 Appendix 3B	E1-37, 38, 40; P1-41, 42, P2-48, P1-47, 48, 52, P1-49, 50, 51
2/27			
3/3	Exam 1		
3/5	Penman Profitability Analysis Assignment 1 Due	Module 3	M3-27, 33, 37; P3-46, 48, 49, 60
3/10	Pro-forma Adjustments	2-13 to 2-14; 5-24 to 5-33; 6-24 to 6-26; 8-26 to 8-27	E5-37, P6-45, E8-50
3/12	Risk Analysis	Module 4; 7-22 to 7-27	M4-16, 17, 21; E4-22, 26; P4-30, 32
3/24	Risk Analysis Continued		

2. In this section of the course, you will learn how to understand and analyze accounting disclosures. We will:

- Understand how accounting choices affect cross-sectional and time-series variation in financial ratios
- Learn how to identify and evaluate critical accounting policies contained in the footnotes to the financial statements
- Understand the effects of these choices on the historical and future financial statements
- Learn how to adjust the financial statements to allow for cross-sectional comparison
- Learn how changes in the asset and liability valuations on the balance sheet impact the measurement of net income on the income statement

Date	Topic	Before Class Readings 5e	After Class Practice Problems 5e
3/26	Revenue and COGS	5/2 - 5/16	Q5-5,8; M5-13,15,16,22; EE5-32,34,35; P5-47,53
3/31	Accounts Receivable	5-17 to 5-23 HP 10K (Item 1)	Q5-2; M5-18, 19, 20, 21; E 5-41; P5-54
4/2	Exam 2		
4/7	Investments in Securities, Intercorporate Investments, and Foreign Currency Translation Assignment 2 Due	6-17 to 6-23; 6-29 to 6-31 United Tech. 10K (Item 1)	Q6-7, 8; M6-17, 19; E6-31, 32, 36; P6-38, 42
4/9	Investments, ..., Continued	9-01 to 9-24	Q9-4, 5; M9-17, 18; E9-30, 35; P9-48
4/14	Investments, ..., Continued, Quality of Earnings		
4/16	Leases, and Topics in Equity and Debt	10-3 to 10-10 Southwest 10K (Item 1)	Q10-1, 2, 3; M10-14, 15, 20; E10-28, 31; P10-41
4/21	Income Taxes	10-25 to 10-33; 10-37 to 10-39	M10-22,25; E10-38; P10-50
4/23	Income Taxes Continued		

3. In this section of the course, you will learn how to use company disclosures to forecast financial statements.

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

Date	Topic	Before Class Readings 5e	After Class Practice Problems 5e
4/28	Forecasting Revenues	Mod. 11	Q11-7, 9
4/30	Forecasting Other Items	Module 11	Q11-3; M11-13, 16, E11-23, E11-30

5/5	Potential Review and Group Presentations		
5/7	Potential Review and Group Presentations		