

## ACCT 5300/FINC 5300:



### **Financial Statement Analysis and Security Valuation**

Faculty: Dr. Davit Adut

Office: Pigott 507; phone 206-296-5713; email:adutd@seattleu.edu

Class Meetings: Monday, 6:00-9:00pm, Pigott 305.

Wednesday, 6:00-8:40pm, Pigott 203.

Office Hours: Mondays and Wednesday from 2:00-3:30 pm or by appointment.

**Course Description:** The objectives of this course are (1) to present a framework for financial statement data to make investment decisions and (2) to provide a hands-on experience in creating a financial report and understanding valuation issues. We will be using real data and real accounting information to value a company.

To enjoy and to be successful in this course, you should be curious about the valuation of a company and about the relationship between financial statements and the valuation of a company. Success is not guaranteed by effort alone, but by effort supported by a solid foundation in financial accounting, along with business sense and the ability to integrate multiple pieces (usually conflicting) of qualitative and non-qualitative information. Other key factors for success will be the ability and/or a strong desire to learn how to be an effective team member, design reliable excel spreadsheets and communicate well verbally and in writing about technical accounting and financial issues.

### **Learning Objectives:**

At the end of this course students will be able to:

- Obtain financial information from COMPUSTAT.
- Evaluate a company's performance and financial position using financial ratios.
- Use a financial model to forecast financial statements.
- Use a financial model to estimate the fair value of a business.
- Perform a basic analysis of accounting quality using quantitative models.
- Create a report with a specific recommendation for potential investors.

This course meets the following among Seattle University's graduate learning outcomes:

- Demonstrate mastery of competencies required in their profession or field.
- Demonstrate effective communication in speech and in writing.
- Exhibit effective collaboration skills.

This course also meets the following among the Albers School of Master's in Professional Accounting learning outcomes:

- Recommend a course of action to a prospective client by using a model to analyze financial statements and other relevant data.
- Evaluate the accounting implications of an economic event by applying the principles, standards and practices of financial accounting.
- Advise stakeholders of how strategic business risks relate to financial reporting using archival data.
- Construct arguments for and against alternative accounting decisions by weighing the ethical, stakeholder and stewardship implications of each.

### **Accounting Knowledge and Understanding:**

In addition to two prerequisites (ACCT 5300, FINC 5300 and FINC 5050), I assume that students enrolled in this course have an advanced understanding of:

- Financial statement preparation and the connection between financial statements. Mainly, transaction analysis, Income statement and Statement of Cash Flows.
- The structure of an annual report and where to go and find the information.
- Accounting for a set of transactions including leases, fair value adjustments and investments.
- The concept of present value of cash flows, and know how to estimate the fair value of an asset as the present value of a stream of expected cash flows at the appropriate discount rate. (I am assuming that you know how to use the formulas in conjunction with excel spreadsheets. Please refresh your memory of these subjects within the first week of the class).

If your memory of these topics has faded, but you have known them well before, you can probably catch up. But if your knowledge of accounting principles is weak or you are unfamiliar with discounted cash flow techniques and basic managerial finance please come and talk to me as soon as possible. This course may be inappropriate for you now.

### **Materials and Required Tools:**

- “ Equity Valuation and Analysis with eval “ 3<sup>rd</sup> edition by R. Lundholm and R. Sloan (McGraw-Hill Irwin). Website: <http://www.lundholmandsloan.com/index.html>
- Software: Microsoft Excel 2013.
- A laptop computer is recommended for every class and is dispensable for taking the exam. If you do not have a laptop computer, or if it is not convenient for you to bring one to class, please let me know and I will attempt to reserve one for you with the IT group.

Note: If you own an Apple Computer, I strongly recommend that you run Excel 2013 on Windows or use one of the schools' laptops.

**Assessment:**

Your Grades will be based on participation, homework exercises, an exam and a professional quality group valuation and analysis report leading to a buy, sell or hold recommendation on a publicly traded stock. All the deliverables will be submitted to Canvas under appropriate assignments. You can only submit an assignment once. If It is a group assignment, every member of the group must submit the assignment individually. Late assignments will receive a grade of 75% at a maximum. Although this does not happen too often, it is your responsibility to make sure that I can access your assignment in excel so that it can be graded. On occasion, I cannot open the file you have sent and you will be assigned a grade of “0”. It is your responsibility to make sure that these incomplete assignments become real grades before the last day of classes otherwise, you may not be able to complete the course with success. The relative weights stated below will eventually become your grade.

| <i>Activity</i> | <i>Assigned Weight</i> |
|-----------------|------------------------|
| Participation   | 5%                     |
| Assignments     | 30%                    |
| Exam            | 35%                    |
| Class Paper     | 15%                    |
| Presentation    | 15%                    |
| Total           | 100%                   |

| Letter Grades           |              |
|-------------------------|--------------|
| Numerical Scores Earned | Letter Grade |
| >=90                    | A-, A        |
| >=85                    | B+           |
| >=75                    | B            |
| >=70                    | B-           |
| >=60                    | C-, C, C+    |
| >=50                    | D            |
| <50                     | F            |

**Class Participation:** I will measure degree of positive participation by means of attendance and instances in which a student shares interesting news, asks good questions, or answers questions asked in the class. I expect every student to be actively involved in the class discussions and asks questions.

**Analysis and Evaluation Report:** *The analysis and valuation report leads to a buy, sell, or hold recommendation on the stock of a jointly agreed upon company. The paper's outline and grading rubrics are attached to this document. Here are some ground rules that apply to all the groups.*

*(1) Every group must analyze a different company.*

(2) Groups will be formed randomly before the end of the second class. If the class size is an exact multiple of 4, all groups will have 4 members. If the class size is a multiple of 5, every group will have a size of 5 people.

(3) Your final grade in the term project will reflect a weighted average of your peer's evaluations with my own evaluation. Your peer's evaluation will determine 60% of your grade while my contribution will make up the remaining 40%.

(4) A company cannot be used in your valuation report if :(i) you work there or have access to inside information; (ii) you are now involved, or have been recently involved in an auditing or consulting engagement with the company. (iii) you have prepared, or are now preparing , a project on financial ratios or valuation of the same company for another course at Seattle University. Submitting a report covered by any of these restrictions, will be considered a violation of the honor code.

(5) All members of a group must be in attendance and actively involved in the discussion when their group is presenting. Absentee members will receive an "I" (incomplete) grade in the course.

(6) At the mid-level of the course, every team needs to schedule a meeting with me to discuss their progress in the project. The failure to have this meeting can result in a less than optimal grade in the project.

**Policies Governing the class:** As in every class thought in Seattle University. Please find the link to important resources and policies.

- **Library and Learning Commons** <https://www.seattleu.edu/learningcommons> (resources include the Research [Library] Services, Learning Assistance Programs, Writing Center, and Math Lab.
- **Academic Integrity Tutorial** <https://www2.seattleu.edu/academicintegrity> you are responsible for.
- **Academic Policies** (<https://www.seattleu.edu/registrar/academics/performance>) you are responsible for including: the Academic Integrity Policy, Academic Grading Grievance Policy, and the Performance Criteria for Undergraduate Albers School of Business & Economics Policy.
- **Notice for students concerning Disabilities** <http://www.seattleu.edu/DisabilitiesServices/>. If you have, or think you may have, a disability (including an 'invisible disability' such as a learning disability, a chronic health problem, or a mental health condition) that interferes with your performance as a student in this class, you are encouraged to arrange support services and/or accommodations through Disabilities Services staff in Loyola 100, (206) 296-5740. Disability-based adjustments to course expectations can be arranged only through this process. You are responsible for seeking help in a timely fashion to obtain disability-based adjustments to course expectations.

**Assignments:** The specifics about the assignments will be distributed either as a hard copy in class or as an electronic file on Canvas. You will have at least one week to complete assignment and submit it to me. These assignments can be in the form of professional reports or excel assignments that emphasize the lecture. Please observe the following additional guidelines in your papers.

(i) Type your paper and submit everything in a single file. (ii) Number your pages (iii) Give credit when quoting or using the work of others. Not doing so, is a violation of Seattle University's

Academic Honesty Policies. (IV) If the assignment requires the use of excel or any other software, please make sure that I can see the formulas or relevant coding associated with the assignment. (V) I like to use technology and do not like to kill trees unless I must. Consistent with this idea, I will ask you to submit your work through Canvas , rather than bringing in a hard copy.

The assignments in the class have been designed to be challenging and will mirror challenging duties in the real life. These assignments are designed to be like real life challenges where there will not be someone to hold your hand. You must make it happen and present a polished product. I will be more than happy to help you a long the way but the final product must be your product not your product with my corrections. It is your product and I will evaluate it when it is submitted. You are only allowed to submit your work once and not multiple times. If you think that you can benefit from collaborations with your class mates, feel free to use this resource before you submit your work. Just like in real life, you are allowed one time opportunity to pitch your ideas to your boss.

**Team Work:** Team work is designed so that you all can take on more complex projects (than you would be able to individually) and to help you improve your ability to work effectively in teams. Often students choose one of two simple strategies to deal with team assignments: (i) divide-and-conquer: split the task evenly, concentrate on your share, and ignore the rest; (ii) extreme specialization: choose to do only the part of the assignment that you are most proficient in. Both strategies tend to defeat the purpose of team work and hurt your learning experience. Please let me know if I can help with ideas for organizing your team and distributing the workload. Another common approach is to be a “free-rider”: pretend the problem doesn’t exist and your teammates will do the project for you. To make this approach less attractive, each student’s contribution to a project is evaluated by all the other members of the team and by myself.

**Important note regarding academic dishonesty and team projects:**

- Saying that you did not know that a certain member of your group did not do their work properly and/or was cheating (e.g., plagiarizing) does not protect you from getting a low grade in a group assignment. Be sure you know where any work came from, and how it was prepared, before you put your name on it. If you are suspicious ask about how the work was done, and try to determine whether your teammate would have been capable of doing it.
- If academic dishonesty is involved in group work, the individual student who committed the dishonest act will receive a grade of zero in the entire project. However, the grade in that individual’s component of the project will still be zero for all members of the group.

**Class Schedule and Office Hours:**

I have prepared a week-by-week tentative distribution of topics throughout the quarter. Please check the schedule for assignment deadlines, exam dates, and topics that we will cover in class each time we meet. I may adjust the schedule from time to time as the course progresses due to variations in the time needed to explain each topic. I will announce any scheduling changes by email and in class with sufficient time for you to prepare. My office hours are posted in the header of the syllabus. Office hours are a great opportunity for you and me to discuss the course, financial accounting concepts, career choices, or any other topic that you think I may be able to help you with. It is best to come to office hours regularly throughout the course, rather than just before an important deadline, because at that time many of your classmates may want to see me as well. Office hour meetings are on a first-come first-served basis, and there is no need to make an appointment

to meet with me during office hours.

**Students with Disabilities:**

If you have or think you may have a disability (including an “invisible disability” such as a learning disability, a chronic health problem, or a mental health condition) that interferes with your performance as a student in this class, I encourage you to arrange special support services and/or accommodations through Disabilities Services staff in the Seattle University Learning Center (Loyola 200, tel. 206-296-5740). Disability-based adjustments to course expectations can only be arranged through this process. You should also let me know at the beginning of the course so that I can make appropriate arrangements for you.

**Learning Center:**

The University’s Learning Center provides academic support and study skill enhancement for all students. Experienced staff explore specific academic needs with students in individual consultations. The Learning Center also provides tutors, learning strategy workshops, learning styles assessment and assistance with improving time management, reading comprehension, test preparation and test taking. All services are free. Additional resources are located on the Learning Center's website at [www.seattleu.edu/sas/LearningAssistance](http://www.seattleu.edu/sas/LearningAssistance). To make an appointment, stop by Loyola 100 or call (206) 296-5740.

**Online Communications:**

I expect that you will check Seattle University’s email frequently. Please use Seattle University email instead of Canvas email, as it is easier for me to follow the thread of the conversation. Also, avoid communicating with me by means of the multiple text messaging windows available within Canvas, as it becomes very difficult to monitor multiple sources of messages. I cannot guarantee replying to messages sent by any means other than SU email. Online communications are not meant to substitute for class attendance. Some materials may be distributed only in class, and many course-related announcements will be made only in class. The fact that you did not receive materials by electronic means is not an acceptable reason for failing to meet assignment deadlines if those materials were distributed in class. I plan to check email daily on weekdays and will reply to your messages within 24 hours except during weekends and holidays. Do write to me if you must miss class. Please include the course title in the subject line of your messages to me. Due to the threat of viruses, I usually delete without reading messages without a subject, or with a subject that I find suspicious.

**Course Evaluations :**

Towards the end of the quarter you will receive a message from the Albers School with instructions on how you can provide us with your opinion on the conduct of this course, its strong and weak points, and recommendations for the future. Please contribute to our continuous improvement by completing your course evaluation forms online and turning them in on time. We treasure your feedback. With your ideas and suggestions, comments and constructive criticism, we will continue working to make Seattle University and the Albers School of Business and Economics a wonderful place to grow and learn, for you and for future generations of students. Keep in mind that students’ evaluations are completely anonymous. I will only have access to the results (never to the source) after posting final grades in the course.

Tentative Class Schedule

| <i>Date</i>                | <i>Topic</i>   | <i>Study</i>  | <i>Deliverables<br/>Due on the Friday of<br/>Every- Class Week</i>  |
|----------------------------|--|---|---|
| <b>1<sup>st</sup> Week</b> | Introductions,<br>Course Objectives,<br>Assignments, Grading,<br>WRDS  | Chapter 1<br>Chapter 2<br>Chapter 3   |   |
| <b>2<sup>nd</sup> Week</b> | The Accounting Cycle   | A Review of the<br>transaction analysis,<br>Income Statement,<br>Balance Sheet and<br>Cash-Flow<br>Statements | <b>Assignment 1:</b><br>Due on Friday by<br>5:00pm.<br>Transaction Cycle  |
| <b>3<sup>rd</sup> Week</b> | Cash Flow Analysis<br>Accounting Quality   | Chapter 4<br>Chapter 6  |   |
| <b>4<sup>th</sup> Week</b> | Analysis of performance<br>(returns) using basic and<br>advanced Dupont methods.<br>Analysis of financial risk.<br>Models to estimate credit<br>rating, pr(bankruptcy).                      | Chapter 5   | <b>Assignment 2:</b> due<br>on Friday by 5:00pm.<br>Please refer to<br>Canvas module<br>associated with this<br>week, |
| <b>5<sup>th</sup> Week</b> | Financial forecasting. How<br>to design, build, implement,<br>and use a reliable financial<br>forecasting model in Excel.  | Chapter 7<br>Chapter 8  |   |
| <b>6<sup>th</sup> Week</b> | Valuation models. Drivers<br>of M-to-B and P/E.<br>Residual income (RIM) and<br>discounted cash flow (DCF)<br>models. Performing a<br>“reality check”.                                       | Chapter 10<br>Chapter 11  |   |
| <b>7<sup>th</sup> Week</b> | EXAM PREPARATION:<br>An in-class exercise on<br>obtaining data, computing<br>ratios, interpreting ratios,<br>forecasting, and writing<br>brief reports. ( <i><u>laptop<br/>needed</u></i> ). | Chapters 1-11   | Public Company “A”  |
| <b>8<sup>th</sup> Week</b> | Mid-Term Exam: An in-<br>class exercise on obtaining<br>data, computing ratios,<br>interpreting ratios,<br>forecasting, and writing<br>brief reports. ( <i><u>laptop<br/>needed</u></i> ).   |   | Public Company “B”  |

|                             |  |           |  |
|-----------------------------|--|-----------|--|
| <b>9<sup>th</sup> Week</b>  | Cost of capital. (First 60 minutes.) Group work with instructor to finalize valuation projects, including presentation slides. | Chapter 9 | <b>Assignment 3:</b><br>Due on Friday by 5:00pm. Please refer to Canvas. |
| <b>10<sup>th</sup> Week</b> | PROJECT PRESENTATIONS (in lieu of final exam)  |           | Every Team member must be present during the presentations.              |

## *Attachment I*

### *Outline of the Security Analysis & Valuation Paper*

Your term paper on the analysis and valuation of a company should contain the following sections: (1) executive summary; (2) discussion of the company's market, goals, strategies, and environment; (3) ratio-based financial analysis, covering both time-series and cross-sectional comparisons of the key ratios; (4) evaluation of the company's accounting policies and quality of earnings, including the possibility of manipulation; (5) forecasts of financial statements; (6) assessment of the fair value of the company's equity; (7) a buy, sell or hold recommendation. In addition to these 7 requirements, there is one more additional requirement that needs to be included in your paper; (8) you need to find a point on which you do not agree with the choices that the company makes. This choice can be related to the accounting treatment of an item or a marketing issue, or anything else that you are interested. Your presentation as well as your paper should point this issue, support it with your findings and recommend a solution.

The requirements of sections 2-8 are:

**Section 2:** Analyze the company's strategic positioning within its market, as background for the subsequent ratio analysis, financial planning exercise and valuation. This section lays the foundation for estimating growth rates and sustainable rates of return on assets and equity.

**Section 3:** Perform a financial ratio analysis according to the advanced Dupont technique (after restating financial reports for non-productive assets and capital structure.) The Dupont analysis must proceed at least to the breakdown of the asset turnover and net profit margin.

**Section 4:** Before using ratios to build forecasts, it is important to establish the credibility of published financial reports. For this you should investigate degree of accounting quality and the possibility of earnings manipulation. In this course we discuss diagnostic tools presented in Lundholm and Sloan (chapter 6.6) and in Beneish's article on the detection of manipulation. (You should apply at least one of these techniques, preferably both.)

**Sections 5 and 6:** Forecast the company's financial statements (income, balance sheet, cash flows, and changes in shareholders' equity) based on the most recent publicly available information. From the accounting forecasts, estimate the fair value of your company. Your report must include a sensitivity analysis of fair value on two or three relevant factors. Also, compare the value obtained with the DCF/RIM models with value obtained using one or more popular multiple techniques. Include in this section a description of the market's expectations about earnings.

**Section 7:** A recommendation as to whether investors should buy, sell, or hold the stock. If you cannot make a recommendation, explain why not.

**Section 8:** This is the most difficult part of the course and it requires a lot of technical accounting knowledge as well as understanding the company really well. Since these issues are very difficult to detect, it will take a long time to spot these issues. My advice is to keep looking till you find it. This is an exceptional skill that you will learn and will be very useful in real life. I refer to this finding as “Home Run”. Deliverables: (1) executive summary distributed to class before presentation; (2) Excel file; (3) Word file of paper; (4) file of presentation. I am aware of the fact that the standard software for presentations is “Power Point” but there are a lot better and more powerful tools available to you. Please follow the link to see some examples of these new and amazing software. <https://www.seattleu.edu/cdli/toolkit/gadget-finder/>.

**Attachment II**

**Evaluation Rubrics**

(1-Lowest Quality, 5-Highest Quality)

|                     | Profitability | Efficiency | Accounting Flexibility | Financial Risk | Recommendation | Assumptions | Homerun |
|---------------------|---------------|------------|------------------------|----------------|----------------|-------------|---------|
| <b>Overall Team</b> |               |            |                        |                |                |             |         |
| <b>Member 1</b>     |               |            |                        |                |                |             |         |
| <b>Member 2</b>     |               |            |                        |                |                |             |         |
| <b>Member 3</b>     |               |            |                        |                |                |             |         |
| <b>Member 4</b>     |               |            |                        |                |                |             |         |
| <b>Member 5</b>     |               |            |                        |                |                |             |         |