

ACCT/FINC 5300-02:

Financial Statement Analysis and Security Valuation

SYLLABUS AND SCHEDULE | Spring Quarter 2022

Faculty: Dr. Carlos A. De Mello e Souza
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Email: carlosms@seattleu.edu
Zoom link: <https://seattleu.zoom.us/j/9423336718> (*beanctr*)
Class meetings: Tuesdays, 6:00 – 8:40 PM
in Pigott 308
Office hours: Th/M, 11:30 AM – 12:30 PM via the Zoom link above.
Also by appointment, either on Zoom or on campus.

Course Description

This course has the following objectives:

1. Present a conceptual framework for conducting a comprehensive financial statement analysis of a company, estimating its fair value, and making a buy/sell/hold recommendation on its stock.
2. Provide hands-on experience doing what is described in objective #1.

We will use the most recent data on publicly traded companies to make professional-level investment recommendations. I expect that we will have a good time trying to beat the market at this time of very high volatility in stock prices, looming geopolitical and climate risks, and a resurgence of long-dormant inflationary pressures. Not to mention regulatory risks and a rapid pace of technological development.

To succeed professionally as a financial analyst you will need a solid foundation in economics, accounting, and corporate finance, combined with good business sense and with the ability to integrate multiple pieces of information. The abilities to communicate well orally and in writing, and to employ quantitative models to solve problems will be vital as well. If you don't enjoy gathering data, making assumptions about the future based on imperfect information, and running numerous experiments with quantitative models, this course is probably not a good fit for you.

Caveat: In this course you will make investment recommendations, and hear recommendations made by your classmates and professor. You will also learn about recommendations made by other financial analysts and market participants. I urge you to keep in mind that even if we employ the most recent and robust findings from financial markets research, are thorough and diligent in our examination of a company and the downside and upside risks it may be vulnerable to, investing in stocks remains a hazardous activity! The benefit of adhering to well-grounded methodology is to reduce somewhat the degree of hazardousness and give you a slight edge over those who follow mere impulse, fads, or memes.

Learning Objectives

On successful conclusion of this course you will be able to:

- Obtain financial information from COMPUSTAT and CRSP via WRDS.
- Evaluate a company's performance (returns) and financial position (risk) using financial ratios.
- Perform accounting quality analysis using quantitative models.
- Employ a model to forecast financial statements and estimate the fair value of a business.
- Explain the weaknesses and limitations of financial forecasting models and of the recommendations that can be made using such models.

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.

At the program level, this course meets learning outcomes of the Albers School's Master's in Professional Accounting - MPAC, and Master of Science in Finance - MSF. Regarding the MPAC, especially LO#1 (*recommend a course of action to a prospective client by using a model to analyze financial statements and other relevant data*).¹ Regarding the MSF, especially LO#1 (*justify values for both financial and real assets by applying appropriate valuation methods and principles*) and LO#4 (*produce sound financial recommendations by applying financial tools and analytical methods*).

Prerequisites

There are two prerequisites for ACCT/FINC 5300: (a) Principles of Financial Accounting and (b) Corporate Financial Management (FINC 5050 at Seattle University). I assume therefore that you possess a basic understanding of:

- How financial statements are prepared and the relationships among accounting variables.
- The structure of a typical annual report.
- Accounting for a set of common transactions for manufacturing, service, and retail businesses.
- The concept of present value 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.

If your memory of any of these topics has faded, but you have known them well before, you should be able to catch-up on your own. But if your knowledge of financial 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 so that we can figure out a strategy for catching up.

Required Materials

- *"Equity Valuation and Analysis with eVal"* 5th (or earlier) ed., by R. Lundholm and R. Sloan (Independent Edition or McGraw-Hill Irwin).

Website: <https://www.lundholmandsloan.com/home>

¹ The course partially addresses learning outcomes #2, #3 and #5 of the MPAC, and #5 of the MSF.

- Access to WRDS (Wharton Research Data Services) at <https://wrds-www.wharton.upenn.edu/> Username and password will be shared in class and posted on Canvas.
- Computer with internet connection and Zoom-ready (camera + speakers). Zoom will be necessary in case we need to go back to remote learning. Zoom will also be useful for office hour meetings, and possibly for the midterm exam. (The last will depend on a vote by the class.)
- Microsoft Excel. The most up-to-date version, and the one I recommend, is Excel 365. **Note:** I will use certain workbooks that have been prepared for Excel on a PC running Windows. These workbooks do not have full functionality on Apple computers. If you do not have a PC, you may run these workbooks via Seattle University’s Virtual Desktop. This is also the solution for using any software that is available on the Seattle University or Albers School computing networks. There are both web browser and installed software-based procedures for accessing the virtual desktop. To learn more, and download software, go here: [LINK](#).
- Excel Workbook “Pilot” (by C. De Mello e Souza). Distributed through Canvas.
- Excel Workbook “eVal” (by R. Lundholm and R. Sloan). Link: <https://www.lundholmandsloan.com/software>. A version of eVal linked directly to Pilot will be distributed through Canvas.

Course Requirements and Grading

Grades will be based on a team-based project, one exam, and weekly homework assignments. Participation in class will lead to extra points that will be added to the final grade. Due dates for deliverables are shown in the attached schedule of classes and will also be on Canvas. Late submissions will be graded only under extraordinary circumstances.

The correspondence between final numerical scores in the course on a scale of 0-100, letter grades, and GPA units is:

Letter grade	A	A-	B+	B	B-	C+	C	C-	D	F
Numerical score	≥ 95	≥ 90	≥ 85	≥ 75	≥ 70	≥ 67	≥ 63	≥ 60	≥ 50	< 50
GPA units	4	3.7	3.3	3	2.7	2.3	2	1.7	1	0

I will round the final scores in the course up to the nearest tenth of a point. The split between A- and A may be lower than 95 (but not higher) depending on the distribution of grades, as I look for significant gaps in grades to establish this cutoff point. According to University policy, courses graded C- or below do not count toward a graduate degree.

There is a strong team work component in the course. The objective of team work is not simply to *“create (a report) in which all members participate, but for each student to learn specific skills or content through the group’s work together.”*²

Following are summary descriptions of the graded assignments in the course. Additional details for each assignment, including grading rubrics, will be provided on Canvas.

² Feldman, Joe (2019). “Grading for Equity”, p. 104. Corwin, Thousand Oaks, CA.

VALUATION REPORT: (35%) This team-based analysis and valuation report will culminate in a buy, sell, or hold recommendation on the stock of a publicly traded company. The paper's outline and grading rubrics are in Appendices I and II. Your grade on this project may be adjusted up or down based on peer evaluations of your contributions. These adjustments will not exceed ± 15 points. As an example, suppose your group's report has a score of 90%. Assuming peer evaluations indicate you contributed fairly to the work your grade will remain at 90%. If, however, there is evidence that you contributed more or less than your fair share, your grade in this valuation project could be as high as 100%, or as low as 75%. Bottom line: Help your group!

EXAM: (20%) Make a buy, sell, or hold recommendation on the stock of a publicly traded company. I will choose a company different from any company chosen by students in any section of this course. The exam will be done in class or via Zoom (depending on a vote in class) and will by necessity be much shorter and simpler than the team-based project. You will fill out a standard form composed of a series of questions whose answers lead up to the final recommendation. The basic format of the exam will be posted on Canvas in advance.

HOMEWORK: (45%) Best eight out of ten assignments. These will be graded on correctness, diligence, timeliness of the information presented, and quality of presentation. (See paragraph below "On Written Assignments" for what I mean by quality of presentation.) You will find a brief description of each homework assignment in column 3 of the course schedule below. Three of the ten assignments (#'s 5, 8, and 10) are preliminary drafts of the team project and will be submitted jointly by each team. Assignments #6 and the addition of the SoCF will also be team efforts. The six remaining homework assignments are individual. Only one copy needs to be submitted when the assignment is for the team. Peer evaluations will apply to team-based homework as described above for the valuation report.

PARTICIPATION: (Extra credit) I encourage all students to participate in class. Participation is important for learning. It is also an important factor for class meetings to be enjoyable. In my experience with this course, participation tends to have a very strong effect on the grades achieved in the three assignment groups above.³

I assign extra participation points on a discrete scale, from 0 to 5. The scale I use is the following:

- 5: You ask or answer at least one good/important question⁴ in almost every class meeting. Sometimes you also contribute with your perspective or individual experience, to enrich the conversation for all. Your peer's review average is 5.0.
- 4: You ask or answer questions regularly, and once in a while you contribute with your perspective or individual experience. Your questions and or answers demonstrate good preparation for class. Your peer's review average is ≥ 4.0 .
- 3: Between the descriptions for 3 and 4 points.

³ I may deduct up to 20 points from the final course grade for disruptive participation, i.e., actions that negatively affect the learning experience of other students. In case of disruptive behavior I will first warn the student via email. This is extraordinarily rare. In my entire career as an academic it has happened exactly twice.

⁴ Questions related to the administration of the course do not count for extra credit on participation.

- 2: Once in a while you ask questions, answer questions, or contribute with your own perspective or experience in class discussions. Sometimes your questions reveal that you did not prepare for class. You always come to class and your peer's review average is ≥ 4.0 .
- 1: You speak up rarely, if ever throughout the course, but you always come to class. Your peer's review average is ≥ 4.0 .
- 0: You missed four or more classes without a strong reason for doing so.

Note 1: Asking too many questions and in general monopolizing the conversation, can be very disruptive to the class.

Note 2: If you feel that you cannot participate in class in the sense described above for a good reason, please let me know. In that case we will find another way in which you can be involved in the class. It could be, for example, by posting questions, answers, and viewpoints on a Canvas discussion board.

On Written Assignments

I do not read or grade assignments that reveal an unprofessional degree of carelessness in presentation quality. Please observe these recommendations in your submissions:

- (1) Type and format your reports as if they were being submitted to a high-level professional audience, such as prospective clients, or C-level executives. I will provide examples of well-presented student reports.
- (2) Number pages, appendices, pictures, and tables. Any appendix, picture or table must be referred to in the text. Pictures and tables must have a descriptive title and a legend. If the picture or table was copied in part or entirely from another source, that source must be mentioned in the legend.
- (3) To the extent possible, create your own tables and graphs, instead of copying and pasting fuzzy pictures of tables and graphs you found on the web.
- (4) Give credit when quoting or using the work of others. Not doing so is a violation of Seattle University's Academic Honesty Policies.

Scheduling

I have prepared a tentative distribution of topics throughout the quarter (attached below). Please check the schedule for due dates, assigned readings, suggested weekly activities, and topics that we will cover in class. I may adjust the schedule as the course progresses due to variations in the time needed to cover each topic. I will announce scheduling changes by email, in class, and on Canvas with enough time for you to adjust.

Office hours will be held either via Zoom or on campus. Office hours are opportunities for us to discuss the course, financial accounting concepts, career choices, or any other topic with which you believe I might be helpful. Please try to meet with me regularly throughout the course, rather than just before important deadlines, because at those times several of your classmates may want to meet with me as well.

Online Communications

I expect that you will check Canvas announcements and Seattle University's email frequently. If you can, *please* use Seattle University email instead of Canvas email. SU email makes it easier for me to follow the thread of a conversation.

I check email often and will reply to your messages within 48 hours. Normally way less than that. Please include the course title in the subject line of your messages to me.

Academic Honesty

"Seattle University asserts that academic honesty and integrity are important values in the educational process. Academic dishonesty in any form is a serious offense against the academic community." [Policy 2011-3: Downloaded on 12/13/20 from [LINK](#).]

As required by University regulations I must report to the chair of the department all verified instances of plagiarism, cheating and usage of unauthorized sources in exams, papers, projects, homework, or any other academic assignment.

The assignment in which academic dishonesty was detected will be an automatic zero. Depending on the severity and circumstances of the violation I may recommend that the student receive a grade of D or F in the course.

IMPORTANT → In group assignments only the student(s) involved in academic dishonesty will suffer these penalties, but the team's project will end up lacking one or more relevant sections that resulted from dishonest acts. Those sections will need to be redone. Therefore, in group work it is important that each member be satisfied that no contribution to the project was produced dishonestly.

If you are not sure about whether an action is acceptable per the Academic Honesty Code, you should check with me before engaging in it.

Office of Institutional Equity (Title IX)

Title IX of the Education Amendments of 1972 (Title IX) prohibits discrimination based on sex in educational programs or activities that receive Federal financial assistance. This prohibition includes sexual misconduct, which encompasses sexual harassment and sexual violence. Seattle University remains committed to providing a safe and equitable learning, living, and working environment. Seattle University offers emergency, medical, and other support resources, as well as assistance with safety and support measures, to community members who have experienced or been impacted by sexual misconduct.

Seattle University requires all faculty and staff to notify the University's Title IX Coordinator if they become aware of any incident of sexual misconduct experienced by a student.

For more information, please visit <https://www.seattleu.edu/equity/>. If you have any questions or concerns, you may also directly contact the Title IX Coordinator in the Office of Institutional Equity (email: oi@seattleu.edu; phone: 206.296.2824)

Notice on Religious Accommodations

It is the policy of Seattle University to reasonably accommodate students who, due to observance of religious holidays, expect to be absent or endure a significant hardship during certain days of their academic course or program. Please see Policy on Religious Accommodations for Students. (<https://www.seattleu.edu/media/policies/Policy-on-Religious-Accommodations-for-Students---FINAL.pdf>)

Support for Students with Disabilities

Seattle University values diverse types of learners and is committed to ensuring that each student is afforded an equal opportunity to participate in learning experiences. Disability Services (DS) works with students with disabilities to provide reasonable accommodations to support their learning experiences. Disabilities include “invisible disabilities,” such as a learning disability, a chronic health problem, or a mental health condition. This could include any long-term effects of COVID, even after recovery (“long-COVID”), if a health care provider determines it is a chronic health problem.

If you have, or suspect you may have, a disability that may interfere with your performance as a student in this course and have not yet been assessed by DS, please contact DS staff at DS@seattleu.edu or (206) 296-5740. Disability-based accommodations to course expectations can be made only through this process and must be approved by DS before implemented in a course. I am committed to working with you, so please consider meeting with me to discuss the logistics of implementing any accommodations approved by DS.

Academic Resources

- Library and Learning Commons
(<https://www.seattleu.edu//learningcommons/>)
(E.g.: Learning Assistance Programs, Library Research Services, Writing Ctr., Math Lab.)
- Academic Integrity Tutorial
(<https://www.seattleu.edu/academic-integrity/resources-for-students/>)

Academic Policies

- Academic Integrity Policy
- Grading Grievance Policy
- Professional Conduct Policies (program-specific)
You will find these and other policies on the Registrar’s website:
<https://www.seattleu.edu/redhawk-service-center/academic-policies/>

Tentative Schedule

(On the following page.)

**ACCT/FINC 5300-02 - Spring Quarter 2022 -
Tentative Schedule of Classes**

Date	Topics/Activities	Readings	Assignments due
3.29	<ul style="list-style-type: none"> Data sources & Excel Apps. Accounting review: Reading and understanding a 10-K report (1) Group formation and company choices. 	Ch 1, 2	HW#1(i) – First stock recommendation and a list of favorite information sources for your investment decisions or research projects.
4.05	Ratio analysis: Profitability, turnover, and return / Basic and advanced dupont / Risk	Ch 3, 5	HW#2(i) – Reconciliation of debt balances for BC (acct. review).
4.12	Accounting review: Reading and understanding a 10-K report (2)	Ch 4	HW#3(i) – Individual ratio analysis report. Emphasis on writing quality.
4.19	Analysis of accounting quality based on ratios.	Ch 6.6 Beneish	HW#4(i) – Reconciliation of property balances for BC (acct. review).
4.26	Building a forecasting model.	Ch 7, 8	HW#5(g) – Team report (1 st draft).
5.03	Preparing the SoCF under the direct and indirect methods. Analysis of cash flows.	Ch 6 (exc. 6.6)	HW#6(g) – Build a financial statement forecasting model using Excel. Forecast next year’s earnings using your model.
5.10	Valuation: RIM-DCF, multiples.	Ch 10, 11	HW#7(i) – Prepare a statement of cash flows. Add SoCF to model in HW#6.
5.17	Estimating the cost of capital.	Ch 9	HW#8(g) – Team report (2 nd draft).
5.24	Exam: An individual analysis and valuation exercise in a structured format.		HW#9(i) – Estimate the cost of capital.
5.31	Reality checks & sensitivity analysis.	TBA	HW#10(g) – Team report (3 rd draft).
6.7	Final report presentations		Team report, slides, and model.

Note: (i) means the homework assignment is individual; (g) means it is a group effort.

Attachment I:

Description and Outline of the Financial Analysis and Valuation Report

The objective of the financial analysis and valuation report is to justify a buy, sell, or hold recommendation on the stock of a U.S. publicly traded company. This report will be prepared on a team basis. Each team will analyze a different company. Your grade in this project will be affected by your peers' evaluations of your contributions to the group. Therefore, strive to be a good team member! Answer your team's emails promptly, meet all promised deadlines, and generally contribute to the best of your ability to the success of your team.

A company cannot be chosen for this project if any of the following conditions holds: (i) you work for that company or have access to inside information that affects the company's valuation; (ii) you are now involved, or have been involved less than 12 months ago in an auditing or consulting engagement with the company; (iii) you have recently prepared, or are now preparing, a project on financial ratios or valuation of that same company and time period for another course at Seattle University. Submitting a report on a company covered by one or more of the restrictions above for any member of the group will be considered a violation of Seattle University's code of academic honesty. Please check with me if you are not sure.

Your report will contain the following sections: (1) executive summary; (2) brief description of the company's market, goals, strategies, and environment; (3) financial analysis, covering both time-series and cross-sectional comparisons of key ratios; (4) evaluation of the company's accounting quality; (5) forecasts of financial statements with emphasis on the reasoning behind your assumptions; (6) assessment of the fair value of the company's equity, including sensitivity analysis; (7) a buy, sell or hold recommendation, including "reality checks" based on the short position, insider trades, and recommendations by market analysts.

Further details on what is required in sections 2-6 are given below:

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

Section 3: Perform a financial ratio analysis according to the advanced Dupont technique. Your report must include a breakdown of asset turnover and net profit margin into their components, as well as explanations for key return and/or risk ratio changes in recent years based on the company's MD&A and other public sources.

Section 4: Before using historical relationships to build forecasts, it is important to establish the credibility of published financial reports. To achieve this you will investigate the quality of the company's accounting quality and the possibility of earnings manipulation using the Beneish method.

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. Based on these forecasts, estimate the fair value of the company. Your report will include an analysis of the sensitivity of fair value to three critical assumptions. You should also compare the value obtained with the DCF/RIM models with value estimates obtained using at least three price multiples.

Section 7: *A recommendation as to whether investors should buy, sell, or hold the stock.* If you cannot make a recommendation, explain why not. Include a "reality check" of your recommendation, by observing recent trends in trades by insiders/institutions, short positions, and analyst recommendations.

Deliverables:

- (1) Word file containing the full report.
- (2) Powerpoint file of the presentation.
- (3) Excel file *with the expected valuation* scenario (eVal). The result from this scenario must be on the report.

**Attachment II:
Security Analysis and Valuation Report: Grading Rubrics (*)**

Percentage of points scored →		50	65	80	90	100
I. ORAL PRESENTATION (5%)						
Oral presentation	(5)					
II. WRITTEN & VISUAL COMMUNICATION (25%)						
Strength of argument	(5)					
Grammar and style	(5)					
References	(5)					
Powerpoint slides	(5)					
Tables and graphs	(5)					
III. FINANCIAL STATEMENT ANALYSIS (35%)						
Analysis of profitability	(8)					
Analysis of efficiency	(8)					
Analysis of financial risk	(8)					
Analysis of accounting quality	(8)					
Analysis of taxation	(3)					
IV. FORECASTS & VALUATION (35%)						
Estimation of cost of equity (r_e)	(8)					
Estimation of cost of debt (r_d)	(5)					
Reasonableness of assumptions	(10)					
Reality checks	(6)					
Sensitivity analysis	(6)					

- (*) 0 = Not done, or entirely wrong (row crossed out).
 50 = Reveals minimal effort and/or quality is poor.
 65 = Some effort, but result inadequate.
 80 = Getting there, but problems must be fixed before presenting to client.
 90 = Strong effort with good result; with a few adjustments ready for client.
 100 = Strong effort and great result; ready for distribution as is.

**Attachment III:
Writing Guidelines for Financial Analysts**

DO:

- Find the company's story and tell it in a compelling way. The story can be found in the numbers, in management's explanations for the numbers, and in the market's perceptions about the company.
- Assume that the reader is well versed in the models and techniques that you employ. Refrain from teaching in your report.
- Make strong statements when supported by the data.
- Use charts and tables when they help explain an important point. Refer to any charts or tables included in the report.
- Try to explain *why* ratios have behaved in a certain way. Saying that "the gross margin has declined *because* the product mix has an increasing percentage of groceries" is a useful explanation. Simply stating that "the gross margin has declined over time" is not.
- Make clear what you mean by saying that a ratio increased by 5%. Do you mean that the ratio increased by 5 percentage *points*, or that the value of the ratio is now 1.05 times what it used to be? If the former, say *500 basis points*.
- Write your report so that there is a logical connection between the various ratios you mention, and those ratios lead to well-grounded conclusions.
- State conclusions related to your preceding analysis.
- Read and edit your report before submitting it. Even if the report has several authors, it must look to the reader as if it has been designed and written by a single person.
- Give credit to all external sources that you draw upon.

DON'T:

- Write your story mechanically as a roller-coaster sequence of ratios going up and down.
- Make statements that are patently incorrect. A single incorrect statement is all it takes to lose the reader's confidence.
- Make statements that are true by definition, i.e., tautologies. (Example: the profit margin is up because profits increased faster than revenues.)
- Pretend your numbers are more precise than they really are by reporting them with too many decimal places.
- Make too many vague statements indicated by words such as "maybe," "perhaps," or "possibly".
- State conclusions that are not supported by your preceding analysis.
- Make investment recommendations based on financial ratios alone. (Investment advice must be based on comparisons of market value with estimates of fair value.)

(Source: Wal-Mart Case by Vidya Awasthi and C. A. De Mello e Souza, Seattle University)

**Peer Evaluation of Individual Contributions:
Financial Analysis and Valuation Project**

Evaluator's Name: _____

Please rate the contributions and effort by each of your team's members, including yourself by choosing the degree to which you agree with the following statement: ***"This member of my team has contributed her or his fair share or more."***

Enter your team members below:	Ratings (*)					
	1	2	3	4	5	∅
1. Yourself						
2.						
3.						
4.						
5.						

(*) The meaning of each of the five possible ratings is as follows:

- 1** = I absolutely disagree with the statement
- 2** = I tend to disagree
- 3** = I am not sure if I agree or disagree
- 4** = I tend to agree
- 5** = I absolutely agree with the statement
- ∅** = If someone did not contribute AT ALL.

Optional comments: