Financial Statement Analysis (BA 381N) The University of Texas at Austin Texas MBA at Houston: Spring 2013 Dr. James W. Deitrick

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Required items:

a. <u>Financial Reporting, Financial Statement Analysis, and Valuation</u> (7th edition), by Wahlen, Baginski and Bradshaw, South-Western Cengage, 2011.

b. Course packet prepared by me.

c. Regular reading of the financial media.

Course objectives:

The course has many objectives. Among other things, it will attempt to:

- a. increase your comprehension of financial statements and their related footnotes,
- b. introduce you to several tools and procedures common to financial statement analysis,
- c. expand your understanding of the relationship between business transactions, environmental forces (e.g., political, economic, social) and reported financial information,
- d. examine how financial statement information can help solve certain business problems, and
- e. encourage you to think logically and creatively about the strengths and weaknesses of information available to decision-makers.

Evaluation scheme:

a. Team project 35% (ideally due February 22,23)

b. Final Exam, Quizzes 65%

100%

Class participation:

Class participation is strongly encouraged. Learning is a participatory activity, not a spectator sport. Although it is not a direct factor in the evaluation scheme, class participation can play an important role in the assignment of final course grades, especially for "border-line" cases. I hope we can create an environment that encourages you to come to each class well prepared, fosters intellectual curiosity and promotes insightful questions and exchanges. Let's have fun as we learn together.

Laptop and cell phones:

As a courtesy to everyone, please refrain from using your laptop computer during class unless instructed otherwise, and please have your cell phone turned off.

Honor code:

The Pledge

I affirm my desire to be part of the honorable community at the University of Texas at Austin, Graduate School of Business. I understand that any act of lying, stealing or cheating is a violation of the Honor Code, and may be punishable by dishonorable dismissal from the school.

I hereby formally pledge to give my full support to the Honor System and agree to be bound at all times by the Honor Code.

Ideals

Upon entering the Texas Graduate School of Business, every student becomes a part of the Honor System. The purpose of this system is to promote a spirit of community and provide an enriching learning environment, while sanctioning any individuals who fail to uphold its tenets.

The Honor System is mainly concerned with eliminating three dishonorable types of behavior—lying, cheating and stealing. Through the Honor Code, students maintain the integrity of the system and eliminate these behaviors from it. Every student is responsible for understanding the provisions of this code and abiding by them, or leaving the school of business. Ignorance of the Honor Code is not an acceptable excuse for violations under any circumstances.

The effectiveness of the Honor System is dependent upon the students' acceptance of their responsibility toward the System. The students maintain this system through their adherence to and support of the Honor Code.

Serious and intentional violations of the Honor Code destroy the foundation of the learning environment, and thus must be eliminated. All students share the responsibility not only for obeying the code, but also for reporting any violations. Established University of Texas procedures will be used in investigating all alleged violations of the Code, conducting any necessary hearings, recommending and implementing appropriate sanctions.

The Honor Code Prohibits: Lying, Cheating and Stealing

Lying refers to any statement of untruth made with the intent to mislead others. Lying is a violation of the Honor Code whether the untruth involves another student or a university official.

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In practice, lying can come in many forms. For instance, resubmitting a previously graded paper, case or assignment for credit without the explicit consent of the instructor, is considered an act of lying. In addition, if a student wishes to use the same paper or case for two different classes concurrently, he or she must receive approval from both instructors.

Stealing refers to the knowing deprivation of another's property or possessions, and is a violation of the honor code.

Intentionally removing course materials from the reserve room—and not returning them—is considered an act of stealing. Intentionally removing company information before interviews and tampering with resumes in a drop box are also considered acts of stealing.

Cheating refers to the fabrication of written assignments; giving or receiving aid without the consent of the professor on tests, quizzes, homework or any other class assignments; and the act of plagiarism. These are all violations of the Honor Code.

Consulting unauthorized materials on tests, quizzes, case preparations or assignments shall constitute *prima facie* evidence of the intent to subvert the purpose of the exercise, and shall be interpreted as cheating. Plagiarism is the act of presenting the information, ideas or phrasing of another person as if they were one's own. Regardless of the reason, any amount of plagiarism shall constitute a violation of the Honor Code.

Any student who violates the Honor Code or witnesses a violation of the Honor Code must immediately report that breach to the Associate Dean for Graduate Programs. Failure to report a violation constitutes a violation of the Honor Code.

Financial Statement Analysis Team Project Company Analysis and Price Valuation

Part I.

This project requires you to gather and study several years of financial statement information for your team's company. It also requires you to use an electronic spreadsheet to build a database and to construct some special reports and ratios that play financial statement analysis.

Specifically, you are to obtain at least five years of annual report information for your company. The information can be obtained from 10-K filings (annual report to the SEC) found on Edgar or your firm's website (see Investor Relations). It is better for learning purposes if you analyze a manufacturer, retailer, wholesaler or other business with inventory, fixed assets and <u>segment disclosures</u> (see footnotes). Oil and gas companies should be avoided. At minimum, the database needs to include five consecutive years of balance sheets, income statements, statements of cash flows and segment disclosures. This information is to be <u>manually</u> entered in your spreadsheet for analysis. See my example for Kimberly-Clark in the Course Packet.

Next, you are to program the spreadsheet so that it generates (a) common size balance sheets for five years; (b) common size income statements for five years; (c) trend or base year income statements for five years; (d) trend balance sheets for five years; (e) trend statements of cash flows for five years (It is OK to combine some of the immaterial items or insignificant details from the CFFO); (f) year-to-year percentage change balance sheets, income statements. and statements of cash flow for five years; (g) three-year analysis of industry and geographic segments as performed in (a)-(f) above; and (h) several key financial ratios. You may wish to use my analysis of Kimberly-Clark included among the materials in the Course Packet as a general guide.

Part II.

You may call upon any publicly available information relevant to the following tasks at hand. First, you are to use the results from Part 1, especially the most recent three

(3) years' financial data (e.g., balance sheets, income statements, and statements of cash flows and perhaps segment and geographical disclosures) to prepare *pro forma* financial statements for the next two (2) years. These three spreadsheets should now have data for the three most recent years plus *pro forma* data for the next two years. Examine the resulting 5-year trends for reasonableness. My course packet and Chapter 10 of the textbook describe a few helpful approaches for developing *pro forma* financial data. Next, you should use a few different valuation methodologies to estimate your firm's stock price at the end of the second year of the *pro forma* time frame. Using this estimate, you are to predict the percentage return an investor would experience by buying your company's stock soon after the last "historical financials" are published and selling two years later at your estimated price.

The report should include a title page, a detailed table of contents that shows what is to follow, an executive summary not to exceed five pages (double-spaced), plus several appendices. You should start the executive summary with a strong introduction that explains the purposes of the report. You should then identify the company, its industry, its major products, and its key competitors. Review past and expected relevant economic, political and social events during the 5-year period. Next, discuss only major findings from your analysis of the company's financial data and provide probable explanations and insights. Carefully note significant trends and patterns of the key variables. The executive summary is then concluded with a clear summary of the risks and expected rewards (percentage returns) from owning your company's stock for the pro forma two years, (i.e., buying the stock on the last trading day of the month in which the last annual historical earnings were reported in The Wall Street Journal and holding the stock until the end of the two-year *pro forma* period). The trailing appendices should include a list of the <u>major</u> assumptions used in the development of the *pro forma* data, and the stock price projections as well as all of the financial reports you prepared and studied. Be sure to include a brief summary of the firm's major accounting policies and show clearly how you estimated your firm's stock price. The appendices should end with a detailed, complete bibliography.

Good luck and have fun with this real-world learning experience!

Cohort 1

Session	Date	Day	Topics	Course Packet	Text
1	January 4	Friday	Introduction; Review of Financial Accounting and Reporting; Strategy (Text pp. 1-23)	Review Ch. 1, 2, 3, and Appendix 1	Accrual Acctg and Income (pp. 1-139); P2-14
2	January 12	Saturday (PM)	Cash Flows; Analytical Model of ROA and ROE	Review Ch. 4, 5, 6,7 and 8	Chapters 3 and 4. P3-25 (Year 8 only); Case 3.3
3	January 26	Saturday (PM)	Adjusting Reported Data; Preparing Pro Forma Statements	Appendices B, C, D, E and F	Chapter 10
4	February 8	Friday	Various Risk, Valuation and Market Theories/Evidence	pp. 332-376	Chapters 12 and 14
5	February 23	Saturday (PM)	Examination		
Cohort 2	_				
Session	Date	Day	Topics	Course Packet	Text
1	January 5	Saturday (PM)	Introduction; Review of Financial Accounting and Reporting	Review Ch. 1, 2, 3, and Appendix 1	Accrual Acctg and Income (pp. 1-139); P2-14.
2	January 11	Friday	Cash Flows; Analytical Model of ROA and ROE	Review Ch. 4, 5,6,7 and 8	Chapters 3 and 4. P3-25 (Year 8 only); Case 3.3
3	January 25	Friday	Adjusting Reported Data; Preparing Pro Forma Statements	Appendices B, C, D, E and F	Chapter 10
4	February 9	Saturday (PM)	Valuation and Market Theories/Evidence	pp. 332-376	Chapters 12 and 14

5 February 23 Saturday Examination (AM)