

Accounting 380K.7 – Spring 2014 (IDs: 02800 and 02805)

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| | Financial Statement Analysis¹ |
| Professor | Dr. Patrick Badolato, CPA |
| Office Hours | 4M.252. To be determined. |
| Phone | (512) 471-7920 |
| E-Mail | patrick.badolato@mcombs.utexas.edu (best method) |
| Course Time/Location | M W: 11:00-12:30; 12:30 to 2:00 |
| Teaching Assistants | Shelby Henderson; Rishnie Richards |
| Office Hours | To be determined. |

Our objectives include:

- Increase our understanding of financial filings (including financial statements, managers' commentaries, footnotes and other sources of financial information) in order to:
 - Understand how firms operate and create value
 - Concisely articulate the firm's past—*tell the story of the firm*
 - Increase our understanding and ability to use tools to analyze information presented in financial statements
 - Understand the benefits and limitations of financial information provided in financial filings and the motivation for and process of making adjustments to this information
 - Use our understanding of the firm and its financials to make informed predictions about future performance
 - Motivate, understand, construct and implement various inputs in valuation models

We will review (and learn) accounting concepts as this knowledge is critical to making decisions with financial information. However, the primary objective of the course is *not to improve our understanding of Generally Accepted Accounting Principles (GAAP)*; the goal is to improve our ability to interpret and use financial statements in a variety of settings including a primary focus on credit and equity analyses and supplemental coverage of corporate finance, planning and control.

A few notes:

Historically this has been a very challenging class that requires a commitment. *This is also a class that actively shuns memorization of terms and formulas and the regurgitation of anything.* Memorization and regurgitation is not learning, is not useful, and has no place in higher education. We will not waste your time (and your educational investment) with memorizing, and we will focus on more useful ways of approaching various issues. Therefore, you may hear many “Yes, but...” questions from me: “Yes, but *in your own words.*” “Yes, but *why?*” “Yes, that is the general economic argument, but *how has it played out in this scenario?*” “Yes, that is the change, but *what drove that change?*” “Yes, but what should we *focus on* for forecasting in this expected scenario?”

¹ This syllabus is a pre-semester draft and may be revised up through the first day of class.

In addition:

1. By financial statements, we mean “information provided in financial filings and other publicly available sources,” which involves more than the Balance Sheet, Income Statement and Statement of Cash Flows.
2. This course is not a review of financial accounting. It is expected that you have mastered the material covered during your intro to financial accounting class.
 - a. This class will consistently build off of and *apply* this knowledge
3. This course is not a valuation class. It is a course that helps you use financial information *to better understand the main inputs to valuation models*. This course enables you to move away from an over-reliance or fixation on valuation inputs provided by firms or other analysts and move towards understanding and constructing firm-specific inputs. ... Besides, once we have a solid set of inputs, valuation is simply division and addition.
4. This course does not cover technical analysis (analyzing fluctuations in stock prices). If you want to master technical analysis, we recommend that you consider an advanced degree in math and psychology-intensive fields in addition to your business studies.

Materials

- **Required text:** The textbook for the course is *Financial Reporting, Financial Statement Analysis and Valuation: A Strategic Perspective* by Wahlen, Baginski and Bradshaw, **seventh edition**.
 - The text provides **our background reading**, so while you need consistent and reliable access to the text and the cases, *you can share the textbook with another student if you are able to work out a plan that ensures sufficient access*. Also, I have a few copies for you to access in the two hour reserve at the PCL.
 - Suggested Text: *Accounting for Value* by Stephen Penman
 - Excerpts are provided on Blackboard. Anyone who is planning to pursue a career in finance is strongly encouraged to obtain this book.
- Throughout the course we will be examining publicly available material including corporate press releases, corporate filings (10K's, etc.), analyst reports and articles from the business press. When appropriate, these and other supplemental information (or links to these documents) will be provided via Blackboard. You will be responsible for downloading and printing these articles.
- ***This semester Hoot.me will take the place of our Blackboard Discussion Board and access to Hoot.me is essential to our class.***

Course Structure

The class format involves coverage of the main areas and tools noted below. In addition, there will be a considerable amount of discussions/cases that focus on specific firms and specific financial issues. These cases will involve a careful analysis of the financials, the opportunity to dig deeper to support (or challenge) information that is presented, and the consideration of the benefits and limitations of various tools, metrics and ratios.

During the semester we will learn a framework for business analysis and valuation. The steps in the framework include:

- (1) **Business Strategy Analysis:** The purpose of business strategy analysis is to assess the profit potential of the firm at a qualitative level. This involves an understanding of the firm's strategy and its industry and considering how these affect and are affected by the firm's financial performance.
- (2) **Accounting Analysis:** The purpose of accounting analysis is to develop an understanding of whether a firm's accounting captures its true underlying economic condition(s). This involves understanding accounting transactions, identifying accounting flexibility, evaluating the appropriateness of accounting policies and estimates, and at times, altering financial statements to enhance decision making.
- (3) **Financial Analysis:** The purpose of financial analysis is to assess the firm's historical financial performance in the context of its stated goals and strategies. Tools used for financial analysis include ratio analysis, cash flow analysis, and common size financial statements.
- (4) **Valuation/Prospective Analysis:** The purpose of valuation/prospective analysis is to forecast the firm's future financial performance and valuation. To do this we will learn the mechanics and intricacies of forecasting financial statements and we will cover the components and usage of valuation models.
 - The course will be taught using a combination of examples, discussion questions, cases and homework problems. We will learn new concepts using various firms' historical and current financial data.
 - A tentative schedule of class meetings is attached to the end of this document. This schedule may be revised.

Course Requirements and Grading

Your grade in the course will be determined as a combination of assignments as follows:

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|----------------------------|-------------|
| Individual Cases | 55% |
| Class Participation | 10% |
| Group Project | 35% |
| Total | 100% |

Description of Requirements

Group Course Project (35%)

Each student will be part of a small team that is responsible for conducting an analysis of a public company. These teams can be between three and five students and must involve an individual who can be considered an expert in financial accounting. Each team will choose two competing firms and conduct an analysis of them for the midterm project. After this, the teams will choose one of these firms and write a brief report and make a short “stock pitch” presentation to convince the class what investment they would advise for this particular company (and why). Part of this assignment will involve the assessment of another firm’s presentation. More details about course project will be posted to Blackboard in the Assignments section during the semester.

Individual Cases and Assignments (55%)

The primary objective of the Case and Assignments is to help you review the class material *before* attending class; many of these constitute the reading for the course as well.² You should assume that all cases are due by 11:00 am the day of the class, which is before the start of each class—any exceptions to this will be explicitly noted.

There is a set amount of scheduled assignments in total; you are required to submit ALL of the cases or assignments labeled as CORE. However, as I know things come up and prevent you from doing everything on time, students only turn in a total of 13 of the 17 non-core cases and assignments. To get credit, Cases must be turned in by their due dates and times.

This lenient policy is designed to incorporate all valid and unavoidable reasons for missing any of the required work (for example, students whose textbooks and computers are stolen and whose hotels' internet completely stops working while they are busy saving a litter of puppies from a nearby fire when they are out of town on an interview, which was a once-in-a-lifetime opportunity and had to occur the night before the case is due) as well as those reasons, which are less valid, such as missing a name, missing a deadline or turning in an incomplete version.

All assignments should be submitted electronically through Blackboard using a program that is compatible with Microsoft Office or Adobe.

Some of the questions on the cases and assignments are graded based on effort, while most of the others are graded on the correct completion of the assignment. These are not disclosed beforehand and students should work for complete, correct and concise answers. Many questions offer more than one right answer and students can receive a top score without having answers that are exactly the same as the class discussion. Please note: for most questions you will not get a perfect score if you simply filled out the page with some words, but not much thought.

² Recently I attended a seminar and have read many articles which call this approach a “Flipped Classroom.” These noted that a flipped classroom was the new way of approaching education. I have not been in the profession that long, but my initial thought was that this is just a new way to market common-sense, student-focused education that deemphasizes memorization and regurgitation.

Format and length for case and assignment write-ups:

- a. Cases should be written as memos that are written concisely and in a proper memo format (as if you are writing a memo to professional colleagues). Proper memo format is NOT simply listing question numbers and responding (i.e., a memo should be a stand-alone document that can be understood without having to refer back to the questions). No cover page is needed.
- b. Memos must reference any attached exhibits that are used to resolve case issues. Exhibits are not always needed and can include computations or any other analyses that are required in the case assignment and/or that you believe are needed to support arguments advanced in your memo. Exhibits do not count toward the memo's maximum page length.
- c. Memos must include your name and section number at the top of each page (in a header), and page numbers at the bottom (in a footer).
- d. The length of the content portion of memos (excluding exhibits) will be two pages unless otherwise noted and must also be typed, double spaced, with 12 point Times New Roman font and a minimum of 1" margins for the text of the memo.
- e. Cases and assignments that involve Excel submissions will be explicitly noted and guidance and/or Excel worksheets will be provided for these.

Class participation (10%)

Much of class is conducted in a discussion setting. We will not spend much time going over basic computations or mechanics, rather we will analyze specific firms and discuss which metrics are important, the reasons for our approach, and the implications of our choices. The assignments are geared to prepare you to participate in and learn from these discussions. Accordingly, your completion of the assignments and your participation in our discussions are vital. At times, I will only be a facilitator of your discussions with each other. After each class, I will make class participation notes, with particular attention to the quality of comments *or questions*, not the quantity. You do not need to always be correct to participate: insightful questions are also important and I encourage students to answer, even when they are unsure—this is a great way to learn.

I expect you to treat this class as you would a professional responsibility. Accounting at McCombs has consistently been ranked as the #1 program in the country, and the professionalism of our graduates is a big part of that. You therefore owe it to yourself, your professors, your fellow students, and past and future McCombs graduates to behave professionally, both inside and outside of the classroom.

Active participation in class and group work is a key element of professionalism. Accordingly, I will assess your participation in class discussion. Some characteristics of effective class participation include:

- Are the points that are made substantive and relevant to the discussion in terms of increasing everyone's understanding, or are they merely regurgitation of facts? Do the comments provide useful insights?
- Do the comments take into consideration the ideas offered by others earlier in the class, or are the points isolated and disjointed? The best contributions tend to be those that reflect not only excellent preparation but also good listening, interpretative and integrative skills.
- Do the comments show evidence of a thorough reading and analysis of the required readings/cases and of prior class information?
- Does the person distinguish among different kinds of data (facts vs. opinions vs. assumptions) and provide reasonable substantiation of arguments?
- Do the comments take the discussion into a new and relevant direction, without disrupting the current flow of the discussion?
- Is there a willingness to test new ideas or share uncertainties, or are all comments "cautious" or "safe" (sharing uncertainties about an issue can be valuable and can in fact lead the discussion in interesting directions)?
- Is the person willing to interact with classmates by asking questions or challenging conclusions in a courteous manner?

You are not required to contribute to each and every class session. You *are* required to make good contributions in multiple class sessions in order to earn a B for your class participation grade; you'll need to make good contributions consistently over the semester in order to earn an A. Some of the best contributors in the past have been those who participated in only some sessions, but their contributions were truly insightful and persuasive --- the issue is one of quality, not quantity.

Since so much of the learning in this class takes place through discussion and debate, attendance is necessary to your success --- it's impossible either to contribute or to benefit from others if you're not in class. However, perfect but passive attendance is not sufficient for your success and it will not ensure you achieve passing grade for your participation grade. In short, don't confuse participation with attendance.

Here's a general idea of how I plan to grade your class participation over the course of the semester:

- **Outstanding Contributor (A±):** Contributions to large-group discussions reflect thorough preparation. Ideas offered are usually substantive, provide good insights and sometimes change the direction of the class for the better. Arguments, when presented, are generally well-substantiated and often persuasive. If this person were not a member of the class, the quality of the large-group discussions would be diminished significantly. In addition to exceptional large-group discussion contributions, also actively participates in small-group discussions.
- **Good Contributor (B±):** Contributions to large-group discussions reflect satisfactory preparation. Ideas offered are usually substantive, generally provide useful insights, and occasionally offer a new direction for the discussion. Arguments, if presented, are reasonably well-substantiated. If this person were not a member of the class, the quality of the large-group discussions would be diminished. In addition, also offers comments in small-group discussions.
- **Marginal Contributor (C±):** Contributions to large-group discussions reflect some minimal preparation. Ideas offered are occasionally substantive but seldom provide clear insights or new directions for the discussion. Arguments may be occasionally presented but are generally not well-substantiated. If this person were not a member of the class, the quality of the large-group discussions would be diminished only slightly. This grade is warranted for those who participate only in small-group activities with no large-group contributions.
- **Non-participant (D):** This person has maintained attendance to some extent but has said little or nothing in class; hence there is no adequate basis for evaluation. If this person were not a member of the class, the quality of the discussions would be unchanged.
- **Disruptive Contributor (F):** If present in class at all, contributions to discussions reflect inadequate preparation. Ideas offered are rarely substantive, provide few, if any, insights and never offer a constructive direction. At best, contributions are obscure, confused, and indicate a lack of familiarity with the fact of the issues under discussion. At worst, comments demonstrate disrespect for others. If this person were not a member of class, valuable airtime would be saved. *I hope no one achieves this grade as this represents a major lack of professionalism and respect for our University.*

The Classroom is a Boardroom

I ask that you observe the MBA Program's "the classroom is a boardroom" protocol:

1. Arrive on time and post your name card (at least until I learn your names)
2. Be prepared (to discuss the case, summarize the readings, etc...)
3. Listen respectfully
4. Build on previous points
5. Direct comments to your classmates
6. State your assumptions
7. Speak concisely
8. Articulate your argument systematically
9. Give evidence to support your claims
10. Participate wholeheartedly
11. **No cell phones or laptops. No texting. Ever.**

Our class will also make use of Discussion Board on Hoot.me in place of Blackboard. This is the forum for outside-of-class questions related to assignments, our class coverage and any related current events. Your Discussion Board involvement can help enhance your class participation grade.

Grading Distribution

The following target grade distribution is a general approximation of the possible grades in our class: A (4.0) 25%; A- (3.67) 20%; B+ (3.33) 15%; B (3.0) 35%; B- or below (2.67) 5%. The spirit of this distribution is that it yields a target GPA of 3.42 in each class. A grade of a C- or lower is a failing grade. Cheating is the easiest way to fail the class and any instance will be reported through the appropriate channels. Historically students who choose to not work to their potential self select out of the higher grades.

At the end, and only at the end, of the semester, grades are determined by summing up all pieces, then ranking all students and then following the class distribution. Some areas of the distribution may be very tight. This means that it is mathematically unavoidable that some students with *similar* grades do not get the *exact same* final letter grades. Ultimately, someone must fall at each “break point” that means that someone gets the lowest of one grade (for example, the lowest A-) and someone else, with similar grades, gets the highest of the next letter grade (for example, the highest B+). The class’s historical distribution dictates the percentage of each of the letter grades.

Academic Integrity

Don't cheat as (1) it is wrong; (2) the costs far outweigh the benefits: you don't want to get kicked out in a short-sighted attempt to make a B a B+; and (3) there is a very good chance that your cheating will be revealed and we will all be extremely disappointed.

Policy on Scholastic Dishonesty

The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the BBA Program’s Statement on Scholastic Dishonesty at <http://www.mcombs.utexas.edu/BBA/Code-of-Ethics.aspx>. By teaching this course, I have agreed to observe all faculty responsibilities described in that document. By enrolling in this class, you have agreed to observe all student responsibilities described in that document. If the application of the Statement on Scholastic Dishonesty to this class or its assignments is unclear in any way, it is your responsibility to ask me for clarification. Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Since dishonesty harms the individual, all students, the integrity of the University, and the value of our academic brand, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> to access the official University policies and procedures on scholastic dishonesty as well as further elaboration on what constitutes scholastic dishonesty.

Additional Important Notifications

Students with Disabilities

Students with disabilities may request appropriate academic accommodations from the Division of Diversity and Community Engagement, Services for Students with Disabilities, 512-471-6259, <http://www.utexas.edu/diversity/ddce/ssd/>.

Religious Holy Days

By UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious holy day. If you must miss a class, an examination, a work assignment, or a project in order to observe a religious holy day, you will be given an opportunity to complete the missed work within a reasonable time after the absence.

Campus Safety

Please note the following recommendations regarding emergency evacuation from the Office of Campus Safety and Security, 512-471-5767, <http://www.utexas.edu/safety>:

- Occupants of buildings on The University of Texas at Austin campus are required to evacuate buildings when a fire alarm is activated. Alarm activation or announcement requires exiting and assembling outside.
- Familiarize yourself with all exit doors of each classroom and building you may occupy. Remember that the nearest exit door may not be the one you used when entering the building.
- Students requiring assistance in evacuation should inform the instructor in writing during the first week of class.
- In the event of an evacuation, follow the instruction of faculty or class instructors.
- Do not re-enter a building unless given instructions by the following: Austin Fire Department, The University of Texas at Austin Police Department, or Fire Prevention Services office.
- Behavior Concerns Advice Line (BCAL): 512-232-5050
- Further information regarding emergency evacuation routes and emergency procedures can be found at: <http://www.utexas.edu/emergency>.

| Class # | Day | Month | Date | Coverage | Assignment |
|---|-----------|-------|------|---|--|
| 1 | Monday | Jan | 13 | Intro to FSA | Survey (BB) |
| 2 | Wednesday | Jan | 15 | Financial Accounting Review | Acme Packets (BB) |
| | Monday | Jan | 20 | No Class: MLK Holiday. | |
| 3 | Wednesday | Jan | 22 | Business Strategy Analysis | Mystery Firm (BB) |
| 4 | Monday | Jan | 27 | Intro to Accounting Analysis (AA) | Accounting Flexibility with Apple (BB) |
| 5 | Wednesday | Jan | 29 | Intro to Valuation | CORE: Coke Valuation Case (CP) |
| | Friday | Jan | 31 | No Class: Firm and Group Choices | Due: 5:00 PM CST |
| 6 | Monday | Feb | 3 | Financial Analysis: Ratios, IS and BS | WFM Income Statement Analysis (BB) |
| 7 | Wednesday | Feb | 5 | Financial Analysis: Ratios, IS and BS | WFM Balance Sheet Analysis (BB) |
| 8 | Monday | Feb | 10 | Financial Analysis: Ratios and Cash Flows | WFM Cash Flows Analysis (BB) |
| 9 | Wednesday | Feb | 12 | Financial Analysis: Ratios and Cash Flows | Groupon and Free Cash Flows (BB) |
| 10 | Monday | Feb | 17 | AA: Revenue Recognition | Groupon and Revenue Recognition (BB) |
| 11 | Wednesday | Feb | 19 | AA: Expenses and Margins | Expenses and Margins (BB) |
| 12 | Monday | Feb | 24 | AA: Income Taxes | Citigroup and Deferred Taxes (CP) |
| 13 | Wednesday | Feb | 26 | AA: Derivatives | Starbucks and Hedges (BB) |
| 14 | Thursday | Feb | 27 | AA: Fair Value | SIPEF and Fair Value (CP) |
| 15 | Monday | March | 3 | AA: Accounting Quality and Catch Up | |
| 16 | Wednesday | March | 5 | No Class: Group Project Midterm | Due: 5:00 PM CST |
| | Monday | March | 10 | Spring Break (FSA focus optional) | |
| | Wednesday | March | 12 | Spring Break (FSA focus optional) | |
| 17 | Monday | March | 17 | AA: R&D and Asset Capitalization | R&D and Dendreon (BB) |
| 18 | Wednesday | March | 19 | AA: Leases and Off Balance Sheet Analysis | Lease Case (BB) |
| 19 | Monday | March | 24 | AA: Fixed Assets and Capital Expenditures | |
| 20 | Wednesday | March | 26 | AA: Working Capital and Liquidity | Apple and Working Capital (BB) |
| 21 | Monday | March | 31 | AA: Financing and Financial Arrangements | Financing at Starbucks (BB) |
| 22 | Wednesday | April | 2 | AA: Wrap Up | |
| 23 | Monday | April | 7 | Intro to Forecasting | |
| 24 | Wednesday | April | 9 | Forecasting Continued | CORE: Forecasting Case |
| 25 | Monday | April | 14 | Valuation | |
| 26 | Wednesday | April | 16 | Valuation Continued | CORE: Valuation Case |
| 27 | Monday | April | 21 | Course Wrap Up/Final Projects | |
| 28 | Wednesday | April | 23 | Final Project Presentations | |
| 29 | Monday | April | 28 | Final Project Presentations | |
| 30 | Wednesday | April | 30 | Final Project Presentations | |
| | Wednesday | May | 7 | Written Final Projects (all groups) | Due: 5:00 PM CST |
| <p>All Assignments and Cases are due 11:00 am the day of class unless otherwise noted. BB = Case will be accessible on Blackboard under the Assignment's Tab. CP = Case will be accessible in the Course Packet. CORE = Case is required for all students. Students only need to turn in 14 of the 17 non-core cases.</p> | | | | | |