Accounting 381N – Spring 2015

Financial Statement Analysis (FSA)

Professor: Dr. Patrick Badolato, CPA
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Our objectives include:

- Increase our understanding of financial filings (including financial statements, manager’s commentaries, footnotes and other sources of financial information) in order to:
  - Broaden our understanding how firms operate and create value
  - Increase our understanding and ability to use tools to analyze information presented in financial statements
  - Concisely articulate the firm’s financial past—tell the story of the firm
  - Use our understanding of the firm and its financials to make informed predictions about future performance
  - Motivate, understand, construct and implement various inputs to and outputs from 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 ability to apply Generally Accepted Accounting Principles (GAAP); the goal is to improve our ability to interpret and use financial statements.

Materials

- **Required text:** The textbook for the course is excerpts from *Financial Reporting, Financial Statement Analysis and Valuation: A Strategic Perspective* by Wahlen, Baginski and Bradshaw, eight edition. This is provided for you by the program in a manner that the program has chosen.
- Class Materials: Will be accessible on Canvas associated with each class.
- Throughout the course we will be examining publicly available material including corporate press releases, corporate filings (10K’s, etc.) and articles from the business press. When appropriate, these and other supplemental information (or links to these documents) will be provided via Canvas. You will be responsible for downloading and printing these articles. *Canvas and internet access are essential to this class.*

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1 The class and case schedule and specific class-by-class coverage may change.
Course Structure

- Financial Statement Analysis is a part of the framework for fundamental 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 understanding the firm’s strategy and its industry and considering how these affect and are affected by the firm’s financial performance. Given the knowledge of the class, the coverage of this topic will be brief. However, throughout the class we will discuss the financial implications and expectations given a firm’s strategy.
  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. The goal of this is not to change the accounting, but to change how we use financial information, especially in comparisons and 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 strategy. The steps and tools used for financial analysis include ratio analysis, cash flow analysis, and the use of common size financial statements and other metrics. This process may also involve altering financial statements and developing thoughtful financial comparables (“comps”).
  4. Forecasting and Valuation: The purpose of forecasting is to use our knowledge of the firm to develop well-founded motivations of the firm’s expected financial performance. These forecasts can be used for a variety of business decisions, including budgeting and valuation. To do this we will learn the mechanics and intricacies of forecasting financial statements and we will (very briefly) 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 explore the concepts using various firms’ historical and current financial data.
- A tentative schedule for each class is attached to the end of this document. This schedule may be revised.

Course Requirements and Grading

Your grade in the FSA portion of the course will be determined as follows:

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<tbody>
<tr>
<td><strong>Exam</strong></td>
<td>50%</td>
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<tr>
<td><strong>Cases</strong></td>
<td>40%</td>
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<tr>
<td><strong>Class Participation</strong></td>
<td>10%</td>
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<tr>
<td><strong>Total</strong></td>
<td>100%</td>
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Description of Requirements

Exams

There will be one exam worth 50% of your grade. It will be held on April 25, 2015. This is a cumulative exam covering the main ideas covered in all of the FSA classes. The exam will involve the lessons from class applied to a set of financial information from one or a small number of publicly traded firms. A sample exam will be provided during the semester, but this is not an exam worth “cramming” for. You can study by preparing for and actively attending class and then relaxing the week before the exam. Class is essential; cramming is only a waste of your time. You should not ask me how to prepare for the exam with a week or so remaining. Please notify me immediately if you have a conflict with the exam date. All notifications of exam conflicts must be received at the start of the FSA portion of the class.

Class Participation

Class participation is entirely about quality. Quality is defined as relevant comments, insights, answers or questions that add value to the discussion during the class or on the Discussion Board. In addition, quality trumps quantity. For example a student, who only offers a handful of extremely insightful and relevant comments over the entire semester, would absolutely outperform a student who offers numerous redundant, irrelevant or distracting comments each class. Class attendance is required and is critical, but class participation is more than passive attendance.

Cases

The primary objective of the Cases is to help you review the material before attending class. The fancy term for this is the “flipped classroom” but this is simply old-fashioned education (from your rather old-school professor) that helps ensure you can master the material by taking ownership before class. All Cases are due before the start of each class. These Cases will be posted on Canvas.

*There are 4 Cases required by all students. In addition, Case #0 is optional. Students who choose to complete this case will have their Case grades allocated over 5 Cases (if Case #0 is higher than their average). Students who do not choose to complete this Case, or those whose Case #0 is lower than their average on Cases #1-#4, will have their homework grades allocated over 4 Cases. Completing Case 0 may not improve your grade, but it cannot bring it down.

You are required to submit ALL of Cases #1 through #4. As we discuss them in class, Cases cannot be submitted late under any circumstances. Cases must be submitted on Canvas in the respective link. You can work in a group of two to three students on all of the Cases. If you work in a group you may only submit one assignment, so at times, you may need to choose the best answer in your group. The goal of groups is to enable you to actively share ideas but still be involved. There is a cap to group sizes as large groups remove the benefit from working through the material. Whether you are flying solo, or working in a group of two or of three, ALL students’ names must be on the final submission. If a name is missing, no one gets credit. While no one can prevent you from casually discussing the cases with others outside of your group, directly sharing files or copying answers (including copied answers with minor edits) across groups, will not be accepted and constitute a violation of the policies of our University. This will, at the minimum, lead to a grade 0 out of 40 total percentage points of the total Case grade.
Policies of OUR University

McCombs Classroom Professionalism Policy
The University of Texas and the McCombs School of Business are incredible places to learn; let’s not take this opportunity for granted. Students are expected to be professional in all respects. If the expectation and importance of professionalism is not abundantly clear, please let me know immediately.

Academic Dishonesty
The McCombs School of Business has no tolerance for acts of scholastic dishonesty. 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. Because dishonesty harms the individual, all students, and the integrity of the University, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at http://deanofstudents.utexas.edu/sjs/ or the General Information Catalog to access the official University policies and procedures on scholastic dishonesty. If the application of that Policy Statement to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification.

Students with Disabilities
Upon request, the University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. Services for Students with Disabilities (SSD) is housed in the Office of the Dean of Students, located on the fourth floor of the Student Services Building. Information on how to register, downloadable forms, including guidelines for documentation, accommodation request letters, and releases of information are available online at http://deanofstudents.utexas.edu/sss/index.php. Please do not hesitate to contact SSD at (512) 471-6259, VP: (512) 232-2937 or via e-mail if you have any questions.

Class Web Sites and Student Privacy
Password-protected class sites will be available for all accredited courses taught at The University. Syllabi, handouts, assignments and other resources are types of information that may be available within these sites. Site activities could include exchanging e-mail, engaging in class discussions and chats, and exchanging files. In addition, class e-mail rosters will be a component of the sites. Students who do not want their names included in these electronic class rosters must restrict their directory information by notifying the Office of the Registrar in the Main Building, Room 1. For information on restricting directory information see: http://www.utexas.edu/student/registrar/catalogs/gi02-03/app/appe09.html.
### Tentative Schedule of FSA Classes (as of 1/10/15)*

*Schedule may be amended.

**Case and class details are provided on Canvas.**

Cases are due before the start of all classes the weekend they are assigned unless otherwise noted.

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<th>Date</th>
<th>Topic</th>
<th>Homework</th>
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| 1st Class  | This class introduces our class—Financial Statement Analysis (FSA). During this class we will discuss how companies’ strategies and industry conditions are reflected in financial statements and discuss the information environment in which firms operate. We will begin analyzing firms by examining policies to recognize revenue and the resulting implications.  
- The Acme Packets Case is designed to review some of the main aspects from Financial Accounting. We will not cover this in class, but you can post comments to our Discussion Board.  
- The Intro to Analyzing Firms Case is designed to start our exposure to FSA and we will build off of this in class. | Case #0: Acme Packets Case  
Case #1: Intro to Analyzing Firms:  
Both are due: Jan 9th at 4 pm. |
| Mar 6-7    |                                                                      |                                                                          |
| 2nd Class  | During this class we will expand our analysis by focusing on a few specific topics that are a part of our Accounting Analysis. These include examining expenses, operating assets and liabilities, investments, risk mitigation and other areas critical to operating our firms. | Case #2  
Starbucks and Groupon  
Due: Jan 23rd at 4 pm.  
Case #3 WFM:  
Income Statement Balance Sheet Assignment  
Due: Jan 30th at 4 pm. |
| Mar 20-21  |                                                                      |                                                                          |
| 3rd Class  | During this class we will discuss and use various financial tools to examine Whole Foods Market between 2006 and 2014. The analysis of Whole Foods Markets will involve ratio and profitability analysis including the DuPont Analysis and the decomposition of these measures. We will carefully consider various ratios and tools and how they can help us understand the main drivers of firm performance. | Case #4 WFM:  
Statement of Cash Flows Assignment  
Due: Feb 13th at 4 pm. |
| March 27-28|                                                                      |                                                                          |
| 4th Class  | During this class we will expand our analysis by focusing on the construction and assessment of the Statement of Cash Flows. We will dig into the specific inflows and outflows of cash to fully assess firms’ choices and the implications of these choices. To continue our analysis, we will focus on additional turnovers, working capital measures and measures of liquidity. | Study and review materials |
| April 11   |                                                                      |                                                                          |
| 5th Class  | Exam: Our exam will involve qualitative and quantitative questions based on the actual financial statements of a firm not extensively discussed during class. Please note: this is not an exam that you should “cram” for (I hope none of your MBA exams are). Studying is done by working on the cases and actively attending class, for a new company. The questions will be similar to what we do in class. Think of the exam like a playoff game: the preparation is what you do week by week; the night before the best you can do is get a good night’s sleep (and take some PED—kidding). | Study and review materials |
| April 25   |                                                                      |                                                                          |