



# Rotman Commerce UNIVERSITY OF TORONTO

## Course Outline

### **RSM 429H1 F**

Financial Statement Analysis and Valuation

Fall 2016

Course Meets: Tuesday, 1-3 & 3-5 – AH 107

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## Course Scope and Mission

This course will help you value businesses using financial statements. We will discuss how accounting regulations and managerial discretion influence presented financial statements. You will understand how to interpret financial statements, analyze cash flows, make judgments about earnings quality and uncover hidden assets and liabilities. You will also be exposed to research from accounting and finance that focuses on financial statement analysis and valuation methods and techniques. Finally, we will use financial statement analysis prospectively to forecast and value firms using cash flow based and accounting based methods.

The course will consist of the following five modules. In the first module (strategic and industry analysis) you will learn why the critical first step is to understand industry structure and a company's strategic choices. The second module (accounting analysis) will provide you with a framework to understand and evaluate a firm's accounting and disclosure choices and learn how to adjust financial statements to ensure better comparability. The third module (financial analysis) will present a comprehensive framework for ratio analysis where a firm's operations are separated from its financing to better understand the true drivers of profitability and risk. The fourth module (prospective analysis) will expose you to techniques of integrated forecasting; where you will apply the insights from the earlier modules and apply them to truly understand what the future holds for the firm being analyzed. You will then use these forecasts to value firms using a variety of techniques including DCF, multiples and abnormal earnings based valuation methods. In the fifth module, you will apply the business valuation techniques in a variety of settings including credit analysis and M&A.

## Course Prerequisites

Prerequisite: RSM219H1, RSM222H1

## Required Readings

REQUIRED BOOK: Krishna G. Palepu, Paul M. Healy and Eric Peek, "Business Analysis and Valuation using Financial Statements: IFRS Edition. 4th Edition". There are many excellent cases in this book and we shall a number of them as examples. Therefore be careful when you buy this book: there are many versions – make sure you buy the IFRS, 4th edition. If you choose to buy the book online, please ensure you have the correct edition.

In addition, a lot of material will be AVAILABLE on course website: Presentations for class, Excel Spreadsheets, Links to Articles from Business Press, Additional readings. There will be no additional course packet as all material will be made available online.

## Evaluation and Grades

Grades are a measure of the performance of a student in individual courses. Each student shall be judged on the basis of how well he or she has command of the course materials.

<u>Work</u>		<u>Due Date</u>
5 Individual HW	25%	Due in Class
Class Participation	15%	Ongoing
Group Project	30%	Hand-in and group presentations in Week 12
Final Exam	30%	During Faculty of Arts & Science Final Examination period

## COURSE FORMAT AND EXPECTATIONS

### For Written Assignments:

Please note that clear, concise, and correct writing will be considered in the evaluation of HW assignments. That is, you may lose points for writing that impedes communication: poor organization, weak paragraph development, excessive wordiness, hard-to-follow sentence structure, spelling mistakes and grammatical errors. Students who require additional support and/or tutoring with respect to their writing skills are encouraged to visit the Academic Success Centre ([www.asc.utoronto.ca](http://www.asc.utoronto.ca)) or one of the College Writing Centres ([www.writing.utoronto.ca/writing-centres](http://www.writing.utoronto.ca/writing-centres)). These centres are teaching facilities – not editing services, where trained staff can assist students in developing their academic writing skills. There is no charge for the instruction and support.

### For Group Work:

Form Groups of either 4 OR 5. Choose a publicly traded firm that uses either IFRS or US (Canadian) GAAP. *You should avoid any regulated industries as well as firms in financial services as there will be added complications for these analyses.*

One of the group members should email me with the details of group members as well as the firm chosen. As only 1 group may choose a given firm, it will be first come first served. If someone else has taken the firm you wish to analyze, you will have to choose some other firm.

Upon selecting your firm, try and obtain the most recent financial statements. You could use the web as most firms have a lot of information usually under investor relations on their web sites, or the financials are available on the EDGAR database ([www.sec.gov](http://www.sec.gov)) or the SEDAR database ([www.sedar.com](http://www.sedar.com)). IR websites may have the statements in useful formats such as excel. Any other public information available on the firm can also be used. The reference librarians in the library may be able to direct you to sources of information on industries and particular firms. In addition, make use of the internet and Lexis/Nexis. Finally, you will also want to look at those financial statements of the firm's major competitors.

## Main Objective:

Your group should take the role of investment advisor to a group of investors. Your ultimate objective is to advise whether they should buy the stock of the company. Of course to arrive at your final conclusion you will need to address a number of issues, including but NOT limited to:

1. Analyze the industry in which the firm operates in. Do a 5 forces analysis for instance or use any other framework you feel comfortable with. (Maximum 5 pages)
2. Analyze the strategy of the firm and compare it with other firms in that industry. (Maximum 5 pages)
3. Do a Risk and Profitability analysis of the firm using past data. Carry out time series analysis as well as cross-sectional analysis by comparing the firm to other firms in the industry.
  - a. Make sure to do a ROE decomposition as well as a ROA breakdown.
  - b. Make adjustments for items such as restructuring, discontinued items etc, to get a better measure of continuing operations.
4. Do an Accounting Analysis. Analyze the firms accounting choices and compare with the others in the industry. Look for red flags. Also, analyze substantive accounting issues – such as leases, pensions, income taxes etc looking for accounting related problems.
5. Make assessments about what the future balance sheets, income statements and cash flow statements (forecasting).
6. Value the firm using the Abnormal Earnings Based Valuation. Also, value the firm using one other technique (DCF, Multiples – any other method you want to use)
7. Compare the valuation with actual stock price and try to provide plausible reasons for why the firm's actual stock price may be different from what you valued it at. Use this to make your recommendation.

Please remember that while this is an “integrative” course, greater weight will be placed on the accounting aspects. Use the industry and strategic analysis as a way to set the stage and don't focus too much attention on them. Similarly, greater weight will be placed on abnormal earnings based valuation than other methods.

## Group Project Dynamics

Learning to work together in teams is an important aspect of your education and preparation for your future careers. That said, project-based teamwork is often new to students; to work well in teams, it helps to follow a set of core expectations to best succeed at your team projects.

1. Read the document entitled, “Working in Teams: Guidelines for Rotman Commerce Students” which is available on the RC portal under the Academic Services tab.
2. When working in a team, Rotman Commerce students are expected to:
  - Treat other members with courtesy and respect;
  - Honour the ground rules established by the team;
  - Contribute substantially and proportionally to the final project;
  - Ensure enough familiarity with the entire contents of the group project/assignment so as to be able to sign off on it as original work;
  - Meet the project timeline as established by the team.
3. Resolving conflicts: Conflicts are part of the team's process of learning how to work together. When handled well, it can generate creativity and bring-multiple perspectives to the solution.

Student teams are expected to work through their misunderstandings as soon as they arise (and prior to submission of the final project). When teams are unable to arrive at a solution that works for all members, the team must meet with the Rotman Commerce Team Coach\*\* as soon as possible. The Coach will listen to the team and help develop options for improving the team process. All members of the project team must commit to, and, utilize their action plans.

\*\*For an appointment with a Rotman Commerce Team Coach, please contact Nouman Ashraf at [nouman.ashraf@rotman.utoronto.ca](mailto:nouman.ashraf@rotman.utoronto.ca) Nouman is highly skilled at facilitating team dynamics and collaboration. Note that the Team Coach's role is to provide guidance, support and advice on team matters – not to formally evaluate or assess teamwork for academic purposes.

### **Weekly Schedule**

In almost all cases, I plan to break up each session into two parts. After the first class, any material that needs to be discussed (in lecture format) will be covered in the second part. The case relevant to that topic will be covered in the first session of the next class, as the outline will indicate. Questions for the case will be either on the website or at the end of the case itself.

All presentations will be uploaded onto the course web-site at least 3 days prior to each class. In addition, all supplementary files will also be made available (excel spreadsheets etc). The 5 highlighted cases will also serve as the 5 graded HW submissions. All other cases are not required to be handed in, but it is expected that you are prepared and ready to participate

Session	Date	Topic	Cases to be discussed	Item location
1-A 1-B	Sep 13	Introduction Strategic Analysis	Identify the firms exercise	Course website
2-A 2-B	Sep 20	Strategic Analysis Case Accounting Analysis	Case Study: Part I	Course website
3-A 3-B	Sep 27	Accounting Analysis Case Accounting Adjustments	<b>Sunbeam (HW1)</b>	Course website
4-A 4-B	Oct 4	Accounting Adjustments Accounting Adjustments Exercises	Exercises from book (TBD)	Book
5-A 5-B	Oct 11	Accounting Adjustments Case Financial Analysis	<b>Marks and Spencer (HW2)</b>	Book
6-A 6-B	Oct 18	Financial Analysis Case Forecasting	Best Buy	Course website
7-A 7-B	Oct 25	Forecasting Case Valuation Theory	<b>Case Study: Part II (HW3)</b>	Course website
8-A 8-B	Nov 1	Valuation Theory Case Valuation Implementation	Valuation Ratios in Airline Industry	Book
9-A 9-B	Nov 15	Valuation Case Credit Analysis	<b>Case Study: Part III (HW4)</b>	Course website
10-A 10-B	Nov 22	Credit Analysis Case M&A	BBRY	Course website
11-A 11-B	Nov 29	M&A Case Wrap up	<b>Glencore/Xstrata (HW5)</b>	Book
12-A 12-B	Dec 6	Project presentations Project presentations		
Final Exam	TBA by FAS			

## **POLICY AND PROCEDURE**

### **Missed Tests and Assignments (including midterm examinations)**

Students who miss a test or assignment for reasons entirely beyond their control (e.g. illness) may submit a request for special consideration. Provided that notification and documentation are provided in a timely manner, and that the request is subsequently approved, no academic penalty will be applied.

In such cases, students must notify Rotman Commerce on the date of the missed test (or due date in the case of course work) and submit supporting documentation (e.g. [Verification of Student Illness or Injury form](#)) to the Rotman Commerce Program Office within **48 hours** of the originally scheduled test or due date. Students who do not provide Rotman Commerce or the instructor with appropriate or sufficient supporting documentation will be given a grade of 0 (zero) for the missed test or course deliverable.

**Note that the physician's report must establish that the patient was examined and diagnosed at the time of illness, not after the fact. Rotman Commerce will not accept a statement that merely confirms a report of illness made by the student and documented by the physician.**

If a student misses an assignment for a valid reason (personal or illness related), I will either provide a makeup assignment or rescale other assignments.

### **Late Assignments**

*All assignments are due at the beginning of class on the date specified in the course outline.* Late submissions will not be accepted. Students who, for reasons beyond their control, are unable to submit an assignment by its deadline must obtain approval from the instructor for an extension. Supporting documentation will be required as per the policy on missed tests and assignments.

### **Accessibility Needs**

The University of Toronto is committed to accessibility. If you require accommodations for a disability, or have any accessibility concerns about the course, the classroom or course materials, please contact Accessibility Services as soon as possible: [accessibility.services@utoronto.ca](mailto:accessibility.services@utoronto.ca) or <http://www.accessibility.utoronto.ca/>.

### **Academic Integrity**

Academic Integrity is a fundamental value essential to the pursuit of learning and scholarships at the University of Toronto. Participating honestly, respectfully, responsibly, and fairly in this academic community ensures that the UofT degree that you earn will continue to be valued and respected as a true signifier of a student's individual work and academic achievement. As a result, the University treats cases of academic misconduct very seriously.

*The University of Toronto's Code of Behaviour on Academic Matters*

<http://www.governingcouncil.utoronto.ca/policies/behaveac.htm> outlines the behaviours that constitute academic misconduct, the process for addressing academic offences, and the penalties that may be imposed. You are expected to be familiar with the contents of this document. Potential offences include, but are not limited to:

In papers and assignments:

- Using someone else's ideas or words without appropriate acknowledgement.

- Submitting your own work in more than one course without the permission of the instructor.
- Making up sources or facts.
- Obtaining or providing unauthorized assistance on any assignment (this includes collaborating with others on assignments that are supposed to be completed individually).

On test and exams:

- Using or possessing any unauthorized aid, including a cell phone.
- Looking at someone else's answers
- Misrepresenting your identity.
- Submitting an altered test for re-grading.

Misrepresentation:

- Falsifying institutional documents or grades.
- Falsifying or altering any documentation required by the University, including (but not limited to), medical notes.

All suspected cases of academic dishonesty will be investigated by the following procedures outlined in the *Code of Behaviour on Academic Matters*. If you have any question about what is or is not permitted in the course, please do not hesitate to contact the course instructor. If you have any questions about appropriate research and citation methods, you are expected to seek out additional information from the instructor or other UofT resources such as College Writing Centres or the Academic Success Centre.

### **Email**

At times, the course instructor may decide to communicate important course information by email. As such, all UofT students are required to have a valid UTmail+ email address. You are responsible for ensuring that your UTmail+ email address is set up AND properly entered on the ROSI system. For more information please visit <http://help.ic.utoronto.ca/category/3/utmail.html>

Forwarding your utoronto.ca email to a Hotmail, Gmail, Yahoo or other type of email account is not advisable. In some cases, messages from utoronto.ca addresses sent to Hotmail, Gmail or Yahoo accounts are filtered as junk mail, which means that important messages from your course instructor may end up in your spam or junk mail folder.

### **Blackboard and the Course Page**

The online course page for this course is accessed through Blackboard. To access the course page, go to the UofT Portal login at <https://portal.utoronto.ca/> and log in using your UTORid and password. Once you have logged in, look for the My Courses module where you'll find the link to all your course websites. If you don't see the course listed here but you are properly registered for the course in ROSI, wait 48 hours. If the course does not appear, go to the Information Commons Help Desk in Robarts Library, 1st floor, for help, or explore the Portal Information and Help at <http://www.portalinfo.utoronto.ca/content/information-students> and review the Frequently Asked Questions.

### **Recording Lectures**

Lectures and course materials prepared by the instructor are considered by the University to be an instructor's intellectual property covered by the Canadian Copyright Act. Students wishing to record a lecture or other course material in any way are required to ask the instructor's explicit permission, and may not do so unless permission is granted (note: students who have been previously granted permission to record lectures as an accommodation for a disability are, of course, excepted). This includes tape recording, filming, photographing PowerPoint slides, Blackboard materials, etc.

If permission is granted by the instructor (or via Accessibility Services), it is intended for the individual student's own study purposes and does not include permission to "publish" them in anyway. It is absolutely forbidden for a student to publish an instructor's notes to a website or sell them in any other form without formal permission.