



# Rotman Commerce UNIVERSITY OF TORONTO

## Course Outline

### **RSM 429H1 F**

Financial Statement Analysis and Valuation

Fall 2017

Course Meets: Tuesday, 1-3 & 3-5, Room OI 2-212 (OISE)

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Office Hours: TBD

## 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

I will make notes, slides, cases, examples, and extra reading available on the course website. There will be no additional course packet as all material will be made available online. You may use these as a supplement for a textbook.

Therefore, whilst there is no required book, the following is an excellent companion to the course: Krishna G. Palepu, Paul M. Healy and Eric Peek, "Business Analysis and Valuation using Financial Statements: IFRS Edition. 4th Edition". *NB If you intend to purchase this textbook then please be careful to get the right edition.*

## 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>
2 Group HW	25%	Due in Class
2 Individual HW	25%	Due in Class
Class Participation	15%	Ongoing
Final Examination	35%	During Faculty of Arts & Science Final Examination period

## Objective of the Assessed Written Assignments:

Each week we will learn new skills, techniques and models of financial statement analysis. The individual assessed written assignments will cover the four core components of the course and, in so doing, prepare you for the final examination. In each assignment you 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. Therefore, each part is necessarily inter-related. 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.
2. Analyze the strategy of the firm and compare it with other firms in that industry.
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 will look like (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.

## **Individual / Group Work:**

Please form groups of 4 or 5. You should choose a publicly traded firm that uses either IFRS or US GAAP. You should avoid any regulated industries as well as firms in financial services as there will be added complications for these analyses.

You should email me on or before **1PM on Friday 15<sup>th</sup> September** with the details of the firm chosen as well as names of group members.

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.

## **Unassessed Individual Assignments and Participation**

Everyone is expected to have read the material and to have prepared the assigned material (including all cases) for discussion, prior to class. On the rare occasion that you are unable to participate fully, please let me know in advance. Participants will be called upon for their views of the issues under discussion, and the class participation grade will be based upon the level of preparedness and the quality (not necessarily quantity) of comments offered. There are no penalties for "wrong" answers. It is the attempt to thoughtfully reason through a problem or to ask a pertinent question that is valued and adds to the classroom experience for everyone.

Therefore, you are expected to make every effort to attend every class. Accommodations for any absence that may impact your class participation or any other graded deliverable must be approved. Multiple absences may make it impossible for you achieve the stated learning outcomes for the course. Therefore, please contact the Instructor as soon as practical if you anticipate that you will miss a total of 25% of class time or more for any reason to have a conversation about whether the course learning outcomes can still be achieved.

Participation should not be confused with attendance. The participation mark will be given for the contribution made by the student in that class and not based on "air time". The University Of Toronto Code Of Conduct and the Rotman Code of Learning include the following statement about attendance:

"All students are expected to do their best to... make every effort to attend every class."

## **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.

## Weekly Schedule<sup>1</sup>

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). I have highlighted (in **bold**) 'what' and 'when' the work needs to be submitted for grading. 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
1-A 1-B	Sep 12	Introduction Strategic Analysis	In-class: Identify the firms exercise
2-A 2-B	Sep 19	Strategic Analysis Accounting Analysis and Financial Manipulation	Chipotle Mexican Grill (CMG) strategy analysis
3-A 3-B	Sep 26	Accounting Analysis Accounting Adjustments	CMG Manipulation Analysis <b>Group Homework 1 due date</b> <b>Case Study: Part I</b>
4-A 4-B	Oct 3	Accounting Analysis Accounting Adjustments	BA / Lufthansa PPE
5-A 5-B	Oct 10	Financial Analysis	Sunbeam Case
6-A 6-B	Oct 17	Financial Analysis Forecasting	In-class: Coke versus Pepsi <b>Group Homework 1 due date</b> <b>Case Study: Part II</b>
7-A 7-B	Oct 24	Forecasting Valuation Theory	CMG Forecasting
8-A 8-B	Oct 31	Valuation Theory Valuation Implementation	Indigo Forecasting <b>Individual Homework due date</b> <b>Case Study: Part III</b>
9-A 9-B	Nov 14	Valuation Implementation Valuation Implementation	CMG Valuation
10-A 10-B	Nov 21	Valuation Implementation Credit Analysis	Indigo Valuation
11-A 11-B	Nov 28	M&A	CMG Credit Analysis
12-A 12-B	Dec 5	M&A Case Wrap up	AB Inbev / SAB Miller <b>Individual Homework due date</b> <b>Case Study: Part IV</b>
Final Exam	TBA by FAS		

<sup>1</sup> NB This is a tentative schedule and is subject to change at my discretion.

## **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.

Documentation submitted in support of petitions for missing tests and assignments must be original; no faxed or scanned copies will be accepted.

**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 later report of illness made by the student to a physician.**

### **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.studentlife.utoronto.ca/as>.

### **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.