THE UNIVERSITY OF TEXAS AT AUSTIN
McCOMBS SCHOOL OF BUSINESS

MBA and MPA Programs: Acc 380K.7– Spring 2019
Financial Statement Analysis

Professor	Dr. Patrick Badolato, CPA
Office Hours	TBD. CBA 4M.252.
Phone	(512) 471-7920
E-Mail	patrick.badolato@mccombs.utexas.edu
	Please post all non-personal questions on our Discussion Board
TAs	Sravani Kolli, John Strother, Muhanned Alsharekh

Course Summary: This Financial Statement Analysis course focuses on using an array of financial information to best determine the *why* behind past and current performance. To achieve this we combine quantitative and qualitative factors to understand drivers of performance and to tell the story of the firm. With a solid understanding of the past and current conditions, we move towards motivating sound forecasts and briefly discuss well-supported inputs to valuation models.

This course is advised for individuals who possess all of the following:
1) an interest in learning and a willingness to develop new skills and perspectives;
2) an interest in how businesses operate, make decisions, change and report their performance;
3) a willingness to benefit from and contribute to the UT/McCombs' educational experience;
4) a general, but strong, understanding of financial accounting at an introductory level as the logical language of business. This course builds off introductory Accounting classes.

What you should expect:
Historically this has been a challenging class that requires a commitment. It is not challenging as you must memorize complex formulas that you could easily look up, but as it will challenge perspectives and require critical thinking and the synthesis of information. This is also a class that actively shuns memorization of terms and formulas and the regurgitation of anything. We will not waste your time (and your educational investment) with memorizing items such as ratios or formulas or emphasizing jargon and catchphrases over thoughtful analysis. Instead we will focus on more useful ways of approaching various issues. Therefore, you may hear many "Yes, but…" questions: "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*? …We will get dirty trying to best understand various firms and how to best use financial information. You need to be involved in these discussions.

How to do well and get the most out of the experience:
This class is also one that has a straightforward plan for success as directly affirmed by former students. Students who truly commit to all of the following usually end up with solid grades: (1) consistently preparing for class, using the materials provided and asking questions when needed; (2) being active learners within the classroom and (3) thoughtfully reviewing the material (with peers) after class. Individuals who do not do or want to do the work, check out during class or miss class, believe they know everything, maintain a closed mind or refuse to be thoughtful usually find this class to be dreadful.

A Broader Background of the Course

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—w*e put considerable emphasis on understanding how financial information helps us understand and guide operating decisions.*
  - Concisely articulate the firm's past—*without this, valuation and forecasting could be misguided, so we must be able to **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—*we will adjust, change and challenge ratios, metrics and formulas to ensure they work in specific real-world situations.*
  - Use our understanding of the firm and its financials to make informed predictions about future performance—*we will stress how understanding financial information provides us with an excellent framework for considering the future.*
  - Motivate, understand, construct and implement various inputs in valuation models—*we will very briefly note the mechanics of valuation while stressing the more useful and challenging steps of motivating inputs to valuation. Valuation is not only a mindless mechanical exercise.*

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. To achieve these objectives, 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) Financial Analysis: The purpose of financial analysis is to assess the firm's historical financial performance in the context of its goals and strategies. Tools used for financial analysis include ratio analysis, cash flow analysis, and common-size financial statements. *Ratio Analysis is not computing ratios (i.e., division), but carefully <u>using and changing</u> ratios to provide us with information.*

(3) 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.

(4) Valuation/Prospective Analysis: The purpose of valuation/prospective analysis is to forecast the firm's future financial performance and determine a potential valuation of the firm—our best assessment of intrinsic value. To do this we will learn the mechanics and intricacies of forecasting financial statements and we will (very briefly) note the components and usage of 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 (US GAAP or IFRS)*; 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. *This is not a journal entry class; in fact, we will likely not see any journal entries during the entire semester (unless specifically requested by students).*

Structure, Materials and Logistics

Course Structure
- The class format involves coverage of the main areas and tools noted above. 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.
- 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 and all updates will be posted on Canvas or discussed in class.

Materials
- **Required:** Cases, slides and other materials created by the professor and available on Canvas. Students are required to access Canvas, read takeaways, exam questions, case feedback commentaries and other class materials and post any unanswered questions directly to Canvas. There is no substitute for the vast amount of information that will be on Canvas.
  - ***To ensure the highest dissemination of information and to maintain a fair playing field, all non-personal questions <u>must</u> be asked on the Discussion Board and not emailed to me.***
- **Required**: It is required that you read, used and retained the materials and information from an financial accounting class. Our course builds off these.
- **Recommended Text:** The textbook for the course is *Financial Reporting, Financial Statement Analysis and Valuation: A Strategic Perspective* by Wahlen, Baginski and Bradshaw, <u>**eighth edition**</u>. ISBN: 978-1285190907
  - The textbook is recommended for students who have not had sufficient exposure to the material we cover in class. The class moves fast and assumes you mastered material from prior classes. We do not have slides from, cover or read from the text; it provides background reading.
  - Suggested Texts:
    - *Accounting for Value* by Stephen Penman; Ben Graham's *The Intelligent Investor;* Michael Lewis's *The Big Short*; Pat Dorsey's *The Little Book that Builds Wealth* and Michael Shearn's *The Investment Checklist: The Art of In-Depth Research.* James Marshall's *The Three Little Pigs.* Business and economic-focused podcasts including Freakonomics, Planet Money and Masters in Business. This is not a comprehensive list and I am open to your suggestions.
- 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 the Canvas. You will be responsible for downloading and printing these articles and using links posted on Canvas. UT Box links expire 30 days after posting—please download the files you need in a timely fashion.

Assignments and Grading Information (page 1 of 5)

Disclaimer: The following contains extensive details about each part of the class and expectations. If this seems excessively specific and elaborate, I apologize in advance. This is only included as a small percent of individuals have struggled with these areas.

Course Requirements and Grading

We will determine the final distribution of letter grades *at the end of the semester*. This means that numerical scores on specific assignments do not correspond to a particular letter grade prior to the end of the semester. Final grades are determined by summing up all pieces, then ranking all students and then following the class distribution provided by the respective Program(s). 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," which 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 distribution dictates the percentage of each of the letter grades. That is, you and your classmates' performance, more than I, determine your final letter grade. Students <u>may not</u> ask for exclusive extra credit or grade changes at the end of the semester. This is unprofessional and requesting specific treatment violates our University's academic goals.

The letter grades will be determined by the guidelines set out by the **MBA/MPA Programs**. Numerical points will be accumulated as follows:

Assignment Area	Deliverables	Percentage
Extra Credit Case	1	
Cases (1 in-class, 18 pre-class)	19	40.00%
Class Leadership and Involvement	1	10.00%
Group Project	1	20.00%
Final Exam	1	30.00%
Total		**100.0%**

Description of Requirements
Exam (30%)

There will be one exam. The exam will follow class at the end of the term; the specific date is provided by the University later in the semester. This is cumulative exam covering all 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. Please notify me within 72 hours of the exam date being set if you have a conflict with the exam date. Outside of this 72 hour window, there are no makeup exams, except for SSD accommodations. Please check here for the exam date: https://registrar.utexas.edu/students/exams

The exam is primarily built around class discussions and cases and involves your analysis of an actual company's (or companies) financial information. *This exam is not one for which you should try to cram. You prepare for the exam by doing the work day to day in this class and then by **relaxing** the week before the exam. Cramming is not useful and a class for which you can cram is a good example of a class not worth taking.* Please do not interpret "no cramming" as "no need to work." The work is done on the cases, in class and in your reviews week by week. Also, the cases provide a general idea of the exam questions (although the time to complete and grading differs between the cases and the exams) and other types or examples of questions are posted on Canvas.