



## ACC 380K.7 – Fall 2018 Financial Statement Analysis

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<b>Office Hours</b>	Tuesday and Thursday 9:30 – 10:30, or by appointment
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<b>Course Web Page</b>	via Canvas ( <a href="http://canvas.utexas.edu/">http://canvas.utexas.edu/</a> )
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<b>TA office Hours</b>	TBD
<b>TA office</b>	TBD

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### Course Meeting Times and Location

<u>Unique #</u>	<u>Days</u>	<u>Time</u>	<u>Location</u>
02645	Tue, Thu	08:00am – 09:15am	GSB 2.122

### Course Objectives

- To go through 10-Ks and other corporate filings
- To learn a framework for making investment decisions using financial statement information
- To practice applying the framework, primarily from the perspective of an equity investor
- To practice communicating our decisions using written and oral communication skills

A concrete objective of this course is that you should be able to analyze stocks and publish your analysis on semi-professional outlets such as Seeking Alpha (SA for short – I will refer to this website numerous times).

Although we will review some accounting concepts, the primary objective of the course is **NOT** to improve your understanding of Generally Accepted Accounting Principles (GAAP). Instead the goal is to improve your ability to interpret and manipulate financial statements.

## Materials

### Required text:

- Course reader: supplemental readings packet available at McCombs Copy Service (Room 3.136)
- *Financial Statement Analysis & Valuation 5e*, by Easton, McAnally, Sommers and Zhang

### Optional texts:

- *Financial Reporting, Financial Statement Analysis, and Valuation - A Strategic Perspective 8e*, by Wahlen, Baginski, and Bradshaw.
- *Business Analysis and Valuation: Using Financial Statements 5e*, by Palepu and Healy.
- *Financial Statement Analysis and Security Valuation 5e*, by Penman.
- Regular readings of *The Wall Street Journal*, *Barron's*, *Business Week*, *Fortune*, *Seeking Alpha*, and various short-selling reports.

## Course Structure

During the semester we will learn a framework (I call it “PH framework” as it is highlighted by Palepu and Healy in their famous textbook listed above) and a set of in-depth tools for business analysis and valuation. The steps in the framework include: (1) business strategy analysis, (2) accounting analysis, (3) financial analysis, and (4) prospective analysis (i.e., valuation).

1. Business (or Industry/strategy) analysis (Session 3)
  - The purpose of business strategy analysis is to assess the profit potential of the firm at a qualitative level. This step involves industry and competitive strategy analysis.
2. Accounting analysis (Sessions 4-13)
  - The purpose of accounting analysis is to develop an understanding of whether a firm's accounting captures its true underlying economic condition. This step involves analyzing management incentives, identifying areas of accounting flexibility, and evaluating the appropriateness of accounting policies and estimates.
3. Financial analysis (Sessions 15-16)
  - The purpose of financial analysis is to assess the firm's historical financial performance in the context of its stated goals and strategy. Tools used for financial analysis include ratio analysis, cash flow analysis, and common size financial statements.
4. Prospective analysis (Sessions 17-22)
  - The purpose of prospective analysis is to forecast the firm's future. Tools used for prospective analysis include forecasts of financial statements and valuation models.

The course will be taught using a combination of brief lectures on textbook materials, discussion on cases and assignment questions, and extension related to research insights and current events – there will also be a “**real-time**” aspect to the class. We will use Amazon (AMZN) as the master case that appears in most of our classes and assignments.

I have attached a tentative schedule of class meetings (Appendix A) and the framework (Appendix B) to the end of this document. I will also post a “plan for the week” to Canvas that will outline

what we plan to cover that week. It is possible that we may have to **periodically revise the schedule**. Should significant revisions be required, I will post a revised schedule on Canvas.

## Course Requirements and Grading

Your grade in the course will be determined as follows:

Components	Weights	Notes
Homework Assignments	20%	1 point per assignment
Group Project	20%	5/10/5 points for mid/final/presentation
Midterm 1	25%	Covering business/accounting analysis
Midterm 2	25%	Covering financial/prospective analysis
Class Participation	10%	
	100%	

The historical distribution of grades is *roughly* as follows: 35% A's, 60% B's, 5% below B. Plus/Minus grading applies to this course.

## Description of Course Requirements

I design the class in a way that all course requirements are served the same purpose: to reinforce your understanding of the framework and to enable you to write a complete analyst report.

## Homework Assignments

One primary objective of homework assignments is to help you review the lecture material *before* attending class. For this purpose, each assignment should be submitted before the according session starts (see the class schedule in Appendix A). For example, you should submit Assignment 1 (#1 hereafter, which is on business analysis) by the time your section starts on September 6 (session 3 on business analysis). Then we will spend time discussing #1 on that day.

Another objective of homework is to help you understand the framework and prepare for both the group project and the exams. Many assignments are associated with AMZN. In #1, #11, #14, and #19, you are asked to write-up the four parts of the framework by analyzing AMZN. In #20, you need to combine all these four parts together and write-up a complete report on AMZN.

**To “force” you to write in a clear and concise way, please use the following format in all assignments (except #1, #11, #14, #19, and #20): maximum two pages, font 12, 1 inch margin for all, and 1.5 space.**

Assignments will be graded based on an **effort** basis. You will receive 0 if you did not hand in the assignment, 0.5 if your effort appears to be unreasonably low and 1 if you made a reasonable attempt to answer **all** of the questions.

Unless explicitly discouraged, you can work in groups on all assignments, but **each person should turn in his or her own solution. Failure to turn in your own work could result in a zero score for that assignment.**

You will submit all assignments via the course Canvas site. Let me repeat: **all assignments are due by the start of class, and you must submit one copy before the beginning of your class section.** Also you may consider bringing a copy for your use during class so that you can participate in that day's discussion.

Assignments will not be accepted after the stated date and time. **There are no exceptions to this policy, including sleeping late, computer problems, etc. I realize this is tough, but a deadline is a deadline.** In fairness to the many students who submit their work on time, I will not grant extensions. In general, neither excused nor unexcused absences will change assignment deadlines.

## Mid-terms

There will be two computer-based midterms scheduled on October 16, 2018 and November 27, 2018 from 6-9 pm in GSB 2.122.<sup>1</sup> Midterm 1 covers business analysis and accounting analysis, while Midterm 2 covers financial analysis and prospective analysis. You will find out that the best way to prepare for the exams is to put your effort into assignments and group projects. I will post sample exams two weeks before each midterm.

You will be using your own laptop in GSB 2.122. The use of internet is strictly forbidden except (1) in the first five minutes when you download the exam from Canvas and (2) in the last five minutes when you upload your report to Canvas.

## Group Project

In this course, as in life, working effectively in a team is important. This is reflected by the fact that a large portion (20%) of your final grade will be based on a semester-long group project, which includes a midterm report, a presentation, and a final written report. **In the second week of class, you will self-select into groups (3-4 members/group).** As a group, you will choose **one from the four: Walmart (WMT), Target (TGT), Best Buy (BBY), and Costco (COST).** You may notice that all of them are from the retail industry.

As in PH framework, a complete firm analysis has four parts: (1) a business (or industry/strategy) analysis, which includes an analysis of the primary industry or industries in which the firm operates, and an analysis of the firm's competitive and corporate strategies; (2) an accounting analysis, which includes an analysis of the firm's accounting flexibilities, management incentives to potentially misreport, featured accounting practices, and procedures and any adjustments necessary to bring reported numbers closer to economic reality; (3) a financial analysis, which includes profitability and credit risk analysis; and (4) a prospective analysis, which includes forecasts of future performance and valuation. **The midterm written report will cover parts (1) and (2) of the firm analysis described above. The final written report will cover all four parts (you can revise the first two parts in your mid report), and will require you to make an investment recommendation (buy, hold, or sell/short) based on your analysis. You will also present your analysis in class toward the end of the semester.**

Due dates and times are listed on the course schedule. I will post detailed requirements for the midterm and final projects to Canvas no later than four weeks prior to the due date for each project.

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<sup>1</sup> The time and location of the midterms are still subject to change. I will let you know as soon as there is any update.

Grades for the midterm project, final project and presentation will be numerical scores (with full marks of 5, 10, and 5 points, respectively). Each member of the group will receive the same score.

**To make sure all group projects are on the right track, each group should have a brief meeting with me about two weeks before the each deadline. All group members are required to attend.** We can have such meetings in the classroom (e.g., right before or after the lecture) or in my office (e.g., during office hour or by appointment). After your submissions, I will provide each group with detailed feedback that should be useful in improving future work.

I strongly encourage all groups to submit their reports to Seeking Alpha. This is very beneficial for several reasons. First, you will find that the investing community cares about your work – people read your report and provide comments. Second, you can improve your analysis and/or your delivery by addressing other people's comments. To provide some additional incentives, I will give a bonus of maximum five points to students who publish their individual work (3 points) or group project (2 points for every member) on Seeking Alpha by the last class (December 6 2018).

### Grading Disputes

My TAs and I will do our best to grade your work fairly, but grading errors can occur. If you believe we have made an error, you may request a re-grading of the assignment, project, or midterms. Be aware, however, that grading errors can occur in both directions—errors can make grades too high as well as too low. Therefore, if you request a re-grading, *your entire work (either an assignment or group project or mid-term) will be re-graded*, and *all* grading errors will be corrected. By requesting a re-grade, you accept the possibility that your grade may go *either up or down*.

**To request a re-grade, you must submit a written request to me within 48 hours from the time when the assignment was first returned.** The request must state (1) the specific area of dispute, (2) your recommendation for change in grade, and (3) an explanation or justification for your recommendation.

### Class Participation

I will ask for self-reporting of class participation prior to two midterms. For each round of evaluation, class participation is graded on A (Outstanding Contributor: 4 points), B (Good Contributor: 3 points), C (Marginal Contributor: 2 points), D (Non-participant: 1 point), and F (Disruptive Contributor: 0 point). The details of the participation grading policy can be found in Appendix C (Interim and Final Assessment). **Those who attend the group meetings with me will get one point for each meeting (i.e., one for midterm report and one for final report).**

To help me more effectively evaluate your participation, I'll make a tremendous effort to learn everyone's name so that I can easily identify contributions. **You should also display your name cards in class.** You'll receive an interim assessment of your participation around the middle of the semester so you can gauge your performance in this area to date (you'll also have a chance to give me interim feedback). At the end of the semester, you'll receive a final assessment which is for your participation in the second part of the course. **So for your own record, please also keep a brief note on every important participation you make in this class.**

I view class participation as both an opportunity and a responsibility. Class participation provides an opportunity for students to practice important career skills in a low cost environment. Among other skills, these include the ability to express and defend one's ideas. (Remember, we may challenge ideas, but we will not challenge people. Rude classroom behavior will result in a reduction in class participation points.) The cost of not developing these skills will increase as your career progresses (e.g., lost promotions). Class participation is also a responsibility because students who attend a top business school expect to learn from the viewpoints of their classmates. Non-participating students do not provide their classmates with this important benefit. I therefore reserve the right to "cold call" students who are not participating in class discussions. My intent is not to embarrass you; rather it is to help you get involved in the discussion where your classmates can benefit from your ideas.

### **McCombs Classroom Professionalism Policy**

The highest professional standards are expected of all members of the McCombs community. The collective class reputation and the value of the McCombs experience hinges on the execution of this policy. Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects. The McCombs classroom experience is enhanced when:

- **Students arrive on time.** On time arrival ensures that classes are able to start and finish at the scheduled time. On time arrival shows respect for both fellow students and faculty and it enhances learning by reducing avoidable distractions.
- **Students display their name cards.** This permits fellow students and faculty to learn names, enhancing opportunities for community building and evaluation of in-class contributions.
- **Students minimize unscheduled personal breaks.** The learning environment improves when disruptions are limited.
- **Students are fully prepared for each class.** Much of the learning at McCombs takes place during classroom discussions. When students are not prepared they cannot contribute to the overall learning process. This affects not only the individual, but their peers who count on them, as well.
- **Students attend the class section to which they are registered.** Learning is enhanced when class sizes are optimized. Limits are set to ensure a quality experience. When section hopping takes place some classes become too large and it becomes difficult to contribute. When they are too small, the breadth of experience and opinion suffers.
- **Students respect the views and opinions of their colleagues.** Disagreement and debate are encouraged. Intolerance for the views of others is unacceptable.
- **Laptops are closed and put away.** When students are surfing the web, responding to e-mail, instant messaging each other, and otherwise not devoting their full attention to the topic at hand they are doing themselves and their peers a disservice. Those students around the offending students face additional distraction because fellow students cannot benefit from the insights of the students who are not engaged. In addition, faculty office hours are spent going over class material with students who chose not to pay attention, rather than adding value by helping students who want a better understanding of the material or want to explore the issues

in more depth. There are often cases where learning is enhanced by the use of laptops in class. Faculty will let you know when it is appropriate to use them. In such cases, professional behavior is exhibited when misuse does not take place.

- **Phones and wireless devices are turned off.** We've all heard the annoying ringing of a phone in the middle of a meeting. Not only is it not professional, it cuts off the flow of discussion when the search for the offender begins. When a true need to communicate with someone outside of class exists (e.g., for some medical need) please inform the professor prior to class.

### **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 (<http://deanofstudents.utexas.edu/sjs/>) or the General Information Catalog Sec. 11-402 (<http://catalog.utexas.edu/general-information/appendices/appendix-c/student-discipline-and-conduct/>) 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 and registration documentation (e.g., downloadable forms, including guidelines for documentation, accommodation request letters, and releases of information are available online at <http://ddce.utexas.edu/disability/>. Please do not hesitate to contact SSD via phone (512) 471-6259, videophone (512) 410-6644, or e-mail [ssd@austin.utexas.edu](mailto:ssd@austin.utexas.edu), 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: <https://registrar.utexas.edu/students/records/restrictmyinfo/rmifaqs>

### **Accommodations for Religious Holidays**

A student who misses classes or other required activities, including examinations, for the observance of a religious holy day should inform the instructor as far in advance of the absence as possible, so that arrangements can be made to complete an assignment within a reasonable time after the absence.

**Quantitative Reasoning Flag**

This course carries the Quantitative Reasoning flag. Quantitative Reasoning courses are designed to equip you with skills that are necessary for understanding the types of quantitative arguments you will regularly encounter in your adult and professional life. You should therefore expect a substantial portion of your grade to come from your use of quantitative skills to analyze real-world problems.

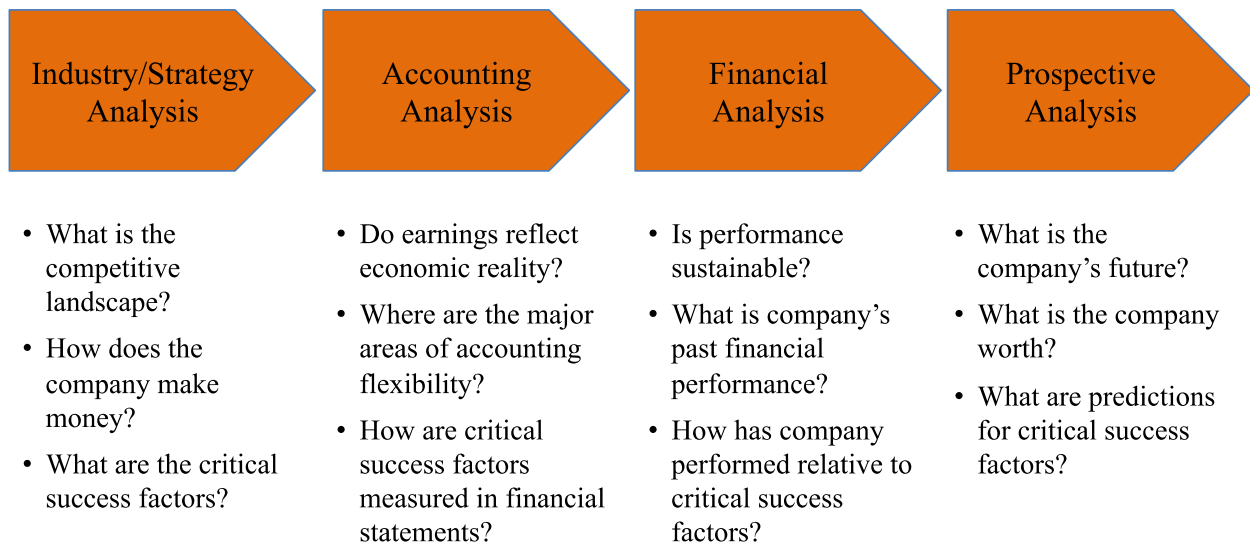


### Appendix A: Tentative Schedule of Classes

Session	Date	Day	2018 Topics	Readings: (M: Module; L: Learning objective; CP: Course packet)	Assignments:	Group Project
1	30-Aug	Thu	Introduction			
2	4-Sep	Tue	Review of Accounting	M1: L2-3, 1A; M2: L1-5, L10;		
3	6-Sep	Thu	Business Analysis	M1: L4-5; CP: Industry structure	#1: <b>Business analysis</b>	
4	11-Sep	Tue	Management incentives	CP: Numbers game; Earnings quality	#2: Management incentives	Member list & stock due
5	13-Sep	Thu	Revenue I	M5: L1; CP: Apple case	#3: Revenue recognition	
6	18-Sep	Tue	Revenue II	M5: L2, L3, L5-7	#4: Income statement items	
7	20-Sep	Thu	Asset I	M6: L1-6	#5: Assets	
8	25-Sep	Tue	Asset II	CP: Cisco case A&B	#6: Case questions	
9	27-Sep	Thu	Liability and Equity	M7: L1; M8: L1, L3, L6, L8	#7: Liability and equity	
10	2-Oct	Tue	Cash Flow Analysis	Appendix B: L1, L5, L6	#8: Cash flow analysis	
11	4-Oct	Thu	Leases	M10: L1, L4	#9: Lease items	
12	9-Oct	Tue	Taxes	M10: L3, L6	#10: Tax items	
13	11-Oct	Thu	Accounting analysis wrap-up		#11: <b>Accounting analysis</b>	
14	16-Oct	Tue	<b>Midterm 1</b>			
15	18-Oct	Thu	Profitability Analysis	M3: L1-8	#12: Profitability ratios	Mid-term report due
16	23-Oct	Tue	Credit Risk Analysis	M4: L3	#13: Credit ratios	
17	25-Oct	Thu	Forecasting I	M11:L1-4	#14: <b>Financial analysis</b>	
18	30-Oct	Tue	Forecasting II	M11:L5-8	#15: Forecasting	
19	1-Nov	Thu	Cost of Capital	M12: L1-4	#16: Cost of capital	
20	6-Nov	Tue	Cash Flow Based Valuation	M13: L1, L2	#17: Valuation model 1	
21	8-Nov	Thu	Income Based Valuation	M14: L2-4	#18: Valuation model 2	
22	13-Nov	Tue	Market Based Valuation	M15: L3, L4	#19: <b>Prospective analysis</b>	
23	15-Nov	Thu	Sophisticated Users	CP: Financial analyst	#20: <b>Wrap-up whole report</b>	
24	20-Nov	Tue	Course Review & Wrap-up			
	22-Nov	Thu	<b>Thanksgiving</b>			
25	<b>27-Nov</b>	<b>Tue</b>	<b>Midterm 2</b>			
26	29-Nov	Thu	Group presentation			Final report due
27	4-Dec	Tue	Group presentation			
28	6-Dec	Thu	Group presentation			

## Appendix B: Financial Statement Analysis Course Overview

### The PH Framework



### **Appendix C: Midterm/Final Participation & Professionalism Evaluation**

In recognition of the high value I place on professionalism, my assessment of your participation and professionalism will make up approximately 10% of your course grade (specifically, 8% based on two evaluations and 2% based on group meetings with me – see Group Project on pages 4-5).

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

- **Outstanding Contributor (A±: 4 points):** 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±: 3 points):** 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±: 2 points):** 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: 1 point):** 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: 0 point):** 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.

Name \_\_\_\_\_

**YOUR assessment of your participation and professionalism in class since mid-term.**

[Please circle one of the letter grades below. If you believe you deserve a “+” or a “-” please add it to the corresponding letter grade]

A                      B                      C                      D                      F

**Please provide evidence to support your above assessment.**

**MY assessment of your participation and professionalism in class since mid-term.**

[Please note I am not assigning pluses or minuses at this point in the semester]

A                      B                      C                      D                      F