Overview

This course is about the analysis of financial information - particularly firms’ financial reports - for making decisions to invest in businesses. The primary focus is on equity (share) valuation, with some attention given to credit analysis and the valuation of debt. The methods of fundamental analysis will be examined in detail and applied in cases and projects involving listed companies. Topics include models of shareholder value and a comparison of accounting and discounted cash flow approaches to valuation, methods of financial statement analysis, testing the quality of financial reports, designing value-added metrics, forecasting earnings and cash flows, pro-forma analysis for strategy and planning, and the determination of price/earnings and market-to-book ratios. The analysis will be carried out from the perspective of both the outside security analyst and the corporate financial analyst.

The course is of interest to those contemplating careers in investment banking, security analysis, consulting, public accounting, and corporate finance. And it will also help with personal investing.

The course will be in the form of lectures, discussions, exercises and cases and will involve a course project.

By the end of the course students should have answers to the following questions:

− How are “intrinsic values” calculated?

− What are the relevant firm attributes that determine value?

− What is the role of financial statements in determining equity values?

− Are some aspects of the financial statements more important than others? What is the role of “bottom line” earnings (net income) and book value?

− How does one pull apart the financial statements to get at the relevant information?

− How does traditional ratio analysis help in valuation?

− What is the relevance of cash-flow information? What is the relevance of the accruals in accounting?

− How does one analyze the quality of financial reports?

− How is financial analysis developed for strategy and planning?

− How does one measure value added?
– How does one deal with the accounting methods used in financial statements?

– What determines a firm’s P/E ratio?

– What determines a firm’s market-to-book (P/B) ratio?

– How does fundamental analysis differ across countries?

– How does one evaluate risk? For equity? For debt?

– How does one evaluate an equity research report?

– How does one trade on fundamental information?

**Text**

The main text is ‘Financial Statement Analysis and Security Valuation’ by Stephen Penman, to be published by Irwin/McGraw-Hill in 1999. This is in manuscript form on the course web page. Notes that accompany the text are also on the web page.

**Other reading**

The following books provide useful reference for the course. Those marked (*) are on one-day reserve in the Long Library.

A good introduction is:

Other books on financial statement analysis:


A text on US GAAP:

A corporate finance text:
The Web Page:  http://www.haas.berkeley.edu/Courses/BA222/Index.html

The web page contains the course outline, the text, course notes, exercises and cases, and links to financial information and research engines. Some copyrighted material is behind a password that will be given out in class. Please do not give this password to others.

The text, notes, exercises and cases can be downloaded using Adobe Acrobat Reader, version 3.0 or higher (which itself can be downloaded) or with a browser with a PDF plug-in.

You will find the links to be a valuable device for fundamental research. Use it as a window to resources on the internet. Hard copy resources and resources on CD Rom are available in the Long Library.

Assessment

The course grade will be calculated 40% from an exam and 60% from a project. The exam will be of 1½ hours duration. The course project may be done individually or in groups of up to four people. The project should involve equity analysis. The following are some suggestions:

- An equity research report on a company or set of comparison companies.
- Evaluation of an acquisition from the point of view of the acquiring firm or the target firm.
- An analysis of accounting issues in valuation for a particular industry sector.
- Evaluation of a restructuring.
- Evaluation of a firm’s strategic choices with the goal of creating shareholder value.
- Discovery of mispriced firms.
- Evaluation of a privatization or an IPO.

The submission will be graded on its creativity, demonstration of depth of knowledge, rigour, and clarity in communication. You may choose firms or industry sectors in any country, or make comparisons between countries.

Important dates

<table>
<thead>
<tr>
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<tr>
<td>February 24, 1999</td>
<td>No class - Spring Symposium</td>
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<tr>
<td>April 21, 1999</td>
<td>Exam</td>
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<tr>
<td>May 21, 1999</td>
<td>Projects due</td>
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Instructor

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Office hours:  Wednesday, 4:00 pm - 5:30 pm, F491
# Course Schedule

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<td>January 27</td>
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<td>6</td>
<td>February 24</td>
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<td>May 5</td>
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Case assignments will be made in class and posted on the web page under “Applications.”