BA7110: Financial Statement Analysis and Valuation. Professor Penman
Course Description

With a stock market bubble and a financial crisis in our recent history, there have been increasing calls to “return to fundamentals.” This is a course on fundamental analysis. The primary emphasis is on equity (share) valuation, with a focus on developing and applying methods for valuing firms using financial statement analysis.

The course has the very practical emphasis. We adopt the view of an active investor who not only wants to “return to fundamentals” but to earn returns from fundamentals. We will apply methods of fundamental analysis in a series of class exercises, cases, and an assignment involving listed companies. Topics include models of shareholder value, a comparison of residual earnings, abnormal earnings growth, and discounted cash flow approaches to valuation, the analysis of growth and valuation generation in a firm, diagnosing accounting quality, forecasting earnings and cash flows, pro-forma analysis for strategy and planning, and the determination of price/earnings and market-to-book ratios.

The course will be taught with a view to designing techniques to be used in an equity research department of a bank or independent research firm, a long/short equity hedge fund, or individual investing. Accordingly, the material is pertinent to equity analysts, both buy and sell side, who issue buy and sell recommendations on stocks. However, much of the material covered in the course is also relevant to the corporate financial analyst and for private equity analysis, for evaluating acquisitions, restructurings and other investments, and for calculating the value generated by strategic scenarios.

By the end of the course, the student will feel competent in writing a thorough, credible equity research report or investment analysis that meets the highest standards. More importantly, the student will gain a sense of security in equity investing, for he or she will be “grounded in the fundamentals.” The course is of interest to those contemplating careers in investment banking (particularly in equities), security analysis, equity hedge funds, private equity, consulting, public accounting, and corporate finance. And it will also help with personal investing.

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

- How are fundamental values (or “intrinsic values”) estimated?
- How are business strategies analyzed in order to understand the value they create?
- How is “value created for shareholders” identified?
- How does one pull apart the financial statements to get at the relevant information for valuing equities?
- What is the relevance of cash-flows? Of dividends? Of earnings? Of book values? How are these measures treated in a valuation?
- What are the pitfalls in buying growth?
- How does ratio analysis help in valuation?
- How does profitability tie into valuation?
• What is growth? How does one analyze growth? How does one value a growth firm?
• How does one analyze the quality of financial reports?
• How does one deal with the accounting methods used in financial statements?
• How is financial analysis developed for strategy and planning?
• What determines a firm's P/E ratio? How does one calculate what the P/E should be?
• What determines a firm's market-to-book (P/B) ratio? How does one calculate what the P/B should be?
• How does one evaluate risk? For equity? For debt?
• How does one evaluate an equity research report? What does a good one look like?
• How does one trade on fundamental information?

Text


Preliminary Reading for this Course


Other Reading

The following books provide useful reference for the course.

A good introduction is:


Other books on financial statement analysis and valuation are:


Assessment

The course grade will be calculated 40% (Take-home Final Exam), 50% (Course Project) and 10% (Exercise Sets). The exam will be a take-home exam, open book. It will be handed out in the last class and is due a week later.

Course Project

The course project may be done individually or in groups of up to five people. Students organize groups on their own. The project must contain only original work. It has the Columbia Business School assignment designation, A, meaning that the project is submitted by the group and each member of the group gets the same grade. Students are best advised to develop the project as they proceed through the course. The project should involve equity analysis and in most cases is presented as an equity research report. 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 a valuation for a particular industry sector.
- A quality of earnings analysis for a particular company.
- 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, rigor, and clarity in communication. It must be original work. You may choose firms or industry sectors in any country, or make comparisons between countries.

The project is due on January 25, 2010 at 5:00 pm. It must be a hard copy, delivered to Professor Penman's office, his Uris Hall Mailbox, or by mail. Mailing address: Professor Stephen Penman, 612 Uris Hall, Columbia Business School, 3022 Broadway, New York, NY 10027.