Financial Statement Analysis and Valuation
B8009-001 – Summer 2015

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Course description and objectives

The purpose of this course is to learn about drivers of fundamental value and risk, by analyzing financial statements of businesses in different industries. This is a course in fundamental analysis.

Every public company provides a lot of financial information in its filings. How can this information be used to understand and evaluate the company’s operations, its prospects and its risks? The course is organized around the twin themes of understanding and evaluating the financial information reported by firms, and coupling it with sound analytical methodology. To this end, we will review the methodologies for valuation and risk analysis used by banks and asset management firms. We will cover a number of techniques such as building simple models, performing risk analysis and learning to fine tune and adjust the value drivers used in valuations and risk analysis. Much of the data for the analysis comes from the financial statements – but it requires a careful study of arcane footnotes to unearth the information provided by the companies. This is an advanced course that goes into the details of footnote analysis, accounting rules, and financial presentations. This course builds on the material you have already learned in Financial Accounting and Corporate Finance. It is assumed that you already know what you have learned in these courses and will build significantly on that knowledge. If your basics are solid and you are interested in learning to read financial statements; if you wish to learn to apply forensic analysis on them; this course is for you. We will use excel to build some of the models – but this is not a course in excel. But, it is highly recommended that you have a working knowledge of how to build formulas in excel before you come to this class.

By the end of the course, the student should be able to perform a thorough, credible investment or credit analysis that meets a high standard. Students should have the ability to estimate fundamental values, and pull apart the information in the financial statements to get relevant information. This course should be of interest to those contemplating careers in investment banking, security analysis, private equity, hedge funds, and corporate finance.

Course materials

I will be teaching this course entirely from my own notes that draw heavily from my personal experiences in financial markets. The recommended (but not required) book for the course is “Financial Statement Analysis and Security Valuation”, 5th edition, by Stephen H. Penman, Irwin/McGraw Hill Publishing. This book is a good reference, and I will draw from it from time to time. Please note though

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that the book is not a substitute for my notes, and if you miss my class, you will not be able to make up
by reading the book. It is highly advised that you do not miss any of the classes. If it is unavoidable, you
should watch the video of the class you miss to make up. All the teaching will be from my notes and
your assignment questions, cases and projects will be based on what I teach in class.

Course notes for each session will be available in advance (on Canvas). A tentative course schedule is
attached. I will assume that when you show up for class, you have already skimmed through the
assigned material and worked on the assignment for the day, if any.

Sharing of course material with someone who is not enrolled in the course or someone who is not in
your section is not allowed (both receiving and giving). It would be considered a violation of the honor
code (and potentially of copyrights).

**Pedagogy**

A significant portion of the work will be done in the form of in-class exercises or cases. Some cases will
require advance preparation while some will require work in groups in class.

The purpose of this course is to teach you to make judgments about value and risk of firms and
industries through an analysis of their financial statements. You will therefore be required to work on
two projects during the course. One of the projects is an individual project while the other is a group
project. For the individual project, you will be asked to choose a firm that you are curious about in the
first class of the course. At the end of the course, you will prepare and submit a report on the firm you
studied. You will make a recommendation – whether to buy, hold or sell the stock. It is expected that
you will apply what you learn in this course to arrive at your conclusion. The individual project will be
done in two stages. You will prepare an interim report just prior Session 4 and your final report before
Session 10. For the group project, you will be assigned to a team. For this purpose, the entire class will
be divided into teams of four. Each team will study one industry. We will study at least three
(maximum four) industries during the course. More than one team may be assigned to the same
industry. For the group project, you will critically analyze the footnote disclosures of your assigned
industry and prepare a report on the value and risk relevant information in them. You will submit your
report prior to Session 9. Each team will make a presentation of the project during Session 10 of the
course. The due dates for the submissions is given in the schedule below. All submission become due at
11:59 p.m. on the date shown in the schedule.

**Grading**

Your grade will be decided based on a combination of the following:

<table>
<thead>
<tr>
<th>Individual assignment</th>
<th>50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group assignment</td>
<td>40</td>
</tr>
<tr>
<td>Class Participation</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
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Individual Project

There is one individual project to be submitted during the course. This will be submitted in two parts. On the first day of class, each of you will select a company. Just prior to Session 4 you will submit your first report. For this report you will perform a detailed fundamental analysis of the company and present a report on your findings. Just prior to Session 10 you will submit your second report. In this report you will present a stock recommendation on the company you studied.

This is a Type C assignment.

Team Projects

For the team project, each group will perform a dissection of specific footnotes of the assigned industry firms and present a report on the findings. You will submit your group report (one per group) just prior to Session 9. Each group will also present its analysis to the whole class during Session 10.

This is a Type A assignment.

Since I require you to make presentations of your team projects, I will be instituting a mandatory requirement for the group to meet me before the presentation where I will review your presentation and approve it. I have found this to be very helpful to the teams and to the class. This requirement will not be waived.

Class Participation

The class participation grade will depend on class attendance, on-time arrival and professional behavior during class including but not limited to, not leaving while the class is in session, no private conversations, no use of unauthorized electronics like computers, tablets and phones, preparedness, responses to questions asked during class (cold calls or voluntary), questions, comments, and sharing your professional experience and similar demonstrations of positive engagement. If you cannot attend a class or need to come in late or leave early, I will expect you to inform me in advance and take my permission as a common courtesy.

There is no midterm or final exam for this course.

I reserve the right to improve any student’s course grade based on my subjective assessment of the student’s contribution to the learning of the class. On the other hand, consistent demonstration of unprofessional behavior might negatively impact a student’s course grade, beyond its impact on class participation.

A tentative course schedule is provided on the next page. Your deliverables are indicated in bold.
<table>
<thead>
<tr>
<th>Session</th>
<th>Topics, Assignments</th>
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</table>
| Session 1  
(6/1/2015:  
9:00 – 1:15) | Introduction to valuation with multiples. Why fundamental analysis?  
How to read a 10-K.  
In class Case: Proctor & Gamble. |
| Session 2  
(6/8/2015:  
9:00 – 1:15) | Overview of information in the footnotes  
In class Case: PepsiCo |
| Session 3  
(6/15/2015:  
9:00 – 1:15) | Basics of fundamental analysis. The power of fundamental analysis  
In Class Case: TBD  
In class exercises. |
| Session 4  
(6/22/2015:  
9:00 – 1:15) | Valuation methodologies – Part 2  
In class Exercises.  
**Individual assignment – Part 1 Due on 6/21/2015** |
| Session 5  
(7/6/2015:  
9:00 – 1:15) | Introduction to Credit Analysis  
Analyzing the cash flow statement  
In Class Case: TBD |
| Session 6  
(7/13/2015:  
9:00 – 1:15) | Analysis of revenues: Games companies play.  
Introduction to building an income model  
In class case: IBM, Apple, Alcatel |
| Session 7  
(7/16/2015:  
5:00 – 9:15) | Analysis of costs: How are these costs reported?  
Analyzing the stock options and pensions footnote.  
In class case: TBD |
| Session 8  
(7/20/2015:  
9:00 – 1:15) | Introduction to modeling the balance sheet  
In class Exercises. |
| Session 9  
(7/27/2015:  
9:00 – 1:15) | Introduction to modeling the cash flow statement  
Review  
**Group Assignment Due on 7/26/2015** |
| Session 10  
(8/3/2015:  
9:00 – 1:15) | **Group presentations**  
**Individual assignment – Part 2 Due on 8/2/2015** |